Territorial Bancorp Inc.
Form 10-Q
November 07, 2014
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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, 2014

or

o 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 o.

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 o

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 o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

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

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

9,969,600 shares of Common Stock, par value $0.01 per share, were issued and outstanding as of October 31, 2014.

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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, 2014		December 31, 2013
ASSETS				
Cash and cash equivalents	$	64,723	$	75,365
Investment securities held to maturity, at amortized cost (fair value of $592,470 and $598,007 at September 30, 2014 and December 31, 2013, respectively)		589,079		613,436
Federal Home Loan Bank stock, at cost		11,352		11,689
Federal Reserve Bank stock, at cost		2,904		
Loans held for sale		2,602		2,210
Loans receivable, net		925,484		856,542
Accrued interest receivable		4,450		4,310
Premises and equipment, net		5,844		6,056
Bank-owned life insurance		41,039		40,243
Deferred income taxes receivable		6,468		5,075
Prepaid expenses and other assets		2,432		1,978
Total assets	$	1,656,377	$	1,616,904
LIABILITIES AND STOCKHOLDERS EQUITY				
Liabilities:				
Deposits	$	1,327,254	$	1,288,709
Advances from the Federal Home Loan Bank		15,000		15,000
Securities sold under agreements to repurchase		72,000		72,000
Accounts payable and accrued expenses		21,370		23,933
Current income taxes payable		1,366		1,414
Advance payments by borrowers for taxes and insurance		2,301		3,708
Total liabilities		1,439,291		1,404,764
Stockholders Equity:				
Preferred stock, $.01 par value; authorized 50,000,000 shares, no shares issued or outstanding				
Common stock, $.01 par value; authorized 100,000,000 shares; issued and outstanding 9,969,600 and 10,051,377 shares at September 30, 2014 and December 31, 2013, respectively		100		101
Additional paid-in capital		75,371		77,340
Unearned ESOP shares		(6,973)		(7,340)
Retained earnings		152,295		145,826
Accumulated other comprehensive loss		(3,707)		(3,787)

Total stockholders equity		217,086		212,140
Total liabilities and stockholders equity	$	1,656,377	$	1,616,904

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, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Interest and dividend income:				
Investment securities	$ 4,895	$ 4,775	$ 15,055	$ 13,847
Loans	10,020	9,267	29,320	27,696
Other investments	75	49	153	213
Total interest and dividend income	14,990	14,091	44,528	41,756
Interest expense:				
Deposits	1,138	1,031	3,332	3,225
Advances from the Federal Home Loan Bank	67	67	199	235
Securities sold under agreements to repurchase	346	422	1,032	1,370
Total interest expense	1,551	1,520	4,563	4,830
Net interest income	13,439	12,571	39,965	36,926
Provision for loan losses	23	45	188	47
Net interest income after provision for loan losses	13,416	12,526	39,777	36,879
Noninterest income:				
Service fees on loan and deposit accounts	555	598	1,578	1,667
Income on bank-owned life insurance	265	295	797	774
Gain on sale of investment securities	392	922	1,047	2,834
Gain on sale of loans	118	365	283	1,390
Other	68	143	330	329
Total noninterest income	1,398	2,323	4,035	6,994
Noninterest expense:				
Salaries and employee benefits	5,402	5,318	16,062	15,682
Occupancy	1,474	1,387	4,305	3,971
Equipment	956	853	2,775	2,576
Federal deposit insurance premiums	202	193	602	574
Other general and administrative expenses	1,045	969	2,946	3,228
Total noninterest expense	9,079	8,720	26,690	26,031
Income before income taxes	5,735	6,129	17,122	17,842
Income taxes	2,273	2,298	6,479	6,709
Net income	$ 3,462	$ 3,831	$ 10,643	$ 11,133
Basic earnings per share	$ 0.38	$ 0.40	$ 1.16	$ 1.13
Diluted earnings per share	$ 0.37	$ 0.39	$ 1.15	$ 1.12
Cash dividends declared per common share	$ 0.15	$ 0.13	$ 0.44	$ 0.38
Basic weighted-average shares outstanding	9,218,745	9,676,304	9,190,476	9,810,725
Diluted weighted-average shares outstanding	9,323,306	9,809,987	9,283,425	9,930,438

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 September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Net income	$ 3,462	$ 3,831	$ 10,643	$ 11,133
Change in unrealized loss on securities	1	3	5	21
Noncredit related gains on securities not expected to be sold	3	14	75	83
Other comprehensive income	4	17	80	104
Comprehensive income	$ 3,466	$ 3,848	$ 10,723	$ 11,237

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders Equity (Unaudited)

(Dollars in thousands, except per share data)

	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Total Stockholders Equity
Balances at December 31, 2012	$ 108	$ 93,616	$ (7,829)	$ 137,410	$ (4,333)	$ 218,972
Net income				11,133		11,133
Other comprehensive income					104	104
Cash dividends declared ($0.38 per share)				(3,896)		(3,896)
Share-based compensation	1	2,001				2,002
Allocation of 36,699 ESOP shares		478	367			845
Repurchase of 739,197 shares of company common stock	(7)	(16,564)				(16,571)
Balances at September 30, 2013	$ 102	$ 79,531	$ (7,462)	$ 144,647	$ (4,229)	$ 212,589
Balances at December 31, 2013	$ 101	$ 77,340	$ (7,340)	$ 145,826	$ (3,787)	$ 212,140
Net income				10,643		10,643
Other comprehensive income					80	80
Cash dividends declared ($0.44 per share)				(4,174)		(4,174)
Share-based compensation	1	2,001				2,002
Allocation of 36,699 ESOP shares		410	367			777
Repurchase of 195,109 shares of company common stock	(2)	(4,380)				(4,382)
Balances at September 30, 2014	$ 100	$ 75,371	$ (6,973)	$ 152,295	$ (3,707)	$ 217,086

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, 2014	Nine Months Ended September 30, 2013
Cash flows from operating activities:		
Net income	$ 10,643	$ 11,133
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	188	47
Depreciation and amortization	1,032	837
Deferred income tax benefit	(1,445)	(1,108)
Amortization of fees, discounts, and premiums	(310)	395
Origination of loans held for sale	(27,195)	(67,252)
Proceeds from sales of loans held for sale	27,086	70,181
Gain on sale of loans, net	(283)	(1,390)
Purchases of investment securities held for trading	(5,041)	
Proceeds from sale of investment securities held for trading	5,071	
Gain on sale of investment securities held for trading	(30)	
Gain on sale of investment securities held to maturity	(1,017)	(2,834)
ESOP expense	777	845
Share-based compensation expense	2,002	2,002
Increase in accrued interest receivable	(140)	(15)
Net increase in bank-owned life insurance	(796)	(774)
Net (increase) decrease in prepaid expenses and other assets	(454)	1,379
Net increase (decrease) in accounts payable and accrued expenses	(2,038)	2,255
Net decrease in advance payments by borrowers for taxes and insurance	(1,407)	(1,256)
Net decrease in income taxes payable	(48)	(244)
Net cash provided by operating activities	6,595	14,201
Cash flows from investing activities:		
Purchases of investment securities held to maturity	(34,831)	(240,496)
Principal repayments on investment securities held to maturity	48,705	146,301
Proceeds from sale of investment securities held to maturity	11,506	42,034
Loan originations, net of principal repayments on loans receivable	(68,694)	(52,345)
Proceeds from redemption of Federal Home Loan Bank stock	337	330
Purchases of Federal Reserve Bank stock	(2,904)	
Purchases of bank-owned life insurance		(8,000)
Purchases of premises and equipment	(820)	(922)
Net cash used in investing activities	(46,701)	(113,098)

(Continued)

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
Cash flows from financing activities:				
Net increase in deposits	$	38,545	$	20,511
Proceeds from advances from the Federal Home Loan Bank				5,000
Repayments of advances from the Federal Home Loan Bank				(10,000)
Repayments of securities sold under agreements to repurchase				(23,000)
Purchases of Fed Funds		10		
Sales of Fed Funds		(10)		
Repurchases of company stock		(4,907)		(16,571)
Cash dividends paid		(4,174)		(3,896)
Net cash provided by (used in) financing activities		29,464		(27,956)
Net decrease in cash and cash equivalents		(10,642)		(126,853)
Cash and cash equivalents at beginning of the period		75,365		182,818
Cash and cash equivalents at end of the period	$	64,723	$	55,965
Supplemental disclosure of cash flow information:				
Cash paid for:				
Interest on deposits and borrowings	$	4,502	$	4,861
Income taxes		7,972		8,061
Supplemental disclosure of noncash investing activities:				
Loans transferred to real estate owned	$		$	143
Investments purchased, not settled				1,096

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. (the Company) 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, 2013. 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 (MHC) approved a plan of conversion and reorganization under which MHC 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.

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 balance of the liquidation account at December 31, 2013 was $17.6 million.

On June 25, 2014, Territorial Savings Bank converted from a federal savings bank to a Hawaii state-chartered savings bank. On July 10, 2014, Territorial Savings Bank became a member of the Federal Reserve System.

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(3) Recently Adopted Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) amended the Receivables topic of the FASB Accounting Standards Codification (ASC). The amendment clarifies when an in substance repossession or foreclosure occurs and when a mortgage loan should be derecognized and the related real property recognized. The amendment also requires disclosures about the amount of foreclosed residential real property held and the recorded investment in mortgage loans collateralized by residential real property in the process of foreclosure. The amendment is effective for interim and annual periods beginning after December 15, 2014, with early adoption allowed. The Company does not expect the adoption of this amendment to have a material effect on its consolidated financial statements.

In May 2014, the FASB amended the Revenue Recognition topic of the FASB ASC. The amendment seeks to clarify the principles for recognizing revenue as well as to develop common revenue standards for U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendment is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. 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 2014, the FASB amended the Transfers and Servicing topic of the FASB ASC. The amendment modifies the accounting for certain types of repurchase transactions as well as adds new disclosure requirements for repurchase transactions. The amendment is effective for interim and annual periods beginning after December 15, 2014, with early adoption prohibited. The Company does not expect the adoption of this amendment to have a material effect on its consolidated financial statements.

In August 2014, the FASB amended the Receivables topic of the FASB ASC. The amendment seeks to clarify the classification of foreclosed mortgage loans that are either fully or partially guaranteed under government programs, such as from the Federal Housing Administration (FHA) or the U.S. Department of Veterans Affairs (VA). The amendment is effective for interim and annual periods beginning after December 15, 2014. The Company does not expect the adoption of this amendment to have any 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, 2014**		**December 31, 2013**
Cash and due from banks	$	8,036	$	9,962
Interest-earning deposits in other banks		56,687		65,403
Cash and cash equivalents	$	64,723	$	75,365

Interest-earning deposits in other banks consist primarily of deposits at the Federal Reserve Bank.

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(5) Investment Securities

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

(Dollars in thousands)	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
September 30, 2014:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 588,418	$ 13,269	$ (9,878)	$ 591,809
Trust preferred securities	661			661
Total	$ 589,079	$ 13,269	$ (9,878)	$ 592,470
December 31, 2013:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 612,899	$ 7,979	$ (23,408)	$ 597,470
Trust preferred securities	537			537
Total	$ 613,436	$ 7,979	$ (23,408)	$ 598,007

The carrying and estimated fair value of investment securities at September 30, 2014 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)	Carrying Value	Estimated Fair Value
Held to maturity:		
Due within 5 years	$ 7	$ 7
Due after 5 years through 10 years	61	65
Due after 10 years	589,011	592,398
Total	$ 589,079	$ 592,470

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 September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Proceeds from sales	$ 4,307	$ 13,943	$ 16,577	$ 43,131
Gross gains	392	922	1,047	2,834
Gross losses				

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During the three months ended September 30, 2014 and 2013, the Company recorded proceeds of $4.3 million and $13.9 million, respectively, from the sale of $3.9 million and $13.0 million, respectively, of held-to-maturity debt securities, resulting in gross realized gains of $392,000 and $922,000, respectively. During the nine months ended September 30, 2014 and 2013, the Company recorded proceeds of $11.5 million and $43.1 million, respectively, from the sale of $10.5 million and $40.3 million, respectively, of held-to-maturity debt securities, resulting in gross realized gains of $1.0 million and $2.8 million, respectively. 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.

Investment securities with carrying values of $273.9 million and $273.2 million at September 30, 2014 and December 31, 2013, 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 September 30, 2014 and December 31, 2013. 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**
September 30, 2014:							
Mortgage-backed securities	$ 26,763	$ 142	$ 215,945	$ 9,736	45	$ 242,708	$ 9,878
December 31, 2013:							
Mortgage-backed securities	$ 361,445	$ 21,678	$ 22,010	$ 1,730	69	$ 383,455	$ 23,408

Mortgage-Backed Securities. The unrealized losses on the Company s investment in mortgage-backed securities were caused by increases in market interest rates. All of the mortgage-backed securities are guaranteed by Freddie Mac or Fannie Mae, which are U.S. government-sponsored enterprises, or Ginnie Mae, which is a U.S. government agency. Since the decline in market value is attributable to changes in interest rates and not credit quality, and the Company does not intend to sell these investments until maturity and it is not more likely than not that the Company will be required to sell such investments prior to recovery of its amortized cost basis, the Company does not consider these investments to be other-than-temporarily impaired as of September 30, 2014 and December 31, 2013.

Trust Preferred Securities. At September 30, 2014, the Company owns two trust preferred securities, PreTSL XXIII and XXIV. 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. Both of these securities are classified in the Company s held-to-maturity investment portfolio.

The trust preferred securities market is considered to be inactive as only five transactions have occurred over the past 33 months in the same tranche of 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.

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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, 2014.

PreTSL XXIV has a book value of $0 at September 30, 2014. PreTSL XXIII has a book value of $661,000 at September 30, 2014. The difference between the book value of $661,000 and the remaining amortized cost basis of $1.1 million is reported as other comprehensive loss and is related to noncredit factors such as the trust preferred securities market being inactive.

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 remaining amortized cost basis of $1.1 million on its trust preferred securities could be credit-related 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)		**2014**		**2013**
Balance at January 1,	$	5,885	$	5,885
Credit losses on debt securities for which other-than-temporary impairment was not previously recognized				
Balance at September 30,	$	5,885	$	5,885

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

		September 30,		
(Dollars in thousands)		**2014**		**2013**
Noncredit losses on other-than-temporarily impaired securities, net of taxes	$	301	$	362

(6) Loans Receivable and Allowance for Loan Losses

The components of loans receivable are as follows:

(Dollars in thousands)		**September 30, 2014**		**December 31, 2013**
Real estate loans:				
First mortgages:				
One- to four-family residential	$	885,540	$	823,273
Multi-family residential		5,151		4,877

Construction, commercial, and other		20,359		13,554
Home equity loans and lines of credit		15,787		16,524
Total real estate loans		926,837		858,228
Other loans:				
Loans on deposit accounts		462		342
Consumer and other loans		4,097		4,307
Total other loans		4,559		4,649
Less:				
Net unearned fees and discounts		(4,384)		(4,849)
Allowance for loan losses		(1,528)		(1,486)
Total unearned fees, discounts and allowance for loan losses		(5,912)		(6,335)
Loans receivable, net	$	925,484	$	856,542

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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, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Balance, beginning of period	$ 1,510	$ 1,622	$ 1,486	$ 1,672
Provision for loan losses	23	45	188	47
	1,533	1,667	1,674	1,719
Charge-offs	(10)	(68)	(163)	(205)
Recoveries	5	68	17	153
Net charge-offs	(5)		(146)	(52)
Balance, end of period	$ 1,528	$ 1,667	$ 1,528	$ 1,667

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 September 30, 2014:						
Balance, beginning of period	$ 344	$ 932	$ 7	$ 159	$ 68	$ 1,510
Provision (reversal of allowance) for loan losses	9	78	(1)	(5)	(58)	23
	353	1,010	6	154	10	1,533
Charge-offs				(10)		(10)
Recoveries		1	1	3		5
Net charge-offs		1	1	(7)		(5)
Balance, end of period	$ 353	$ 1,011	$ 7	$ 147	$ 10	$ 1,528
Nine months ended September 30, 2014:						
Balance, beginning of period	$ 376	$ 799	$ 10	$ 229	$ 72	$ 1,486
Provision (reversal of allowance) for loan losses	95	211	4	(60)	(62)	188
	471	1,010	14	169	10	1,674
Charge-offs	(118)		(10)	(35)		(163)
Recoveries		1	3	13		17
Net charge-offs	(118)	1	(7)	(22)		(146)
Balance, end of period	$ 353	$ 1,011	$ 7	$ 147	$ 10	$ 1,528

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(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 September 30, 2013:						
Balance, beginning of period	$ 513	$ 813	$ 35	$ 125	$ 136	$ 1,622
Provision (reversal of allowance) for loan losses	(16)	14	(1)	44	4	45
	497	827	34	169	140	1,667
Charge-offs	(13)			(55)		(68)
Recoveries	49	11	1	7		68
Net charge-offs	36	11	1	(48)		
Balance, end of period	$ 533	$ 838	$ 35	$ 121	$ 140	$ 1,667
Nine months ended September 30, 2013:						
Balance, beginning of period	$ 590	$ 818	$ 35	$ 107	$ 122	$ 1,672
Provision (reversal of allowance) for loan losses	(84)	9	(7)	111	18	47
	506	827	28	218	140	1,719
Charge-offs	(94)			(111)		(205)
Recoveries	121	11	7	14		153
Net charge-offs	27	11	7	(97)		(52)
Balance, end of period	$ 533	$ 838	$ 35	$ 121	$ 140	$ 1,667

Management considers the allowance for loan losses at September 30, 2014 to be at an appropriate level to provide for probable losses that can be reasonably estimated based on general and specific conditions at that date. 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 bank regulatory agencies periodically review the allowance for loan losses and 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
September 30, 2014:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	$	$	$	$	$	$
Collectively evaluated for impairment	353	1,011	7	147	10	1,528
Total ending allowance balance	$ 353	$ 1,011	$ 7	$ 147	$ 10	$ 1,528
Loans:						
Ending loan balance:						
Individually evaluated for impairment	$ 6,739	$	$ 301	$ 1	$	$ 7,041
Collectively evaluated for impairment	879,573	20,344	15,492	4,562		919,971
Total ending loan balance	$ 886,312	$ 20,344	$ 15,793	$ 4,563	$	$ 927,012
December 31, 2013:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	$	$	$	$	$	$
Collectively evaluated for impairment	376	799	10	229	72	1,486
Total ending allowance balance	$ 376	$ 799	$ 10	$ 229	$ 72	$ 1,486
Loans:						
Ending loan balance:						
Individually evaluated for impairment	$ 8,373	$	$ 160	$	$	$ 8,533
Collectively evaluated for impairment	814,960	13,514	16,372	4,649		849,495
Total ending loan balance	$ 823,333	$ 13,514	$ 16,532	$ 4,649	$	$ 858,028

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

(Dollars in thousands)	September 30, 2014	December 31, 2013
Loans with no allocated allowance for loan losses	$ 7,041	$ 8,533
Loans with allocated allowance for loan losses		
Total impaired loans	$ 7,041	$ 8,533
Amount of allocated loan loss allowance	$	$

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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, 2014:		
With no related allowance recorded:		
One- to four-family residential mortgages	$ 6,739	$ 7,327
Home equity loans and lines of credit	301	324
Consumer and other	1	1
Total	$ 7,041	$ 7,652
December 31, 2013:		
With no related allowance recorded:		
One- to four-family residential mortgages	$ 8,373	$ 8,716
Home equity loans and lines of credit	160	165
Total	$ 8,533	$ 8,881

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
2014:				
With no related allowance recorded:				
One- to four-family residential mortgages	$ 6,785	$ 28	$ 6,931	$ 88
Home equity loans and lines of credit	302		311	
Consumer and other	1		1	
Total	$ 7,088	$ 28	$ 7,243	$ 88
2013:				
With no related allowance recorded:				
One- to four-family residential mortgages	$ 7,440	$ 33	$ 7,477	$ 98
Home equity loans and lines of credit	162		161	
Total	$ 7,602	$ 33	$ 7,638	$ 98

There were no loans individually evaluated for impairment with a related allowance for loan loss as of September 30, 2014 or December 31, 2013. Loans individually evaluated for impairment do not have an allocated allowance for loan loss because they are written down to fair value.

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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
September 30, 2014:								
One- to four-family residential mortgages	$ 402	$ 840	$ 722	$ 1,964	$ 879,217	$ 881,181	$ 4,726	$
Multi-family residential mortgages					5,131	5,131		
Construction, commercial and other mortgages					20,344	20,344		
Home equity loans and lines of credit			161	161	15,632	15,793	301	
Loans on deposit accounts					462	462		
Consumer and other	11	2	1	14	4,087	4,101	1	
Total	$ 413	$ 842	$ 884	$ 2,139	$ 924,873	$ 927,012	$ 5,028	$
December 31, 2013:								
One- to four-family residential mortgages	$ 376	$ 612	$ 1,577	$ 2,565	$ 815,917	$ 818,482	$ 5,840	$
Multi-family residential mortgages					4,851	4,851		
Construction, commercial and other mortgages					13,514	13,514		
Home equity loans and lines of credit					16,532	16,532	160	
Loans on deposit accounts					342	342		
Consumer and other	11	4		15	4,292	4,307		
Total	$ 387	$ 616	$ 1,577	$ 2,580	$ 855,448	$ 858,028	$ 6,000	$

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 that 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 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.

The Company had 20 nonaccrual loans with a book value of $5.0 million at September 30, 2014 and 19 nonaccrual loans with a book value of $6.0 million as of December 31, 2013. The Company collected interest on nonaccrual loans of $197,000 and $137,000 during the nine months ended September 30, 2014 and 2013, respectively, but due to regulatory requirements, we recorded it as a reduction of principal. The Company would have recognized additional interest income of $164,000 and $200,000 during the nine months ended September 30, 2014 and 2013, 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 September 30, 2014 and December 31, 2013.

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The table below presents information related to loans modified in a troubled debt restructuring during the three and nine months ended September 30, 2014 and 2013:

(Dollars in thousands)	2014 Number of Loans	2014 Pre-Modification Recorded Investment	2014 Post-Modification Recorded Investment	2013 Number of Loans	2013 Pre-Modification Recorded Investment	2013 Post-Modification Recorded Investment
Three months ended September 30:						
One- to four-family residential		$	$		$	$
Total		$	$		$	$
Nine months ended September 30:						
One- to four-family residential		$	$	1	$ 700	$ 700
Total		$	$	1	$ 700	$ 700

There were no new troubled debt restructurings within the past 12 months that subsequently defaulted.

The Company had 18 troubled debt restructurings totaling $4.9 million as of September 30, 2014 that were considered to be impaired. This total included 17 one- to four-family residential mortgage loans totaling $4.8 million and one home equity loan for $139,000. Six of the loans, totaling $2.0 million, are performing in accordance with their restructured terms and accruing interest at September 30, 2014. Eleven of the loans, totaling $2.7 million, are performing in accordance with their restructured terms but not accruing interest at September 30, 2014. One of the loans, for $191,000, is more than 149 days delinquent and not accruing interest as of September 30, 2014. The Company had 20 troubled debt restructurings totaling $5.8 million as of December 31, 2013 that were considered to be impaired. This total included 19 one- to four-family residential mortgage loans totaling $5.6 million and one home equity loan for $160,000. Eight of the loans, totaling $2.5 million, were performing in accordance with their restructured terms and accruing interest at December 31, 2013. Twelve of the loans, totaling $3.3 million, were performing in accordance with their restructured terms but not accruing interest at December 31, 2013. 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 nine months ended September 30, 2014 and 2013, the Company sold $26.9 million and $69.2 million, respectively, of mortgage loans held for sale and recognized gains of $283,000 and $1.4 million, respectively. During the three months ended September 30, 2014 and 2013, the Company sold $10.0 million and $22.1 million, respectively, of mortgage loans held for sale and recognized gains of $118,000 and $365,000, respectively. The Company had eight loans held for sale totaling $2.6 million at September 30, 2014 and six loans held for sale totaling $2.2 million at December 31, 2013.

The Company serviced loans for others of $62.8 million at September 30, 2014 and $68.4 million at December 31, 2013. Of these amounts, $2.5 million and $3.1 million relate to securitizations for which the Company continues to hold the related mortgage-backed securities at September 30, 2014 and December 31, 2013, respectively. The amount of contractually specified servicing fees earned for the nine-month periods ended September 30, 2014 and 2013 was $137,000 and $164,000, respectively. The amount of contractually specified servicing fees earned for the three-month periods ended September 30, 2014 and 2013 was $44,000 and $51,000, respectively. The fees are reported in service fees on loan and deposit accounts in the consolidated statements of income.

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(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:

(Dollars in thousands)	September 30, 2014 Repurchase Liability	September 30, 2014 Weighted Average Rate	December 31, 2013 Repurchase Liability	December 31, 2013 Weighted Average Rate
Maturing:				
1 year or less	$ 47,000	2.11%	$	%
Over 1 year to 2 years			47,000	2.11
Over 3 years to 4 years	25,000	1.46	25,000	1.46
Total	$ 72,000	1.88%	$ 72,000	1.88%

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, 2014. 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	$ 77,416	$ 77,232	$ 72,000	$ 5,416	16

(8) Offsetting of Financial Liabilities

Securities sold under agreements to repurchase are subject to a conditional right of offset in the event of default. See Footnote 7, Securities Sold Under Agreements to Repurchase, for additional information.

(Dollars in thousands)	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet	Gross Amount Not Offset in the Balance Sheet: Financial Instruments	Gross Amount Not Offset in the Balance Sheet: Cash Collateral Pledged	Net Amount
September 30, 2014:						
Securities sold under agreements to repurchase	$ 72,000	$	$ 72,000	$ 72,000	$	$
December 31, 2013:						

Securities sold under agreements to repurchase	$	72,000	$		$	72,000	$	72,000	$	$

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(9) 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)	**2014**	**2013**	**2014**	**2013**
Net periodic benefit cost for the period				
Service cost	$ 25	$ 41	$ 75	$ 124
Interest cost	30	28	89	83
Expected return on plan assets				
Amortization of prior service cost				
Recognized actuarial loss				
Recognized curtailment loss				
Net periodic benefit cost	$ 55	$ 69	$ 164	$ 207

(10) 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

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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, 2014 and 2013 amounted to $216,000 and $249,000, respectively. Compensation expense recognized for the nine months ended September 30, 2014 and 2013 amounted to $673,000 and $772,000, respectively.

Shares held by the ESOP trust were as follows:

	September 30, 2014	December 31, 2013
Allocated shares	271,198	239,241
Unearned shares	697,290	733,989
Total ESOP shares	968,488	973,230
Fair value of unearned shares, in thousands	$ 14,148	$ 17,029

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 September 30, 2014 and 2013, we accrued $63,000 and $63,000, respectively, for the ESOP restoration plan. For the nine months ended September 30, 2014 and 2013, we accrued $156,000 and $183,000, respectively, for the ESOP restoration plan.

(11) 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 five- to six-year vesting period during which participants are required to provide services in exchange for the awards.

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The Company recognized compensation expense, measured as the fair value of the share-based award on the date of grant, on a straight-line basis over the vesting period. Share-based compensation is recorded in the statement of income as a component of salaries and employee benefits with a corresponding increase in shareholders equity. The table below presents information on compensation expense and the related tax benefit for all share-based awards:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(In thousands)	**2014**	**2013**	**2014**	**2013**
Compensation expense	$ 675	$ 675	$ 2,002	$ 2,002
Income tax benefit	302	314	911	966

Shares of our common stock issued under the 2010 Equity Incentive 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.

Stock Options

The table below presents the stock option activity for the nine months ended September 30, 2014 and 2013:

	Options	**Weighted Average Exercise Price**	**Remaining Contractual Life (Years)**	**Aggregate Intrinsic Value (in Thousands)**
Options outstanding at December 31, 2013	832,954	$ 17.38	6.68	$ 4,845
Granted				
Exercised				
Forfeited				
Expired				
Options outstanding at September 30, 2014	832,954	$ 17.38	5.93	$ 2,421
Options outstanding at December 31, 2012	832,954	$ 17.38	7.67	$ 4,554
Granted				
Exercised				
Forfeited				
Expired				
Options outstanding at September 30, 2013	832,954	$ 17.38	6.92	$ 3,821
Options vested and exercisable at September 30, 2014	555,097	$ 17.38	5.93	$ 1,615

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There were no stock options exercised during the three and nine months ended September 30, 2014 and 2013.

As of September 30, 2014, the Company had $1.4 million of unrecognized compensation costs related to the stock option plan. The cost of the stock option plan is being amortized over the five- to six-year vesting period.

There were no options granted in the three or nine months ended September 30, 2014 and 2013.

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:

	Restricted Stock Awards		Weighted Average Grant Date Fair Value
Nonvested at December 31, 2013	340,065	$	17.39
Granted			
Vested	113,332		17.39
Forfeited			
Nonvested at September 30, 2014	266,733	$	17.39
Nonvested at December 31, 2012	453,397	$	17.39
Granted			
Vested	113,332		17.39
Forfeited			
Nonvested at September 30, 2013	340,065	$	17.39

As of September 30, 2014, the Company had $3.8 million of unrecognized compensation costs related to restricted stock awards. The cost of the restricted stock awards is being amortized over the five- or six-year vesting period.

(12) 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, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Net income	$ 3,462	$ 3,831	$ 10,643	$ 11,133
Weighted-average number of shares used in:				
Basic earnings per share	9,218,745	9,676,304	9,190,476	9,810,725
Dilutive common stock equivalents:				
Stock options and restricted stock units	104,561	133,683	92,949	119,713
Diluted earnings per share	9,323,306	9,809,987	9,283,425	9,930,438
Net income per common share, basic	$ 0.38	$ 0.40	$ 1.16	$ 1.13
Net income per common share, diluted	$ 0.37	$ 0.39	$ 1.15	$ 1.12

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(13) Other Comprehensive Loss

The table below presents the changes in the components of accumulated other comprehensive loss, net of taxes:

(Dollars in thousands)	Unfunded Pension Liability	Noncredit Related Losses on Securities Not Expected to Be Sold	Unrealized Loss on Securities	Total
Three months ended September 30, 2014				
Balances at beginning of period	$ 3,338	$ 304	$ 69	$ 3,711
Other comprehensive income before reclassifications		(3)	(1)	(4)
Amounts reclassified from accumulated other comprehensive loss				
Net current period other comprehensive income		(3)	(1)	(4)
Balances at end of period	$ 3,338	$ 301	$ 68	$ 3,707
Three months ended September 30, 2013:				
Balances at beginning of period	$ 3,792	$ 376	$ 78	$ 4,246
Other comprehensive income before reclassifications		(14)	(3)	(17)
Amounts reclassified from accumulated other comprehensive loss				
Net current period other comprehensive income		(14)	(3)	(17)
Balances at end of period	$ 3,792	$ 362	$ 75	$ 4,229
Nine months ended September 30, 2014				
Balances at beginning of period	$ 3,338	$ 376	$ 73	$ 3,787
Other comprehensive income before reclassifications		(75)	(5)	(80)
Amounts reclassified from accumulated other comprehensive loss				
Net current period other comprehensive income		(75)	(5)	(80)
Balances at end of period	$ 3,338	$ 301	$ 68	$ 3,707
Nine months ended September 30, 2013:				
Balances at beginning of period	$ 3,792	$ 445	$ 96	$ 4,333
Other comprehensive income before reclassifications		(83)	(21)	(104)
Amounts reclassified from accumulated other comprehensive loss				
Net current period other comprehensive income		(83)	(21)	(104)
Balances at end of period	$ 3,792	$ 362	$ 75	$ 4,229

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

	Three Months Ended September 30,					
	2014			2013		
(Dollars in thousands)	Pretax Amount	Tax	After Tax Amount	Pretax Amount	Tax	After Tax Amount
Unfunded pension liability	$	$	$	$	$	$
Noncredit related losses on securities not expected to be sold	(4)	1	(3)	(23)	9	(14)
Unrealized loss on securities	(2)	1	(1)	(5)	2	(3)
Total	$ (6)	$ 2	$ (4)	$ (28)	$ 11	$ (17)

	Nine Months Ended September 30,					
	2014			2013		
(Dollars in thousands)	Pretax Amount	Tax	After Tax Amount	Pretax Amount	Tax	After Tax Amount
Unfunded pension liability	$	$	$	$	$	$
Noncredit related losses on securities not expected to be sold	(124)	49	(75)	(138)	55	(83)
Unrealized loss on securities	(8)	3	(5)	(35)	14	(21)
Total	$ (132)	$ 52	$ (80)	$ (173)	$ 69	$ (104)

(14) 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 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.

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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 as only five transactions have occurred over the past 33 months in the same tranche of securities owned by the Company. The fair value of our trust preferred securities was determined using a discounted cash flow model. Our model used a discount rate equal to three-month LIBOR plus 20.00% and provided a fair value estimate of $18.65 per $100 of par value for PreTSL XXIII.

The discounted cash flow analysis 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.

FRB Stock. FRB 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.

Loans Held for Sale. The fair value of loans held for sale is determined based on the prices quoted in the secondary market for similar loans.

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
September 30, 2014					
Assets					
Cash and cash equivalents	$ 64,723	$ 64,723	$ 64,723	$	$
Investment securities held to maturity	589,079	592,470		591,809	661
FHLB stock	11,352	11,352		11,352	
FRB stock	2,904	2,904		2,904	
Loans held for sale	2,602	2,644		2,644	
Loans receivable, net	925,484	954,573			954,573
Accrued interest receivable	4,450	4,450	4,450		
Interest rate contracts	14	14		14	
Liabilities					
Deposits	1,327,254	1,327,481	1,114,881		212,600
Advances from the Federal Home Loan Bank	15,000	14,998			14,998
Securities sold under agreements to repurchase	72,000	72,478			72,478
Accounts payable and accrued expenses (excluding interest rate contracts)	21,357	21,357	21,357		
Interest rate contracts	13	13		13	
Current income taxes payable	1,366	1,366	1,366		
Advance payments by borrowers for taxes and insurance	2,301	2,301	2,301		
December 31, 2013					
Assets					
Cash and cash equivalents	$ 75,365	$ 75,365	$ 75,365	$	$
Investment securities held to maturity	613,436	598,007		597,470	537
FHLB stock	11,689	11,689		11,689	
Loans held for sale	2,210	2,252		2,252	
Loans receivable, net	856,542	880,852			880,852
Accrued interest receivable	4,310	4,310	4,310		
Interest rate contracts	25	25		25	
Liabilities					
Deposits	1,288,709	1,289,348	1,078,712		210,636
Advances from the Federal Home Loan Bank	15,000	15,110			15,110
Securities sold under agreements to repurchase	72,000	73,151			73,151
Accounts payable and accrued expenses (excluding interest rate contracts)	23,905	23,905	23,905		
Interest rate contracts	28	28		28	
Current income taxes payable	1,414	1,414	1,414		
Advance payments by borrowers for taxes and insurance	3,708	3,708	3,708		

At September 30, 2014 and December 31, 2013, 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
September 30, 2014:					
Interest rate contracts	assets	$	$ 14	$	$ 14
Interest rate contracts	liabilities		(13)		(13)
December 31, 2013:					
Interest rate contracts	assets	$	$ 25	$	$ 25
Interest rate contracts	liabilities		(28)		(28)

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 September 30, 2014 and December 31, 2013 and the related gains and losses for the nine months ended September 30, 2014 and the year ended December 31, 2013:

(Dollars in thousands)	Level 1	Level 2	Level 3	Total	Total Gains/ (Losses)
September 30, 2014:					
Impaired loans	$	$	$ 328	$ 328	$ (4)
Trust preferred securities			661	661	124
December 31, 2013:					
Impaired loans	$	$	$ 5,456	$ 5,456	$ 76
Trust preferred securities			537	537	116

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 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. The fair value of trust preferred securities is determined using a discounted cash flow model. The assumptions used in the discounted cash flow model are discussed above. Gains and losses on trust preferred securities that are credit related are included in net other-than-temporary impairment losses in the consolidated statements of income. Gains and losses on trust preferred securities that are not credit related are included in other comprehensive income in the consolidated statements of comprehensive income.

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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
September 30, 2014:					
Impaired loans non-collateral dependent	$	328	Discounted cash flow	Discount rate (1)	6.10%
Trust preferred securities		661	Discounted cash flow	Discount rate	Three-month LIBOR plus 20%
December 31, 2013:					
Impaired loans non-collateral dependent	$	5,456	Discounted cash flow	Discount rate (1)	3.15% - 6.94%
Trust preferred securities		537	Discounted cash flow	Discount rate	Three-month LIBOR plus 20%

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

(15) Subsequent Events

On October 30, 2014, the Board of Directors of Territorial Bancorp Inc. declared a quarterly cash dividend of $0.16 per share of common stock. The dividend is expected to be paid on November 26, 2014 to stockholders of record as of November 13, 2014.

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, 2013.

Comparison of Financial Condition at September 30, 2014 and December 31, 2013

Assets. At September 30, 2014, our assets were $1.656 billion, an increase of $39.5 million, or 2.4%, from $1.617 billion at December 31, 2013. The increase in assets was primarily the result of an increase in loans receivable that was partially offset by decreases in investment securities and cash.

Cash and Cash Equivalents. Cash and cash equivalents were $64.7 million at September 30, 2014, a decrease of $10.6 million since December 31, 2013. During the nine months ended September 30, 2014, cash was used to fund a $69.3 million increase in total loans. In addition, the Company repurchased $4.4 million of common stock and paid $4.2 million of common stock dividends. This was partially offset by a $38.5 million increase in deposits and a $24.4 million decrease in investment securities.

Loans. Total loans, including $2.6 million of loans held for sale, were $928.1 million at September 30, 2014, or 56.0% of total assets. During the nine months ended September 30, 2014, the loan portfolio increased by $69.3 million, or 8.1%. The increase in the loan portfolio primarily occurred as the production of new one-to four-family residential loans exceeded principal repayments and loan sales.

Securities. At September 30, 2014, our securities portfolio totaled $589.1 million, or 35.6% of total assets. During the nine months ended September 30, 2014, the securities portfolio decreased by $24.4 million, or 4.0%. The decrease in the securities portfolio occurred as repayments and the amount of securities sold exceeded the amount of securities purchased.

At September 30, 2014, 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.

At September 30, 2014, we owned trust preferred securities with a carrying value of $661,000. 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 five transactions have occurred over the past 33 months in the same tranche of securities that we own. We used a discounted cash flow model to determine whether these securities were 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. We used a discount rate equal to three-month LIBOR plus 20.00% and provided a fair value estimate of $18.65 per $100 of par value for PreTSL XXIII.

Based on the Company s review, the Company s investment in trust preferred securities did not incur additional impairment during the quarter ended September 30, 2014.

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 remaining amortized cost basis of $1.1 million on its trust preferred securities could be credit-related other-than-temporarily impaired in the near term. The impairment could be material to the Company s consolidated statements of income.

Deposits. Deposits were $1.327 billion at September 30, 2014, an increase of $38.5 million, or 3.0%, since December 31, 2013. The growth in deposits occurred primarily in savings and checking accounts.

Borrowings. Our borrowings consist of advances from the Federal Home Loan Bank of Seattle and funds borrowed under securities sold under agreements to repurchase. During the nine months ended September 30, 2014, our borrowings remained constant at $87.0 million. We have not required any other borrowings to fund our operations. Instead, we have primarily funded our operations with additional deposits, proceeds from loan and security 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.

	For the Three Months Ended September 30,					
	2014			2013		
	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)	$ 870,909	$ 9,448	4.34%	$ 790,885	$ 8,750	4.43%
Multi-family residential	5,068	71	5.60	5,404	77	5.70
Construction, commercial and other	20,030	247	4.93	13,449	168	5.00
Home equity loans and lines of credit	15,341	184	4.80	15,133	200	5.29
Other loans	4,824	70	5.80	4,818	72	5.98
Total loans	916,172	10,020	4.37	829,689	9,267	4.47
Investment securities:						
U.S. government sponsored mortgage-backed securities (2)	600,548	4,895	3.26	594,898	4,775	3.21
Trust preferred securities	656			535		
Total securities	601,204	4,895	3.26	595,433	4,775	3.21
Other	75,588	75	0.40	92,371	49	0.21
Total interest-earning assets	1,592,964	14,990	3.76	1,517,493	14,091	3.71
Non-interest-earning assets	65,639			62,052		
Total assets	$ 1,658,603			$ 1,579,545		
Interest-bearing liabilities:						
Savings accounts	$ 931,040	$ 868	0.37%	$ 890,488	$ 722	0.32%
Certificates of deposit	211,426	263	0.50	196,151	302	0.62
Money market accounts	776			835		
Checking and Super NOW accounts	144,190	7	0.02	132,251	7	0.02
Total interest-bearing deposits	1,287,432	1,138	0.35	1,219,725	1,031	0.34
Federal Home Loan Bank advances	15,000	67	1.79	15,000	67	1.79
Securities sold under agreements to repurchase	72,000	346	1.92	60,612	422	2.78
Total interest-bearing liabilities	1,374,432	1,551	0.45	1,295,337	1,520	0.47
Non-interest-bearing liabilities	67,247			65,285		
Total liabilities	1,441,679			1,360,622		
Stockholders equity	216,924			218,923		
Total liabilities and stockholders equity	$ 1,658,603			$ 1,579,545		
Net interest income		$ 13,439			$ 12,571	
Net interest rate spread (3)			3.31%			3.24%
Net interest-earning assets (4)	$ 218,532			$ 222,156		

Net interest margin (5)		3.37%		3.31%
Interest-earning assets to interest-bearing liabilities	115.90%		117.15%	

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(1) Annualized

(2) Average balance includes loans or investments available for sale.

(3) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(4) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(5) Net interest margin represents net interest income divided by average total interest-earning assets.

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	For the Nine Months Ended September 30,					
	2014			2013		
	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)	$ 846,210	$ 27,666	4.36%	$ 771,725	$ 26,121	4.51%
Multi-family residential	4,887	206	5.62	5,980	259	5.77
Construction, commercial and other	17,767	669	5.02	13,392	497	4.95
Home equity loans and lines of credit	15,756	575	4.87	14,985	606	5.39
Other loans	4,706	204	5.78	4,743	213	5.99
Total loans	889,326	29,320	4.40	810,825	27,696	4.55
Investment securities:						
U.S. government sponsored mortgage-backed securities (2)	612,974	15,055	3.27	569,196	13,847	3.24
Trust preferred securities	617			472		