BankGuam Holding Co
Form 10-Q
August 09, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

or

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

For the transition period from _________ to _________.

Commission file number: 000-54483

BankGuam Holding Company

(Exact name of registrant as specified in its charter)

Guam	**66-0770448**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

111 West Chalan Santo Papa

Hagatna, Guam 96910

(671) 472-5300

(Address, including Zip Code, and telephone number, including area code, of the registrant s principal executive offices)

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registration was required to submit and post such files). Yes x No ¨

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

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

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

As of June 30, 2013, the registrant had outstanding 8,787,749 shares of common stock.

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BANKGUAM HOLDING COMPANY

FORM 10-Q

QUARTERLY REPORT

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Cautionary Note Regarding Forward-Looking Statements

For purposes of this Quarterly Report, the terms the Company, we, us and our refer to BankGuam Holding Company and its subsidiaries. This Quarterly Report on Form 10-Q contains statements that are not historical in nature, are predictive in nature, or that depend upon or refer to future events or conditions or contain forward-looking statements within the meaning of Section 21 of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. These include, among other things, statements regarding:

Competition for loans and deposits and failure to attract or retain deposits and loans;

Local, regional, national and global economic conditions and events, and the impact they may have on us and our customers, and our assessment of that impact on our estimates, including the allowance for loan losses;

Risks associated with concentrations in real estate related loans;

Changes in the level of nonperforming assets and charge-offs and other credit quality measures, and their impact on the adequacy of our allowance for loan losses and our provision for loan losses;

The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;

Stability of funding sources and continued availability of borrowings;

The effect of changes in laws and regulations with which the Company and Bank of Guam must comply, including any increase in Federal Deposit Insurance Corporation insurance premiums;

Our ability to raise capital or incur debt on reasonable terms;

Regulatory limits on Bank of Guam s ability to pay dividends to the Company;

The impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and its implementing regulations;

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setting bodies;

Changes in the deferred tax asset valuation allowance in future quarters;

The costs and effects of legal and regulatory developments, including resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;

The ability to increase market share and control expenses; and,

Our success in managing the risks involved in the foregoing items,
as well as other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements may be preceded by, followed by or include the words expects, anticipates, intends, plans, believes, seeks, estimates, will, to and similar expressions. We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about our business and the environment in which it operates that could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in Risk Factors included elsewhere in this Quarterly Report and as may be updated in filings we make from time to time with the U.S. Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for our fiscal year ended December 31, 2012, and our other Quarterly Reports on Form 10-Q filed by us in fiscal 2013. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements. New information, future events or risks could cause the forward-looking events we discuss in this Quarterly Report not to occur. You should not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this Quarterly Report.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

The financial statements and the notes thereto begin on the next page.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Condition

(in Thousands, Except Par Value)

	June 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 27,262	$ 36,575
Federal Funds sold	5,000	5,000
Interest bearing deposits in banks	70,521	32,614
Total cash and cash equivalents	102,783	74,189
Restricted cash	150	150
Investment securities available for sale, at fair value	232,849	273,522
Investment securities held to maturity, at amortized cost	49,126	58,125
Federal Home Loan Bank stock, at cost	2,120	2,159
Loans, net of allowance for loan losses (6/30/13: $11,675 and 12/31/12: $12,228)	822,648	748,832
Accrued interest receivable	3,728	3,599
Premises and equipment, net	17,601	17,712
Goodwill	783	783
Other assets	32,235	32,310
Total assets	$ 1,264,023	$ 1,211,381
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 292,990	$ 279,322
Interest bearing	870,852	823,218
Total deposits	1,163,842	1,102,540
Accrued interest payable	152	161
Borrowings	0	10,145
Other liabilities	6,710	4,111
Total liabilities	1,170,704	1,116,957
Commitments and contingencies (Note 6)		
Stockholders equity:		
Common stock $0.2083 par value; 48,000 shares authorized; 8,820 and 8,814 shares issued and 8,788 and 8,782 shares outstanding at 6/30/13 and 12/31/12, respectively	1,845	1,844
Additional paid-in capital	15,350	15,304
Retained earnings	78,834	76,092
Accumulated other comprehensive income (loss)	(2,420)	1,474
	93,609	94,714
Common stock in treasury, at cost (32 shares)	(290)	(290)
Total stockholders equity	93,319	94,424
Total liabilities and stockholders equity	$ 1,264,023	$ 1,211,381

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Income

(Dollar and Share Amounts in Thousands, Except Per Share Data)

	Three months ended June 30, 2013	Three months ended June 30, 2012	Six months ended June 30, 2013	Six months ended June 30, 2012
Interest income:				
Loans	$ 14,523	$ 15,195	$ 28,372	$ 28,471
Investment securities	1,270	1,444	2,638	2,665
Federal Funds sold	2	2	3	3
Deposits with banks	72	85	130	168
Total interest income	15,867	16,726	31,143	31,307
Interest expense:				
Time deposits	68	66	126	132
Savings deposits	1,037	1,188	2,324	2,367
Other borrowed funds	0	100	80	198
Total interest expense	1,105	1,354	2,530	2,697
Net interest income	14,762	15,372	28,613	28,610
Provision for loan losses	(680)	975	295	1,950
Net interest income, after provision for loan losses	15,442	14,397	28,318	26,660
Non-interest income:				
Service charges and fees	1,236	1,139	2,245	2,048
Investment securities gains, net	243	63	450	180
Income from merchant services	434	505	967	1,092
Income from cardholders	170	325	685	787
Wire transfer fees	173	159	336	333
Trustee fees	144	191	264	337
Other income	594	103	1,067	1,076
Total non-interest income	2,994	2,485	6,014	5,853
Non-interest expenses:				
Salaries and employee benefits	6,884	6,213	12,397	12,103
Occupancy	1,800	1,554	3,373	3,087
Furniture and equipment	1,383	1,346	3,022	2,801
Insurance	423	440	838	871
Telecommunications	355	373	737	751
Federal Deposit Insurance Corporation assessment	274	256	550	485
Contract services	380	443	710	847
Stationery & supplies	199	243	382	479
Professional services	337	501	668	591
Education	181	136	415	227
General, administrative and other	1,912	1,729	4,244	3,639
Total non-interest expenses	14,128	13,234	27,336	25,881

Income before income taxes	4,308	3,648	6,996	6,632
Income tax expense	1,294	1,025	2,056	1,843
Net income	$ 3,014	$ 2,623	$ 4,940	$ 4,789
Earnings per share:				
Basic	$ 0.34	$ 0.30	$ 0.56	$ 0.55
Diluted	$ 0.34	$ 0.30	$ 0.56	$ 0.55
Dividends declared per share	$ 0.125	$ 0.125	$ 0.25	$ 0.25
Basic weighted average shares	8,788	8,779	8,785	8,779
Diluted weighted average shares	8,793	8,779	8,790	8,779

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

(in Thousands)

	Three months ended June 30, 2013	Three months ended June 30, 2012	Six months ended June 30, 2013	Six months ended June 30, 2012
Net income	$ 3,014	$ 2,623	$ 4,940	$ 4,789
Other comprehensive income (loss) components, net of tax effects:				
Unrealized holding gain (loss) on available-for-sale securities arising during the period	(3,270)	1,243	(3,511)	1,144
Reclassification for gains (losses) realized on available-for-sale securities	(243)	63	(450)	180
Net change in unrealized holding loss on held-to-maturity securities during the period	33	39	67	89
	(3,480)	1,345	(3,894)	1,413
Comprehensive income (loss)	$ (466)	$ 3,968	$ 1,046	$ 6,202

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Cash Flows

(in Thousands)

	Six months ended June 30, 2013	Six months ended June 30, 2012
Cash flows from operating activities:		
Net income:	$ 4,940	$ 4,789
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	295	1,950
Depreciation and amortization	1,493	1,476
Amortization of fees, discounts and premiums	1,221	1,247
Write-down and (gain)/loss on sales of other real estate owned, net	66	(62)
Proceeds from sales of loans held for sale	19,692	13,808
Origination of loans held for sale	(19,692)	(13,963)
(Increase) decrease in mortgage servicing rights	(51)	(192)
Realized gain on sale of available-for-sale securities	(450)	(180)
Net change in:		
Accrued interest receivable	(130)	(43)
Other assets	(1,524)	1,099
Accrued interest payable	(8)	9
Other liabilities	2,598	3,097
Net cash provided by operating activities	8,450	13,035
Cash flows from investing activities:		
Purchases of available-for-sale securities	(97,746)	(118,260)
Purchases of held-to-maturity securities	0	(25,709)
Proceeds from sales of available-for-sale securities	110,036	35,179
Maturities, prepayments and calls of available-for-sale securities	23,902	21,305
Maturities, prepayments and calls of held-to-maturity securities	8,815	6,248
Loan originations and principal collections, net	(72,899)	(14,681)
Proceeds from sales of other real estate owned	373	498
Purchases of premises and equipment	(1,383)	(1,433)
Net cash used in investing activities	(28,902)	(96,853)
Cash flows from financing activities:		
Net increase in deposits	61,302	29,460
Payment of Federal Home Loan Bank advances	(10,000)	0
Proceeds from Federal Home Loan Bank stock redemption	39	0
Proceeds from related party borrowings	0	160
Repayment of other borrowings	(145)	(165)
Proceeds from issuance of common stock	47	0
Dividends paid	(2,197)	(2,195)
Net cash provided by financing activities	49,046	27,260
Net change in cash and cash equivalents:	28,594	(56,558)

Cash and cash equivalents at beginning of year	74,189	130,959
Cash and cash equivalents at end of year	$ 102,783	$ 74,401
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 2,530	$ 2,697
Income taxes	$ 130	$ 169
Supplemental schedule of noncash investing and financing activities:		
Net change in unrealized loss on held-to-maturity securities, net of tax	$ 67	$ 89
Net change in unrealized loss on available-for-sale securities, net of tax	$ (3,961)	$ 1,324
Other real estate owned transferred from loans, net	$ 1,212	$ 406
Other real estate owned transferred to loans, net	$ 0	$ (176)

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Notes to Condensed Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

Note 1 Nature of Business

Organization

The accompanying condensed consolidated financial statements include the accounts of BankGuam Holding Company (Company) and its wholly-owned subsidiary, Bank of Guam (Bank). The Company is a Guam corporation organized on October 29, 2010, to act as a holding company of the Bank, a Guam banking corporation, a 24-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), the Republic of Palau (ROP), and San Francisco, California. On August 15, 2011, the Company acquired all of the outstanding common stock of the Bank in a holding company formation transaction.

Other than holding the shares of the Bank, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System (the Federal Reserve Board), to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company s operations are conducted and substantially all of the assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank provides a variety of financial services to individuals, businesses and governments through its branches. The Bank s headquarters is located in Hagåtña, Guam. The Bank currently has twelve branches in Guam, five in the CNMI, four in the FSM, one in the RMI, one in the ROP, and one in San Francisco, California. Its primary deposit products, which are insured by the Federal Deposit Insurance Corporation up to the maximum amounts allowed by law, are demand deposits, savings and time certificate accounts, and its primary lending products are consumer, commercial and real estate loans.

For ease of reference we will sometimes refer to the Company as we , us or our .

Note 2 Summary of Significant Accounting Policies and Recent Accounting Pronouncements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all footnotes that would be required for a full presentation of financial position, results of operations, changes in cash flows and comprehensive income in accordance with generally accepted accounting principles in the United States (GAAP). However, these interim financial statements reflect all adjustments (consisting of normal recurring adjustments and accruals) which, in the opinion of our management, are necessary for a fair presentation of our financial position and our results of operations for the interim periods presented. The condensed consolidated statement of condition as of March 31, 2013, was derived from the Company s audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012.

These unaudited condensed consolidated financial statements have been prepared on a basis consistent with prior periods, and should be read in conjunction with our audited consolidated financial statements as of and for the year ended December 31, 2012, and the notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 on March 21, 2013.

Our consolidated financial position at June 30, 2013, and the consolidated results of operations for the three and six month periods ended June 30, 2013, are not necessarily indicative of what our financial position will be as of December 31, 2013, or of the results of our operations that may be expected for the full year ending December 31, 2013.

The Company has evaluated events subsequent to August 8, 2013, through the date at which these unaudited consolidated financial statements are being filed with the Securities and Exchange Commission, for transactions and other events which may require adjustment of and/or disclosure in such financial statements.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of income and expenses during the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of other real estate owned, other than temporary impairment of securities and the fair value of financial instruments.

Recent Accounting Pronouncements

On February 5, 2013, the FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which gives additional guidance to improve the reporting of reclassifications out of accumulated other comprehensive income (AOCI). For significant items reclassified out of AOCI to net income in their entirety during a reporting period, companies must report the effect on the line items in the statement where net income is presented. This can be done on the face of the statement in certain circumstances or in the notes. For public companies, this guidance is effective on a prospective basis for fiscal years and interim periods within those years beginning after December 15, 2012. The adoption of this guidance did not have a material impact on our financial statements.

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Note 3 Earnings Per Common Share

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to shares subscribed but not yet issued in 2013 under the Employee Stock Purchase Plan, and are reported as dilutive options.

Earnings per common share have been computed based on reported net income and the following share data:

	For the Three Months Ended June 30,		For the Six months Ended June 30,	
	2013	2012	2013	2012
Net income available for common stockholders	$ 3,014	$ 2,623	$ 4,940	$ 4,789
Weighted average number of common shares outstanding	8,788	8,779	8,785	8,779
Effect of dilutive options	5	0	5	0
Weighted average number of common shares outstanding used to calculate diluted earnings per common share	8,793	8,779	8,790	8,779
Income per common share:				
Basic	$ 0.34	$ 0.30	$ 0.56	$ 0.55
Diluted	$ 0.34	$ 0.30	$ 0.56	$ 0.55

Under the 2011 Plan, eligible employees can purchase, through payroll deductions, shares of common stock at a discount. The right to purchase stocks is granted to eligible employees during a period of time that is established from time to time by the Board of Directors of the Company. Eligible employees cannot accrue the right to purchase more than $25 thousand worth of stock at the fair market value at the beginning of each offer period. Eligible employees also may not purchase more than one thousand five hundred (1,500) shares of stock in any one offer period. The shares are purchased at 85% of the fair market price of the stock on the enrollment date.

An amended Plan was approved by the Board of Directors and went into effect on September 1, 2012.

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Note 4 Investment Securities

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, follows:

	June 30, 2013			
	Amortized Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Securities Available for Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 51,431	$ (1,894)	$ 0	$ 49,537
U.S. government agency pool securities	58,076	(208)	174	58,042
U.S. government agency or GSE mortgage-backed securities	126,689	(1,784)	365	125,270
	$ 236,196	$ (3,886)	$ 539	$ 232,849
Securities Held to Maturity				
U.S. government agency pool securities	$ 1,835	$ (10)	$ 37	$ 1,862
U.S. government agency or GSE mortgage-backed securities	47,291	(373)	1,002	47,920
	$ 49,126	$ (383)	$ 1,039	$ 49,782

	December 31, 2012			
	Amortized Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Securities Available for Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 59,923	$ (138)	$ 360	$ 60,145
U.S. government agency pool securities	73,663	(140)	275	73,798
U.S. government agency or GSE mortgage-backed securities	137,282	(152)	2,449	139,579
	$ 270,868	$ (430)	$ 3,084	$ 273,522
Securities Held to Maturity				
U.S. government agency pool securities	$ 1,966	$ (3)	$ 45	$ 2,008
U.S. government agency or GSE mortgage-backed securities	56,159	0	2,054	58,213
	$ 58,125	$ (3)	$ 2,099	$ 60,221

At June 30, 2013, and December 31, 2012, investment securities with a carrying value of $204.2 million and $142.3 million, respectively, were pledged to secure various government deposits and other public requirements.

The amortized cost and fair value of investment securities by contractual maturity at June 30, 2013, and December 31, 2012, are shown below. Securities not due at a single maturity date, such as agency pool securities and mortgage-backed securities, are shown separately.

	June 30, 2013			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one but within five years	$ 0	$ 0	$ 0	$ 0
Due after five years	51,431	49,537	0	0
U.S. Government agency pool securities	58,076	58,042	1,835	1,862
Mortgage-backed securities	126,689	125,270	47,291	47,920
Total	$ 236,196	$ 232,849	$ 49,126	$ 49,782

	December 31, 2012			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one but within five years	$ 4,997	$ 5,035	$ 0	$ 0
Due after five years	54,926	55,110	0	0
U.S. Government agency pool securities	73,663	73,798	1,966	2,008
Mortgage-backed securities	137,282	139,579	56,159	58,213
Total	$ 270,868	$ 273,522	$ 58,125	$ 60,221

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Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of the Company s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2013, and December 31, 2012.

	June 30, 2013					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Securities Available for Sale						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ (1,894)	$ 45,445	$ 0	$ 0	$ (1,894)	$ 45,445
U.S. government agency pool securities	(208)	38,275	0	0	(208)	38,275
U.S. government agency or GSE mortgage-backed securities	(1,784)	89,757	0	0	(1,784)	89,757
Total	$ (3,886)	$ 173,477	$ 0	$ 0	$ (3,886)	$ 173,477
Securities Held to Maturity						
U.S. government agency pool securities	$ (5)	$ 147	$ (5)	$ 292	$ (10)	$ 439
U.S. government agency or GSE mortgage-backed securities	(373)	20,282	0	0	(373)	20,282
Total	$ (378)	$ 20,429	$ (5)	$ 292	$ (383)	$ 20,721

	December 31, 2012					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Securities Available for Sale						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ (138)	$ 29,836	$ 0	$ 0	$ (138)	$ 29,836
U.S. government agency pool securities	(139)	29,921	(1)	76	(140)	29,997
U.S. government agency or GSE mortgage-backed securities	(136)	25,420	(16)	3,216	(152)	28,636
	$ (413)	$ 85,177	$ (17)	$ 3,292	$ (430)	$ 88,469
Securities Held to Maturity						
U.S. government agency pool securities	$ 0	$ 29	$ (3)	$ 302	$ (3)	$ 331
U.S. government agency or GSE mortgage-backed securities	0	0	0	0	0	0
	$ 0	$ 29	$ (3)	$ 302	$ (3)	$ 331

The Bank does not believe that any of the investment securities that were in an unrealized loss position as of June 30, 2013, which comprised a total of 49 securities, were other-than-temporarily impaired. Specifically, the 49 securities are comprised of the following: 12 Small Business Administration (SBA) Pool securities, 4 mortgage-backed securities and 1 U.S. Government agency issued by the Federal Home Loan Mortgage Corporation (FHLMC), 16 mortgage-backed securities issued by the Government National Mortgage Association (GNMA), 7 mortgage-backed securities and 8 U.S. Government agencies issued by the Federal National Mortgage Association (FNMA), and 1 U.S. Government agency issued by the Federal Home Loan Bank (FHLB).

Total gross unrealized losses were primarily attributable to changes in market interest rates, relative to when the investment securities were purchased, and not due to any change in the credit quality of the investment securities. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not likely that the Company will be required to sell the investment securities before recovery of their amortized cost bases, which may be at maturity.

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Note 5 Loans Held for Sale, Loans and Allowance for Loan Losses

Loans Held for Sale

In its normal course of business, the Bank originates mortgage loans held for sale for the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). The Bank has elected to measure its residential mortgage loans held for sale at the lower of cost or market. Origination fees and costs are recognized in earnings at the time of origination for newly originated loans held for sale, and the loans are sold to Freddie Mac at par, so there is no gain or loss reported in earnings.

During the six months ended June 30, 2013, the Bank has originated approximately $19.7 million and sold approximately $19.7 million.

Loans

Outstanding loan balances are presented net of unearned income, deferred loan fees, and unamortized discount and premium. Loans subject to ASC 310-30 are presented net of the related accretable yield and nonaccretable difference.

The loan portfolio consisted of the following at:

	June 30, 2013		December 31, 2012	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial				
Commercial & industrial	$ 168,746	20.17%	$ 138,951	18.21%
Commercial mortgage	365,356	43.67%	314,462	41.22%
Commercial construction	1,655	0.20%	3,908	0.51%
Total commercial	535,757	64.04%	457,321	59.94%
Consumer				
Residential mortgage	160,816	19.23%	164,774	21.60%
Home equity	1,117	0.13%	1,211	0.16%
Automobile	7,770	0.93%	8,227	1.08%
Other consumer loans [1]	131,076	15.67%	131,412	17.22%
Total consumer	300,779	35.96%	305,624	40.06%
Gross loans	836,536	100.0%	762,945	100.0%
Deferred fee (income) costs, net	(2,213)		(1,885)	
Allowance for loan losses	(11,675)		(12,228)	
Loans, net	$ 822,648		$ 748,832	

[1] Comprised of other revolving credit, installment loans, and overdrafts.

At June 30, 2013, total gross loans increased by $73.6 million to $836.5 million from $762.9 million at December 31, 2012. The increase in loans was largely attributed to a $78.4 million increase in commercial loans to $535.8 million at June 30, 2013, from $457.3 million at December 31, 2012. This was due to several large loans originated in California and in Guam. The increase in commercial loans was due to a $50.9 million growth in the commercial mortgage portfolio, supplemented by the $29.8 million increase in commercial & industrial loans, and partially offset by a $2.3 million decrease in commercial construction. There was a $4.8 million decrease in consumer loans to $300.8 million at June 30, 2013, down from $305.6 million at December 31, 2012. The decrease in consumer loans was principally due to a $4.0 million reduction in residential mortgage loans as the result of principal paydowns, payoffs, and refinancings with the Federal Home Loan Mortgage Corporation in reaction to favorable interest rates.

Allowance for Loan Losses

The allowance for loan losses is evaluated on a quarterly basis by Bank management, and is based upon management s periodic review of the collectability of loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or conditions change.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. ASC 310-10 defines an impaired loan as one for which there is uncertainty concerning collection of all principal and interest per the contractual terms of the loan. For those loans that are classified as impaired, an allowance is established when the discounted cash flow (or the collateral value or the observable market price) of the impaired loan is lower than the carrying value of the loan. The general component covers unimpaired loans, and is estimated using a loss migration analysis based on historical charge-off experience and expected loss, given the default probability derived from the Bank s internal risk rating process. The loss migration analysis tracks a certain number of quarters of loan loss history and industry loss factors to determine historical losses by classification category for each loan type, except certain consumer loans. These calculated loss factors are then applied to outstanding loan balances for all loans on accrual designated as Pass, Special Mention, Substandard or Doubtful (classified loans or classification categories). Additionally, a qualitative factor that is determined utilizing external economic factors and internal assessments is applied to each homogeneous loan pool. We also conduct individual loan review analyses, as part of the allowance for loan loss allocation process, applying specific monitoring policies and procedures in analyzing the existing loan portfolio.

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Credit Quality Indicators

The Bank uses several credit quality indicators to manage credit risk, including an internal credit risk rating system that categorizes loans into pass, special mention, substandard, doubtful or loss categories. Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics and that benefit from a case-by-case evaluation. These are typically loans to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk-rated and monitored collectively. These are typically loans to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Bank s credit quality indicators:

Pass (A): *Exceptional:* Essentially risk-free credit. These are loans of the highest quality that pose virtually no risk of loss to the Bank. This includes loans fully collateralized by means of a savings account(s) and time certificate(s) of deposit, and by at least 110% of the loan amount. Borrowers should have strong financial statements, good liquidity and excellent credit.

Pass (B): *Standard:* Multiple strong sources of repayment . These are loans to strong borrowers with a demonstrated history of financial and managerial performance. The risk of loss is considered to be low. Loans are well-structured, with clearly identified primary and readily available secondary sources of repayment. These loans may also be secured by an equal amount of funds in a savings account or time certificate of deposit. These loans may be secured by marketable collateral whose value can be reasonably determined through outside appraisals. The borrower characteristically has a very strong cash flow and relatively low leverage.

Pass (C): *Acceptable:* Good primary and secondary sources of repayment. These are loans to borrowers of average financial strength, stability and management expertise. The borrower should be a well-established individual or company with adequate financial resources to withstand short-term fluctuations in the marketplace. The borrower s financial ratios and trends are favorable. The loans may be unsecured or supported by non-real estate collateral for which the value is more difficult to determine, represent a reasonable credit risk and require an average amount of account officer attention. The borrower s ability to repay unsecured credit is to be of unquestionable strength.

Pass (D): *Monitor:* Sufficient primary source of repayment and an acceptable secondary source of repayment. Acceptable business or individual credit, but the borrower s operations, cash flow or financial conditions evidence average levels of risk. These loans are considered to be collectable in full, but may require a greater-than-average amount of loan officer attention. Borrowers are capable of absorbing normal setbacks without failing to meet the terms of the loan agreement.

Special Mention: A Special Mention asset has potential weaknesses that deserve close monitoring. These potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the institution s credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. The Special Mention classification should neither be a compromise between a pass grade and substandard, nor should it be a catch all grade to identify any loan that has a policy exception.

Substandard: A substandard asset is inadequately protected by the current sound worth and payment capacity of the obligor or the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Assets classified as substandard are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Formula Classified: Formula classified loans are all loans and credit cards delinquent 90 days and over which have yet to be formally classified Special Mention, Substandard or Doubtful by the Bank s Loan Committee. In most instances, the monthly formula total is comprised primarily of real estate loans, consumer loans and credit cards. Commercial loans are typically formally classified by the Loan Committee no later than their 90-day delinquency, and thus do not become part of the formula classification. Real estate loans 90-days delinquent are in the foreclosure process, which is typically completed within another 60 days, and thus are not formally classified during this period.

Doubtful: A loan with weaknesses well enough defined that eventual repayment in full, on the basis of currently existing facts, conditions and values, is highly questionable, even though certain factors may be present which could improve the status of the loan. The probability of some loss is extremely high, but because of certain known factors that may work to the advantage of strengthening of the assets (i.e. capital injection, perfecting liens on additional collateral, refinancing plans, etc.), its classification as an estimated loss is deferred until its more exact status can be determined.

Loss: Loans classified as Loss are considered uncollectible, and are either unsecured or are supported by collateral that is of little to no value. As such, their continuance as recorded assets is not warranted. While this classification does not mandate that a loan has no ultimate recovery value, losses should be taken in the period during which these loans are deemed to be uncollectible. Loans identified as loss are immediately approved for charge-off. The Bank may refer loans to outside collection agencies, attorneys, or its internal collection division to continue collection efforts. Any subsequent recoveries are credited to the Allowance for Loan Losses.

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Set forth below is a summary of the Bank s activity in the allowance for loan losses during the three and six months ended June 30, 2013, and the year ended December 31, 2012:

	Three Months Ended June 30, 2013	Six months Ended June 30, 2013	Year Ended December 31, 2012
		(Dollars in thousands)	
Balance, beginning of period	$ 12,728	$ 12,228	$ 11,101
Provision for loan losses	(680)	295	3,900
Recoveries on loans previously charged off	463	881	3,294
Charged off loans	(836)	(1,729)	(6,067)
Balance, end of period	$ 11,675	$ 11,675	$ 12,228

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Set forth below is information regarding loan balances and the related allowance for loan losses, by portfolio type, for the three- and six-month periods ended June 30, 2013, and the year ended December 31, 2012, respectively.

	Commercial	Residential Mortgages	Consumer	Total
		(Dollars in thousands)		
Six months Ended June 30, 2013				
Allowance for loan losses:				
Balance at beginning of period	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Charge-offs	(70)	(30)	(1,629)	(1,729)
Recoveries	53	4	824	881
Provision	(785)	(361)	1,441	295
Balance at end of period	$ 5,449	$ 1,066	$ 5,160	$ 11,675
Three Months Ended June 30, 2013				
Allowance for loan losses:				
Balance at beginning of quarter	$ 6,867	$ 1,116	$ 4,745	$ 12,728
Charge-offs	(26)	(30)	(780)	(836)
Recoveries	17	4	442	463
Provision	(1,409)	(24)	753	(680)
Balance at end of quarter	$ 5,449	$ 1,066	$ 5,160	$ 11,675
Allowance balance at end of quarter related to:				
Loans individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0
Loans collectively evaluated for impairment	$ 5,449	$ 1,066	$ 5,160	$ 11,675
Loan balances at end of quarter:				
Loans individually evaluated for impairment	10,669	6,685	228	17,582
Loans collectively evaluated for impairment	525,088	155,248	138,618	818,954
Ending Balance	$ 535,757	$ 161,933	$ 138,846	$ 836,536
Year Ended December 31, 2012				
Allowance for loan losses:				
Balance at beginning of year	$ 6,654	$ 318	$ 4,129	$ 11,101
Charge-offs	(1,320)	(68)	(4,679)	(6,067)
Recoveries	159	3	3,132	3,294
Provision	758	1,200	1,942	3,900
Balance at end of year	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Allowance balance at end of year related to:				
Loans individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0
Loans collectively evaluated for impairment	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Loan balances at end of year:				

Loans individually evaluated for impairment	9,367	7,242	234	16,843
Loans collectively evaluated for impairment	447,954	158,743	139,405	746,102
Ending Balance	$ 457,321	$ 165,985	$ 139,639	$ 762,945

Impairment is measured on a loan-by-loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral (if the loan is collateral-dependent). Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. The Bank performs direct write-downs of impaired loans with a charge to the allocated component of the allowance, therefore reducing the allocated component of the allowance to zero at the end of each reporting period.

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Credit Quality

The following table provides a summary of the delinquency status of the Bank s loans by portfolio type:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater	Total Past Due	Current	Total Loans Outstanding
			(Dollars in thousands)			
June 30, 2013						
Commercial						
Commercial & industrial	$ 210	$ 276	$ 326	$ 812	$ 167,934	$ 168,746
Commercial mortgage	2,553	1,025	4,979	8,557	356,799	365,356
Commercial construction	0	0	0	0	1,655	1,655
Total commercial	2,763	1,301	5,305	9,369	526,388	535,757
Consumer						
Residential mortgage	10,170	7,470	3,836	21,476	139,340	160,816
Home equity	68	0	0	68	1,049	1,117
Automobile	253	30	0	283	7,487	7,770
Other consumer [1]	2,134	1,140	1,274	4,548	126,528	131,076
Total consumer	12,625	8,640	5,110	26,375	274,404	300,779
Total	$ 15,388	$ 9,941	$ 10,415	$ 35,744	$ 800,792	$ 836,536
December 31, 2012						
Commercial						
Commercial & industrial	$ 65	$ 222	$ 521			