

Territorial Bancorp Inc.
Form 10-K/A
March 21, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

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

For the Fiscal Year Ended December 31, 2017

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.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by 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. (Check one):

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, 2017 (\$31.19) was \$266.0 million.

As of February 28, 2018, there were 9,731,022 shares outstanding of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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TERRITORIAL BANCORP INC.

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EXPLANATORY NOTE

Territorial Bancorp Inc. (the “Company”) is filing this Amendment No. 1 on Form 10-K/A to its Annual Report on Form 10-K to re-file Item 8 of Part II of the Form 10-K, to include the signature and final date of the Report of Independent Registered Public Accounting Firm, which were inadvertently omitted from the previous filing.

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PART II

ITEM 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors of

Territorial Bancorp, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Territorial Bancorp, Inc. and subsidiaries (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework 2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework 2013 issued by COSO.

Basis for Opinions

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s consolidated financial statements and an opinion on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of

material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the

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transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Moss Adams LLP

Portland, Oregon

March 15, 2018

We have served as the Company's auditor since 2015.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2017 and 2016

(Dollars in thousands, except share data)

	December 31, 2017	December 31, 2016
ASSETS		
Cash and cash equivalents	\$ 32,089	\$ 61,273
Investment securities available for sale	2,851	—
Investment securities held to maturity, at amortized cost (fair value of \$406,663 and \$407,922 at December 31, 2017 and December 31, 2016, respectively)	404,792	407,656
Loans held for sale	403	1,601
Loans receivable, net	1,488,971	1,335,987
Federal Home Loan Bank stock, at cost	6,541	4,945
Federal Reserve Bank stock, at cost	3,103	3,095
Accrued interest receivable	5,142	4,732
Premises and equipment, net	5,721	4,327
Bank-owned life insurance	44,201	43,294
Income taxes receivable	1,571	122
Deferred income tax assets, net	4,609	7,905
Prepaid expenses and other assets	3,852	2,625
Total assets	\$ 2,003,846	\$ 1,877,562
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	\$ 1,597,295	\$ 1,493,200
Advances from the Federal Home Loan Bank	107,200	69,000
Securities sold under agreements to repurchase	30,000	55,000
Accounts payable and accrued expenses	26,390	23,258
Income taxes payable	1,483	1,616
Advance payments by borrowers for taxes and insurance	6,624	5,702
Total liabilities	1,768,992	1,647,776
Stockholders' Equity:		
Preferred stock, \$0.01 par value; authorized 50,000,000 shares, no shares issued or outstanding	—	—
Common stock, \$0.01 par value; authorized 100,000,000 shares; issued and outstanding 9,915,058 and 9,778,974 shares at December 31, 2017 and December 31, 2016, respectively	99	98
Additional paid-in capital	73,050	71,914
Unearned ESOP shares	(5,383)	(5,872)

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Retained earnings	172,782	168,962
Accumulated other comprehensive loss	(5,694)	(5,316)
Total stockholders' equity	234,854	229,786
Total liabilities and stockholders' equity	\$ 2,003,846	\$ 1,877,562

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Income

For the years ended December 31, 2017, 2016 and 2015

(Dollars in thousands, except per share data)

	2017	2016	2015
Interest income:			
Loans	\$ 55,144	\$ 51,168	\$ 45,903
Investment securities	12,526	14,365	16,873
Other investments	663	540	316
Total interest income	68,333	66,073	63,092
Interest expense:			
Deposits	7,666	5,933	4,821
Advances from the Federal Home Loan Bank	1,105	1,035	697
Securities sold under agreements to repurchase	818	876	997
Total interest expense	9,589	7,844	6,515
Net interest income	58,744	58,229	56,577
Provision for loan losses	52	310	455
Net interest income after provision for loan losses	58,692	57,919	56,122
Noninterest income:			
Service fees on loan and deposit accounts	1,962	1,960	2,161
Income on bank-owned life insurance	907	966	1,026
Gain on sale of investment securities	431	370	701
Gain on sale of loans	199	406	503
Other	347	392	520
Total noninterest income	3,846	4,094	4,911
Noninterest expense:			
Salaries and employee benefits	21,614	20,591	21,497
Occupancy	5,937	5,749	5,809
Equipment	3,614	3,566	3,894
Federal deposit insurance premiums	605	743	857
Other general and administrative expenses	4,704	4,230	4,442
Total noninterest expense	36,474	34,879	36,499
Income before income taxes	26,064	27,134	24,534
Income taxes	11,102	10,787	9,786

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Net income	\$ 14,962	\$ 16,347	\$ 14,748
Basic earnings per share	\$ 1.61	\$ 1.78	\$ 1.59
Diluted earnings per share	\$ 1.57	\$ 1.74	\$ 1.56
Cash dividends declared per common share	\$ 1.20	\$ 0.92	\$ 0.76
Basic weighted-average shares outstanding	9,273,783	9,093,385	9,073,015
Diluted weighted-average shares outstanding	9,532,724	9,311,975	9,263,267

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2017, 2016 and 2015

(Dollars in thousands)

	2017	2016	2015
Net income	\$ 14,962	\$ 16,347	\$ 14,748
Change in unfunded pension liability	(373)	(240)	(12)
Change in unrealized loss on securities	(5)	13	27
Change in noncredit related loss on trust preferred securities	—	147	137
Other comprehensive income (loss), net of tax	(378)	(80)	152
Comprehensive income	\$ 14,584	\$ 16,267	\$ 14,900

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

For the years ended December 31, 2017, 2016 and 2015

(Dollars in thousands, except share data)

	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances at December 31, 2014	\$ 99	\$ 75,229	\$ (6,851)	\$ 153,289	\$ (5,388)	\$ 216,378
Net income	—	—	—	14,748	—	14,748
Other comprehensive income	—	—	—	—	152	152
Cash dividends paid (\$0.76 per share)	—	—	—	(7,013)	—	(7,013)
Share-based compensation	1	3,085	—	—	—	3,086
Allocation of 48,932 ESOP shares	—	720	490	—	—	1,210
Repurchase of 373,711 shares of company common stock	(4)	(8,933)	—	—	—	(8,937)
Exercise of 1,000 options for common stock	—	17	—	—	—	17
Balances at December 31, 2015	\$ 96	\$ 70,118	\$ (6,361)	\$ 161,024	\$ (5,236)	\$ 219,641
Net income	—	—	—	16,347	—	16,347
Other comprehensive loss	—	—	—	—	(80)	(80)
Cash dividends paid (\$0.92 per share)	—	—	—	(8,409)	—	(8,409)
Share-based compensation	1	2,041	—	—	—	2,042
Allocation of 48,932 ESOP shares	—	864	489	—	—	1,353
Repurchase of 118,723 shares of company common stock	(1)	(3,293)	—	—	—	(3,294)
Exercise of 125,870 options for common stock	2	2,184	—	—	—	2,186
Balances at December 31, 2016	\$ 98	\$ 71,914	\$ (5,872)	\$ 168,962	\$ (5,316)	\$ 229,786
Net income	—	—	—	14,962	—	14,962
Other comprehensive loss	—	—	—	—	(378)	(378)
Cash dividends paid (\$1.20 per share)	—	—	—	(11,142)	—	(11,142)
Share-based compensation	—	106	—	—	—	106
Allocation of 48,932 ESOP shares	—	1,040	489	—	—	1,529

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Repurchase of 160,003 shares of company common stock	(2)	(5,127)	—	—	—	(5,129)
Exercise of 294,887 options for common stock	3	5,117	—	—	—	5,120
Balances at December 31, 2017	\$ 99	\$ 73,050	\$ (5,383)	\$ 172,782	\$ (5,694)	\$ 234,854

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the years ended December 31, 2017, 2016 and 2015

(Dollars in thousands)

	2017	2016	2015
Cash flows from operating activities:			
Net income	\$ 14,962	\$ 16,347	\$ 14,748
Adjustments to reconcile net income to net cash from operating activities:			
Provision for loan losses	52	310	455
Depreciation and amortization	1,129	1,139	1,296
Deferred income tax expense (benefit)	3,436	1,490	(2,223)
Amortization of fees, discounts, and premiums	(478)	(715)	(492)
Origination of loans held for sale	(23,665)	(49,157)	(57,337)
Proceeds from sales of loans held for sale	25,063	49,207	56,493
Gain on sale of loans, net	(199)	(406)	(503)
Net gain on sale of real estate owned	—	—	(12)
Gain on sale of investment securities held to maturity	(431)	(370)	(701)
Net loss on disposal of premises and equipment	24	—	4
ESOP expense	1,529	1,353	1,210
Share-based compensation expense	106	2,042	3,086
Increase in accrued interest receivable	(410)	(48)	(248)
Net increase in bank-owned life insurance	(907)	(966)	(1,025)
Net increase in prepaid expenses and other assets	(1,227)	(355)	(366)
Net increase (decrease) in accounts payable and accrued expenses	2,604	(1,081)	249
Net increase in advance payments by borrowers for taxes and insurance	922	578	1,208
Net increase in income taxes receivable	(1,449)	(122)	—
Net increase (decrease) in income taxes payable	(133)	(479)	1,269
Net cash from operating activities	20,928	18,767	17,111
Cash flows from investing activities:			
Purchases of investment securities held to maturity	(56,899)	(3,803)	(11,606)
Purchases of investment securities available for sale	(2,970)	—	—
Principal repayments on investment securities held to maturity	52,831	83,234	85,802
Principal repayments on investment securities available for sale	99	—	—
Proceeds from sale of investment securities held to maturity	7,446	5,462	7,718
Loan originations, net of principal repayments on loans receivable	(152,631)	(146,095)	(220,215)
Purchases of Federal Home Loan Bank stock	(5,929)	(1,075)	(3,120)
Proceeds from redemption of Federal Home Loan Bank stock	4,333	920	9,564

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Purchases of Federal Reserve Bank stock	(8)	(73)	(97)
Proceeds from sale of real estate owned	—	—	204
Purchases of premises and equipment	(2,547)	(563)	(604)
Net cash from investing activities	(156,275)	(61,993)	(132,354)

(Continued)

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the years ended December 31, 2017, 2016 and 2015
(Dollars in thousands)

	2017	2016	2015
Cash flows from financing activities:			
Net increase in deposits	\$ 104,095	\$ 48,097	\$ 85,424
Proceeds from advances from the Federal Home Loan Bank	144,525	23,000	120,000
Repayments of advances from the Federal Home Loan Bank	(106,325)	(23,000)	(66,000)
Proceeds from securities sold under agreements to repurchase	—	—	30,000
Repayments of securities sold under agreements to repurchase	(25,000)	—	(47,000)
Purchases of Fed Funds	10	10	10
Sales of Fed Funds	(10)	(10)	(10)
Proceeds from exercise of stock options	—	566	17
Repurchases of common stock	(9)	(1,674)	(9,326)
Cash dividends paid	(11,123)	(8,409)	(7,013)
Net cash from financing activities	106,163	38,580	106,102
Net decrease in cash and cash equivalents	(29,184)	(4,646)	(9,141)
Cash and cash equivalents at beginning of the period	61,273	65,919	75,060
Cash and cash equivalents at end of the period	\$ 32,089	\$ 61,273	\$ 65,919
Supplemental disclosure of cash flow information:			
Cash paid for:			
Interest on deposits and borrowings	\$ 9,231	\$ 7,863	\$ 6,648
Income taxes	9,319	9,645	10,324
Supplemental disclosure of noncash investing and financing activities:			
Company stock acquired through stock swap and net settlement transactions	\$ 5,120	\$ 1,620	\$ —
Loans transferred to real estate owned	—	—	192
Investments purchased, not settled	—	—	1,200
Investments purchased prior period, settled current period	—	1,200	—
Company stock repurchased prior period, settled current period	—	—	389
Dividends declared, not yet paid	19	—	—

See accompanying notes to consolidated financial statements.

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(1) Organization

On July 10, 2009, Territorial Savings Bank completed a conversion from a mutual holding company to a stock holding company. As part of the conversion, Territorial Mutual Holding Company and Territorial Savings Group, Inc., the former holding companies for Territorial Savings Bank, ceased to exist as separate legal entities, and Territorial Bancorp Inc. became the holding company for Territorial Savings Bank. Upon completion of the conversion and reorganization, a special “liquidation account” was established in an amount equal to the total equity of Territorial Mutual Holding Company as of December 31, 2008. The liquidation account is to provide eligible account holders and supplemental eligible account holders who maintain their deposit accounts with Territorial Savings Bank after the conversion with a liquidation interest in the unlikely event of the complete liquidation of Territorial Savings Bank after the conversion. The balance of the liquidation account at December 31, 2017 was \$11.0 million.

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

(2) Summary of Significant Accounting Policies

(a) Description of Business

Territorial Bancorp Inc. (the Company), through its wholly-owned subsidiary, Territorial Savings Bank (the Bank), provides loan and deposit products and services primarily to individual customers through 29 branches located throughout Hawaii. We deal primarily in residential mortgage loans in the State of Hawaii. The Company’s earnings depend primarily on its net interest income, which is the difference between the interest income earned on interest-earning assets (loans receivable and investments) and the interest expense incurred on interest-bearing liabilities (deposit liabilities and borrowings). Deposits traditionally have been the principal source of the Bank’s funds for use in lending, meeting liquidity requirements, and making investments. The Company also derives funds from receipt of interest and principal repayments on outstanding loans receivable and investments, borrowings from the Federal Home Loan Bank (FHLB), securities sold under agreements to repurchase, and proceeds from issuance of common stock.

(b) Principles of Consolidation

The consolidated financial statements include the accounts and results of operations of Territorial Bancorp Inc. and Territorial Savings Bank and its wholly-owned subsidiaries, Territorial Real Estate Co., Inc. and Territorial Financial Services, Inc. Significant intercompany balances and transactions have been eliminated in consolidation.

(c) Cash and Cash Equivalents

Cash and cash equivalents includes cash and due from banks, interest-bearing deposits in other banks, federal funds sold, and short-term, highly liquid investments with original maturities of three months or less.

(d) Investment Securities

The Company classifies and accounts for its investment securities as follows: (1) held-to-maturity debt securities in which the Company has the positive intent and ability to hold to maturity are reported at amortized cost; (2) trading securities that are purchased for the purpose of selling in the near term are reported at fair value, with unrealized gains and losses included in current earnings; and (3) available-for-sale securities not classified as either held-to-maturity or trading securities are reported at fair value, with unrealized gains and losses excluded from current earnings and reported as a separate component of equity.

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At December 31, 2017, the Company classified all of its investments, except \$2.9 million of securities, as held-to-maturity. At December 31, 2016, the Company classified all of its investments as held-to-maturity.

A decline in the market value of any available-for-sale or held-to-maturity security below cost, that is deemed to be other than temporary, results in an impairment to reduce the carrying amount to fair value. To determine whether impairment is other than temporary, the Company considers the type of the investment, the cause of the decline in value and the amount and duration of the decline in value. It also considers whether it has the intent and ability not to sell and would not be required to sell for a sufficient period of time to recover the remaining amortized cost basis.

Gains or losses on the sale of investment securities are computed using the specific-identification method. The Company amortizes premiums and accretes discounts associated with investment securities using the interest method over the contractual life of the respective investment security. Such amortization and accretion is included in the interest income line item in the consolidated statements of income. Interest income is recognized when earned.

(e) Loans Receivable

This policy applies to all loan classes. Loans receivable are stated at the principal amount outstanding, less the allowance for loan losses, loan origination fees and costs, and commitment fees. Interest on loans receivable is accrued as earned. The Company has a policy of placing loans on a nonaccrual basis when 90 days or more contractually delinquent or when, in the opinion of management, collection of all or part of the principal balance appears doubtful. For nonaccrual loans, the Company records payments received as a reduction in principal. The Company, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, if the loan is considered to be collateral dependent, based on the fair value of the collateral less estimated costs to sell. Impairment losses are written off against the allowance for loan losses. For nonaccrual impaired loans, the Company records payments received as a reduction in principal. A nonaccrual loan may be restored to an accrual basis when principal and interest payments are current and full payment of principal and interest is expected.

(f) Loans Held for Sale

Loans held for sale are stated at the lower of aggregate cost or market value. Net fees and costs of originating loans held for sale are deferred and are included in the basis for determining the gain or loss on sales of loans held for sale.

(g) Deferred Loan Origination Fees and Unearned Loan Discounts

Loan origination and commitment fees and certain direct loan origination costs are being deferred, and the net amount is recognized over the life of the related loan as an adjustment to yield. Net deferred loan fees are amortized using the interest method over the contractual term of the loan, adjusted for actual prepayments. Net unamortized fees on loans paid in full are recognized as a component of interest income.

(h) Real Estate Owned

Real estate owned is valued at the time of foreclosure at fair value, less estimated cost to sell, thereby establishing a new cost basis. The Company obtains appraisals based on recent comparable sales to assist management in estimating the fair value of real estate owned. Subsequent to acquisition, real estate owned is valued at the lower of cost or fair value, less estimated cost to sell. Declines in value are charged to expense through a direct write-down of the asset. Costs related to holding real estate are charged to expense while costs related to development and improvements are capitalized.

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Gains from the sale of real estate owned, if any, are recognized when title has passed, minimum down payment requirements are met, the terms of any notes received are such as to satisfy continuing investment requirements, and the Company is relieved of any requirements for continued involvement with the properties. If the minimum down payment or the continuing investment is not adequate to meet the criteria specified in the Property, Plant and Equipment topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), the Company will defer income recognition and account for such sales using alternative methods, such as installment, deposit, or cost recovery.

(i) Allowance for Loan Losses

The Company maintains an allowance adequate to cover Management's estimate of probable loan losses as of the balance sheet date. The Company's allowance for loan losses is maintained at a level considered adequate to provide for losses that can be estimated based upon specific and general conditions. All loan losses are charged, and all recoveries are credited, to the allowance for loan losses. Additions to the allowance for loan losses are provided by charges to income based on various factors, which, in the Company's judgment, deserve current recognition in estimating probable losses. Charge-offs to the allowance are made when management determines that collectability of all or a portion of a loan is doubtful and available collateral is insufficient to repay the loan.

General allowances are established for loan losses on a portfolio basis for loans that do not meet the definition of impaired, in accordance with the Receivables topic of the FASB ASC. The portfolio is grouped into similar risk characteristics, primarily loan type and loan-to-value ratio. The Company applies an estimated loss rate to each loan group. The loss rates applied are based upon its loss experience adjusted, as appropriate, for environmental factors discussed below. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses the Company has established, which could have a material negative effect on its financial results.

Residential mortgage loans represent the largest segment of the Company's loan portfolio. All of the residential mortgage loans are secured by a first mortgage on residential real estate in Hawaii and consist primarily of fixed-rate mortgage loans which have been underwritten to Freddie Mac and Fannie Mae guidelines and have similar risk characteristics. The loan loss allowance is determined by first calculating the historical loss rate for this segment of the portfolio. The loss rate may be adjusted for qualitative and environmental factors. The allowance for loan loss is calculated by multiplying the adjusted loss rate by the total loans in this segment of the portfolio.

The adjustments to historical loss experience are based on an evaluation of several qualitative and environmental factors, including:

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- changes in lending policies and procedures, including changes in underwriting standards and collections, charge-off and recovery practices;
- changes in international, national, and local economic trends;
- changes in the types of loans in the loan portfolio;
- changes in the experience and ability of personnel in the mortgage loan origination and loan servicing departments;
- changes in the number and amount of delinquent loans and classified assets;
- changes in the type and volume of loans being originated;
- changes in the value of underlying collateral for collateral dependent loans;
- changes in any concentration of credit; and
- external factors such as competition, legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio.

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The Company also uses historical loss rates adjusted for qualitative and environmental factors to establish loan loss allowances for the following portfolio segments:

- home equity loans and lines of credit; and

- consumer and other loans.

The Company has a limited loss experience for the construction, commercial and other mortgage segment of the loan portfolio. The loan loss allowance on this portfolio segment is determined using the loan loss rate of other financial institutions in the State of Hawaii. The allowance for loan loss is calculated by multiplying the loan loss rate of other financial institutions in the state by the total loans in this segment of the Company's loan portfolio.

The allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories. In addition, the unallocated allowance is established to provide for probable losses that have been incurred as of the reporting date but are not reflected in the allocated allowance.

While the Company uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of their examination process, the bank regulators will periodically review the allowance for loan losses. The bank regulators may require the Company to increase the allowance based on their analysis of information available at the time of their examination.

(j) Transfer of Financial Assets

Transfers of financial assets are accounted for as sales when control is surrendered. Control is surrendered when the assets have been isolated from the Company, the transferee obtains the right to pledge or exchange the assets without constraint, and the Company does not maintain effective control over the transferred assets. Mortgage loans sold for cash are accounted for as sales as the above criteria have been met.

Mortgage loans may also be packaged into securities that are issued and guaranteed by U.S. government-sponsored enterprises or a U.S. government agency. The Company receives 100% of the mortgage-backed securities issued. Securitizations are not accounted for as sales and no gain or loss is recognized. The mortgage-backed securities received in securitizations are valued at amortized cost and classified as held-to-maturity.

Mortgage loan transfers accounted for as sales and securitizations are without recourse, except for normal representations and warranties provided in sales transactions, and the Company may retain the related rights to service the loans. The retained servicing rights create mortgage servicing assets that are accounted for in accordance with the Transfers and Servicing topic of the FASB ASC. Mortgage servicing assets are initially valued at fair value and subsequently at the lower of cost or fair value and are amortized in proportion to and over the period of estimated net servicing income. The Company uses a discounted cash flow model to determine the fair value of retained mortgage servicing rights. Prior to 2010, we retained the servicing rights on residential mortgage loans sold. In 2010, we began selling loans primarily on a servicing-released basis.

(k) Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is principally computed on the straight-line method over the estimated useful lives of the respective assets. The estimated useful life of buildings and improvements is 30 years, furniture, fixtures, and equipment is 3 to 10 years, and automobiles are 3 years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset.

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(l) Income Taxes

The Company files consolidated federal income tax and consolidated state franchise tax returns.

Deferred tax assets and liabilities are recognized using the asset and liability method of accounting for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

We establish income tax contingency reserves for potential tax liabilities related to uncertain tax positions. A liability for income tax uncertainties would be recorded for unrecognized tax benefits related to uncertain tax positions where it is more likely than not that the position will be sustained upon examination by a taxing authority.

As of December 31, 2017 and 2016, the Company had not recognized a liability for income tax uncertainties in the accompanying consolidated balance sheets because Management concluded that the Company does not have uncertain tax positions.

The Company recognizes interest and penalties related to tax liabilities in other interest expense and other general and administrative expenses, respectively, in the consolidated statements of income.

Tax years 2014 to 2016 currently remain subject to examination by the Internal Revenue Service and by the Department of Taxation of the State of Hawaii.

(m) Impairment of Long-Lived Assets

Long-lived assets, such as premises and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheets and reported at the lower of

the carrying amount or fair value less costs to sell, and are no longer depreciated.

(n) Pension Plan

Pension benefit costs (returns) are charged (credited) to salaries and employee benefits expense, and the corresponding prepaid (accrued) pension cost is recorded in prepaid expenses and other assets or accounts payable and accrued expenses in the consolidated balance sheets. The Company's policy is to fund pension costs in amounts that will not be less than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 and will not exceed the maximum tax-deductible amounts. The Company generally funds at least the net periodic pension cost, subject to limits and targeted funded status as determined with the consulting actuary.

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(o) Supplemental Employee Retirement Plan (SERP)

The SERP is a noncontributory supplemental retirement plan covering certain current and former employees of the Company. Benefits in the SERP plan are paid after retirement, in addition to the benefits provided by the Pension Plan. The Company accrues SERP costs over the estimated period until retirement by charging salaries and employee benefits expense in the consolidated statements of income, with a corresponding credit to accounts payable and accrued expenses in the consolidated balance sheets.

(p) Employee Stock Ownership Plan (ESOP)

The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of stockholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest.

(q) Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the sum of the weighted-average number of shares outstanding plus the dilutive effect of stock options and restricted stock. ESOP shares not committed to be released are not considered outstanding.

We have two forms of our outstanding common stock: common stock and unvested restricted stock awards. Holders of unvested restricted stock awards receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings. The computed basic and diluted earnings per share are substantially equivalent using both the two-class and the treasury stock methods of calculating earnings per share.

(r) Common Stock Repurchase Program

In 2016, 2014, 2013, 2011 and 2010, the Company adopted common stock repurchase programs in which shares repurchased reduce the amount of shares issued and outstanding. The repurchased shares may be reissued in connection with share-based compensation plans and for general corporate purposes. As of December 31, 2017 and 2016, the Company had accumulated repurchases of 3,138,153 of the total 3,374,253 shares authorized by the Board

of Directors. There were no shares repurchased as part of our common stock repurchase program during 2017. During 2016, shares were repurchased at an average cost of \$25.96.

(s) Bank-Owned Life Insurance

The Company's investment in bank-owned life insurance is based on cash surrender value. The Company invests in bank-owned life insurance to provide a funding source for benefit plan obligations. Bank-owned life insurance also generally provides noninterest income that is nontaxable. Federal regulations generally limit the investment in bank-owned life insurance to 25% of the Bank's Tier 1 capital plus the allowance for loan losses. At December 31, 2017, this limit was \$55.4 million and the Company had invested \$44.2 million in bank-owned life insurance at that date.

(t) Use of Estimates

The preparation of the consolidated financial statements requires management to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the allowance for loan losses; valuation of certain investment securities and determination as to whether declines in fair value below amortized cost are other than temporary; valuation

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allowances for deferred income tax assets; mortgage servicing assets; and assets and obligations related to employee benefit plans. Accordingly, actual results could differ from those estimates.

(u) Recently Issued Accounting Pronouncements

In May 2014, the FASB amended the Revenue Recognition topic of the FASB ASC. The amendment seeks to clarify the principles for recognizing revenue as well as to develop common revenue standards for U.S. generally accepted accounting principles and International Financial Reporting Standards. The Company has reviewed all revenue sources to determine if the sources are in scope for this guidance. Net interest income from financial assets and liabilities are explicitly excluded from the scope of the amendment. The Company's overall assessment of key in-scope revenue sources include service charges on deposit accounts, rental income from safe deposit boxes and commissions on insurance and annuity sales. The guidance will not have a significant impact on the Company's revenue recognition for these key in-scope revenue sources. The Company adopted this amendment effective January 1, 2018, under the modified retrospective approach.

In January 2016, the FASB amended the Financial Instruments – Overall topic of the FASB ASC. The amendment addresses several aspects of recognition, measurement, presentation and disclosure of financial instruments. Included are: (a) a requirement to measure equity investments at fair value, with changes in fair value recognized in net income, (b) a simplification of the impairment assessment of equity investments without readily determinable fair values, (c) the elimination of the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet, and (d) a requirement to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Since the Company does not own any equity securities subject to the amendment in its investment portfolio, the amendment will not have a material impact on its consolidated financial statements. The Company will continue to evaluate the effects that the use of exit prices will have on its fair value disclosures. The amendment is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years.

In February 2016, the FASB amended the Leases topic of the FASB ASC. The primary effects of the amendment will be to recognize lease assets and lease liabilities on the balance sheet and to disclose certain information about leasing arrangements. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company has several lease agreements for branch locations and equipment that will require recognition on the consolidated balance sheets upon adoption of the amendment. The Company will continue to evaluate the effects that the adoption of this amendment will have on its consolidated financial statements.

In March 2016, the FASB amended the Compensation – Stock Compensation topic of the FASB ASC. The amendment includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of the amendment require companies to record all excess tax benefits and tax deficiencies as income tax benefit or expense in the income statement rather than as an adjustment to additional paid-in capital. In addition, the amendment requires that excess

tax benefits should be reported as an operating activity on the statement of cash flows and increases the amount an employer can withhold for taxes for share-based compensation awards. The amendment is effective for annual periods beginning after December 15, 2016. The Company adopted this amendment effective January 1, 2017. The adoption of this amendment has resulted in increased volatility to income tax expense related to excess tax benefits and tax deficiencies for share-based compensation. The amount of tax benefits or deficiencies recognized in income tax expense depends on the number of options exercised and the difference in the stock prices at the exercise and grant dates. For the year ended December 31, 2017, the Company recognized in earnings \$1.0 million of tax benefits related to the exercise of stock options.

In June 2016, the FASB amended various sections of the FASB ASC related to the accounting for credit losses on financial instruments. The amendment changes the threshold for recognizing losses from a “probable” to an “expected” model. The new model is referred to as the current expected credit loss model

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and applies to loans, leases, held-to-maturity investments, loan commitments and financial guarantees. The amendment requires the measurement of all expected credit losses for financial assets as of the reporting date (including historical experience, current conditions and reasonable and supportable forecasts) and enhanced disclosures that will help financial statement users understand the estimates and judgments used in estimating credit losses and evaluating the credit quality of an organization's portfolio. The amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company will apply the amendment's provisions as a cumulative-effect adjustment to retained earnings at the beginning of the first period the amendment is effective. The Company is currently evaluating the effects that the adoption of this amendment will have on its consolidated financial statements by gathering the information that is necessary to make the calculations required by the amendment. This may result in increased credit losses on financial instruments recorded in the consolidated financial statements.

In March 2017, the FASB amended the Compensation – Retirement Benefits topic of the FASB ASC. The amendment requires the service cost component of net benefit cost to be reported in the same line item as other compensation costs arising from employee services. It also requires the other components of net benefit cost to be reported in the income statement separately from the service cost component. The amendment is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The Company does not expect the adoption of this amendment to have a material effect on its consolidated financial statements.

In February 2018, the FASB amended the Income Statement – Reporting Comprehensive Income topic of the FASB ASC. Existing accounting standards require that the tax effects of tax rate changes on deferred taxes be recorded in current income. Deferred taxes previously included in accumulated other comprehensive income are not allowed to be adjusted and may not reflect current tax rates. This amendment allows the reclassification from accumulated other comprehensive income to retained earnings the tax effects resulting from the Tax Cuts and Jobs Act passed in December 2017. The amendment is effective for fiscal years beginning after December 15, 2018, with early adoption permitted in any period for which financial statements have not yet been issued. The Company expects to adopt this amendment during the first quarter of 2018 with the reclassification of \$1.1 million of deferred taxes between accumulated other comprehensive income and retained earnings.

(3)Cash and Cash Equivalents

The table below presents the balances of cash and cash equivalents:

(Dollars in thousands)	December 31,	
	2017	2016
Cash and due from banks	\$ 9,114	\$ 9,043

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Interest-earning deposits in other banks	22,975	52,230
Cash and cash equivalents	\$ 32,089	\$ 61,273

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

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(4)Investment Securities

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

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Value
December 31, 2017:				
Available-for-sale:				
U.S. government-sponsored mortgage-backed securities				