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Territorial Bancorp Inc.
Form 10-K
March 15, 2019
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2018

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: 001-34403

Territorial Bancorp Inc.

(Name of Registrant as Specified in its Charter)

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Maryland (State or Other Jurisdiction of Incorporation or Organization)	26-4674701 (I.R.S. Employer Identification Number)
1132 Bishop Street, Suite 2200, Honolulu, Hawaii (Address of Principal Executive Office)	96813 (Zip Code)

(808) 946-1400

(Registrant's Telephone Number including area code)

Securities Registered pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.01 per share

(Title of Class)

The NASDAQ Stock Market LLC

(Name of exchange on which registered)

Securities Registered Under Section 12(g) of the Exchange Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES NO

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 reports), and (2) has been subject to such requirements for the past 90 days.

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YES NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES NO

The aggregate value of the voting common equity held by nonaffiliates of the registrant, computed by reference to the closing price of the registrant's shares of common stock as of June 30, 2018 (\$31.00) was \$266.4 million.

As of February 28, 2019, there were 9,674,152 shares outstanding of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

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Portions of the Proxy Statement for the 2019 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

Table of Contents

TERRITORIAL BANCORP INC.

FORM 10-K

INDEX

PART I

<u>ITEM 1.</u>	<u>Business</u>	2
<u>ITEM 1A.</u>	<u>Risk Factors</u>	16
<u>ITEM 1B.</u>	<u>Unresolved Staff Comments</u>	25
<u>ITEM 2.</u>	<u>Properties</u>	25
<u>ITEM 3.</u>	<u>Legal Proceedings</u>	27
<u>ITEM 4.</u>	<u>Mine Safety Disclosures</u>	27

PART II

<u>ITEM 5.</u>	<u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	28
<u>ITEM 6.</u>	<u>Selected Financial Data</u>	29
<u>ITEM 7.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	31
<u>ITEM 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	55
<u>ITEM 8.</u>	<u>Financial Statements and Supplementary Data</u>	55
<u>ITEM 9.</u>	<u>Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u>	105
<u>ITEM 9A.</u>	<u>Controls and Procedures</u>	105
<u>ITEM 9B.</u>	<u>Other Information</u>	105

PART III

<u>ITEM 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	106
<u>ITEM 11.</u>	<u>Executive Compensation</u>	106
<u>ITEM 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	106
<u>ITEM 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	106
<u>ITEM 14.</u>	<u>Principal Accountant Fees and Services</u>	106

PART IV

<u>ITEM 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	107
<u>ITEM 16.</u>	<u>Form 10-K Summary</u>	109

Table of Contents

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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 limited to:

- 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. Except as may be required by law, we disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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, 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 or credit markets;

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- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- changes in monetary or fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities, if any;
- changes in consumer demand, 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;
- the timing and amount of revenues that we may recognize;
- the value and marketability of collateral underlying our loan portfolios;
- our ability to retain key employees;
- cyber attacks, computer viruses and other technological risks that may breach the security of our websites or other systems to obtain unauthorized access to confidential information, destroy data or disable our systems;
- technological changes that may be more difficult or expensive than expected;
- the ability of third-party providers to perform their obligations to us;

Table of Contents

- the ability of the U.S. Government to manage federal debt limits;
- the effects of any federal government shutdown;
- the quality and composition of our investment portfolio;
- changes in market and other conditions that would affect our ability to repurchase our common stock;
- 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. Please also see “Item 1A. Risk Factors.”

PART I

ITEM 1. Business

Territorial Bancorp Inc.

Territorial Bancorp Inc. (the Company) is a Maryland corporation and owns 100% of the outstanding common stock of Territorial Savings Bank. In 2009, we completed our initial public offering of common stock in connection with the mutual-to-stock conversion of Territorial Mutual Holding Company. Since the completion of our initial public offering, we have not engaged in any significant business activity other than owning the common stock of and having savings deposits in Territorial Savings Bank, paying dividends and repurchasing shares of common stock. At December 31, 2018, we had consolidated assets of \$2.1 billion, consolidated deposits of \$1.6 billion and consolidated stockholders' equity of \$235.1 million.

Our executive offices are located at 1132 Bishop Street, Suite 2200, Honolulu, Hawaii 96813. Our telephone number at this address is (808) 946-1400.

Territorial Savings Bank

Territorial Savings Bank is a Hawaii state-chartered savings bank headquartered in Honolulu, Hawaii. Territorial Savings Bank was organized in 1921, and reorganized into the mutual holding company structure in 2002. Territorial Savings Bank is currently the wholly-owned subsidiary of Territorial Bancorp Inc. We provide financial services to individuals, families and businesses through our 29 banking offices located throughout the State of Hawaii.

In 2014, Territorial Savings Bank converted from a federal savings bank to a Hawaii state-chartered savings bank and became a member of the Federal Reserve System.

Territorial Savings Bank's executive offices are located at 1132 Bishop Street, Suite 2200, Honolulu, Hawaii 96813. Our telephone number at this address is (808) 946-1400.

Available Information

Territorial Bancorp Inc. is a public company, and files interim, quarterly and annual reports with the Securities and Exchange Commission. These reports and any amendments to these reports are available for free on our website, www.territorialsavings.net. Information on our website should not be considered a part of this Annual Report on Form 10-K. The Securities and Exchange Commission maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (<http://www.sec.gov>).

General

Territorial Savings Bank's business consists primarily of accepting deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in one- to four-family

Table of Contents

residential mortgage loans and investment securities. To a much lesser extent, we also originate home equity loans and lines of credit, construction, commercial and other nonresidential real estate loans, consumer loans, multi-family mortgage loans and other loans. Territorial Savings Bank offers a variety of deposit accounts, including passbook and statement savings accounts, certificates of deposit, money market accounts, commercial and regular checking accounts and Super NOW accounts. Through our subsidiary, Territorial Financial Services, Inc., we engage in insurance agency activities. We also offer various non-deposit investments to our customers, including annuities and mutual funds, through a third-party broker-dealer.

Market Area

We conduct business from our corporate offices and from our 29 full-service branch offices located throughout the State of Hawaii.

The largest sector of Hawaii's economy is the visitor industry. The Hawaii Tourism Authority reported that 10.0 million visitors came to the state in 2018, a 5.9% increase compared to 2017. The increase in visitor arrivals is primarily due to growth in the number of visitors from the continental United States. Total visitor expenditures in 2018 totaled \$17.8 billion, a 6.8% increase compared to 2017.

The unemployment rate for the State of Hawaii was 2.5% in December 2018, representing an increase from a 2.1% rate in December 2017. Hawaii's unemployment rate continued to be lower than the rate for the entire United States, which was 3.9% in December 2018. The growth in the visitor and construction industries have supported the local economy and kept the state's unemployment rate lower than the national rate. The construction of several new condominium projects and work on the City and County of Honolulu's mass transit project has increased employment in Hawaii's construction industry.

The number of single-family homes sold on the Island of Oahu, the primary real estate market in Hawaii, decreased while the median sales price in December rose in 2018 compared to 2017. The sales of existing single-family homes totaled 3,609 units for the year ended December 31, 2018, a decrease of 7.7% compared to sales in 2017. The median price paid on Oahu for a single-family home in December 2018 was \$788,000, an increase of 5.1% compared to the median price in December 2017. The number of condominium sales and the median sale price in December decreased in 2018 compared to 2017. The number of condominium sales, a notable portion of the overall housing market, decreased by 2.5% in 2018 compared to 2017. The median price paid on Oahu for condominiums in December 2018 was \$398,500, a decrease of 1.6% compared to the median price in December 2017.

On the island of Maui, the second largest real estate market in Hawaii, sales of existing single-family homes totaled 1,137 units in 2018, a 3.3% increase compared to the number of units sold in 2017. The median price paid for a single-family home on Maui in December 2018 was \$710,000, an increase of 2.2% compared to the median price in

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December 2017. The number of condominium sales totaled 1,654 units in 2018, an increase of 13.8% compared to the number of units sold in 2017. The median price paid on Maui for condominiums in December 2018 was \$500,000, a 12.4% increase compared to the median price in December 2017.

In 2018, there were 1,490 bankruptcy filings, an increase of 10.2% compared to the number of filings in 2017. Although bankruptcy filings have risen in 2018, the total number of filings is considered to be relatively low. Several local economists believe the increase in bankruptcy filings is due to an improvement in the economy, leading people to spend more and to sometimes take on too much debt.

Competition

We face intense competition in our market area both in making loans and attracting deposits. We compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies and investment banking firms. Some of our competitors have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide.

Our deposit sources are primarily concentrated in the communities surrounding our banking offices, located in all four counties in the State of Hawaii. As of June 30, 2018 (the latest date for which information is publicly available),

Table of Contents

we ranked fifth in FDIC-insured deposit market share in the State of Hawaii (out of 12 banks and thrift institutions with offices in Hawaii), with a 3.7% market share. As of that date, our largest market share was in the City and County of Honolulu, where we ranked fifth in deposit market share (out of 12 banks and thrift institutions with offices in the City and County) with a 4.0% market share.

Lending Activities

Our primary lending activity is the origination of one- to four-family residential mortgage loans. To a much lesser extent, we also originate home equity loans and lines of credit, construction, commercial and other nonresidential real estate loans, consumer loans, multi-family mortgage loans and commercial business loans.

One- to Four-Family Residential Mortgage Loans. At December 31, 2018, \$1.5 billion, or 96.9% of our total loan portfolio, consisted of one- to four-family residential mortgage loans. We offer conforming, fixed-rate and adjustable-rate residential mortgage loans with maturities generally up to 30 years. There has been little demand for adjustable-rate mortgage loans in our market area.

One- to four-family residential mortgage loans are generally underwritten according to Fannie Mae and Freddie Mac guidelines, and we refer to loans that conform to such guidelines as “conforming loans.” We generally originate both fixed- and adjustable-rate mortgage loans in amounts up to the maximum conforming loan limits as established by the Federal Housing Finance Agency, which was between \$679,650 and \$721,050 for single-family homes located in the State of Hawaii for 2018. We also originate loans above this amount, which are referred to as “jumbo loans.” These jumbo loan amounts are generally up to \$1.0 million, although we originate loans above this amount. We generally originate fixed-rate jumbo loans with terms of up to 30 years. We have not originated significant amounts of adjustable-rate jumbo loans in recent years due to customer preference for fixed-rate loans in our market area. We generally underwrite jumbo loans in a manner similar to conforming loans. Jumbo loans are not uncommon in our market area.

We originate loans with loan-to-value ratios in excess of 80%, up to and including a loan-to-value ratio of 100%. We generally require private mortgage insurance for loans with loan-to-value ratios in excess of 80%. During the year ended December 31, 2018, we originated \$4.7 million of one- to four-family residential mortgage loans with loan-to-value ratios in excess of 80%. We offer a variety of credit programs for low- to moderate-income and first-time home purchasers. These include our first time home purchaser program, where the borrower will receive up to a 50 basis point reduction in points charged in connection with the loan. We also originate first mortgage loans to lower-income individuals who reside in rural census tracts where the U.S. Department of Agriculture will issue a second mortgage and complete the underwriting of the loan, subject to our review before origination. We also offer both Federal Housing Administration (FHA) and Veterans Administration (VA) fixed-rate loans.

Other than our loans for the construction of one- to four-family residential mortgage loans (described under “—Nonresidential Real Estate Loans”), we currently do not originate new “interest only” mortgage loans on one- to four-family residential properties (where the borrower pays interest for an initial period, after which the loan converts to a fully amortizing loan). We also do not offer loans that provide for negative amortization of principal, such as “Option ARM” loans, where the borrower can pay less than the interest owed on their loan, resulting in an increased principal balance during the life of the loan. We do not offer “subprime loans” (loans that generally target borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios) or Alt-A loans (traditionally defined as nonconforming loans having less than full documentation).

Home Equity Loans and Lines of Credit. In addition to traditional one- to four-family residential mortgage loans, we offer home equity loans and home equity lines of credit that are secured primarily by one- to four-family residential homes. Home equity lines of credit have a maximum term of 10 years during which time the borrower is required to make payments to principal based on the amortization of 0.125% of principal outstanding per month. Home equity loans may be underwritten with a loan-to-value ratio of 80% when combined with the principal balance of the existing mortgage loan, while lines of credit for owner-occupied properties and investment properties may be underwritten with loan-to-value ratios of 80% and 65%, respectively, when combined with the principal balance of the existing mortgage loan. At December 31, 2018, the outstanding balance of home equity loans totaled \$1.2 million, or

Table of Contents

0.1% of our total loan portfolio, and the outstanding balance of home equity lines of credit totaled \$9.9 million, or 0.6% of our total loan portfolio.

Nonresidential Real Estate Loans. Our nonresidential real estate loans consist primarily of commercial real estate loans and construction loans for residential real estate projects. These loans totaled \$20.8 million, or 1.3% of our loan portfolio as of December 31, 2018. The commercial real estate properties primarily include owner-occupied light industrial properties. We generally seek to originate commercial real estate loans with initial principal balances of \$1.0 million or less. Loans secured by commercial real estate totaled \$9.6 million, or 0.6%, of our total loan portfolio at December 31, 2018, and consisted of 12 loans outstanding with an average loan balance of approximately \$800,000. All of our nonresidential real estate loans are secured by properties located in our primary market area. At December 31, 2018, our largest commercial real estate loan had a principal balance of \$2.9 million and was secured by real property and improvements utilized as an office building. This loan was performing in accordance with its original terms at December 31, 2018.

In the underwriting of commercial real estate loans, we generally lend up to the lesser of 75% of the property's appraised value or purchase price. We base our decision to lend primarily on the economic viability of the property and the creditworthiness of the borrower. In evaluating a proposed commercial real estate loan, we emphasize the ratio of the property's projected net cash flow to the loan's debt service requirement (generally requiring a minimum ratio of 110%), computed after deduction for a vacancy factor and property expenses we deem appropriate. Personal guarantees are usually obtained from commercial real estate borrowers. We require title insurance, fire and extended coverage casualty insurance, and, if appropriate, flood insurance, in order to protect our security interest in the underlying property. Almost all of our commercial real estate loans are generated internally by our loan officers.

Commercial real estate loans generally carry higher interest rates and have shorter terms than one- to four-family residential mortgage loans. Commercial real estate loans, however, entail greater credit risks compared to one- to four-family residential mortgage loans, as they typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment of loans secured by income-producing properties typically depends, in large part, on sufficient income from the property to cover operating expenses and debt service. Changes in economic conditions that are not in the control of the borrower or lender could affect the value of the collateral for the loan or the future cash flow of the property. Additionally, any decline in real estate values may be more pronounced for commercial real estate than for residential properties.

We also originate a limited amount of construction loans to experienced developers, almost exclusively for the construction of residential real estate projects. Construction loans are also made to individuals for the construction of their personal residences. Construction loans to individuals are generally "interest-only" loans during the construction period, and convert to permanent, amortizing loans following the completion of construction. At December 31, 2018, construction loans totaled \$5.7 million, or 0.4% of total loans receivable. At December 31, 2018, the additional unadvanced portion of these construction loans totaled \$1.2 million.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost is inaccurate, we may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project is inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment of the construction loan upon the sale of the property. In the event we make a land acquisition loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. We currently do not have any land acquisition development and construction loans. Construction loans also expose us to the risk that improvements will not be completed on time in accordance with specifications and projected costs. In addition, the ultimate sale or rental of the property may not occur as anticipated.

Loan Originations, Purchases, Sales and Servicing. All loans that we originate are underwritten pursuant to our policies and procedures, which incorporate standard underwriting guidelines, including those of Freddie Mac and Fannie Mae, to the extent applicable. We originate both adjustable-rate and fixed-rate loans. However, in our market area, customer demand is primarily for fixed-rate loans. Our loan origination and sales activity may be adversely affected by a rising interest rate environment that typically results in decreased loan demand. Most of our one- to four-

Table of Contents

family residential mortgage loan originations are generated by our branch managers and employees located in our banking offices and our additional commissioned loan officers located in our corporate headquarters. We also advertise throughout our market area. We also receive loans from mortgage brokers, mortgage bankers and other financial institutions that work with our staff to process and close these loans. We underwrite and approve all of these loans.

We sell loans to assist us in managing interest rate risk. We sold \$10.0 million and \$25.0 million of residential mortgage loans (all fixed-rate loans, with terms of 10 years or longer) during the years ended December 31, 2018 and 2017, respectively. We had one loan for \$309,000 classified as held for sale at December 31, 2018.

We sell our loans without recourse, except for normal representations and warranties provided in sales transactions. Since 2009, we have been selling loans primarily on a servicing released basis where servicing is transferred to a third-party at the time the loan is sold. Prior to 2009, most of our loan sales were conducted on a servicing retained basis. At December 31, 2018, we were servicing loans owned by others with a principal balance of \$30.3 million. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent borrowers, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. We retain a portion of the interest paid by the borrower on the loans we service as consideration for our servicing activities. For the year ended December 31, 2018, we received servicing fees of \$88,000. At December 31, 2018, substantially all of the loans serviced for Freddie Mac and Fannie Mae were performing in accordance with their contractual terms and we believe that there are no material repurchase obligations associated with these loans.

Loan Approval Procedures and Authority. Our lending activities follow written, nondiscriminatory underwriting standards and loan origination procedures established by our Board of Directors. The loan approval process is intended to assess the borrower's ability to repay the loan and value of the property that will secure the loan. To assess the borrower's ability to repay, we review the borrower's employment and credit history and information on the historical and projected income and expenses of the borrower.

Our policies and loan approval limits are established by the Board of Directors. Aggregate lending relationships in amounts up to \$5.0 million can be approved by designated individual officers or officers acting together with specific lending approval authority. Relationships in excess of \$5.0 million require the approval of the Loan Committee of the Board of Directors.

Territorial Savings Bank also uses automated systems to underwrite one- to four-family residential mortgage loans up to the maximum conforming loan limits as established by the Federal Housing Finance Agency, which was between \$679,650 and \$721,050 in the State of Hawaii for 2018. We require appraisals of all real property securing one- to four-family residential real estate loans, and on property securing home equity loans and lines of credit. All appraisers are licensed appraisers and all third-party appraisers are approved by the Board of Directors annually.

Investments

Our Board of Directors has primary responsibility for establishing and overseeing our investment policy. The Board of Directors has delegated authority to implement the investment policy to our Investment Committee, consisting of our President and Chief Executive Officer, our Vice Chairman and Co-Chief Operating Officer, our Senior Vice President and Chief Financial Officer and our Vice President and Controller. The investment policy is reviewed at least annually by the Investment Committee, and any changes to the policy are subject to approval by the full Board of Directors. The overall objectives of the Investment Policy are to maintain a portfolio of high quality and diversified investments to maximize interest income over the long term and to minimize risk, to provide collateral for borrowings, to provide additional earnings when loan production is low, and to reduce our tax liability. The policy dictates that investment decisions give consideration to the safety of principal, liquidity requirements and potential returns. Our Senior Vice President and Chief Financial Officer executes our securities portfolio transactions as directed by the Investment Committee. All purchase and sale transactions are reported to the Board of Directors on a monthly basis.

Our current investment policy permits investments in securities issued by the United States Government as well as mortgage-backed securities and direct obligations of Fannie Mae, Freddie Mac and Ginnie Mae. The investment policy also permits, with certain limitations, investments in certificates of deposit, bank-owned life insurance, collateralized mortgage obligations, trust preferred securities, municipal securities and stock in the Federal Home Loan

Table of Contents

Bank (FHLB) and the Federal Reserve Bank (FRB). We purchase stock in the FHLB in order to obtain services such as demand deposit accounts, certificates of deposit, security safekeeping services and borrowings in the form of advances. As a member of the Federal Reserve System, we are required to hold stock in the FRB.

Our current policies do not permit hedging activities, such as engaging in futures, options or swap transactions, or investing in high-risk mortgage derivatives, such as collateralized mortgage obligation residual interests, real estate mortgage investment conduit residual interests or stripped mortgage-backed securities. As of December 31, 2018, we held no asset-backed securities other than mortgage-backed securities. As a state savings bank, Territorial Savings Bank is not permitted to invest in equity securities. This general restriction does not apply to Territorial Bancorp Inc.

The Investments — Debt and Equity Securities topic of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) requires that, at the time of purchase, we designate a security as either held-to-maturity, available-for-sale, or trading, based upon our ability and intent to hold the security until maturity. Securities in the available-for-sale and trading classifications are reported at market value and securities in the held-to-maturity classification are reported at amortized cost. A periodic review and evaluation of the available-for-sale and held-to-maturity securities portfolios is conducted to determine if the fair value of any security has declined below its carrying value and whether such decline is other-than-temporary. If we do not have the intent to sell a security and it is not more likely than not that we will be required to sell a security, impairment occurs when the present value of the remaining cash flows is less than the remaining amortized cost basis. The difference between the present value of remaining cash flows and the remaining amortized cost basis is considered a credit loss. If a credit loss has occurred, impairment is recorded by writing down the value of a security to the present value of remaining cash flows as a charge to earnings. The difference between the book value of the security after the write down and the fair market value is considered other comprehensive loss, which is a reduction of stockholders' equity.

Our held-to-maturity securities at December 31, 2018 consisted primarily of securities with the following carrying values: \$371.4 million of mortgage-backed securities and \$75,000 of trust preferred securities that were issued by pools of issuers consisting primarily of financial institution holding companies. At December 31, 2018, all of our mortgage-backed securities were issued by Fannie Mae, Freddie Mac or Ginnie Mae. At December 31, 2018, we had one security for \$2.6 million classified as available-for-sale. At December 31, 2018, none of the collateral underlying our securities portfolio was considered subprime or Alt-A, and we did not hold any common or preferred stock issued by Freddie Mac or Fannie Mae as of that date. The fair values of our securities are usually based on published or securities dealers' market values.

Mortgage-backed securities are securities issued in the secondary market that are collateralized by pools of mortgages. Certain types of mortgage-backed securities are commonly referred to as "pass-through" certificates because the principal and interest of the underlying loans is "passed through" to investors, net of certain costs, including servicing and guarantee fees. Mortgage-backed securities typically are collateralized by pools of one- to four-family or multi-family mortgages. We invest primarily in mortgage-backed securities backed by one- to four-family mortgages. The interest rate of the security is lower than the interest rates of the underlying loans to allow for payment of servicing and guarantee fees. Ginnie Mae, a United States Government agency, and government sponsored enterprises, such as Fannie Mae and Freddie Mac, either guarantee the payments or guarantee the timely

payment of principal and interest to investors. Mortgage-backed securities are more liquid than individual mortgage loans since there is an active trading market for such securities. In addition, mortgage-backed securities may be used to collateralize our borrowings. Investments in mortgage-backed securities involve a risk that actual payments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or accretion of any discount relating to such interests, thereby affecting the net yield on our securities.

Sources of Funds

General. Deposits traditionally have been our primary source of funds for our investment and lending activities. We also borrow from the FHLB and from securities dealers through securities sold under agreements to repurchase to supplement cash flow needs, to lengthen the maturities of liabilities for interest rate risk management purposes and to manage our cost of funds. Our additional sources of funds are loan and security repayments, maturing investments, retained earnings, income on other earning assets and the proceeds of loan and security sales.

Table of Contents

Deposits. At December 31, 2018, deposits totaled \$1.6 billion or 88.8% of total liabilities. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposit accounts consist of passbook and statement savings accounts, certificates of deposit, money market accounts, commercial and regular checking accounts and Super NOW accounts. Historically, we have not accepted brokered deposits. We accept deposits primarily from the areas in which our offices are located. We rely on our competitive pricing and products, convenient locations and quality customer service to attract and retain deposits.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies, market interest rates, liquidity requirements and our deposit growth goals.

Borrowings. Our borrowings consist of advances from the FHLB and funds borrowed from securities sold under agreements to repurchase. At December 31, 2018, our FHLB advances totaled \$142.2 million, or 7.8% of total liabilities, and securities sold under agreements to repurchase totaled \$30.0 million, or 1.6% of total liabilities. At December 31, 2018, we had access to additional FHLB advances of up to \$769.3 million. Advances from the FHLB are secured by our investment in the common stock of the FHLB as well as by a blanket pledge on our assets not otherwise pledged. Securities sold under agreements to repurchase are secured by mortgage-backed securities.

Subsidiary Activities

Territorial Savings Bank owns 100% of the common stock of Territorial Financial Services, Inc., a Hawaii corporation that is authorized to engage in insurance activities. At December 31, 2018, Territorial Savings Bank's investment in Territorial Financial Services, Inc. was \$12,000, and Territorial Financial Services, Inc. had assets of \$76,000 at that date. Territorial Savings Bank also owns 100% of the common stock of Territorial Real Estate Co., Inc., an inactive Hawaii corporation that is authorized to manage and dispose of problem real estate.

Personnel

As of December 31, 2018, we had 268 full-time employees and 17 part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have a good working relationship with our employees.

FEDERAL AND STATE TAXATION

Federal Taxation

General. Territorial Bancorp Inc. and Territorial Savings Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize material federal income tax matters and is not a comprehensive description of the tax rules applicable to Territorial Bancorp Inc. and Territorial Savings Bank.

Federal Tax Reform. On December 22, 2017, the President signed into law H.R. 1, commonly known as the Tax Cuts and Jobs Act of 2017 (the Act). The Act includes a number of changes in existing tax law impacting businesses including, among other things, a reduction of the federal corporate income tax rate from 35% to 21% effective January 1, 2018. In addition to the reduction in the federal corporate income tax rate, stricter limits were placed on the tax deductibility of business meals and entertainment expenses for amounts paid or incurred on or after January 1, 2018. The reduction in the federal corporate tax rate from 35% to 21% required us to re-measure, through income tax expense, our deferred tax assets and liabilities using the enacted rate at which we expect them to be recovered or settled. The re-measurement of our net deferred tax asset resulted in additional income tax expense of \$2.1 million for the year ended December 31, 2017.

Method of Accounting. For federal income tax purposes, Territorial Bancorp Inc. currently reports its income and expenses on the accrual method of accounting and uses a tax year ending December 31st for filing its consolidated federal income tax returns.

Table of Contents

Alternative Minimum Tax. Prior to January 1, 2018, the Internal Revenue Code imposes an alternative minimum tax (AMT) at a rate of 20% on a base of regular taxable income plus certain tax preferences, which we refer to as “alternative minimum taxable income.” The AMT is payable to the extent such alternative minimum taxable income is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90% of alternative minimum taxable income. Certain AMT payments may be used as credits against regular tax liabilities in future years. Effective January 1, 2018, the corporate AMT was repealed. At December 31, 2018, the Company did not have any AMT payments available to carry forward to future periods and under existing federal tax regulations, we do not expect to have any going forward.

Net Operating Loss Carryovers. Prior to January 1, 2018, subject to certain limitations, a company may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. For net operating losses generated beginning January 1, 2018, there are no carry backs allowed and an unlimited carry forward period. At December 31, 2018, the Company did not have any net operating loss carry forwards for federal income tax purposes.

Corporate Dividends. We may exclude from our income 100% of dividends received from Territorial Savings Bank as a member of the same affiliated group of corporations.

Audit of Tax Returns. Territorial Bancorp Inc.’s 2011 federal income tax return was audited in 2013. The audit did not result in any material changes to the federal income tax return. Tax years 2015 to 2017 currently remain subject to examination by the IRS.

State Taxation

Territorial Bancorp Inc. and Territorial Savings Bank are subject to a franchise tax imposed under Hawaii law at a rate of 7.92% of net income. The net income to which the tax rate is applied is determined in a manner consistent with the taxable income determined for federal purposes with some adjustments. The principal adjustment to federal taxable income is the inclusion of interest received on municipal bonds in gross income for Hawaii franchise tax purposes.

Territorial Bancorp Inc.’s state franchise tax returns have not been audited in the most recent five-year period. Tax years 2015 to 2017 currently remain subject to examination by the Department of Taxation of the State of Hawaii.

SUPERVISION AND REGULATION

General

Territorial Savings Bank is a Hawaii state-chartered savings bank and a member of the Federal Reserve System. Accordingly, Territorial Savings Bank is examined and supervised by the Hawaii Division of Financial Institutions, as its primary state regulator, and by the Board of Governors of the Federal Reserve System, or Federal Reserve Board, as its primary federal regulator. Territorial Savings Bank is also subject to examination by the Federal Deposit Insurance Corporation, its deposit insurer, under certain circumstances. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation's deposit insurance fund and depositors, and not for the protection of security holders. Under this system of state and federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. The Hawaii Division of Financial Institutions and the Federal Reserve Board examine Territorial Savings Bank and prepare reports for the consideration of the Bank's Board of Directors on any operating deficiencies. Territorial Savings Bank's relationship with its depositors and borrowers also is regulated to a great extent by federal law and, to a much lesser extent, state law, especially in matters concerning the ownership of deposit accounts and the form and content of Territorial Savings Bank's loan documents.

Any change in these laws or regulations, whether by the Hawaii Division of Financial Institutions, the Federal Reserve Board, the Federal Deposit Insurance Corporation or Congress, could have a material adverse impact on Territorial Bancorp Inc., Territorial Savings Bank and their operations.

Table of Contents

Territorial Bancorp Inc. maintained its status as a savings and loan holding company in connection with Territorial Savings Bank's charter conversion. Accordingly, Territorial Bancorp Inc. is required to file certain reports with, is subject to examination by, and otherwise must comply with the rules and regulations of the Federal Reserve Board. Territorial Bancorp Inc. is also subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Certain regulatory requirements that are applicable to Territorial Savings Bank and Territorial Bancorp Inc. are described below. This description of statutes and regulations is not intended to be a complete description of such statutes and regulations and their effects on Territorial Savings Bank and Territorial Bancorp Inc. and is qualified in its entirety by reference to the actual statutes and regulations.

Federal Banking Regulation

Capital Requirements. Federal regulations require that federally insured depository institutions meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets ratio of 8%, and a 4% Tier 1 capital to total assets leverage ratio. The current capital requirements were effective January 1, 2015 and are the result of a final rule implementing recommendations of the Basel Committee on Banking Supervision (BASEL III) and certain requirements of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of accumulated other comprehensive income, up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations. In assessing an institution's capital adequacy, the Federal Reserve Bank takes into consideration, not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where deemed necessary.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increased each year until fully implemented at 2.5% on January 1, 2019.

At December 31, 2018, Territorial Savings Bank’s regulatory capital exceeded that required by the capital requirements.

Legislation enacted in May 2018 requires the federal banking agencies, including the Federal Reserve Board, to establish a “community bank leverage ratio” of between 8 to 10% of average total consolidated assets for qualifying institutions with assets of less than \$10 billion. Institutions with capital meeting the specified requirements and electing to follow the alternative framework would be deemed to comply with the applicable regulatory capital requirements, including the risk based requirements. The federal regulators have issued a proposed rule that would set the ratio at 9%.

Prompt Corrective Action Regulations. Under prompt corrective action regulations, the Federal Reserve Board is authorized and, under certain circumstances, required to take supervisory actions against undercapitalized member

Table of Contents

banks. The extent of supervisory action depends upon the degree of the institution's undercapitalization. For this purpose, a member bank is placed in one of the following five categories based on the bank's capital:

- well-capitalized (at least 5% leverage capital, 8% Tier 1 risk-based capital, 10% total risk-based capital and 6.5% common equity Tier 1 risk-based capital);
- adequately capitalized (at least 4% leverage capital, 6% Tier 1 risk-based capital, 8% total risk-based capital and 4.5% common equity Tier 1 risk-based capital);
- undercapitalized (less than 4% leverage capital, 6% Tier 1 risk-based capital, 8% total risk-based capital or 4.5% common equity Tier 1 risk-based capital);
- significantly undercapitalized (less than 3% leverage capital, 4% Tier 1 risk-based capital, 6% total risk-based capital or 3% common equity Tier 1 risk-based capital); and
- critically undercapitalized (less than 2% tangible capital).

At December 31, 2018, Territorial Savings Bank met the criteria for being considered "well-capitalized."

Capital Distributions. Federal Reserve member banks must receive the prior approval of the Federal Reserve Board to pay dividends: (i) in an amount that exceeds the sum of the bank's net income during the calendar year and retained net income of the prior two calendar years or (ii) that would exceed the bank's undivided profits. Even if an application is not otherwise required, every savings bank that is a subsidiary of a savings and loan holding company must file a notice with the Federal Reserve Board at least 30 days before the Board of Directors declares a dividend.

The Federal Reserve Board may disapprove a notice or application if:

- the savings bank would be undercapitalized following the distribution;
- the proposed dividend raises safety and soundness concerns; or
- the dividend would violate a prohibition contained in any statute, regulation with a federal banking regulatory agency or any formal or informal enforcement action.

In addition, the Federal Deposit Insurance Act provides that an insured depository institution shall not make any capital distribution if, after making such distribution, the institution would be undercapitalized.

Community Reinvestment Act and Fair Lending Laws. All institutions with Federal Deposit Insurance Corporation deposit insurance have a responsibility under the Community Reinvestment Act and related federal regulations to help meet the credit needs of their communities, including low- and moderate-income borrowers. In connection with its examination of a state member bank, the Federal Reserve Board is required to assess the savings bank's record of compliance with the Community Reinvestment Act. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. A savings bank's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in denial of certain corporate applications such as branches or mergers, or in restrictions on its activities. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the Federal Reserve Board, as well as other federal regulatory agencies and the Department of Justice. The Community Reinvestment Act requires all Federal Deposit Insurance Corporation-insured institutions to publicly disclose their rating. Territorial Savings Bank received a "satisfactory" Community Reinvestment Act rating in its most recent federal examination.

Insurance of Deposit Accounts. Territorial Savings Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. Deposit insurance per account owner is \$250,000.

The Federal Deposit Insurance Corporation charges insured depository institutions premiums to maintain the Deposit Insurance Fund. Under the Federal Deposit Insurance Corporation's risk-based assessment system, institutions deemed less risky pay lower assessments. Assessments for institutions of less than \$10 billion of assets are based on financial measures and supervisory ratings derived from statistical modeling estimating the probability of failure within

Table of Contents

three years. That system, effective July 1, 2016, replaced the previous system under which institutions were placed in risk categories.

The Dodd-Frank Act required the Federal Deposit Insurance Corporation to revise its procedures to base its assessments upon each insured institution's total assets less tangible equity instead of deposits. The Federal Deposit Insurance Corporation finalized a rule, effective April 1, 2011, that set the assessment range at 2.5 to 45 basis points of total assets less tangible equity. In conjunction with the Deposit Insurance Fund reserve ratio achieving 1.15%, the assessment range (inclusive of possible adjustments) was reduced for insured institutions of less than \$10 billion in total assets to 1.5 basis points to 30 basis points, effective July 1, 2016.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund. That payment is established quarterly and during the quarter ended December 31, 2018, equaled 0.32 basis points of total assets less tangible capital. The last of the remaining bonds will mature in September 2019.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The Federal Deposit Insurance Corporation was required to seek to achieve the 1.35% ratio by September 30, 2020. The Federal Deposit Insurance Corporation indicated that the 1.35% ratio was exceeded in November 2018. The Dodd-Frank Act required insured institutions with assets of \$10 billion or more to fund the increase from 1.15% to 1.35% and, effective July 1, 2016, such institutions were subject to a surcharge to achieve that goal. Insured institutions of less than \$10 billion of assets will receive credits for the portion of their assessments that contributed to the reserve ratio between 1.15% and 1.35%. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the Federal Deposit Insurance Corporation, and the Federal Deposit Insurance Corporation has exercised that discretion by establishing a long-range fund ratio of 2%.

The Federal Deposit Insurance Corporation has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Federal Home Loan Bank System. Territorial Savings Bank is a member of the Federal Home Loan Bank System, which consists of eleven regional Federal Home Loan Banks. The FHLB System provides a central credit facility primarily for member institutions as well as other entities involved in home mortgage lending. As a member of the FHLB of Des Moines, Territorial Savings Bank is required to acquire and hold shares of capital stock in the FHLB. As of December 31, 2018, Territorial Savings Bank held \$8.1 million of capital stock in the FHLB of Des Moines and was in compliance with this requirement.

Hawaii Banking Regulation

Authority granted by Hawaii laws includes accepting and holding deposits, borrowing from any source, making loans and extensions of credit of any kind, investing in service corporation subsidiaries engaged in activities permissible for service corporations of federal savings banks and engaging in other activities that are usual or incidental to the business of a savings bank. Hawaii law requires that at least 50% of a savings bank's loans and extensions of credit be secured by real estate. In addition, certain commercial loans are limited to 15% of the savings bank's assets and education loans are limited to 10% of assets.

Hawaii law generally limits a savings bank's capital distributions to the amount of its retained earnings.

Hawaii has a parity statute, which provides Hawaii savings banks with authority to engage in any activity permitted by federal law for federal savings banks, upon receiving the approval of the Commissioner of Financial Institutions. Territorial Savings Bank received such approval when it converted from a federal savings bank to a Hawaii savings bank.

Table of Contents

Other Regulations

Territorial Savings Bank's operations are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one- to four-family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;

- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;

- fair lending laws;

- Unfair or Deceptive Acts or Practices laws and regulations;

- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

- Truth in Savings Act; and

- rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of Territorial Savings Bank are further subject to the:

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Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services;
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check;
- The USA PATRIOT Act, which requires financial institutions to, among other things, establish broadened anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control regulations; and
- The Gramm-Leach-Bliley Act, which places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Specifically, the Gramm-Leach-Bliley Act requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution's privacy policy and provide such customers the opportunity to "opt out" of the sharing of certain personal financial information with unaffiliated third parties.

Holding Company Regulation

General. Territorial Bancorp Inc. is a nondiversified savings and loan holding company within the meaning of the Home Owners' Loan Act. As such, Territorial Bancorp Inc. is registered with the Federal Reserve Board and subject

Table of Contents

to Federal Reserve Board regulations, examinations, supervision and reporting requirements. In addition, the Federal Reserve Board has enforcement authority over Territorial Bancorp Inc. and its subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. The Dodd-Frank Act regulatory restructuring transferred the responsibility for regulating and supervising savings and loan holding companies from the Office of Thrift Supervision to the Federal Reserve Board, effective July 21, 2011.

Permissible Activities. The business activities of Territorial Bancorp Inc. are generally limited to those activities permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act of 1956, as amended, or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance as well as activities that are incidental to financial activities or complementary to a financial activity. The Dodd-Frank Act specifies that any savings and loan holding company that engages in activities permissible for a financial holding company must meet the qualitative requirements for a bank holding company to be a financial holding company and conduct the activities in accordance with the requirements that would apply to a financial holding company's conduct of the activity. Territorial Bancorp Inc. has not elected financial holding company status. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the Federal Reserve Board, and certain additional activities authorized by Federal Reserve Board regulations. Federal law generally prohibits the acquisition of more than 5% of a class of voting stock of a company engaged in impermissible activities.

Federal law prohibits a savings and loan holding company, including Territorial Bancorp Inc., from directly or indirectly, or through one or more subsidiaries, acquiring more than 5% of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider, among others, the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the federal deposit insurance fund, the convenience and needs of the community and competitive factors.

The Federal Reserve Board is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions:

- (i) the approval of interstate supervisory acquisitions by savings and loan holding companies; and
- (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisition.

The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Capital. Savings and loan holding companies have historically not been subject to specific regulatory capital requirements. The Dodd-Frank Act required the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Consolidated regulatory capital requirements identical to those applicable to the subsidiary depository institutions applied to savings and loan holding companies as of January 1, 2015. As is the case with institutions themselves, the capital conservation buffer for savings and loan holding companies was being phased in between 2016 and 2019. However, legislation enacted in May 2018 required the Federal Reserve Board to raise the threshold of its “small holding company” exception to the applicability of consolidated holding company capital requirements from \$1 billion. That change became effective in August 2018. Consequently, holding companies with less than \$3 billion of consolidated assets, which includes Territorial Bancorp, Inc., are generally not subject to the requirements unless otherwise advised by the Federal Reserve Board.

Source of Strength. The Dodd-Frank Act also extended the “source of strength” doctrine to savings and loan holding companies. The Federal Reserve Board has issued regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

Dividends and Stock Repurchases. The Federal Reserve Board has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank and savings and loan holding companies.

Table of Contents

In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Regulatory guidance provides for prior regulatory review of capital distributions in certain circumstances, such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend. The guidance also provides for prior regulatory review where the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. The policy statement also provides for regulatory review prior to a holding company redeeming or repurchasing regulatory capital instruments when the holding company is experiencing financial weaknesses or redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction in the amount of such equity instruments outstanding as of the end of a quarter compared with the beginning of the quarter in which the redemption or repurchase occurred. These regulatory policies could affect the ability of Territorial Bancorp Inc. to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

Qualified Thrift Lender Test

In order for Territorial Bancorp Inc. to continue to be regulated as a savings and loan holding company (rather than bank holding company) when Territorial Savings Bank converted from a federal savings bank to a Hawaii savings bank, Territorial Savings Bank is required to satisfy the same qualified thrift lender (QTL) test that it did as federal savings bank. The QTL test requires Territorial Savings Bank to either qualify as a "domestic building and loan association" as defined by the Internal Revenue Code or maintain at least 65% of "portfolio assets" in "qualified thrift investments," primarily residential mortgages and related investments, including mortgage-backed and related securities. A savings institution that fails the QTL test must operate under specified restrictions and may be subject to enforcement action. Territorial Savings Bank was in compliance with the QTL test at December 31, 2018.

Change in Control Regulations

Under the Change in Bank Control Act, no person may acquire control of a savings and loan holding company such as the Company unless the Federal Reserve Board has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the company's directors, or a determination by the regulator that the acquirer has the power to direct, or directly or indirectly to exercise a controlling influence over, the management or policies of the institution. Acquisition of more than 10% of any class of a savings and loan holding company's voting stock constitutes a rebuttable presumption of control under the regulations under certain circumstances including where, as is the case with Territorial Bancorp Inc., the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934.

Federal Securities Laws

Territorial Bancorp Inc.'s common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934. Territorial Bancorp Inc. is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

Territorial Bancorp Inc. common stock held by persons who are affiliates (generally officers, directors and principal shareholders) of Territorial Bancorp Inc. may not be resold without registration unless sold in accordance with certain resale restrictions. If Territorial Bancorp Inc. meets specified current public information requirements, each affiliate of Territorial Bancorp Inc. is able to sell in the public market, without registration, a limited number of shares in any three-month period.

Table of Contents

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. We have prepared policies, procedures and systems designed to ensure compliance with the Sarbanes-Oxley Act and related regulations.

ITEM 1A.Risk Factors

Future changes in interest rates could reduce our profits.

Our ability to make a profit largely depends on our net interest income, which could be negatively affected by changes in interest rates. Net interest income is the difference between:

- the interest income we earn on our interest-earning assets, such as loans and securities; and
- the interest expense we pay on our interest-bearing liabilities, such as deposits and borrowings.

As a result of our focus on one- to four-family residential real estate loans and the low demand for adjustable-rate loans in our market area, the interest rates we earn on our loans are generally fixed for long periods of time. Additionally, many of our securities investments are of long maturities with fixed interest rates. Like many savings institutions, our focus on deposit accounts as a source of funds, which have no stated maturity date or shorter contractual maturities than loans, results in our liabilities having a shorter duration than our assets. For example, as of December 31, 2018, 94.7% of our loans had maturities of 15 years or longer, while 52.8% of our certificates of deposits had maturities of one year or less. This imbalance can create significant earnings volatility, because market interest rates change over time. In a period of rising interest rates, the interest income earned on our assets, such as loans and investments, likely will not increase as rapidly as the interest paid on our liabilities, such as deposits. Furthermore, our loan origination and sales activity may be adversely affected by a rising interest rate environment that typically results in decreased loan demand. In a period of declining interest rates, the interest income earned on our assets likely will decrease more rapidly than the interest paid on our liabilities, as borrowers prepay mortgage loans and mortgage-backed securities, thereby requiring us to reinvest these cash flows at lower interest rates. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Management of Market Risk.”

In addition, changes in interest rates can affect the average life of loans and mortgage-backed and related securities and the fair value of mortgage servicing assets. A reduction in interest rates results in increased prepayments of loans

and mortgage-backed and related securities, as borrowers refinance their loans in order to reduce their borrowing costs. This creates reinvestment risk, which is the risk that we may not be able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Additionally, increases in interest rates may make it more difficult for borrowers to repay adjustable-rate loans. Potential reduction, or impairment, to the fair value of mortgage servicing assets generally occurs as market interest rates decline. Alternatively, an increase in market interest rates generally causes an increase in the fair value of mortgage servicing assets.

Changes in interest rates also affect the current fair value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. At December 31, 2018, the fair value of our investment in held-to-maturity securities totaled \$364.9 million. Net unrealized losses on these securities totaled \$6.6 million at December 31, 2018.

At December 31, 2018, our “rate shock” analysis indicated that our economic value of equity (the difference between the market value of our assets and the market value of our liabilities with adjustments made for off-balance sheet items) would decrease by \$44.9 million if there was an instantaneous 200 basis point increase in market interest rates. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Management of Market Risk.”

Table of Contents

Our lending activities provide lower interest rates than financial institutions that originate more commercial loans.

Our principal lending activity consists of originating one- to four-family residential real estate mortgage loans. As of December 31, 2018, these loans totaled \$1.5 billion or 96.9% of total loans. We originate our loans with a focus on limiting credit risk and not to generate the highest return or create the greatest difference between the yield on our interest-earning assets and our cost of funds (interest rate spread).

Residential real estate mortgage loans generally have lower interest rates than commercial business loans, commercial real estate loans and consumer loans. As a result, we may generate lower interest rate spreads and rates of return when compared to our competitors who originate more consumer or commercial loans than we do. We intend to continue our focus on residential real estate lending.

A worsening of economic conditions in our market area could reduce demand for our products and services and/or result in increases in our level of non-performing loans, which could adversely affect our operations, financial condition and earnings.

Local economic conditions have a significant impact on the ability of our borrowers to repay loans and the value of the collateral securing loans. A deterioration in economic conditions could have the following consequences, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations:

- demand for our products and services may decline;
- loan delinquencies, problem assets and foreclosures may increase;
- collateral for loans, especially real estate, may decline in value, thereby reducing customers' future borrowing power, and reducing the value of assets and collateral associated with existing loans;
- the value of our securities portfolio may decrease; and
- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us.

Moreover, a significant decline in general economic conditions caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, unemployment or other factors beyond our control could further impact these local economic conditions and could further negatively affect the financial results of our banking operations. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

We may be adversely affected by recent changes in U.S. tax laws.

The Tax Cuts and Jobs Act, which was enacted in December 2017, is likely to have both positive and negative effects on our financial performance. Although the legislation's reduction in our federal corporate tax rate has had a favorable impact on our earnings and capital generation abilities, the legislation also enacted limitations on certain deductions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. These limitations include (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage and home equity loans, (ii) a limitation on the deductibility of business interest expense and (iii) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the tax laws may have an adverse effect on the market for, and valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, like Hawaii. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in our provision for

Table of Contents

loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

Monetary policies and regulations of the Federal Reserve Board could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve Board. An important function of the Federal Reserve Board is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve Board to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the federal funds and discount rates and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve Board have had a significant effect on the operating results of financial institutions in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

We are subject to the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to material penalties.

The Community Reinvestment Act (CRA), the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. A successful regulatory challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on activities which could result in the denial of certain corporate applications such as branches. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

Nonresidential real estate loans and commercial business loans increase our exposure to credit risks.

At December 31, 2018, our portfolio of commercial real estate, construction and other nonresidential real estate loans totaled \$20.8 million, or 1.3% of total loans. In addition, at December 31, 2018, our portfolio of commercial business loans totaled \$4.3 million, or 0.3% of total loans. These loans generally expose us to a greater risk of nonpayment and loss than residential real estate loans because repayment of such loans often depends on the successful operations and income stream of the borrowers. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans.

We target our business lending and marketing strategy towards small- to medium-sized businesses. These small- to medium-sized businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. If general economic conditions adversely affect these businesses, our results of operations and financial condition may be negatively impacted. In addition, some of our commercial business loans are collateralized by a security interest in furniture, fixtures and equipment and the liquidation of collateral in the event of default is often an insufficient source of repayment because the collateral may have limited use or value.

Strong competition within our market areas may limit our growth and profitability.

Competition in the banking and financial services industry is intense. In our market areas, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally. Some of our competitors have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide. In addition, larger competitors may be able to price loans and deposits more aggressively than we do, which could affect our ability to grow and remain profitable on a long-term basis. Our profitability depends upon

Table of Contents

our continued ability to successfully compete in our market areas. If we must raise interest rates paid on deposits or lower interest rates charged on our loans, our net interest margin and profitability could be adversely affected. For additional information see “Item 1. Business—Competition.”

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover probable incurred losses in our loan portfolio, resulting in additions to our allowance. While our allowance for loan losses was 0.2% of total loans at December 31, 2018, material additions to our allowance could materially decrease our net income.

The Financial Accounting Standards Board has adopted a new accounting standard that will be effective for Territorial Bancorp Inc. and Territorial Savings Bank for our first fiscal year beginning after December 15, 2019. This standard, referred to as Current Expected Credit Loss (CECL), will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which may require us to increase our allowance for loan losses, and to greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our financial condition and results of operations.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities might have a material adverse effect on our financial condition and results of operations.

Our employee stock ownership plan may continue to increase our costs, which would reduce our income.

Our employee stock ownership plan purchased 8% of the total shares of common stock sold in our stock offering using funds borrowed from Territorial Bancorp Inc. We record annual employee stock ownership plan expense in an amount equal to the fair value of the shares of common stock released to employees over the term of the loan. If the value of the shares of common stock appreciates up to the time shares are released, compensation expense relating to the employee stock ownership plan will increase and our net income will decline.

Concentration of loans in our primary market area may increase risk.

Our success depends primarily on the general economic conditions in the State of Hawaii, as nearly all of our loans are to customers in the state. Accordingly, the economic conditions in the State of Hawaii have a significant impact on the ability of borrowers to repay loans as well as our ability to originate new loans. As such, a decline in real estate valuations in this market would lower the value of the collateral securing those loans. In addition, significant weakening in general economic conditions such as inflation, recession, unemployment or other factors beyond our control could negatively affect our financial results.

Our local economy relies heavily on the tourism industry. Downturns in this industry could affect our operations and results.

Tourism is the largest sector of Hawaii's economy. The Hawaii Tourism Authority reported visitor arrivals and visitor spending grew by 5.9% and 6.8%, respectively, in 2018 and 2017. A downturn in the tourism industry, and the related loss of jobs or operating income for businesses, could have a significant impact on our ability to originate loans, and the ability of borrowers to repay loans, either of which could adversely affect our financial condition and results of operations.

Table of Contents

We are subject to extensive regulatory oversight.

We and our subsidiaries are subject to extensive regulation and supervision. Regulators have intensified their focus on bank lending criteria and controls, and on the USA PATRIOT Act's anti-money laundering and Bank Secrecy Act compliance requirements. There also is increased scrutiny of our compliance practices generally and particularly with the rules enforced by the Office of Foreign Assets Control. Our failure to comply with these and other regulatory requirements could lead to, among other remedies, administrative enforcement actions and legal proceedings. In addition, the Dodd-Frank Act and implementing regulations are likely to have a significant effect on the financial services industry, which are likely to increase operating costs and reduce profitability. Regulatory or legislative changes could make regulatory compliance more difficult or expensive for us, and could cause us to change or limit some of our products and services, or the way we operate our business.

The Federal Reserve Board may require us to commit capital resources to support Territorial Savings Bank.

Federal law requires that a holding company act as a source of financial and managerial strength to its subsidiary bank and to commit resources to support such subsidiary bank. Under the "source of strength" doctrine, the Federal Reserve Board may require a holding company to make capital injections into a troubled subsidiary bank and may charge the holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the holding company may not have the resources to provide it and therefore may be required to borrow the funds or raise capital. Any loans by a holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by Territorial Bancorp, Inc. to make a required capital injection becomes more difficult and expensive and could have an adverse effect on our business, financial condition and results of operations.

Severe weather, natural disasters and other external events could significantly affect our operations and results.

Because all of our office locations are in the State of Hawaii, severe weather or natural disasters, such as tsunamis, volcanic eruptions, hurricanes and earthquakes and other adverse external events, could have a significant effect on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. Natural disasters, like the tsunami that occurred in Japan in 2011, could have an impact on the visitor industry in Hawaii. Accordingly, the occurrence of any such severe weather or natural disaster event could have a material adverse effect on our business, which, in turn, could adversely affect our financial condition and results of operations.

We are subject to certain capital requirements, which may adversely impact our return on equity, require us to raise additional capital, or constrain us from paying dividends or repurchasing shares.

A final capital rule that became effective for financial institutions on January 1, 2015, included minimum risk-based capital and leverage ratios, and refined the definition of what constitutes “capital” for purposes of calculating these ratios. The minimum capital requirements are: (i) a common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The final rule also established a “capital conservation buffer” of 2.5%, resulting in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 to risk-based assets capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The capital conservation buffer requirement began to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. A financial institution, such as Territorial Savings Bank, is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that can be utilized for such actions.

Table of Contents

Territorial Savings Bank and Territorial Bancorp Inc. met all of these requirements, including the full 2.5% capital conservation buffer, as if these requirements had been fully phased in as of December 31, 2018.

The application of these capital requirements could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. See “Supervision and Regulation—Federal Banking Regulation—Capital Distributions.”

Government responses to economic conditions may adversely affect our operations, financial condition and earnings.

Ongoing uncertainty and adverse developments in the financial services industry and the domestic and international credit markets, and the effect of new legislation and regulatory actions in response to these conditions, may adversely affect our operations by restricting our business activities, including our ability to originate or sell loans, modify loan terms, or foreclose on property securing loans. These measures may increase our costs of doing business and may have a significant adverse effect on our lending activities, financial performance and operating flexibility. In addition, these risks could affect the performance and value of our loan and investment securities portfolios, which also would negatively affect our financial performance.

If the Federal Reserve Board continues to increase the federal funds rate, overall interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic recovery. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

Noncompliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions.

The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury’s Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions. In the past, several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, these policies and procedures may not be effective in preventing violations of these laws and regulations.

Changes in laws and regulations and the cost of regulatory compliance with new laws and regulations may adversely affect our operations and our income.

In recent years, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the Federal Deposit Insurance Corporation has taken actions to increase insurance coverage on deposit accounts. In addition, there have been proposals made by members of Congress and others that would reduce the amount distressed borrowers are otherwise contractually obligated to pay under their mortgage loans and limit an institution's ability to foreclose on mortgage collateral.

The potential exists for additional federal or state laws and regulations, or changes in policy, regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be active in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. Bank regulatory agencies, such as the Federal Reserve Board, the Hawaii Division of Financial Institutions and the Federal Deposit Insurance Corporation, govern the activities in which we may engage, primarily for the protection of depositors, and not for the protection or benefit of potential investors. In addition, new laws, regulations and other regulatory changes may increase our costs of regulatory compliance and of doing business, and otherwise affect our operations. New laws, regulations, and other regulatory changes may significantly affect the markets in which we do

Table of Contents

business, the markets for and value of our loans and investments, and our ongoing operations, costs and profitability. Federal and state proposals limiting our rights as a creditor could result in credit losses or increased expense in pursuing our remedies as a creditor.

The building of market share through de novo branching could cause our expenses to increase faster than revenues.

We intend to continue to build market share in the State of Hawaii through de novo branching. Since 2010, we have opened four de novo branches including the most recent branch opened in 2017. There are considerable costs involved in opening branches that generally require a period of time to generate the necessary revenues to offset their costs, especially in areas in which we do not have an established presence. Accordingly, any such business expansion can be expected to negatively impact our earnings for some period of time until certain economies of scale are reached. Our expenses could be further increased if we encounter delays in the opening of any of our new branches. Finally, our business expansion may not be successful after establishment.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, these security measures may not be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

We mitigate this risk through guidance promulgated for all financial institutions by the Federal Financial Institutions Examination Council and the regulations issued under the Gramm-Leach-Bliley Act. This guidance also requires our core data processor to meet these standards. We regularly self-audit or review exams from auditors as well as federal banking regulators to assure that these standards are being met, internally as well as by our important data processing vendors. We also implemented firewall and other internal controls to protect our systems from compromise.

Nevertheless, our systems could be compromised and it is possible that significant amounts of time and money may be spent to rectify the harm caused by a breach or hack. While we have general liability insurance and cyber liability insurance, we know there are limitations on coverage as well as dollar amount. Furthermore, cyber incidents carry a greater risk of injury to our reputation. Finally, depending on the type of incident, banking regulators can impose restrictions on our business and consumer laws may require reimbursement of customer loss. In addition, we outsource some of our data processing to certain third-party providers. If these third-party providers encounter difficulties, including as a result of cyber-attacks or information security breaches, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected.

Our risk management framework may not be effective in mitigating risk and reducing the potential for significant losses.

Our risk management framework is designed to minimize risk and loss to us. We seek to identify, measure, monitor, report and control our exposure to risk, including strategic, market, liquidity, compliance and operational risks. While we use a broad and diversified set of risk monitoring and mitigation techniques, these techniques are inherently limited because they cannot anticipate the existence or future development of currently unanticipated or unknown risks.

Table of Contents

Recent economic conditions and heightened legislative and regulatory scrutiny of the financial services industry, among other developments, have increased our level of risk. Accordingly, we could suffer losses as a result of our failure to properly anticipate and manage these risks.

Our business may be adversely affected by an increasing prevalence of fraud, including cyberfraud, and other financial crimes.

Our loans to businesses and individuals and our deposit relationships and related transactions are subject to exposure to the risk of loss due to fraud, including cyberfraud, and other financial crimes. Nationally, reported incidents of fraud and other financial crimes have increased. We have also experienced losses due to apparent fraud and other financial crimes. While we have policies and procedures designed to prevent such losses, losses may still occur.

Legal and regulatory proceedings and related matters could adversely affect us or the financial services industry in general.

We, and other participants in the financial services industry upon whom we rely to operate, may in the future become involved in legal and regulatory proceedings. Most of the proceedings we consider to be in the normal course of our business or typical for the industry; however, it is inherently difficult to assess the outcome of these matters, and other participants in the financial services industry or we may not prevail in any proceeding or litigation. There could be substantial cost and management diversion in such litigation and proceedings, and any adverse determination could have a materially adverse effect on our business, brand or image, or our financial condition and results of our operations.

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. A key component of our business strategy is to rely on our reputation for customer service and knowledge of local markets to expand our presence by capturing new business opportunities from existing and prospective customers in our current market and contiguous areas. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or by our inability to conduct our operations in a manner that is appealing to current or prospective customers, our business and operating results may be adversely affected.

The corporate governance provisions in our articles of incorporation and bylaws, and the corporate governance provisions under Maryland law, may prevent or impede the holders of our common stock from obtaining representation on our Board of Directors and may impede takeovers of the company that our board might conclude are not in the best interest of Territorial Bancorp Inc. or its stockholders.

Provisions in our articles of incorporation and bylaws may prevent or impede holders of our common stock from obtaining representation on our Board of Directors and may make takeovers of Territorial Bancorp Inc. more difficult. For example, our Board of Directors is divided into three staggered classes. A classified board makes it more difficult for stockholders to change a majority of the directors because it generally takes at least two annual elections of directors for this to occur. Our articles of incorporation include a provision that no person will be entitled to vote any shares of our common stock in excess of 10% of our outstanding shares of common stock. This limitation does not apply to the purchase of shares by a tax-qualified employee stock benefit plan established by us. In addition, our articles of incorporation and bylaws restrict who may call special meetings of stockholders and how directors may be removed from office. Additionally, in certain instances, the Maryland General Corporation Law requires a supermajority vote of our stockholders to approve a merger or other business combination with a large stockholder, if the proposed transaction is not approved by a majority of our directors.

Table of Contents

Reductions in defense spending by the federal government could have a detrimental impact on Hawaii's economy.

The defense industry, the second largest contributor to Hawaii's economy after the visitor industry, contributes about \$8.8 billion to the economy each year and accounts for about 9.8% of the state's gross domestic product. The defense industry creates thousands of jobs for residents of the State. Cuts to defense and other general spending could have an adverse impact on Hawaii's economy, which could adversely affect our financial condition and results of operations.

Our funding sources may prove insufficient to replace deposits at maturity and support our future growth.

We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. As we continue to grow, we are likely to become more dependent on these sources, which may include FHLB advances, securities sold under agreements to repurchase, proceeds from the sale of loans, federal funds purchased and brokered certificates of deposit. Adverse operating results or changes in industry conditions could lead to difficulty or an inability to access these additional funding sources. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. If we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real estate, and we could become subject to environmental liabilities with respect to one or more of these properties. During the ordinary course of business, we may foreclose on and take title to properties securing defaulted loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous conditions or toxic substances are found on these properties, we may be liable for remediation costs, as well as for personal injury and property damage, civil fines and criminal penalties regardless of when the hazardous conditions or toxic substances first affected any particular property. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on us.

Changes in management's estimates and assumptions may have a material impact on our consolidated financial statements and our financial condition or operating results.

In preparing this annual report as well as other periodic reports we are required to file under the Securities Exchange Act of 1934, including our consolidated financial statements, our management is and will be required under applicable rules and regulations to make estimates and assumptions as of a specified date. These estimates and assumptions are based on management's best estimates and experience as of that date and are subject to substantial risk and uncertainty. Materially different results may occur as circumstances change and additional information becomes known. Areas requiring significant estimates and assumptions by management include our valuation of investment securities, our determination of our income tax provision, and our evaluation of the adequacy of our allowance for loan losses.

A protracted government shutdown may result in reduced loan originations and related gains on sale and could negatively affect our financial condition and results of operations.

During any protracted federal government shutdown, we may not be able to close certain loans and we may not be able to recognize non-interest income on the sale of loans. Some of the loans we originate are sold directly to

Table of Contents

government agencies, and some of these sales may be unable to be consummated during the shutdown. In addition, we believe that some borrowers may determine not to proceed with their home purchase and not close on their loans, which would result in a permanent loss of the related non-interest income. A federal government shutdown could also result in reduced income for government employees or employees of companies that engage in business with the federal government, which could result in greater loan delinquencies, increases in our nonperforming and classified assets and a decline in demand for our products and services.

We depend on our management team and other key personnel to implement our business strategy and execute successful operations and we could be harmed by the loss of their services or the inability to hire additional personnel.

We are dependent upon the services of the members of our senior management team who direct our strategy and operations. Members of our senior management team, or lending personnel who possess expertise in our markets and key business relationships, could be difficult to replace. Our loss of these persons, or our inability to hire additional qualified personnel, could impact our ability to implement our business strategy and could have a material adverse effect on our results of operations and our ability to compete in our markets.

ITEM 1B.Unresolved Staff Comments

Not applicable.

ITEM 2.Properties

We operate from our corporate office in Honolulu, Hawaii, and from our 29 full-service branches located in the State of Hawaii. The net book value of our premises, land and equipment was \$4.8 million at December 31, 2018. The

Table of Contents

following table sets forth information with respect to our full-service banking offices, including the expiration date of leases with respect to leased facilities.

AINA HAINA Aina Haina Shopping Center 820 West Hind Drive Honolulu, Oahu 96821 4/30/2021	KAIMUKI 1108 12th Avenue Honolulu, Oahu 96816 12/31/2023	KIHEI Azeka Shopping Center 1279 South Kihei Road Kihei, Maui 96753 1/31/2019	PEARLRIDGE 98-084 Kamehameha Highway Aiea, Oahu 96701 6/30/2022
ALA MOANA CENTER 1450 Ala Moana Boulevard Honolulu, Oahu 96814 12/31/2024	KALIHI-KAPALAMA 1199 Dillingham Boulevard Honolulu, Oahu 96817 8/31/2027	KONA Crossroads Shopping Center 75-1027 Henry Street Kailua-Kona, Hawaii 96740 8/31/2020	PIIKOI 1159 South Beretania Street Honolulu, Oahu 96814 12/31/2020
DOWNTOWN 1000 Bishop Street Honolulu, Oahu 96813 12/31/2020	KAMEHAMEHA SHOPPING CENTER 1620 North School Street Honolulu, Oahu 96817 6/30/2025	LAHAINA Old Lahaina Center 170 Papalaua Street Lahaina, Maui 96761 3/31/2023	SALT LAKE Salt Lake Shopping Center 848 Ala Liliko'i Street Honolulu, Oahu 96818 1/31/2021
HAWAII KAI Hawaii Kai Shopping Center 377 Keahole Street Honolulu, Oahu 96825 9/30/2023	KANEOHE 46-005 Kawa Street Kaneohe, Oahu 96744 12/31/2019	MANOA Manoa Marketplace 2752 Woodlawn Drive Honolulu, Oahu 96822 7/10/2023	WAIPAHU Waipahu Town Center 94-050 Farrington Highway Waipahu, Oahu 96797 12/31/2019
HILO Waiakea Center 315 Makaala Street Hilo, Hawaii 96720 12/31/2028	KAPAHULU Kilohana Square 1016 Kapahulu Avenue Honolulu, Oahu 96816 pending renewal	MCCULLY 1111 McCully Street Honolulu, Oahu 96826 4/30/2023	WAIPIO Laniakea Plaza 94-1221 Ka Uka Boulevard Waipahu, Oahu 96797 9/30/2021
KAHALA 4819 Kilauea Avenue Honolulu, Oahu 96816 1/31/2019	KAPOLEI Ace Center at Kapolei 480 Kamokila Boulevard Kapolei, Oahu 96709 7/31/2019	MILILANI Town Center of Mililani 95-1249 Meheula Parkway Mililani, Oahu 96789 10/11/2019	
KAHULUI Queen Kaahumanu Center 275 W. Kaahumanu Avenue Kahului, Maui 96732 12/31/2019	KAUAI Kukui Grove Shopping Center 4393 Kukui Grove Street Lihue, Kauai 96766 2/28/2023	NUUANU Nuuuanu Shopping Center 1613 Nuuuanu Avenue Honolulu, Oahu 96817 7/22/2021	
KAILUA	KEEAUMOKU	PEARL CITY	

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19 Oneawa Street
Kailua, Oahu 96734

735 Keeaumoku Street
Honolulu, Oahu 96814
9/30/2029

Pearl City Shopping Center
850 Kamehameha Highway
Pearl City, Oahu 96782
9/22/2019

Table of Contents

ITEM 3. Legal Proceedings

From time to time, we are involved as plaintiff or defendant in various legal proceedings arising in the ordinary course of business. At December 31, 2018, we were not involved in any legal proceedings, the outcome of which we believe would be material to our financial condition or results of operations.

ITEM 4. Mine Safety Disclosures

Not applicable.

27

Table of Contents

PART II

ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Market, Holder and Dividend Information. Our common stock is traded on the NASDAQ Global Select Market under the symbol “TBNK.” The approximate number of holders of record of Territorial Bancorp Inc.’s common stock as of February 28, 2019 was 1,092. Certain shares of Territorial Bancorp Inc. are held in “nominee” or “street” name and, accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

(b) Sales of Unregistered Securities. Not applicable.

(c) Use of Proceeds. Not applicable.

(d) Securities Authorized for Issuance Under Equity Compensation Plans. See “Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.”

(e) Stock Repurchases. The following table sets forth information in connection with repurchases of our shares of common stock during the fourth quarter of 2018:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs (2)
October 1, 2018 through October 31, 2018	33,005	\$ 29.22	30,000	\$ 1,795,615
November 1, 2018 through November 30, 2018	—	—	—	1,795,615
December 1, 2018 through December 31, 2018	7,500	25.94	7,500	1,601,065
Total	40,505	\$ 28.61	37,500	\$ 1,601,065

(1) Includes shares acquired by the Company to settle the exercise price in connection with stock swap or net settlement transactions related to the exercise of stock options.

(2)

On June 8, 2018, the Company announced its eighth repurchase program. Under the repurchase program, the Company was authorized to repurchase up to \$5,000,000 of our common stock based on certain price assumptions. We have entered into a Rule 10b5-1 plan with respect to our stock repurchase program.

Table of Contents

ITEM 6. Selected Financial Data

The following selected financial data and ratios have been derived, in part, from the consolidated financial statements and notes appearing elsewhere in this Annual Report on Form 10-K.

	At December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Selected Financial Condition Data:					
Total assets	\$ 2,069,206	\$ 2,003,846	\$ 1,877,562	\$ 1,821,141	\$ 1,691,897
Cash and cash equivalents	47,063	32,089	61,273	65,919	75,060
Investment securities held to maturity	371,517	404,792	407,656	493,059	572,922
Loans receivable, net	1,574,714	1,488,971	1,335,987	1,188,649	968,212
Bank-owned life insurance	45,066	44,201	43,294	42,328	41,303
Federal Home Loan Bank stock, at cost	8,093	6,541	4,945	4,790	11,234
Deposits	1,629,164	1,597,295	1,493,200	1,445,103	1,359,679
Federal Home Loan Bank advances	142,200	107,200	69,000	69,000	15,000
Securities sold under agreements to repurchase	30,000	30,000	55,000	55,000	72,000
Stockholders' equity	235,079	234,854	229,786	219,641	216,378
	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Selected Operating Data:					
Interest income	\$ 73,301	\$ 68,333	\$ 66,073	\$ 63,092	\$ 59,615
Interest expense	13,529	9,589	7,844	6,515	6,118
Net interest income	59,772	58,744	58,229	56,577	53,497
Provision for loan losses	119	52	310	455	360
Net interest income after provision for loan losses	59,653	58,692	57,919	56,122	53,137
Noninterest income	3,164	3,846	4,094	4,911	5,177
Noninterest expense	37,494	36,474	34,879	36,499	35,308
Income before income taxes	25,323	26,064	27,134	24,534	23,006
Income taxes	6,111	11,102	10,787	9,786	8,909
Net income	\$ 19,212	\$ 14,962	\$ 16,347	\$ 14,748	\$ 14,097

Table of Contents

	At or for the Year Ended December 31,									
	2018		2017		2016		2015		2014	
Selected Financial Ratios and Other Data:										
Performance Ratios:										
Return on average assets (ratio of net income to average total assets)	0.95	%	0.77	%	0.88	%	0.84	%	0.85	%
Return on average equity (ratio of net income to average equity)	8.14	%	6.34	%	7.20	%	6.75	%	6.54	%
Interest rate spread (1)	2.94	%	3.07	%	3.19	%	3.29	%	3.30	%
Net interest margin (2)	3.05	%	3.15	%	3.26	%	3.36	%	3.37	%
Efficiency ratio (3)	59.57	%	58.27	%	55.96	%	59.36	%	60.18	%
Noninterest expense to average total assets	1.85	%	1.89	%	1.88	%	2.08	%	2.13	%
Average interest-earning assets to average interest-bearing liabilities	114.92	%	115.50	%	115.66	%	115.86	%	115.83	%
Average equity to average total assets	11.62	%	12.20	%	12.25	%	12.46	%	13.02	%
Basic earnings per share	\$ 2.07		\$ 1.61		\$ 1.80		\$ 1.63		\$ 1.53	
Diluted earnings per share	\$ 2.03		\$ 1.57		\$ 1.76		\$ 1.59		\$ 1.51	
Dividend payout ratio (4)	56.16	%	76.43	%	52.27	%	47.80	%	46.36	%
Asset Quality Ratios:										
Nonperforming assets to total assets	0.11	%	0.21	%	0.24	%	0.30	%	0.26	%
Nonperforming loans to total loans	0.14	%	0.28	%	0.34	%	0.45	%	0.46	%
Allowance for loan losses to nonperforming loans	119.39	%	60.28	%	53.78	%	40.00	%	37.97	%
Allowance for loan losses to total loans	0.17	%	0.17	%	0.18	%	0.18	%	0.17	%
Capital Ratios (bank-level only):										
Total capital (to risk-weighted assets)	23.78	%	23.59	%	25.59	%	26.07	%	29.93	%
Common equity Tier 1 capital (to risk-weighted assets) (5)	23.50	%	23.31	%	25.30	%	25.79	%	n/a	
Tier I capital (to risk-weighted assets)	23.50	%	23.31	%	25.30	%	25.79	%	29.68	%
Tier I capital (to total assets)	11.09	%	11.04	%	11.76	%	11.49	%	12.10	%
Other Data:										
Number of full-service offices	29		29		28		28		28	
Full-time equivalent employees	277		276		271		275		268	

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- (1) The average interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities for the year.
- (2) The net interest margin represents net interest income as a percent of average interest-earning assets for the year.
- (3) The efficiency ratio represents noninterest expense divided by the sum of net interest income and noninterest income.
- (4) The dividend payout ratio represents cash dividends declared per share divided by diluted earnings per share.
- (5) Effective January 1, 2015, a new common equity Tier 1 capital standard was implemented.

Table of Contents

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The objective of this section is to help readers understand our views on our results of operations and financial condition. You should read this discussion in conjunction with the consolidated financial statements and notes to the consolidated financial statements that appear elsewhere in this Annual Report on Form 10-K.

Overview

We have historically operated as a traditional thrift institution. The significant majority of our assets consist of long-term, fixed-rate residential mortgage loans and mortgage-backed securities, which we have funded primarily with deposit accounts, securities sold under agreements to repurchase and FHLB advances. As a result, we may be vulnerable to increases in interest rates, as our interest-bearing liabilities mature or reprice more quickly than our interest-earning assets.

We have continued our focus on originating one- to four-family residential real estate loans. Our emphasis on conservative loan underwriting has resulted in continued low levels of nonperforming assets. Our nonperforming assets, which includes nonaccrual loans and real estate owned, totaled \$2.2 million, or 0.11% of total assets at December 31, 2018, compared to \$4.2 million, or 0.21% of total assets at December 31, 2017. As of December 31, 2018, nonperforming assets consisted of 11 mortgage loans with a principal balance of \$2.2 million. Our nonperforming loans and loan loss experience has enabled us to maintain a relatively low allowance for loan losses in relation to other peer institutions and correspondingly resulted in low levels of provisions for loan losses. Our provisions for loan losses were \$119,000 and \$52,000 for the years ended December 31, 2018 and 2017, respectively.

Our operations are affected by our efforts to manage our interest rate risk position. In 2018 and 2017, we sold \$10.0 million and \$25.0 million, respectively, of fixed-rate mortgage loans. Our total long-term fixed rate FHLB advances and securities sold under agreements to repurchase increased in 2018 and 2017 by \$35.0 million and \$13.2 million, respectively. Our long-term public deposits increased in 2018 and 2017 by \$86.6 million and \$43.8 million, respectively. The change in borrowings occurred to reduce our interest rate risk. See "—Management of Market Risk" for a discussion of the actions we have taken in managing interest rate risk.

All of Territorial Savings Bank's investments in mortgage-backed securities and collateralized mortgage obligations have been issued by Freddie Mac or Fannie Mae, which are U.S. government-sponsored enterprises, or Ginnie Mae, which is a U.S. government agency. These agencies guarantee the payment of principal and interest on the Bank's mortgage-backed securities. We do not own any preferred stock issued by Fannie Mae or Freddie Mac. As of December 31, 2018 and 2017, our additional borrowing capacity at the FHLB of Des Moines was \$769.3 million and \$579.4 million, respectively. The increase in borrowing capacity occurred when our credit capacity with the Federal Home Loan Bank was increased from 35% of total assets to 45% of total assets during the third quarter.

Critical Accounting Policies

We consider accounting policies that require management to exercise significant judgment or discretion or make significant assumptions that have, or could have, a material impact on the carrying value of certain assets or on income, to be critical accounting policies. We consider the following to be our critical accounting policies:

Allowance for Loan Losses. We maintain an allowance for loan losses at an amount estimated to equal all credit losses incurred in our loan portfolio that are both probable and reasonable to estimate at a balance sheet date. To estimate credit losses on impaired loans (in accordance with the Receivables topic of the FASB ASC), we evaluate numerous factors, as described below in “—Allowance for Loan Losses.” Based on our estimate of the level of allowance for loan losses required, we record a provision for loan losses to maintain the allowance for loan losses at an amount that provides for all losses that are both probable and reasonable to estimate.

Since we cannot predict with certainty the amount of loan charge-offs that will be incurred and because the eventual level of loan charge-offs is affected by numerous conditions beyond our control, a range of loss estimates can reasonably be used to determine the allowance for loan losses and the related provisions for loan losses. In addition, as an integral part of their examination processes, the bank regulators will periodically review our allowance for loan

Table of Contents

losses. The bank regulators may require that we recognize additions to the allowance for loan losses based on their analysis of information available to them at the time of their examination. Accordingly, actual results could differ materially from those estimates.

Deterioration in the Hawaii real estate market could result in an increase in loan delinquencies, additional increases in our allowance for loan losses and provision for loan losses, as well as an increase in loan charge-offs.

Securities Impairment. We periodically perform analyses to determine whether there has been an other-than-temporary decline in the value of our securities. Our held-to-maturity securities consist primarily of debt securities for which we have a positive intent and ability to hold to maturity, and are carried at amortized cost. Available-for-sale securities are carried at fair value. We conduct a quarterly review and evaluation of the securities portfolio to determine if the value of any security has declined below its cost or amortized cost, and whether such decline is other-than-temporary. If such decline is deemed other-than-temporary, we would adjust the cost basis of the security by writing down the security for any credit losses through a charge on the income statement. The market values of our securities are affected by changes in interest rates as well as shifts in the market's perception of the issuers. The fair value of investment securities is usually based on pricing models that consider bid and ask prices and prices at which similar securities traded. However, if there are no observable market inputs (for securities such as trust preferred securities), we estimate the fair value using unobservable inputs. We discount projected cash flows using a risk-adjusted discount rate in accordance with the Fair Value Measurements and Disclosures topic of the FASB ASC.

Our investment in PreTSL XXIII was determined to be other-than-temporarily impaired and we recorded an impairment charge of \$2.4 million in the year ended December 31, 2010. PreTSL XXIII has an amortized cost and a remaining cost basis of \$75,000 at December 31, 2018 and there is no accumulated other comprehensive loss related to noncredit factors.

We evaluated our \$8.1 million investment in FHLB stock for other-than-temporary impairment as of December 31, 2018. Considering the long-term nature of this investment and the liquidity position of the FHLB of Des Moines, our FHLB stock was not considered to be other-than-temporarily impaired. As of December 31, 2018, the FHLB of Des Moines has met all of its regulatory capital requirements. Moody's Investor Services and Standard and Poor's have given the FHLB of Des Moines long-term credit ratings of Aaa and AA+, respectively.

We evaluated our \$3.1 million investment in FRB stock for other-than-temporary impairment as of December 31, 2018. Based on the long-term nature of this investment and the liquidity position of the FRB of San Francisco, our FRB stock was not considered to be other-than-temporarily impaired.

Deferred Tax Assets. Deferred tax assets and liabilities are recognized for the estimated future tax effects attributable to temporary differences and carryforwards. In 2017, we wrote-down our deferred tax assets by \$2.1 million when the federal corporate tax rate was lowered from 35% to 21% due to the Tax Cuts and Jobs Act of 2017. A valuation allowance may be required if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining whether a valuation allowance is necessary, we consider the level of taxable income in prior years, to the extent that carrybacks are permitted under current tax laws, as well as estimates of future taxable income and tax planning strategies that could be implemented to accelerate taxable income if necessary. If our estimates of future taxable income were materially overstated or if our assumptions regarding the tax consequences of tax planning strategies were inaccurate, some or all of our deferred tax assets may not be realized, which would result in a charge to earnings.

Defined Benefit Retirement Plan. Defined benefit plan obligations and related assets of our defined benefit retirement plan are presented in Note 17 to the Consolidated Financial Statements. Effective December 31, 2008, the defined benefit retirement plan was frozen and all plan benefits were fixed as of that date. Plan assets, which consist primarily of marketable equity securities and mutual funds, are typically valued using market quotations. Plan obligations and the annual pension expense are determined by independent actuaries through the use of a number of assumptions. Key assumptions in measuring the plan obligations include the discount rate and the expected long-term rate of return on plan assets. In determining the discount rate, we utilize a yield that reflects the top 50% of the universe of bonds, ranked in the order of the highest yield. These bonds provide cash flows that match the timing of expected benefit payments. Asset returns are based upon the anticipated average rate of earnings expected on the invested funds of the plans.

Table of Contents

At December 31, 2018, we used weighted-average discount rates of 3.70% and 4.30% for calculating annual pension expense and projected plan liabilities, respectively, and an expected long-term rate of return on plan assets of 7.25% for calculating annual pension expense. At December 31, 2017, we used weighted-average discount rates of 4.30% and 3.70% for calculating annual pension expense and projected plan liabilities, respectively, and an expected long-term rate of return on plan assets of 7.25% for calculating annual pension expense. For both the discount rate and the asset return rate, a range of estimates could reasonably have been used, which would affect the amount of pension expense and pension liability recorded.

A decrease in the discount rate or an increase in the asset return rate would have reduced our pension expense in 2018, while an increase in the discount rate or a decrease in the asset return rate would have the opposite effect. A 25 basis point decrease in the discount rate assumptions would have decreased our 2018 pension expense by \$9,000 and would have increased our year-end 2018 pension liability by \$516,000, while a 25 basis point decrease in the asset return rate would have increased our 2018 pension expense by \$41,000.

Balance Sheet Analysis

Assets. At December 31, 2018, our assets were \$2.1 billion, an increase of \$65.4 million, or 3.3%, from \$2.0 billion at December 31, 2017. The increase was primarily caused by increases of \$85.7 million in loans receivable and \$15.0 million in cash and cash equivalents, which was partially offset by a decrease of \$33.6 million in total investment securities.

Cash and Cash Equivalents. At December 31, 2018, we had \$47.1 million of cash and cash equivalents compared to \$32.1 million at December 31, 2017. During 2018, cash and cash equivalents increased by \$15.0 million primarily due to a \$35.0 million increase in borrowings, a \$33.6 million decrease in total investment securities and a \$31.9 million increase in deposits. These increases were partially offset by funding an \$85.7 million increase in loans receivable.

Table of Contents

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio at the dates indicated.

At December 31, 2018		2017		2016		2015		2014	
Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)									
\$ 1,531,149	96.88 %	\$ 1,444,625	96.65 %	\$ 1,289,364	96.11 %	\$ 1,145,904	95.90 %	\$ 926,074	
12,151	0.77	10,799	0.72	9,551	0.71	9,834	0.82	8,920	
20,780	1.31	21,787	1.46	23,346	1.74	19,288	1.62	18,415	
11,090	0.70	12,882	0.86	14,805	1.10	15,333	1.28	15,992	
5,296	0.34	4,614	0.31	4,564	0.34	4,543	0.38	4,614	
\$ 1,580,466	100.00 %	\$ 1,494,707	100.00 %	\$ 1,341,630	100.00 %	\$ 1,194,902	100.00 %	\$ 974,015	
(3,110)		(3,188)		(3,191)		(4,087)		(4,112)	
(2,642)		(2,548)		(2,452)		(2,166)		(1,691)	
\$ 1,574,714		\$ 1,488,971		\$ 1,335,987		\$ 1,188,649		\$ 968,212	

Loan Portfolio Maturities and Yields. The following table summarizes the scheduled maturities of our loan portfolio at December 31, 2018. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

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Multi-family real estate		Multi-family residential real estate		Construction, commercial and other real estate			Home equity loans and lines of credit			Other loans	
Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	
(thousands)											
4.53	\$ 655	7.26	\$ 1,970	5.28	\$ 242	7.34	\$ 868	7.42			
5.05	1,843	5.13	4,476	5.13	2,387	7.32	1,597	5.65			
3.89	9,653	4.29	14,334	4.64	8,461	4.88	2,831	4.82			
3.89	\$ 12,151	4.58	\$ 20,780	4.80	\$ 11,090	5.46	\$ 5,296	5.50			

Table of Contents

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at December 31, 2018 that are contractually due after December 31, 2019.

	Due After December 31, 2019		
	Fixed	Adjustable	Total
	(In thousands)		
Real estate loans:			
First mortgage:			
One- to four-family residential	\$ 1,529,448	\$ 1,655	\$ 1,531,103
Multi-family residential	11,496	—	11,496
Construction, commercial and other	17,137	1,673	18,810
Home equity loans and lines of credit	1,175	9,673	10,848
Other loans	3,927	501	4,428
Total loans	\$ 1,563,183	\$ 13,502	\$ 1,576,685

Securities. At December 31, 2018, our securities portfolio totaled \$374.1 million, or 18.1% of assets and included \$371.5 million of held-to-maturity securities and \$2.6 million of available-for-sale securities. At that date, our held-to-maturity securities consisted of securities with the following amortized costs: \$371.4 million of mortgage-backed securities and \$75,000 of trust preferred securities. All of the mortgage-backed securities were issued by Fannie Mae, Freddie Mac or Ginnie Mae. At December 31, 2018, none of the underlying collateral consisted of subprime or Alt-A loans (traditionally defined as nonconforming loans having less than full documentation). At December 31, 2018, we held no common or preferred stock of Fannie Mae or Freddie Mac.

The following table sets forth the amortized cost and estimated fair value of our securities portfolio at the dates indicated.

	At December 31,		2017		2016	
	2018		Amortized	Fair Value	Amortized	Fair Value
	Cost	Fair Value	Cost	Fair Value	Cost	Fair Value
	(In thousands)					
Available for Sale:						
U.S. government sponsored mortgage-backed securities:						
Freddie Mac	\$ 2,644	\$ 2,560	\$ 2,870	\$ 2,851	\$ —	\$ —
Total	\$ 2,644	\$ 2,560	\$ 2,870	\$ 2,851	\$ —	\$ —

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Held to Maturity:
U.S. government
sponsored
mortgage-backed
securities:

Fannie Mae	\$ 119,536	\$ 117,079	\$ 127,768	\$ 128,069	\$ 145,065	\$ 144,490
Freddie Mac	211,365	208,015	229,120	231,051	205,227	206,855
Collateralized mortgage obligations (1)	4,877	4,608	5,992	5,744	7,364	7,117
Ginnie Mae	35,664	34,517	41,485	40,954	48,842	48,297
Total U.S. government sponsored mortgage-backed securities	371,442	364,219	404,365	405,818	406,498	406,759
Trust preferred securities	75	703	427	845	1,158	1,163
Total	\$ 371,517	\$ 364,922	\$ 404,792	\$ 406,663	\$ 407,656	\$ 407,922

(1) All of our collateralized mortgage obligations have been issued by Fannie Mae, Freddie Mac or Ginnie Mae.

Table of Contents

Any unrealized loss on individual mortgage-backed securities as of December 31, 2018 and 2017 was caused by increases in market interest rates. All of our mortgage-backed securities are guaranteed by U.S. government-sponsored enterprises or a U.S. government agency. Since the decline in market value has been attributable to changes in interest rates and not credit quality, we continue to have the intent not to sell these investments, and it is not more likely than not that we will be required to sell such investments prior to the recovery of the amortized cost basis, we have not considered these investments to be other-than-temporarily impaired as of December 31, 2018 and 2017.

At December 31, 2018, we owned a trust preferred security with an amortized cost of \$75,000. This security represents an investment in a pool of debt obligations issued primarily by holding companies of Federal Deposit Insurance Corporation-insured financial institutions.

The trust preferred securities market is considered to be inactive as only seven transactions have occurred over the past 84 months in the same tranche of securities that we own and no new issues of pooled trust preferred securities have occurred since 2007. We used a discounted cash flow model to determine whether this security is 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%.

At December 31, 2018, we had no investments in a single company (other than U.S. government sponsored enterprises) or entity that had an aggregate book value in excess of 10% of our consolidated stockholders' equity.

Table of Contents

Portfolio Maturities and Coupons. The composition and maturities of the investment securities portfolio at December 31, 2018 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. No tax-equivalent adjustments have been made, as we did not hold any tax-free investment securities at December 31, 2018.

One Year or Less			More than One Year through Five Years			More than Five Years through Ten Years			More than Ten Years			Total Securities	
Amortized Cost	Weighted Average Coupon		Amortized Cost	Weighted Average Coupon		Amortized Cost	Weighted Average Coupon		Amortized Cost	Weighted Average Coupon		Amortized Cost	Fair Value
(Dollars in thousands)													
\$ —	—	%	\$ —	—	%	\$ —	—	%	\$ 2,644	3.00	%	\$ 2,644	\$ 2,560
\$ —	—		\$ —	—		\$ —	—		\$ 2,644	3.00		\$ 2,644	\$ 2,560
\$ 2	4.55	%	\$ —	—	%	\$ 48	4.37	%	\$ 119,486	3.11	%	\$ 119,536	\$ 117,079
—	—		1	5.00		—	—		211,364	3.11		211,365	208,015
—	—		—	—		—	—		4,877	1.65		4,877	4,608
—	—		—	—		17	3.56		35,647	2.92		35,664	34,517
2	4.55		1	5.00		65	4.16		371,374	3.07		371,442	364,219
—	—		—	—		—	—		75	4.89		75	703
\$ 2	4.55	%	\$ 1	5.00	%	\$ 65	4.16	%	\$ 371,449	3.07	%	\$ 371,517	\$ 364,922

(1) All of our collateralized mortgage obligations have been issued by Fannie Mae, Freddie Mac or Ginnie Mae.

Bank-Owned Life Insurance. We invest in bank-owned life insurance to provide us with a funding source for our benefit plan obligations. Bank-owned life insurance also generally provides us noninterest income that is

nontaxable. Interagency federal guidance generally limits our investment in bank-owned life insurance to 25% of the Bank's Tier 1 capital plus our allowance for loan losses. At December 31, 2018, this limit was \$57.1 million, and we had invested \$45.1 million in bank-owned life insurance at that date.

Table of Contents

Deposits. At December 31, 2018, deposits totaled \$1.6 billion or 88.8% of total liabilities. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposit accounts consist of passbook and statement savings accounts, certificates of deposit, money market accounts, commercial and regular checking accounts and Super NOW accounts. Historically, we have not accepted, and do not currently have, brokered deposits. We accept deposits primarily from the areas in which our offices are located. We rely on our competitive pricing and products, convenient locations and quality customer service to attract and retain deposits.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies, market interest rates, liquidity requirements and our deposit growth goals.

During the year ended December 31, 2018, our deposits grew by \$31.9 million, or 2.0%. The growth in deposits was primarily due to an increase of \$78.9 million in the balance of certificates of deposit, which was partially offset by a \$48.9 million decrease in passbook savings for the year ended December 31, 2018. The increase in certificates of deposit was primarily due to a \$39.2 million increase in public deposits. In 2018, we obtained \$86.6 million long-term public deposits to reduce our interest rate risk.

At December 31, 2018, we had a total of \$391.1 million in certificates of deposit, of which \$206.4 million had remaining maturities of one year or less. Based on historical experience and our current pricing strategy, we believe we will retain a significant portion of these accounts upon maturity.

The following tables set forth the distribution of our average total deposit accounts (including interest-bearing and non-interest-bearing deposits), by account type, for the periods indicated.

	For the Year Ended December 31, 2018				2017			
	Average Balance (Dollars in thousands)	Percent	Weighted Average Rate		Average Balance	Percent	Weighted Average Rate	
Deposit type:								
Non-interest-bearing	\$ 51,063	3.1	% —	%	\$ 47,148	3.1	% —	%
Savings accounts	1,019,966	62.9	0.47	%	1,033,454	67.2	0.43	%
Certificates of deposit	362,699	22.4	1.68	%	270,225	17.6	1.17	%
Money market	5,673	0.3	0.44	%	5,171	0.3	0.44	%
Checking and Super NOW	183,277	11.3	0.02	%	180,858	11.8	0.02	%

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Total deposits \$ 1,622,678 100.0 % 0.70 % \$ 1,536,856 100.0 % 0.51 %

For the Year Ended December 31, 2016

	Average Balance	Percent		Weighted Average Rate	
	(Dollars in thousands)				
Deposit type:					
Non-interest-bearing	\$ 47,097	3.2	%	—	%
Savings accounts	1,017,420	69.5		0.41	%
Certificates of deposit	226,264	15.4		0.76	%
Money market	2,469	0.2		0.41	%
Checking and Super NOW	171,716	11.7		0.02	%
Total deposits	\$ 1,464,966	100.0	%	0.42	%

Table of Contents

As of December 31, 2018, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to \$250,000 was \$244.6 million. The following table sets forth the maturity of those certificates as of December 31, 2018.

	At December 31, 2018 (In thousands)
Three months or less	\$ 53,857
Over three months through six months	36,683
Over six months through one year	42,333
Over one year to three years	88,544
Over three years	23,151
 Total	 \$ 244,568

Borrowings. Our borrowings consist of advances from the FHLB and funds borrowed under securities sold under agreements to repurchase. At December 31, 2018, our FHLB advances totaled \$142.2 million, or 7.8% of total liabilities, and our securities sold under agreements to repurchase totaled \$30.0 million, or 1.6% of total liabilities. At December 31, 2018, we had the capability to borrow up to \$769.3 million in the form of additional advances from the Federal Home Loan Bank.

During the year ended December 31, 2018, our total borrowings increased by \$35.0 million or 25.5%. The increase was due to an increase in FHLB advances. We primarily funded our operations with additional deposits, borrowings, proceeds from loan and security sales and principal repayments on loans and mortgage-backed securities.

The following table sets forth information concerning balances and interest rates on our FHLB advances at the dates and for the years indicated.

	At or for the Year Ended December 31,					
	2018		2017		2016	
	(Dollars in thousands)					
Balance at end of year	\$ 142,200		\$ 107,200		\$ 69,000	
Average balance during year	\$ 106,159		\$ 73,416		\$ 69,504	
Maximum outstanding at any month end	\$ 142,200		\$ 107,200		\$ 69,000	
Weighted average interest rate at end of year	2.35	%	1.70	%	1.49	%
Average interest rate during year	1.89	%	1.51	%	1.49	%

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The following table sets forth information concerning balances and interest rates on our securities sold under agreements to repurchase at the dates and for the years indicated.

	At or for the Year Ended December 31,					
	2018		2017		2016	
	(Dollars in thousands)					
Balance at end of year	\$ 30,000		\$ 30,000		\$ 55,000	
Average balance during year	\$ 30,000		\$ 51,315		\$ 55,000	
Maximum outstanding at any month end	\$ 30,000		\$ 55,000		\$ 55,000	
Weighted average interest rate at end of year	1.66	%	1.66	%	1.57	%
Average interest rate during year	1.68	%	1.59	%	1.57	%

Stockholders' Equity. At December 31, 2018, our stockholders' equity was \$235.1 million, an increase of \$225,000, or 0.1%, from \$234.9 million at December 31, 2017. The increase in stockholders' equity resulted primarily from net income of \$19.2 million, which was partially offset by \$10.6 million of common stock repurchases and \$10.5 million of dividends paid during the year ended December 31, 2018.

Table of Contents

Average Balances and Yields

The following tables set forth average balance sheets, average yields and rates, and certain other information for the years indicated. No tax-equivalent yield adjustments were made, as we did not hold any tax-free investments. 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 Year Ended December 31, 2018			
	Average Outstanding Balance	Interest	Yield/ Rate	
	(Dollars in thousands)			
Interest-earning assets:				
Loans:				
Real estate loans:				
First mortgage:				
One- to four-family residential (1)	\$ 1,480,279	\$ 57,827	3.91	%
Multi-family residential	11,086	505	4.56	
Construction, commercial and other	22,799	1,073	4.71	
Home equity loans and lines of credit	12,267	629	5.13	
Other loans	4,543	245	5.39	
Total loans	1,530,974	60,279	3.94	
Investment securities:				
U.S. government sponsored mortgage-backed securities (1)	395,279	12,236	3.10	
Trust preferred securities	213	—	0.00	
Total securities	395,492	12,236	3.09	
Other	36,102	786	2.18	
Total interest-earning assets	1,962,568	73,301	3.73	
Non-interest-earning assets	68,320			
Total assets	\$ 2,030,888			
Interest-bearing liabilities:				
Savings accounts	\$ 1,019,966	4,841	0.47	%
Certificates of deposit	362,699	6,109	1.68	
Money market accounts	5,673	25	0.44	
Checking and Super NOW accounts	183,277	40	0.02	
Total interest-bearing deposits	1,571,615	11,015	0.70	
Federal Home Loan Bank advances	106,159	2,010	1.89	
Securities sold under agreements to repurchase	30,000	504	1.68	
Total interest-bearing liabilities	1,707,774	13,529	0.79	
Non-interest-bearing liabilities	87,086			
Total liabilities	1,794,860			

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Stockholders' equity	236,028			
Total liabilities and stockholders' equity	\$ 2,030,888			
Net interest income		\$ 59,772		
Net interest rate spread (2)			2.94	%
Net interest-earning assets (3)	\$ 254,794			
Net interest margin (4)			3.05	%
Interest-earning assets to interest-bearing liabilities	114.92	%		

(footnotes on following page)

40

Table of Contents

	For the Year Ended December 31, 2017				2016			
	Average Outstanding Balance	Interest	Yield/ Rate		Average Outstanding Balance	Interest	Yield/ Rate	
(Dollars in thousands)								
Interest-earning assets:								
Loans:								
Real estate loans:								
First mortgage:								
One- to four-family residential (1)	\$ 1,357,508	\$ 52,751	3.89	%	\$ 1,210,635	\$ 48,742	4.03	%
Multi-family residential	9,572	448	4.68		9,686	453	4.68	
Construction, commercial and other	22,603	1,032	4.57		23,268	1,059	4.55	
Home equity loans and lines of credit	13,930	654	4.69		15,493	675	4.36	
Other loans	4,925	259	5.26		4,441	239	5.38	
Total loans	1,408,538	55,144	3.91		1,263,523	51,168	4.05	
Investment securities:								
U.S. government sponsored mortgage-backed securities (1)	403,537	12,526	3.10		454,648	14,365	3.16	
Trust preferred securities	868	—	0.00		974	—	—	
Total securities	404,405	12,526	3.10		455,622	14,365	3.15	
Other	51,686	663	1.28		64,790	540	0.83	
Total interest-earning assets	1,864,629	68,333	3.66		1,783,935	66,073	3.70	
Non-interest-earning assets	69,887				68,444			
Total assets	\$ 1,934,516				\$ 1,852,379			
Interest-bearing liabilities:								
Savings accounts	\$ 1,033,454	4,445	0.43	%	\$ 1,017,420	4,162	0.41	%
Certificates of deposit	270,225	3,159	1.17		226,264	1,724	0.76	
Money market accounts	5,171	23	0.44		2,469	10	0.41	
	180,858	39	0.02		171,716	37	0.02	

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Checking and Super NOW accounts						
Total interest-bearing deposits	1,489,708	7,666	0.51	1,417,869	5,933	0.42
Federal Home Loan Bank advances	73,416	1,105	1.51	69,504	1,035	1.49
Securities sold under agreements to repurchase	51,315	818	1.59	55,000	876	1.59
Total interest-bearing liabilities	1,614,439	9,589	0.59	1,542,373	7,844	0.51
Non-interest-bearing liabilities	84,000			83,012		
Total liabilities	1,698,439			1,625,385		
Stockholders' equity	236,077			226,994		
Total liabilities and stockholders' equity	\$ 1,934,516			\$ 1,852,379		
Net interest income		\$ 58,744			\$ 58,229	
Net interest rate spread (2)			3.07	%		3.19
Net interest-earning assets (3)	\$ 250,190			\$ 241,562		
Net interest margin (4)			3.15	%		3.26
Interest-earning assets to interest-bearing liabilities	115.50	%		115.66	%	

(1) Average balance includes loans or investments available for sale, as applicable.

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

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

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

Table of Contents

Rate/Volume Analysis

The following table presents the effects of changing rates and volumes on our net interest income for the years indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The total column represents the sum of the prior columns. For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Year Ended December 31, 2018 vs. 2017			Year Ended December 31, 2017 vs. 2016		
	Increase (Decrease) Due to Volume	Rate	Total Increase (Decrease)	Increase (Decrease) Due to Volume	Rate	Total Increase (Decrease)
Interest-earning assets:						
Loans:						
Real estate loans:						
First mortgage:						
One- to four-family residential	\$ 4,795	281	5,076	\$ 5,624	(1,615)	4,009
Multi-family residential	69	(12)	57	(5)	—	(5)
Construction, commercial and other	9	32	41	(30)	3	(27)
Home equity loans and lines of credit	(108)	83	(25)	(91)	70	(21)
Other loans	(22)	8	(14)	25	(5)	20
Total loans	4,743	392	5,135	5,523	(1,547)	3,976
U.S. government sponsored mortgage-backed securities	(256)	(34)	(290)	(1,590)	(249)	(1,839)
Other	(94)	217	123	(74)	197	123
Total interest-earning assets	4,393	575	4,968	3,859	(1,599)	2,260
Interest-bearing liabilities:						
Savings accounts	(57)	453	396	66	217	283
Certificates of deposit	1,290	1,660	2,950	383	1,052	1,435
Money market accounts	2	—	2	12	1	13
Checking and Super NOW accounts	1	—	1	2	—	2
Total interest-bearing deposits	1,236	2,113	3,349	463	1,270	1,733
Federal Home Loan Bank advances	573	332	905	59	11	70
Securities sold under agreements to repurchase	(361)	47	(314)	(59)	1	(58)

Total interest-bearing liabilities	1,448	2,492	3,940	463	1,282	1,745
Change in net interest income	\$ 2,945	\$ (1,917)	\$ 1,028	\$ 3,396	\$ (2,881)	\$ 515

Comparison of Operating Results for the Years Ended December 31, 2018 and 2017

General. Net income increased by \$4.3 million, or 28.4%, to \$19.2 million for the year ended December 31, 2018 from \$15.0 million for the year ended December 31, 2017. The increase in net income was caused by a \$5.0 million increase in interest income and a \$5.0 million decrease in income taxes. The increases to net income were offset by a \$3.9 million increase in interest expense, a \$1.0 million increase in noninterest expense, a \$682,000 decrease in noninterest income and a \$67,000 increase in loan loss provisions.

Table of Contents

Net Interest Income. Net interest income increased by \$1.0 million, or 1.7%, to \$59.8 million for the year ended December 31, 2018 from \$58.7 million for the year ended December 31, 2017. Interest income increased by \$5.0 million, or 7.3%, to \$73.3 million for the year ended December 31, 2018 from \$68.3 million for the year ended December 31, 2017. The increase in interest income occurred primarily because of a \$97.9 million increase in average interest-earning assets, which was augmented by a seven basis point increase in the average yield on interest-earning assets. Interest expense increased by \$3.9 million, or 41.1%, to \$13.5 million for the year ended December 31, 2018 from \$9.6 million for the year ended December 31, 2017. The increase in interest expense was due to a 20 basis point increase in the average cost of interest-bearing liabilities and a \$93.3 million increase in average interest-bearing liabilities. The interest rate spread and net interest margin were 2.94% and 3.05%, respectively, for the year ended December 31, 2018, compared to 3.07% and 3.15%, respectively, for the year ended December 31, 2017. The decreases in the interest rate spread and net interest margin were primarily due to an increase in the cost of average interest-bearing liabilities.

Interest Income. Interest income rose by \$5.0 million, or 7.3%, to \$73.3 million for the year ended December 31, 2018 from \$68.3 million for the year ended December 31, 2017. Interest income on loans increased by \$5.1 million, or 9.3%, to \$60.3 million for the year ended December 31, 2018 from \$55.1 million for the year ended December 31, 2017. The increase in interest income on loans occurred because the average balance of loans grew by \$122.4 million, or 8.7%, as new loan originations exceeded loan repayments and loan sales. The increase in interest income that occurred because of growth in the loan portfolio was augmented by a three basis point increase in the average loan yield to 3.94% for the year ended December 31, 2018 compared to 3.91% for the year ended December 31, 2017. The increase in the average yield on loans occurred because of the origination of new loans with higher yields. Interest income on investment securities decreased by \$290,000, or 2.3%, to \$12.2 million for the year ended December 31, 2018 from \$12.5 million for the year ended December 31, 2017. The decrease in interest income on securities occurred primarily because of an \$8.9 million decrease in the average securities balance. The decrease in the average securities balance occurred as repayments and security sales exceeded security purchases. The repayments on securities were reinvested into higher yielding loans.

Interest Expense. Interest expense increased by \$3.9 million, or 41.1%, to \$13.5 million for the year ended December 31, 2018 from \$9.6 million for the year ended December 31, 2017. Interest expense on certificates of deposits increased by \$3.0 million, or 93.4%, to \$6.1 million for the year ended December 31, 2018 from \$3.2 million for the year ended December 31, 2017. This increase was primarily due to an \$86.6 million increase in long-term public deposits at higher interest rates. These deposits were used to extend the maturity of deposits and to reduce interest rate risk. Interest expense on FHLB advances increased by \$905,000, or 81.9%, during the year ended December 31, 2018 compared to the year ended December 31, 2017. The increase in interest expense on FHLB advances was due to a \$32.7 million increase in the average balance of FHLB advances and a 38 basis point increase in the average cost of FHLB advances. The increase in the average cost of advances occurred because of rising FHLB advance rates. Interest expense on securities sold under agreements to repurchase declined by \$314,000, or 38.4%, during the year ended December 31, 2018 compared to the year ended December 31, 2017. The decrease in interest expense on securities sold under agreements to repurchase was caused by a \$21.3 million, or 41.5%, decrease in the average outstanding balance of securities sold under agreements to repurchase. The decline in the average balance of securities sold under agreements to repurchase occurred as the Company paid off matured borrowings in 2018.

Provision for Loan Losses. Based on our analysis of the factors described in “—Allowance for Loan Losses,” we recorded provisions for loan losses of \$119,000 and \$52,000 for the years ended December 31, 2018 and 2017, respectively. The increase in loan loss provisions from 2017 to 2018 is primarily due to an \$85.6 million increase in the loan portfolio. The provisions for loan losses included net chargeoffs of \$25,000 for the year ended December 31, 2018 and net recoveries of \$44,000 for the year ended December 31, 2017. The provisions recorded resulted in ratios of the allowance for loan losses to total loans of 0.17% at December 31, 2018 and 2017. Nonaccrual loans totaled \$2.2 million and \$4.2 million at December 31, 2018 and 2017, respectively. To the best of our knowledge, at December 31, 2018 and 2017, we had provided for all losses that are both probable and reasonable to estimate at those respective dates.

Table of Contents

Noninterest Income. The following table summarizes changes in noninterest income for the years ended December 31, 2018 and 2017.

	Year Ended December		Change 2018/2017		
	31, 2018	2017	\$ Change	% Change	
	(Dollars in thousands)				
Service fees on loan and deposit accounts	\$ 1,886	\$ 1,962	\$ (76)	(3.9)	%
Income on bank-owned life insurance	865	907	(42)	(4.6)	%
Gain on sale of investment securities	45	431	(386)	(89.6)	%
Gain on sale of loans	72	199	(127)	(63.8)	%
Other	296	347	(51)	(14.7)	%
Total	\$ 3,164	\$ 3,846	\$ (682)	(17.7)	%

Noninterest income declined by \$682,000 for the year ended December 31, 2018 compared to the year ended December 31, 2017. During the years ended December 31, 2018 and 2017, we sold \$4.4 million and \$7.0 million, respectively, of held to maturity investment securities and recognized gross realized gains of \$45,000 and \$431,000, respectively. The sale of held to maturity securities, for which the Company had already received a substantial portion of the outstanding principal (at least 85%), is in accordance with the Investments — Debt and Equity Securities 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. During the years ended December 31, 2018 and 2017, we sold \$10.0 million and \$25.0 million, respectively, of mortgage loans held for sale, primarily to reduce interest rate risk, and recognized gains of \$72,000 and \$199,000, respectively.

Noninterest Expense. The following table summarizes changes in noninterest expense for the years ended December 31, 2018 and 2017.

	Year Ended December		Change 2018/2017		
	31, 2018	2017	\$ Change	% Change	
	(Dollars in thousands)				
Salaries and employee benefits	\$ 22,159	\$ 21,482	\$ 677	3.2	%
Occupancy	6,324	5,937	387	6.5	%
Equipment	3,980	3,614	366	10.1	%
Federal deposit insurance premiums	608	605	3	0.5	%
Other general and administrative expenses	4,423	4,836	(413)	(8.5)	%
Total	\$ 37,494	\$ 36,474	\$ 1,020	2.8	%

Noninterest expense increased by \$1.0 million to \$37.5 million for the year ended December 31, 2018 from \$36.5 million for the year ended December 31, 2017. Salaries and employee benefits expense increased by \$677,000 for the year primarily due to a 3.0% company-wide salary increase, an increase in the Company's minimum hourly wage rate to \$15.00 an hour, a decrease in the capitalized costs of new loan originations and an increase in health insurance. As new loans are originated, compensation expense is reduced due to capitalization of the cost of new loan originations. Fewer loans were originated in 2018 compared to 2017 and the decrease in the number of new loan originations resulted in a reduction in loan cost capitalization and higher compensation expense in 2018. Occupancy expense increased primarily due to increases in repairs and maintenance expenses and rent expense. Equipment expense increased primarily due to an increase in depreciation expense and other data processing expense. The decrease in other general and administrative expenses was mainly due to decreases in professional fees, other non-operating expenses, and legal fees.

Income Tax Expense. Income taxes were \$6.1 million for 2018, reflecting an effective tax rate of 24.1% and \$11.1 million for 2017, reflecting an effective tax rate of 42.6%. Income tax expense decreased by \$5.0 million to \$6.1 million for the year ended December 31, 2018 compared to \$11.1 million for the year ended December 31, 2017. The decline in income taxes occurred primarily because the federal income tax rate decreased from 35.0% in 2017 to 21.0% in 2018 with the Tax Cuts and Jobs Act of 2017. In 2018, the Company also recognized a \$476,000 tax benefit by making a \$3.4 million contribution to its defined benefit pension plan. The tax benefit from the pension contribution

Table of Contents

occurred as the tax deduction for pension contributions was calculated at the 35.0% federal corporate tax rate for 2017 rather than the 21.0% federal corporate tax rate for 2018. The decrease in income taxes can also be attributed to a \$2.1 million increase in income tax expense in 2017 when a write-down in deferred tax assets occurred because the federal tax rate was lowered. Income tax expense in 2018 and 2017 also included tax benefits of \$134,000 and \$1.0 million, respectively, from the exercise of stock options.

Nonperforming and Problem Assets

When a residential mortgage loan or home equity line of credit is 15 days past due, we attempt personal, direct contact with the borrower to determine when payment will be made. On the first day of the following month, we mail a letter reminding the borrower of the delinquency, and will send an additional letter when a loan is 60 days or more past due. If necessary, subsequent late notices are issued and the account will be monitored on a regular basis thereafter. By the 121st day of delinquency, unless the borrower has made arrangements to bring the loan current, we will refer the loan to legal counsel to commence foreclosure proceedings.

Commercial business loans, commercial real estate loans and consumer loans are generally handled in the same manner as residential mortgage loans or home equity lines of credit. All commercial business loans that are 15 days past due are immediately referred to our senior lending officer. In addition, we generate past due notices and attempt direct contact with a borrower when a consumer loan is 10 days past due. Because consumer loans are generally unsecured, we may commence collection procedures earlier for consumer loans than for residential mortgage loans or home equity lines of credit.

Loans are placed on nonaccrual status when payment of principal or interest is more than 90 days contractually delinquent or when, in the opinion of management, collection of principal or interest in full appears doubtful. When loans are placed on a nonaccrual status, unpaid accrued interest is fully reversed. The payments received on nonaccrual loans are recorded as a reduction of principal. The loan may be returned to accrual status if both principal and interest payments are brought current and full payment of principal and interest is expected.

Table of Contents

Nonperforming Assets. The table below sets forth the amounts and categories of our nonperforming assets (loans and real estate owned) at the dates indicated.

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Nonaccrual loans:					
Real estate loans:					
First mortgage:					
One- to four-family residential	\$ 2,065	\$ 4,062	\$ 4,402	\$ 5,282	\$ 4,153
Home equity loans and lines of credit	148	165	156	124	296
Other loans	—	—	1	9	4
Total nonaccrual loans	2,213	4,227	4,559	5,415	4,453
Real estate owned:					
Real estate loans:					