Territorial Bancorp Inc.
Form 10-Q
August 12, 2010
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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, 2010

or

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

For transition period from to

Commission File Number 1-34403

TERRITORIAL BANCORP INC.

(Exact Name of Registrant as Specified in Charter)

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

(808) 946-1400

Registrant s telephone number, including area code

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ 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	¨
Non-accelerated filer	x	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.

12,233,125 shares of Common Stock, par value $0.01 per share, were issued and outstanding as of July 29, 2010.

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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, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents	$ 201,682	$ 135,953
Investment securities held to maturity, at amortized cost (fair value of $587,140 and $606,269 at June 30, 2010 and December 31, 2009, respectively)	560,956	598,394
Federal Home Loan Bank stock, at cost	12,348	12,348
Loans held for sale	438	1,084
Loans receivable, net	626,976	597,700
Accrued interest receivable	4,734	4,781
Premises and equipment, net	4,793	4,495
Real estate owned		159
Bank-owned life insurance	28,758	28,249
Prepaid expenses and other assets	6,124	6,449
Total assets	$ 1,446,809	$ 1,389,612
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Deposits	$ 1,083,899	$ 1,014,668
Advances from the Federal Home Loan Bank	10,000	
Securities sold under agreements to repurchase	105,200	130,200
Accounts payable and accrued expenses	19,269	18,837
Current income taxes payable	1,375	670
Deferred income taxes payable	1,115	2,661
Advance payments by borrowers for taxes and insurance	2,925	2,905
Total liabilities	1,223,783	1,169,941
Commitments and contingencies		
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 12,233,125 shares at June 30, 2010 and December 31, 2009	122	122
Additional paid-in capital	119,048	118,823
Unearned ESOP shares	(9,053)	(9,297)
Retained earnings	114,647	111,082
Accumulated other comprehensive loss	(1,738)	(1,059)

Total stockholders equity	223,026	219,671
Total liabilities and stockholders equity	$ 1,446,809	$ 1,389,612

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, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Interest and dividend income:				
Investment securities	$ 6,641	$ 5,957	$ 13,448	$ 12,229
Loans	8,582	8,984	17,111	18,432
Other investments	99	23	175	23
Total interest and dividend income	15,322	14,964	30,734	30,684
Interest expense:				
Deposits	2,970	3,833	5,929	7,627
Advances from the Federal Home Loan Bank	45		45	33
Securities sold under agreements to repurchase	1,057	1,255	2,141	2,469
Subordinated debentures and other borrowings		283		584
Total interest expense	4,072	5,371	8,115	10,713
Net interest income	11,250	9,593	22,619	19,971
Provision for loan losses	158		158	1,102
Net interest income after provision for loan losses	11,092	9,593	22,461	18,869
Non-interest income:				
Total other-than-temporary impairment losses		(426)	(3,510)	(862)
Portion of loss recognized in other comprehensive income (before taxes)		(41)	1,106	97
Net other-than-temporary impairment losses		(467)	(2,404)	(765)
Service fees on loan and deposit accounts	665	650	1,288	1,317
Income on bank-owned life insurance	254	258	509	513
Gain on sale of investment securities	282	230	350	230
Gain on sale of loans	175	378	255	1,177
Other	102	68	148	142
Total non-interest income	1,478	1,117	146	2,614
Non-interest expense:				
Salaries and employee benefits	4,347	3,748	9,007	7,545
Occupancy	1,143	1,098	2,282	2,228
Equipment	734	764	1,450	1,468
Federal deposit insurance premiums	298	1,049	590	1,183
Other general and administrative expenses	909	704	1,891	1,574

Total non-interest expense	7,431	7,363	15,220	13,998
Income before income taxes	5,139	3,347	7,387	7,485
Income taxes	1,904	1,092	2,691	2,559
Net income	$ 3,235	$ 2,255	$ 4,696	$ 4,926
Basic earnings per share	$ .29	N/A	$ .41	N/A
Cash dividends declared per common share	$ .05	N/A	$ .10	N/A
Basic weighted average shares outstanding	11,321,814	N/A	11,315,738	N/A

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	Total Stockholders Equity
Balances at December 31, 2008	$			100,897	(1,516)	99,381
Cumulative effect from adoption of FASB ASC Topic 320, net of taxes of $958				1,524	(1,524)	
Balances at December 31, 2008, as revised	$			102,421	(3,040)	99,381
Comprehensive income:						
Net income				4,926		4,926
Other comprehensive loss, net of tax:						
Investment securities:						
Noncredit related losses on securities not expected to be sold, net of taxes of $37					(60)	(60)
Total comprehensive income						4,866
Balances at June 30, 2009	$			107,347	(3,100)	104,247
Balances at December 31, 2009	$ 122	118,823	(9,297)	111,082	(1,059)	219,671
Comprehensive income:						
Net income				4,696		4,696
Other comprehensive loss, net of tax:						
Investment securities:						
Noncredit related losses on securities not expected to be sold, net of taxes of $427					(679)	(679)
Total comprehensive income						4,017
Cash dividends declared				(1,131)		(1,131)
Allocation of 24,466 ESOP shares		225	244			469
Balances at June 30, 2010	$ 122	119,048	(9,053)	114,647	(1,738)	223,026

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, 2010	Six Months Ended June 30, 2009
Cash flows from operating activities:		
Net income	$ 4,696	$ 4,926
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	158	1,102
Depreciation and amortization	444	472
Deferred income tax benefit	(1,119)	(757)
Amortization of fees, discounts, and premiums	90	(587)
Origination of loans held for sale	(18,872)	(59,842)
Proceeds from sales of loans held for sale	18,689	57,783
Gain on sale of loans, net	(255)	(379)
Net gain on sale of real estate owned	(1)	
Other-than-temporary impairment loss on investment	2,404	765
Purchases of investment securities held for trading	(18,143)	
Proceeds from sale of investment securities held for trading	18,244	
Gain on sale of investment securities held for trading	(101)	
Gain on sale of investment securities available for sale	(249)	(230)
Net gain on sale of premises and equipment		(3)
ESOP expense	469	
Decrease in accrued interest receivable	47	180
Net increase in bank-owned life insurance	(509)	(513)
Net (increase) decrease in prepaid expenses and other assets	325	(1,717)
Net increase in accounts payable and accrued expenses	432	4,199
Net increase (decrease) in federal and state income taxes, net	705	(443)
Net cash provided by operating activities	7,454	4,956
Cash flows from investing activities:		
Purchases of investment securities held to maturity	(30,505)	(42,824)
Purchases of investment securities available for sale	(49,206)	(14,967)
Principal repayments on investment securities held to maturity	63,957	59,641
Principal repayments on investment securities available for sale	90	
Proceeds from sale of investment securities available for sale	49,365	
Loan originations, net of principal repayments on loans receivable	(27,964)	28,058
Proceeds from sale of real estate owned	160	
Proceeds from disposals of premises and equipment		3
Purchases of premises and equipment	(742)	(775)
Net cash provided by investing activities	5,155	29,136

(Continued)

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Cash flows from financing activities:		
Net increase in deposits	$ 69,231	$ 297,785
Proceeds from advances from the Federal Home Loan Bank	10,000	50,476
Repayments of advances from the Federal Home Loan Bank		(86,267)
Proceeds from securities sold under agreements to repurchase	1,136	15,000
Repayments of securities sold under agreements to repurchase	(26,136)	
Purchases of Fed Funds	10	39,367
Sales of Fed Funds	(10)	(39,367)
Net increase (decrease) in advance payments by borrowers for taxes and insurance	20	(294)
Cash dividends paid	(1,131)	
Net cash provided by financing activities	53,120	276,700
Net increase in cash and cash equivalents	65,729	310,792
Cash and cash equivalents at beginning of the period	135,953	11,216
Cash and cash equivalents at end of the period	$ 201,682	$ 322,008
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest on deposits and borrowings	$ 8,249	$ 10,667
Income taxes	3,105	3,759
Supplemental disclosure of noncash investing activities:		
Investments sold, not settled	$	$ 15,198

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 fiscal year ended December 31, 2009. 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.

As used in this Quarterly Report on Form 10-Q, the words Company, we, us and our are intended to refer to Territorial Bancorp Inc. with respe to matters and time periods occurring on and after July 10, 2009.

(2) Organization

On November 4, 2008, the Board of Directors of Territorial Mutual Holding Company approved a plan of conversion and reorganization under which Territorial Mutual Holding Company would convert from a mutual holding company to a stock holding company. The conversion to a stock holding company was approved by the depositors and borrowers of Territorial Savings Bank and the Office of Thrift Supervision (OTS) and included the filing of a registration statement with the U.S. Securities and Exchange Commission. Upon the completion of the conversion and reorganization on July 10, 2009, Territorial Mutual Holding Company and Territorial Savings Group, Inc. ceased to exist as separate legal entities and Territorial Bancorp Inc. became the holding company for Territorial Savings Bank. A total of 12,233,125 shares were issued in the conversion at $10 per share, raising $122.3 million of gross proceeds. Approximately $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 June 2009, the Financial Accounting Standards Board (FASB) amended the Transfers and Servicing topic of the FASB Accounting Standards Codification (ASC). The amendment seeks to improve the usefulness of the information a company provides about a transfer of financial assets, the effects of the transfer on its financial position, performance and cash flows, and its continuing involvement in the transferred financial assets. The amendment is effective as of the beginning of the first annual reporting period that ends after November 15, 2009. The Company adopted this amendment on January 1, 2010 and such adoption did not have a significant impact on its consolidated financial statements.

In June 2009, the FASB amended the Consolidation topic of the FASB ASC. The amendment seeks to improve financial reporting by enterprises involved with variable interest entities and also addresses the effects on consolidations of the June 2009 amendment to the Transfers and Servicing topic of the FASB ASC. The amendment is effective as of the beginning of the first annual reporting period that ends after November 15, 2009. The Company adopted this amendment on January 1, 2010 and such adoption did not have any impact on its consolidated financial statements.

In January 2010, the FASB amended the Fair Value Measurements and Disclosures topic of the FASB ASC. The amendment requires disclosures about the significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers, and requires the reconciliation of activity in Level 3 fair value measurements be made on a gross basis. The amendment also clarifies the level of disaggregation required in disclosures and the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for Level 2 or Level 3 items. The part of the amendment related to the reconciliation of Level 3 activity is effective for interim and annual periods beginning after December 15, 2010. The remaining parts of the amendment are effective for interim and annual periods beginning after December 15, 2009. Except for the part related to the reconciliation of Level 3 activity, the Company adopted the amendment on January 1, 2010 and the Fair Value of Financial Instruments footnote has been updated to include the revised disclosures. The Company does not expect the adoption of the remainder of the amendment to have a significant impact on its consolidated financial statements.

In July 2010, the FASB amended the Receivables topic of the FASB ASC. The amendment requires a greater level of disaggregated information about the credit quality of financing receivables and the allowance for credit losses. The amendment also requires disclosures of credit quality indicators, past due information, and modifications of financing receivables. The amendment is effective for interim and annual reporting periods ending on or after December 15, 2010. The Company does not expect the adoption of this amendment to have a significant impact on its consolidated financial statements.

(4) Cash and Cash Equivalents

Cash and cash equivalents includes cash and due from banks, interest-bearing deposits in other banks, federal funds sold, and short-term, highly liquid investments with original maturities of three months or less. The table below presents the balances of cash and cash equivalents as of June 30, 2010 and December 31, 2009:

(Dollars in thousands)	June 30, 2010	December 31, 2009
Cash and due from banks	$ 10,948	$ 12,466
Interest-bearing deposits in other banks	190,734	123,487
Cash and cash equivalents	$ 201,682	$ 135,953

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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, 2010:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 560,924	26,266	(118)	$ 587,072
Trust preferred securities	32	36		68
Total	$ 560,956	26,302	(118)	$ 587,140
December 31, 2009:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 594,852	12,555	(1,238)	$ 606,169
Trust preferred securities	3,542		(3,442)	100
Total	$ 598,394	12,555	(4,680)	$ 606,269

The amortized cost and estimated fair value of investment securities at June 30, 2010 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	$ 19,623	20,235
Due after 10 years	541,333	566,905
Total	$ 560,956	587,140

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Proceeds from sales of securities available for sale and in the trading account were $44.4 million for the three months ended June 30, 2010, resulting in gross realized gains of $282,000. Proceeds from sales of securities available for sale were $15.2 million for the three months ended June 30, 2009, resulting in gross realized gains of $230,000.

Proceeds from sales of securities available for sale and in the trading account were $67.6 million for the six months ended June 30, 2010, resulting in gross realized gains of $350,000. Proceeds from sales of securities available for sale were $15.2 million for the six months ended June 30, 2009, resulting in gross realized gains of $230,000. All sales of securities classified as available for sale and trading for the six months ended June 30, 2010 and 2009 were U.S. government-sponsored mortgage-backed securities.

The Company did not have any securities classified as available for sale or trading at June 30, 2010 and December 31, 2009.

Investment securities with carrying values of $303.2 million at June 30, 2010 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, 2010 and December 31, 2009. The Company has the ability to hold these securities until such time as the value recovers or the securities mature.

	Less than 12 months		12 months or longer			Total	
Description of securities	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized Losses**	**Number of securities**	**Fair value**	**Unrealized losses**
(Dollars in thousands)							
June 30, 2010							
Mortgage-backed securities	$ 7,894	114	214	4	8	8,108	118
Trust preferred securities							
Total	$ 7,894	114	214	4	8	8,108	118
December 31, 2009:							
Mortgage-backed securities	$ 123,463	1,227	362	11	25	123,825	1,238
Trust preferred securities			100	3,442	1	100	3,442
Total	$ 123,463	1,227	462	3,453	26	123,925	4,680

Trust Preferred Securities. At June 30, 2010, 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 reported as other comprehensive income and is related to non-credit factors such as the trust preferred securities market being inactive. The trust preferred securities represent investments in a pool of debt obligations issued primarily by holding companies for Federal Deposit Insurance Corporation-insured financial institutions. All of these securities are classified in the Bank s held-to-maturity investment portfolio.

The trust preferred securities market is considered to be inactive as only five transactions have occurred over the past 12 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.

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Based on the Company s review, the Company s investment in trust preferred securities did not incur additional impairment charges during the quarter ending June 30, 2010 as the present value of cash flows exceed the amortized cost basis of $1.1 million.

At June 30, 2010, 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)	**2010**	**2009**
Balance at January 1	$ 3,481	$ 1
Credit losses on debt securities for which other-than-temporary impairment was not previously recognized	2,404	
Credit losses on debt securities for which other-than-temporary impairment was previously recognized		298
Balance at June 30	$ 5,885	$ 299

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

(Dollars in thousands)	**June 30, 2010**	**June 30, 2009**
Non-credit losses on other-than-temporarily impaired securities	$ 679	$ 1,584

(6) Loans Receivable

The components of loans receivable at June 30, 2010 and December 31, 2009 are as follows:

(Dollars in thousands)	**June 30, 2010**	**December 31, 2009**
Real estate loans:		
First mortgages:		
One- to four- family residential	$ 584,501	555,473
Multifamily residential	4,598	3,807
Construction, commercial, and other	18,335	20,762
Home equity loans and lines of credit	20,790	21,789
Total real estate loans	628,224	601,831
Other loans:		
Loans on deposit accounts	1,029	1,109
Consumer and other loans	5,531	5,786

Total other loans	6,560	6,895
Less:		
Net unearned fees and discounts	(5,476)	(5,255)
Undisbursed loan funds	(595)	(4,090)
Allowance for loan losses	(1,737)	(1,681)
	(7,808)	(11,026)
Loans Receivable, net	$ 626,976	597,700

Impaired loans at June 30, 2010 and December 31, 2009 amounted to $3.9 million and $3.2 million, respectively, and included all nonaccrual and restructured loans. During the six months ended June 30, 2010, the average recorded investment in impaired loans was $3.9 million and interest income recognized on impaired loans was $77,000. During the six months ended June 30, 2009, the average recorded investment in impaired loans was $1.3 million and interest income recognized on impaired loans was $0.

The Company had five nonaccrual loans for $692,000 at June 30, 2010 and six nonaccrual loans for $520,000 as of December 31, 2009. The Company collected and recognized interest income on nonaccrual loans of $4,000 and $0 during the six months ended June 30, 2010 and June 30, 2009, respectively. The Company would have recognized additional interest income of $16,000 and $41,000 during the six months ended June 30, 2010 and 2009, 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, 2010 and December 31, 2009.

The Company had ten troubled debt restructurings totaling $3.1 million as of June 30, 2010, all of which were one- to four-family residential mortgage loans and considered to be impaired. Nine of the loans totaling $2.9 million are performing and still accruing interest at June 30, 2010. There were nine restructured one- to four-family residential mortgage loan totaling $3.0 million as of December 31, 2009 that were considered to be impaired. Eight of the loans totaling $2.7 million were still accruing interest at December 31, 2009. 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, 2010 and 2009, the Company sold $18.7 million and $58.2 million, respectively, of mortgage loans held for sale and recognized a gain of $248,000 and $1.1 million, respectively. During the three months ended June 30, 2010 and 2009, the Company sold $11.5 million and $33.6 million, respectively, of mortgage loans held for sale and recognized a gain of $114,000 and $492,000, respectively. The Company had three loans held for sale totaling $438,000 at June 30, 2010 and seven loans held for sale totaling $1.1 million at December 31, 2009.

The Company serviced loans for others of $142.1 million at June 30, 2010 and $135.6 million at December 31, 2009. Of these amounts, $9.5 million and $11.9 million relate to securitizations for which the Company continues to hold the related mortgage-backed securities at June 30, 2010 and 2009,

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respectively. The amount of contractually specified servicing fees earned for the six-month periods ended June 30, 2010 and June 30, 2009 was $202,000 and $145,000, respectively. The amount of contractually specified servicing fees earned for the three-month periods ended June 30, 2010 and June 30, 2009 was $103,000 and $84,000, respectively. The fees are reported in service fees on loan and deposit accounts in the consolidated statements of income.

(7) Allowance for Loan Losses

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

(Dollars in thousands)	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Balance, beginning of period	$ 1,658	$ 2,001	$ 1,681	$ 899
Provision for loan losses	158		158	1,102
	1,816	2,001	1,839	2,001
Charge-offs	(95)	(2)	(123)	(3)
Recoveries	16	2	21	3
Net charge-offs	(79)		(102)	
Balance, end of period	$ 1,737	$ 2,001	$ 1,737	$ 2,001

(8) 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 at June 30, 2010 and December 31, 2009 are summarized as follows:

(Dollars in thousands)	June 30, 2010 Repurchase liability	June 30, 2010 Weighted average rate	December 31, 2009 Repurchase liability	December 31, 2009 Weighted average rate
Maturing:				
1 year or less	$ 32,000	3.11%	$ 25,000	3.13%
Over 1 year to 2 years	14,900	4.38	43,900	3.53
Over 2 years to 3 years	40,300	4.12	28,300	4.75
Over 3 years to 4 years	18,000	4.87	33,000	3.91
	$ 105,200	3.98%	$ 130,200	3.82%

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, 2010. The amount at

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risk is the greater of the carrying value or fair value over the repurchase liability. All the agreements to repurchase are with JP Morgan Chase Bank N.A and 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	$ 121,693	128,724	105,200	23,524	22
	$ 121,693	128,724	105,200	23,524	22

(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 defined pension plan.

The components of net periodic benefit cost were as follows:

	SERP Three Months Ended June 30,		SERP Six Months Ended June 30,	
(Dollars in thousands)	2010	2009	2010	2009
Net periodic benefit cost for the period				
Service cost	155	134	310	268
Interest cost	89	77	177	154
Expected return on plan assets				
Amortization of prior service cost				
Recognized actuarial loss				
Recognized curtailment loss				
Net periodic benefit cost	244	211	487	422

(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.

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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 stock. 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 will adjust annually and will be the prime rate on the first business day of the calendar year.

Shares purchased by the ESOP will be held by a trustee in an unallocated suspense account, and shares will be 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 will allocate 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, 2010 and 2009 amounted to $231,000 and $0, respectively. Compensation expense recognized for the six months ended June 30, 2010 and 2009 amounted to $465,000 and $0, respectively.

Shares held by the ESOP trust at June 30, 2010 were as follows:

Allocated shares	73,399
Unearned shares	905,251
Total ESOP shares	978,650
Fair value of unearned shares, in thousands	$ 17,155

The ESOP restoration plan is a non-qualified plan that provides supplemental benefits to certain executives who are prevented from receiving the full benefits contemplated by the employee stock ownership plan s benefit formula. The supplemental cash payments consist of payments representing shares that cannot be allocated to the participants under the ESOP due to IRS limitations imposed on tax-qualified plans. We accrue for these benefits over the period during which employees provide services to earn these benefits. For the three months ended June 30, 2010, we reversed $25,000 of expense for the ESOP restoration plan. For the three months ended June 30, 2009, the ESOP restoration plan expense was $0. For the six months ended June 30, 2010 and 2009, we accrued $155,000 and $0, respectively for the ESOP restoration plan.

(11) Earnings Per Share

The table below presents the information used to compute basic earnings per share for the three and six months ended June 30, 2010. The Company has no dilutive potential common shares for the three and six-month periods ended June 30, 2010. Because the mutual-to-stock conversion was not completed until July 10, 2009, per share earnings data is not presented for the three and six-month periods ended June 30, 2009.

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(Dollars in thousands, except per share data)	Three Months Ended June 30, 2010	Six Months Ended June 30, 2010
Basic		
Earnings:		
Net income	$ 3,235	$ 4,696
Shares:		
Weighted average common shares outstanding	11,321,814	11,315,738
Net income per common share, basic	$ 0.29	$ 0.41

(12) Fair Value of Financial Instruments

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

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

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 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.

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

Our pooled trust preferred securities are collateralized debt obligations issued primarily by banks and bank holding companies in the United States. The trust preferred securities market is considered to be inactive since there have been only five sales transactions of similar rated securities over the past 12 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 22.00% and provided a fair value estimate of $1.93 per $100 of par value for PreTSL XXIII.

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

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.

Short-Term Investments. The fair value of short-term investments is estimated by discounting the future cash flows using the rates currently offered for investments with similar remaining maturities.

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.

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

(Dollars in thousands)	June 30, 2010 Carrying Amount	June 30, 2010 Estimated fair value	December 31, 2009 Carrying amount	December 31, 2009 Estimated fair value
Assets				
Cash and cash equivalents	$ 201,682	201,682	135,953	135,953
Investment securities held to maturity	560,956	587,140	598,394	606,269
FHLB stock	12,348	12,348	12,348	12,348
Loans held for sale	438	452	1,084	1,084
Loans receivable, net	626,976	654,236	597,700	615,858
Accrued interest receivable	4,734	4,734	4,781	4,781
Liabilities				
Deposits	$ 1,083,899	1,086,231	1,014,668	1,017,396
Advances from the Federal Home Loan Bank	10,000	10,222		
Securities sold under agreements to repurchase	105,200	118,478	130,200	136,029
Accounts payable and accrued expenses	19,269	19,269	18,837	18,837
Current income taxes payable	1,375	1,375	670	670
Advance payments by borrowers for taxes and insurance				