UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2009

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)

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

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

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.

(1) YES x NO ¨

(2) YES x NO ¨

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

Indicate by 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. x

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

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

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

There was no outstanding voting common equity of the Registrant as of June 30, 2009. The aggregate value of the voting common equity held by non-affiliates of the Registrant, computed by reference to the closing price of the Registrant s shares of common stock as of July 13, 2009 ($14.99) was $179.01 million.

As of March 15, 2010, there were 12,233,125 shares outstanding of the Registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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FORWARD LOOKING STATEMENTS

This Annual Report contains forward-looking statements, which can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, seek, expect, will, may and words of similar meaning. These forward-looking statements include, but are not 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. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Annual Report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market areas, that are worse than expected;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- adverse changes in the securities markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities, if any;
- changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;

changes in our organization, compensation and benefit plans;

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- the timing and amount of revenues that we may recognize;
- the value and marketability of collateral underlying our loan portfolios;
- the impact of current governmental efforts to restructure the U.S. financial and regulatory system;
- the quality and composition of our investment portfolio;
- 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.

PART I

ITEM 1. Business

Territorial Bancorp Inc.

Territorial Bancorp Inc. is a Maryland corporation and owns 100% of the common stock of Territorial Savings Bank. On July 10, 2009, we completed our initial public offering of common stock in connection with the mutual-to-stock conversion of Territorial Mutual Holding Company, selling 12,233,125 shares of common stock at $10.00 per share and raising $122.3 million of gross proceeds. 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. At December 31, 2009, we had consolidated assets of $1.390 billion, consolidated deposits of $1.015 billion and consolidated stockholders equity of $219.7 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 federally 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 25 banking offices located throughout the State of Hawaii.

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 respective reports are on file and a matter of public record with the Securities and Exchange Commission and may be read and copied at the Securities and

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Exchange Commission s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. 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).

Our website address is www.territorialsavings.net. Information on our website should not be considered a part of this annual report.

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 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 non-residential 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 our operations from our operations center and from our 25 full-service branch offices located throughout the State of Hawaii.

The two largest components of Hawaii s economy are tourism and the federal government, including the military. The State of Hawaii has been striving to diversify the state s economy by attracting more high-technology businesses to the state. The Hawaii Department of Business, Economic Development and Tourism reported a 2.6% increase in tourists for the month of December 2009 compared to the month of December 2008, and a decline of 4.1% in the number of tourists for the first 11 months of 2009 versus the same time period in 2008. Some of the largest individual private employers in the state include a staffing company, financial services companies, the University of Hawaii System of higher education and research and health services companies.

The population in the State of Hawaii grew at an annualized rate of 1.0% from 2000 to 2009, compared to an annualized growth rate of 1.2% for the United States as a whole over the same time period. Median household income increased to $61,537 in 2009, representing an annualized growth rate of 3.1% from 2000, compared to median household income of $54,719 in 2009 for the United States as a whole, and an annualized growth rate of 3.8% from 2000. The unemployment rate for the State of Hawaii was 6.5% as of December 2009, representing an increase from a rate of 5.1% as of December 2008. This rate continued to be lower than the unemployment rate for the United States as a whole during the same time period, which increased to 10.0% as of December 2009 from 3.8% from December 2008.

Through December 2009, the Hawaiian real estate market has experienced declining trends similar to the mainland, although sales activity and home prices have not declined as severly compared to the mainland.

On the island of Oahu, the primary real estate market in Hawaii, sales of existing single-family homes totaled 2,658 units for the year ended December 2009, a decrease of 3.0% compared to sales in

2008. The number of condominium sales, a notable portion of the overall housing market, declined by 10.0% in 2009 compared to 2008. The median price paid on Oahu for a single-family home in 2009 was $578,000, a decrease of 7.0% compared to the median price in 2008. The median price paid on Oahu for condominiums in 2009 was $305,000, a decrease of 6.2% compared to the median price in 2008.

On the island of Maui, the second largest real estate market in Hawaii, sales of existing single-family homes totaled 693 units for 2009, a decrease of 23.9% compared to similar sales during 2008. The number of condominium sales increased by 4.3% in 2009 compared to 2008. The median price paid for a single-family home on Maui in 2009 was $493,000, a decrease of 15.0% compared to the median price in 2008. The median price paid on Maui for condominiums in 2009 was $485,900, a 10.0% decrease compared to the median price in 2008.

The slowing Hawaiian economy also resulted in a rise in delinquency and foreclosure rates. For the third quarter of 2009, Hawaii s foreclosure rate of one filing per 185 households was ranked 14th highest in the nation, lower than the national average of one foreclosure for every 136 households. The number of foreclosures has recently increased from an average of approximately 630 foreclosures per month during the first six months of 2009 to 1,534 foreclosures in the month of December 2009. Approximately one in 21 Hawaii homeowners was delinquent in their mortgage payments as of September 2009, which was lower than the national average of one in 16 homeowners that was delinquent.

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, 2009 (the latest date for which information is publicly available), we ranked fifth in deposit market share (out of 11 banks and thrift institutions with offices in Hawaii) in the State of Hawaii, with a 4.31% market share. As of that date, our largest market share was in the County of Honolulu, where we ranked fifth in deposit market share (out of 11 banks and thrift institutions with offices in Hawaii) with a 4.59% 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 non-residential real estate loans, consumer loans, multi-family mortgage loans and commercial business loans.

One- to Four-Family Residential Mortgage Loans. At December 31, 2009, $555.5 million, or 91.3% 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, and to a much more limited extent, of up to 40 years and non-conforming loans with maturities of up to 50 years. There has been little demand for adjustable-rate mortgage loans in our market area.

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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 Office of Federal Housing Enterprise Oversight, which is currently $625,500 for single-family homes located in the State of Hawaii. We also originate loans above this amount, which are referred to as jumbo loans. Our maximum loan amount for these loans is generally $1.0 million. We originate fixed-rate jumbo loans with terms of up to 30 years due to customer preference for fixed-rate loans. 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 will 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, 2009, we originated $17.2 million of one- to four-family residential mortgage loans with loan-to-value ratios in excess of 80%. We currently retain the servicing rights on loans sold to generate fee income, although we expect that we will be selling loans on a servicing-released basis at some point in the year ending December 31, 2010. For the year ended December 31, 2009, we received servicing fees of $333,000. As of December 31, 2009, the principal balance of loans serviced for others totaled $135.6 million.

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 a 100 basis points reduction in points charged in connection with the loan. We will 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 FHA and 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 non-conforming 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 by the borrower s primary residence. 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. The borrower is permitted to draw against the line during the entire term. Our home equity lines of credit are originated with adjustable rates of interest or with fixed rates of interest that convert to adjustable rates of interest after an initial period of up to three years. Our home equity loans are originated with fixed rates of interest and with terms of up to 30 years. Home equity loans and lines of credit are generally underwritten with the same criteria that we use to underwrite one- to four-family residential mortgage loans. 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 75% and 65%, respectively, when combined with the principal balance of the existing mortgage loan. We require appraisals on home equity loans and lines of credit when the aggregate loan amount exceeds 60% of the property s tax assessed value or when the home equity loan or line of credit is $250,000 or greater. At the time we close a home equity loan or line of credit, we record a mortgage to perfect our security interest in the underlying collateral. At December 31, 2009, the outstanding balance of home equity loans totaled $13.4 million, or 2.2% of our total loan portfolio, and the outstanding balance of home equity lines of credit totaled $8.4 million, or 1.4% of our total loan portfolio.

Nonresidential Real Estate Loans. Our non-residential 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 3.4% of our loan portfolio as of December 31, 2009. The commercial real estate properties primarily include owner-occupied light industrial properties. We seek to originate commercial real estate loans with initial principal balances of $1.0 million or less. Loans secured by commercial real estate totaled $9.1 million, or 1.5%, of our total loan portfolio at December 31, 2009, and consisted of 14 loans outstanding with an average loan balance of approximately $652,000, although we originate loans with balances greater than this average. All of our nonresidential real estate loans are secured by properties located in our primary market area. At December 31, 2009, our largest commercial real estate loan had a principal balance of $1.7 million and was secured by real property and a building. This loan was performing in accordance with its terms at December 31, 2009.

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 115%), 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 on the successful operation of the property, as repayment of the loan generally is dependent, 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 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 financing following the completion of construction. At December 31, 2009, construction loans totaled $5.3 million, or 0.9% of total loans receivable. At December 31, 2009, the additional unadvanced portion of these construction loans totaled $4.1 million.

Advances on construction loans are made in accordance with a schedule reflecting the cost of construction, but are generally limited to an 80% loan-to-completed-appraised-value ratio. Repayment of construction loans on residential properties is normally expected from the sale of units to individual purchasers. In the case of income-producing property, repayment is usually expected from permanent financing upon completion of construction. We typically provide the permanent mortgage financing on our construction loans on income-producing property.

Before making a commitment to fund a construction loan, we require an appraisal of the property by a licensed appraiser. We review and inspect properties before disbursement of funds during the term of the construction loan.

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. 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, Participations 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-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.

Historically, we have retained the servicing rights on residential mortgage loans we sell, although we expect that we will be selling loans on a servicing-released basis at some point in the year ending December 31, 2010. In 2007, in an effort to manage interest rate risk, we sold $43.0 million of fixed-rate loans with terms of 10, 15 and 20 years that we had been holding in our portfolio. In addition, we are authorized to sell loans as originated to assist us in managing interest rate risk. We sold $85.2 million and $1.4 million of residential mortgage loans (all fixed-rate loans, with terms of 10 years or longer) during the years ended December 31, 2009 and 2008. We had four loans totaling $1.1 million classified as held for sale at December 31, 2009.

We sell our loans without recourse, except for normal representations and warranties provided in sales transactions. Historically, we have retained the servicing rights on residential mortgage loans that we sell. At December 31, 2009, we were servicing loans owned by others with a principal balance of $135.6 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. We have not entered into loan participations in recent years.

Loan Approval Procedures and Authority. Our lending activities follow written, non-discriminatory 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 $2.0 million can be approved by designated individual officers or officers acting together with specific lending approval authority. Relationships in excess of $2.0 million require the approval of the Board of Directors.

Territorial Savings Bank also uses automated underwriting systems to review one- to four-family residential mortgage loans. We require appraisals of all real property securing one- to four-family residential real estate loans, and on property securing home equity lines of credit when the aggregate loan amount exceeds 60% of the property s tax assessed value or when the line of credit is $250,000 or greater. 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 the same members as our Asset/Liability Management Committee. 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 Treasurer 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 Bank of Seattle. We purchased stock in the Federal Home Loan Bank of Seattle in order to obtain services such as demand deposit accounts, certificates of deposit, security safekeeping services and borrowings in the form of advances.

Our current investment policy does not permit investment in stripped mortgage-backed securities, complex securities and derivatives as defined in federal banking regulations and other high-risk securities. As of December 31, 2009, we held no asset-backed securities other than mortgage-backed securities. As a federal savings bank, Territorial Savings Bank is not permitted to invest in equity securities. This general restriction does not apply to Territorial Bancorp Inc.

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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.

The Investments Debt and Equity Securities topic of the 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. Securities available-for-sale and trading securities are reported at market value and securities held to maturity 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 current 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 its fair market value. The difference between the write down and the credit loss is considered other comprehensive loss, which is a reduction of net worth.

Our securities portfolio at December 31, 2009, consisted primarily of securities with the following amortized cost: $419.8 million of mortgage-backed securities, $175.1 million of collateralized mortgage obligations and $3.5 million of trust preferred securities, all of which were issued by pools of issuers consisting primarily of financial institution holding companies. All of our mortgage-backed securities and collateralized mortgage obligations were issued by Ginnie Mae, Freddie Mac or Fannie Mae. At December 31, 2009, all of such securities were classified as held to maturity. At December 31, 2009, 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. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Balance Sheet Analysis Securities for a discussion of the recent performance of our securities portfolio. The fair values of our securities, which, at December 31, 2009, consisted primarily of mortgage-backed securities, are based on published or securities dealers market values.

We purchase mortgage-backed securities insured or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Historically, we invested in mortgage-backed securities to achieve positive interest rate spreads with minimal administrative expense and to lower our credit risk as a result of the guarantees provided by Freddie Mac, Fannie Mae or Ginnie Mae. However, in September 2008, the Federal Housing Finance Agency placed Freddie Mac and Fannie Mae into conservatorship. The U.S. Treasury Department has established financing agreements to ensure that Freddie Mac and Fannie Mae meet their obligations to holders of mortgage-backed securities that they have issued or guaranteed. These actions have not affected the markets for mortgage-backed securities issued by Freddie Mac or Fannie Mae.

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 multifamily mortgages, although we invest primarily in mortgage-backed securities backed by one- to four-family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as Territorial Savings Bank. The interest rate of the security is lower than the interest rates of the underlying loans to allow for payment of servicing and guaranty fees. Ginnie Mae, a United States Government agency, and government sponsored enterprises, such as Fannie Mae and Freddie Mac, either guarantee the payments

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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. Current prepayment speeds determine whether prepayment estimates require modification that could cause amortization or accretion adjustments.

Sources of Funds

General. Deposits traditionally have been our primary source of funds for our investment and lending activities. We also borrow from the Federal Home Loan Bank of Seattle and from securities dealers 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 scheduled loan payments, maturing investments, loan repayments, retained earnings, income on other earning assets and the proceeds of loan sales.

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. 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.

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 and market interest rates, liquidity requirements and our deposit growth goals.

Borrowings. Our borrowings consist of advances from the Federal Home Loan Bank of Seattle and funds borrowed from securities dealers under repurchase agreements. At December 31, 2009, our repurchase agreements totaled $130.2 million, or 11.1% of total liabilities, and there were no outstanding Federal Home Loan Bank advances. At December 31, 2009, we had access to additional Federal Home Loan Bank advances of up to $339.1 million. Advances from the Federal Home Loan Bank of Seattle are secured by our investment in the common stock of the Federal Home Loan Bank of Seattle as well as by a blanket pledge on our assets not otherwise pledged. Repurchase agreements are secured by mortgage-backed securities.

Subsidiary Activities

Territorial Savings Bank owns 100% of the common stock of Territorial Holdings, Inc., a Hawaii corporation, which in turn owns 100% of the voting common stock of Territorial Realty, Inc. Territorial Realty, Inc. is a Hawaii real estate investment trust that holds mortgage loans and mortgage-backed securities. These entities enable Territorial Savings Bank to segregate certain assets for management purposes, and promote Territorial Savings Bank s ability to raise regulatory capital in the future through the sale of preferred stock or other capital-enhancing securities by these entities. At December 31, 2009, Territorial Savings Bank s investment in Territorial Holdings, Inc. was $480.3 million, and Territorial Holdings, Inc. had assets of $480.4 million at that date. At December 31, 2009, Territorial Holdings, Inc. s investment in Territorial Realty, Inc. was $480.3 million, and Territorial Realty, Inc. had $480.5 million in assets at that date.

Territorial Savings Bank owns 100% of the common stock of Territorial Financial Services, Inc., a Hawaii corporation that engages primarily in insurance activities. At December 31, 2009, Territorial Savings Bank s investment in Territorial Financial Services, Inc. was $12,000, and Territorial Financial Services, Inc. had assets of $59,000 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 troubled real estate.

Personnel

As of December 31, 2009, we had 250 full-time employees and 11 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.

Method of Accounting. For federal income tax purposes, Territorial Savings Bank 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. The Small Business Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings institutions, effective for taxable years beginning after 1995.

Minimum Tax. The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, referred to as alternative minimum taxable income. The alternative minimum tax is payable to the extent alternative minimum taxable income is in excess of an exemption amount. Net operating losses can, in general, offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. At December 31, 2009, Territorial Savings Bank had no alternative minimum tax credit carryforward.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. However, as a result of recent legislation, subject to certain limitations, the carryback period for net operating losses incurred in 2008 or 2009 (but not both years) has been expanded to five years. At December 31, 2009, Territorial Savings Bank had no net operating loss carryforward 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 Savings Bank s federal income tax returns have not been audited in the most recent five-year period.

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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.

SUPERVISION AND REGULATION

General

Territorial Savings Bank is examined and supervised by the Office of Thrift Supervision and is subject to examination by the Federal Deposit Insurance Corporation. 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 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. Territorial Savings Bank also is regulated to a lesser extent by the Board of Governors of the Federal Reserve System, or Federal Reserve Board, governing reserves to be maintained against deposits and other matters. The Office of Thrift Supervision examines Territorial Savings Bank and prepares reports for the consideration of its 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 Federal Deposit Insurance Corporation, the Office of Thrift Supervision or Congress, could have a material adverse impact on Territorial Bancorp Inc., Territorial Savings Bank and their operations.

Territorial Bancorp Inc., as a savings and loan holding company, is required to file certain reports with, is subject to examination by, and otherwise must comply with the rules and regulations of the Office of Thrift Supervision. Territorial Bancorp Inc. is also subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Certain of the 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.

Proposed Federal Legislation

Legislation has been proposed that would implement sweeping changes to the current bank regulatory structure, including eliminating our current primary federal regulator, the Office of Thrift Supervision, by merging the Office of Thrift Supervision into the Comptroller of the Currency (the primary federal regulator for national banks). The proposed legislation would also establish a Financial Services Oversight Council and grant the Board of Governors of the Federal Reserve System exclusive authority to regulate all bank and thrift holding companies. As a result, Territorial Bancorp Inc. would become a holding company subject to supervision by the Federal Reserve Board as opposed to the Office of Thrift Supervision, and would become subject to the Federal Reserve s regulations, including holding company capital requirements, that Territorial Bancorp Inc. would not be subject to as a savings and loan holding company. In addition, compliance with new regulations and being supervised by one or more new regulatory agencies could increase our expenses.

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Federal Banking Regulation

Business Activities. A federal savings bank derives its lending and investment powers from the Home Owners Loan Act, as amended, and the regulations of the Office of Thrift Supervision. Under these laws and regulations, Territorial Savings Bank may invest in mortgage loans secured by residential and commercial real estate, commercial business and consumer loans, certain types of debt securities and certain other assets, subject to applicable limits. Territorial Savings Bank also may establish subsidiaries that may engage in activities not otherwise permissible for Territorial Savings Bank, including real estate investment and securities and insurance brokerage.

Capital Requirements. Office of Thrift Supervision regulations require savings banks to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for savings banks receiving the highest rating on the CAMELS rating system) and an 8% risk-based capital ratio.

The risk-based capital standard for savings banks requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the Office of Thrift Supervision, based on the risks believed inherent in the type of asset. Core capital is defined as common stockholders equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings bank that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the recourse back to the savings bank. In assessing an institution s capital adequacy, the Office of Thrift Supervision takes into consideration not only these numeric factors but also qualitative factors as well, and has the authority to establish higher capital requirements for individual associations where necessary.

At December 31, 2009, Territorial Savings Bank s capital exceeded all applicable requirements.

Loans-to-One Borrower. Generally, a federal savings bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2009, Territorial Savings Bank s largest lending relationship with a single or related group of borrowers totaled $3.3 million, which represented 1.5% of unimpaired capital and surplus. Therefore, Territorial Savings Bank was in compliance with the loans-to-one borrower limitations.

Qualified Thrift Lender Test. As a federal savings bank, Territorial Savings Bank must satisfy the qualified thrift lender, or QTL, test. Under the QTL test, Territorial Savings Bank must maintain at least 65% of its portfolio assets in qualified thrift investments (primarily residential mortgages and related investments, including mortgage-backed securities) in at least nine months of the most recent 12-month period. Portfolio assets generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings bank s business.

Territorial Savings Bank also may satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code.

A savings bank that fails the qualified thrift lender test must either convert to a commercial bank charter or operate under specified restrictions set forth in the Home Owners Loan Act. At December 31, 2009, Territorial Savings Bank maintained approximately 95.1% of its portfolio assets in qualified thrift investments and, therefore, satisfied the QTL test.

Capital Distributions. Office of Thrift Supervision regulations govern capital distributions by a federal savings bank, which include cash dividends, stock repurchases and other transactions charged to the savings bank s capital account. A savings bank must file an application for approval of a capital distribution if:

- the total capital distributions for the applicable calendar year exceed the sum of the savings bank s net income for that year to date plus the savings bank s retained net income for the preceding two years;
- the savings bank would not be at least adequately capitalized following the distribution;
- the distribution would violate any applicable statute, regulation, agreement or Office of Thrift Supervision-imposed condition; or
- the savings bank is not eligible for expedited treatment of its filings.

Even if an application is not otherwise required, every savings bank that is a subsidiary of a holding company must still file a notice with the Office of Thrift Supervision at least 30 days before the Board of Directors declares a dividend or approves a capital distribution.

The Office of Thrift Supervision may disapprove a notice or application if:

- the savings bank would be undercapitalized following the distribution;
- the proposed capital distribution raises safety and soundness concerns; or
- the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

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.

Liquidity. A federal savings bank is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation. Our primary source of liquidity to meet our short- and long-term funding needs are cash balances at the Federal Reserve Bank, savings deposits, loan repayments, reverse repurchase agreements with security dealers and borrowing lines at the Federal Home Loan Bank of Seattle. At December 31, 2009, we had $136.0 million of cash and cash equivalents which primarily represents the proceeds from our stock offering. We also had the capacity to borrow up to $339.1 million from the Federal Home Loan Bank of Seattle at December 31, 2009.

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Community Reinvestment Act and Fair Lending Laws. All savings banks have a responsibility under the Community Reinvestment Act and related regulations of the Office of Thrift Supervision to help meet the credit needs of their communities, including low- and moderate-income borrowers. In connection with its examination of a federal savings bank, the Office of Thrift Supervision 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 Office of Thrift Supervision, as well as other federal regulatory agencies and the Department of Justice. Territorial Savings Bank received a satisfactory Community Reinvestment Act rating in its most recent federal examination. The Community Reinvestment Act requires all Federal Deposit Insurance-insured institutions to publicly disclose their rating.

Transactions with Related Parties. A federal savings bank s authority to engage in transactions with its affiliates is limited by Office of Thrift Supervision regulations and by Sections 23A and 23B of the Federal Reserve Act and its implementing Regulation W promulgated by the Board of Governors of the Federal Reserve System. An affiliate is generally a company that controls, is controlled by, or is under common control with an insured depository institution such as Territorial Savings Bank. Territorial Bancorp Inc. is an affiliate of Territorial Savings Bank. In general, transactions between an insured depository institution and its affiliates are subject to certain quantitative and collateral requirements. In addition, Office of Thrift Supervision regulations prohibit a savings bank from lending to any of its affiliates that are engaged in activities that are not permissible for bank holding companies and from purchasing the securities of any affiliate, other than a subsidiary. Finally, transactions with affiliates must be consistent with safe and sound banking practices, not involve low-quality assets and be on terms that are as favorable to the institution as comparable transactions with non-affiliates. The Office of Thrift Supervision requires savings banks to maintain detailed records of all transactions with affiliates.

Territorial Savings Bank s authority to extend credit to its directors, executive officers and 10% stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, these provisions require that extensions of credit to insiders:

(i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features, and

(ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Territorial Savings Bank s capital.

In addition, extensions of credit in excess of certain limits must be approved by Territorial Savings Bank s Board of Directors.

Enforcement. The Office of Thrift Supervision has primary enforcement responsibility over federal savings institutions and has the authority to bring enforcement action against all institution-affiliated parties, including directors, officers, stockholders, attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action by the Office of Thrift Supervision may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors of the institution, and the appointment of a receiver or conservator. Civil penalties cover a wide range of violations and actions, and range up to $25,000 per day, unless a finding of reckless disregard is made, in which case penalties may be as high as $1 million per day. The Federal Deposit Insurance Corporation also has the authority to terminate deposit insurance or to recommend to the Director of the Office of Thrift Supervision that enforcement action be taken with respect to a particular savings institution. If action is not taken by the Director, the Federal Deposit Insurance Corporation has authority to take action under specified circumstances.

Standards for Safety and Soundness. Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. Interagency guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to implement an acceptable compliance plan. Failure to implement such a plan can result in further enforcement action, including the issuance of a cease and desist order or the imposition of civil money penalties.

Prompt Corrective Action Regulations. Under prompt corrective action regulations, the Office of Thrift Supervision is authorized and, under certain circumstances, required to take supervisory actions against undercapitalized savings banks. For this purpose, a savings bank is placed in one of the following five categories based on the savings bank s capital:

- well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);
- adequately capitalized (at least 4% leverage capital (3% for savings banks with a composite examination rating of 1), 4% Tier 1 risk-based capital and 8% total risk-based capital);
- undercapitalized (less than 4% leverage capital (3% for savings banks with a composite examination rating of 1), 4% Tier 1 risk-based capital or 8% total risk-based capital);
- significantly undercapitalized (less than 3% leverage capital, 3% Tier 1 risk-based capital or 6% total risk-based capital); and
- critically undercapitalized (less than 2% tangible capital).

Generally, the Office of Thrift Supervision is required to appoint a receiver or conservator for a savings bank that is critically undercapitalized within specific time frames. The regulations also provide that a capital restoration plan must be filed with the Office of Thrift Supervision within 45 days of the date a savings bank receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Any holding company for the savings bank required to submit a capital restoration plan must guarantee the lesser of an amount equal to 5% of the savings bank s assets at the

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time it was notified or deemed to be undercapitalized by the Office of Thrift Supervision, or the amount necessary to restore the savings bank to adequately capitalized status. This guarantee remains in place until the Office of Thrift Supervision notifies the savings bank that it has maintained adequately capitalized status for each of four consecutive calendar quarters, and the Office of Thrift Supervision has the authority to require payment and collect payment under the guarantee. Failure by a holding company to provide the required guarantee will result in certain operating restrictions on the savings bank, such as restrictions on the ability to declare and pay dividends, pay executive compensation and management fees, and increase assets or expand operations. The Office of Thrift Supervision may also take any one of a number of discretionary supervisory actions against undercapitalized associations, including the issuance of a capital directive and the replacement of senior executive officers and directors.

At December 31, 2009, Territorial Savings Bank met the criteria for being considered well-capitalized.

Insurance of Deposit Accounts. In October 2008, deposit insurance by the Federal Deposit Insurance Corporation was increased to a maximum of $250,000 per depositor. On January 1, 2014, the maximum insurance amount will return to $100,000 per depositor for all deposit accounts except certain retirement accounts, which will remain at $250,000 per depositor. In addition, under the Federal Deposit Insurance Corporation s Transaction Account Guarantee Program, most of our non-interest-bearing transaction accounts are guaranteed regardless of amount until June 30, 2010.

Pursuant to the Federal Deposit Insurance Reform Act of 2005 (the Reform Act), the Federal Deposit Insurance Corporation is authorized to set the reserve ratio for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. As of June 30, 2008, the reserve ratio had decreased to 1.01% as a result of bank failures. As part of a plan to restore the reserve ratio to 1.15%, the Federal Deposit Insurance Corporation imposed a special assessment equal to five basis points of assets less Tier 1 capital as of June 30, 2009, which was payable on September 30, 2009. In addition, the Federal Deposit Insurance Corporation has increased its quarterly deposit insurance assessment rates and amended the method by which rates are calculated. Beginning in the second quarter of 2009, institutions are assigned an initial base assessment rate ranging from 12 to 45 basis points of deposits depending on risk category. The initial base assessment is then adjusted based upon the level of unsecured debt, secured liabilities, and brokered deposits to establish a total base assessment rate ranging from seven to 77.5 basis points.

On November 12, 2009, the Federal Deposit Insurance Corporation approved a final rule requiring insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. Estimated assessments for the fourth quarter of 2009 and for all of 2010 are based upon the assessment rate in effect on September 30, 2009, with three basis points added for the 2011 and 2012 assessment rates. In addition, a 5% annual growth in the assessment base is assumed. Prepaid assessments are to be applied against the actual quarterly assessments until exhausted, and may not be applied to any special assessments that may occur in the future. Any unused prepayments will be returned to the institution on June 30, 2013. On December 30, 2009, we prepaid $4.3 million in estimated assessment fees for the fourth quarter of 2009 through 2012. Because the prepaid assessments represent the prepayment of future expense, they do not affect our regulatory capital (the prepaid asset will have a risk-weighting of 0%) or tax obligations.

Insurance of deposits may be terminated by the FDIC upon a finding that an institution has engaged in unsafe or unsound business practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

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We do not currently know of any practice, condition or violation that might lead to termination of our deposit insurance.

Besides the FDIC assessments, the Financing Corporation (FICO) is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended December 31, 2009, the annualized FICO assessment was equal to 1.06 basis points for each $100 in domestic deposits maintained at an institution.

Temporary Liquidity Guarantee Program. On October 14, 2008, the Federal Deposit Insurance Corporation announced a new program the Temporary Liquidity Guarantee Program. This program has two components. One guarantees newly issued senior unsecured debt of a participating organization, up to certain limits established for each institution, issued between October 14, 2008 and June 30, 2009. The guarantee will remain in effect until June 30, 2012. We opted not to participate in this component of the Temporary Liquidity Guarantee Program.

The remaining applicable component of the program provides full federal deposit insurance coverage for non-interest bearing transaction deposit accounts, regardless of dollar amount, until June 30, 2010. An annualized 10 basis point assessment on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of $250,000 will be assessed on a quarterly basis to insured depository institutions that have not opted out of this component of the Temporary Liquidity Guarantee Program. We opted to participate in this component of the Temporary Liquidity Guarantee Program.

U.S. Treasury s Troubled Asset Relief Program Capital Purchase Program. The Emergency Economic Stabilization Act of 2008 was enacted to provide the U.S. Secretary of the Treasury with broad authority to implement certain actions to help restore stability and liquidity to U.S. markets. One of the provisions resulting from the legislation is the Troubled Asset Relief Program Capital Purchase Program (CPP), which provides direct equity investment in perpetual preferred stock by the U.S. Treasury Department in qualified financial institutions. Participation in the program is not automatic and is subject to approval by the U.S. Treasury Department. We opted not to participate in the CPP.

Prohibitions Against Tying Arrangements. Federal savings banks are prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

Federal Home Loan Bank System. Territorial Savings Bank is a member of the Federal Home Loan Bank System, which consists of twelve regional Federal Home Loan Banks. The Federal Home Loan Bank 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 Federal Home Loan Bank of Seattle, Territorial Savings Bank is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of December 31, 2009, Territorial Savings Bank held $12.3 million of capital stock in the Federal Home Loan Bank of Seattle and was in compliance with this requirement.

Overdraft fees. New restrictions mandated by the Federal Reserve Board under Regulation E are currently set to take effect on July 1, 2010. These restrictions will ban overdraft fees on ATM withdrawals or signature debit transactions unless consumers voluntarily opt in for overdraft protection.

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We are currently assessing the impact of the new regulation on future earnings. However, we expect compliance with this new regulation to reduce our non-interest income.

Other Regulations

Interest and other charges collected or contracted for by Territorial Savings Bank are subject to state usury laws and federal laws concerning interest rates. 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 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 also are subject to the:

- 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;

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The USA PATRIOT Act, which requires savings banks 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 non-diversified savings and loan holding company within the meaning of the Home Owners Loan Act. As such, Territorial Bancorp Inc. is registered with the Office of Thrift Supervision and subject to Office of Thrift Supervision regulations, examinations, supervision and reporting requirements. In addition, the Office of Thrift Supervision has enforcement authority over Territorial Bancorp Inc. and its subsidiaries. Among other things, this authority permits the Office of Thrift Supervision to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. Unlike bank holding companies, federal savings and loan holding companies are not subject to any regulatory capital requirements or to supervision by the Federal Reserve Board.

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. 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 Office of Thrift Supervision, and certain additional activities authorized by Office of Thrift Supervision regulations.

Federal law prohibits a savings and loan holding company, including Territorial Bancorp Inc., directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of another savings institution or holding company thereof, without prior written approval of the Office of Thrift Supervision. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary company engaged in activities that are not closely related to banking or financial in nature, or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Office of Thrift Supervision must consider the financial and managerial resources, 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 Office of Thrift Supervision 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.

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 or 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.

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. As directed by the Sarbanes-Oxley Act, our Chief Executive Officer and Chief Financial Officer will be required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting. We will be subject to further reporting and audit requirements beginning with the year ending December 31, 2010 under the requirements of the Sarbanes-Oxley Act. We will prepare policies, procedures and systems designed to ensure compliance with these 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 a longer period of time. Additionally, many of our securities investments are of longer 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, 2009, 88.2% of our loans had maturities of 15 years or longer, while 81.6% 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, may not increase as rapidly as the interest paid on our liabilities, such as deposits. In a period of declining interest rates, the interest income earned on our assets may decrease more rapidly than the interest paid on our liabilities, as borrowers prepay mortgage loans, and mortgage-backed securities and callable investment securities are called or prepaid, 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. A reduction in interest rates results in increased prepayments of loans and mortgage-backed and related securities, as borrowers refinance their debt 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 decrease loan demand and/or make it more difficult for borrowers to repay adjustable-rate loans.

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, 2009, the fair value of our investment and mortgage-backed securities, all classified as held to maturity, totaled $606.3 million. Net unrealized gains on these securities totaled $7.9 million at December 31, 2009.

At December 31, 2009, the Office of Thrift Supervision rate shock analysis indicated that our net portfolio value (the difference between the present value of our assets and the present value of our liabilities) would decrease by $77.6 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.

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, 2009, these loans totaled $555.5 million, or 91.3% of total loans as of that date. We originate our loans with a focus on limiting credit risk and not to generate the highest return or create the greatest difference between our cost of funds and the yield on our interest-earning assets (interest rate spread). We intend to continue our focus on residential real estate lending.

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.

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We could record future losses on our holdings of trust preferred securities that we purchased from issuer pools consisting primarily of financial institution holding companies. In addition, we may not receive full future interest payments on these securities.

We own shares of trust preferred securities with an adjusted cost basis of $3.5 million, and a fair value of $100,000 at December 31, 2009. The trust preferred securities are debt obligations issued by two issuer pools (Preferred Term Securities XXIII, Ltd. co-marketed by Keefe, Bruyette & Woods, Inc. and FTN Financial Capital Markets (PreTSL XXIII) and Preferred Term Securities XXIV, Ltd. co-marketed by Keefe, Bruyette & Woods, Inc. and FTN Financial Capital Markets (PreTSL XXIV)), consisting primarily of holding companies for Federal Deposit Insurance Corporation-insured financial institutions. Each of these securities is a Class D security, and was originated with a credit rating of BBB. As of December 31, 2009, PreTSL XXIII and PreTSL XXIV were rated CC and C, respectively. PreTSL XXIII s credit rating was downgraded to C on February 12, 2010. We recognized a pre-tax loss for other-than-temporary impairment of $2.5 million on PreTSL XXIV for the year ended December 31, 2008. In addition, effective January 1, 2009, the cumulative effect of our adoption of revisions to the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) resulted in the reclassification of $1.5 million of securities impairment from retained earnings to accumulated other comprehensive loss. In subsequent quarters, we determined that PreTSL XXIV was other-than-temporarily impaired and recorded an additional impairment charge of $1.0 million in 2009, of which $3.5 million was a credit loss recorded through our income statement as a charge to non-interest income, and $2.5 million was recorded as a decrease to other comprehensive loss. The $3.5 million impairment charge for 2009 includes the $2.5 million that was previously reflected as a charge against income in the last quarter of 2008, but due to revisions in accounting pronouncements, the Company was required to once again charge income in the amount of $2.5 million for the year ended December 31, 2009 for the same security. Our investment in PreTSL XXIII is not other-than-temporarily impaired because we will not more likely than not be required to sell this security before recovering the amortized cost basis of $3.5 million.

The following table sets forth information with respect to these securities as of December 31, 2009.

Pool Deal Name	Book Value	Fair Value	Unrealized Gain (Loss)	Credit Rating	Number of Financial Institutions in Pool	Deferrals and Defaults as a % of Collateral	Excess Subordination (1)
		(Dollars in Thousands)					
PreTSL XXIII	$ 3,542	$ 100	$ (3,442)	CC	117	22.6%	$ 81,000
PreTSL XXIV	$ 0	$ 0	$ 0	C	83	29.4%	$ 0

(1) Estimated present value of future cash flows in excess of amortized cost basis, assuming that 50% of the security collateral is called in the 10^{th} year following issuance.

A number of factors or combinations of factors could cause us to conclude in one or more future reporting periods that an unrealized loss that exists with respect to PreTSL XXIII constitutes an impairment that is other than temporary, which could result in material losses to us. These factors include, but are not limited to, continued failure to make scheduled interest payments, an increase in the severity of the unrealized loss on a particular security, an increase in the continuous duration of the unrealized loss without an improvement in value or changes in market conditions and/or industry or issuer specific factors that would render us unable to forecast a full recovery in value. In addition, the fair value of PreTSL XXIII could decline if the overall economy and the financial condition of some of the issuers continue to deteriorate and there remains limited liquidity for these securities.

For the year ended December 31, 2009, we received no interest payments on the trust preferred securities. The continued failure of the trust preferred issuers to make interest payments for any quarter will reduce our earnings during that quarter.

The United States economy is in a deep recession. A prolonged economic downturn, especially one affecting our geographic market area, would likely adversely affect our business and financial results.

Negative developments in the global credit and securitization markets have resulted in uncertainty in the financial markets during the latter half of 2007 and during 2008 and 2009, with the expectation of the general economic downturn continuing into 2010. Loan portfolio quality has deteriorated at many institutions, reflecting in part, the deteriorating U.S. economy and rising unemployment. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. The continuing real estate slump also has resulted in reduced demand for the construction of new housing and increased delinquencies in construction, residential and commercial mortgage loans. Bank and bank holding company stock prices have declined substantially, and it is significantly more difficult for banks and bank holding companies to raise capital or borrow in the debt markets.

Specifically, the Federal Deposit Insurance Corporation Quarterly Banking Profile has reported that noncurrent assets plus other real estate owned as a percentage of assets for FDIC insured financial institutions rose to 5.37% as of December 31, 2009, compared to 2.97% as of December 31, 2008. For the year ended December 31, 2009, the Federal Deposit Insurance Corporation Quarterly Banking Profile has reported that return on average assets was 0.03% for FDIC insured financial institutions compared to -1.10% for the year ended December 31, 2008. The NASDAQ Bank Index declined 18.50% between December 31, 2008 and December 31, 2009.

Continued negative developments in the financial industry and the domestic and international credit markets, may significantly affect the markets in which we do business, the markets for and value of our loans and investments, and our ongoing operations, costs and profitability. Further, continued declines in the stock market in general, or for stock of financial institutions and their holding companies, could affect our stock performance.

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 response to the developments described above, 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 Office of

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

If our investment in the Federal Home Loan Bank of Seattle is classified as other-than-temporarily impaired or as permanently impaired, our earnings and stockholders equity could decrease.

We own common stock of the Federal Home Loan Bank of Seattle. We hold this stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the Federal Home Loan Bank of Seattle s advance program. The aggregate cost and fair value of our Federal Home Loan Bank of Seattle common stock as of December 31, 2009 was $12.3 million based on its par value. There is no market for our Federal Home Loan Bank of Seattle common stock.

Recent published reports indicate that certain member banks of the Federal Home Loan Bank System may be subject to accounting rules and asset quality risks that could result in materially lower regulatory capital levels. Specifically, in 2009, the Federal Home Loan Bank of Seattle has incurred credit losses on its investment in private-label mortgage-backed securities. These losses have reduced the Federal Home Loan Bank of Seattle s net income and net worth. The Federal Home loan Bank of Seattle has met all of its regulatory capital requirements but its regulator, the Federal Housing Finance Agency, has classified it as undercapitalized because further losses on private-label mortgage-backed securities will reduce capital. In an extreme situation, it is possible that the capital of a Federal Home Loan Bank, including the Federal Home Loan Bank of Seattle, could be substantially diminished or reduced to zero. Consequently, we believe that there is a risk that our investment in Federal Home Loan Bank of Seattle common stock could be impaired at some time in the future, and if this occurs, it would cause our earnings and stockholders equity to decrease by the after-tax amount of the impairment charge.

The Federal Home Loan Bank of Seattle stopped paying dividends during the fourth quarter of 2008. This will negatively affect our earnings.

The Federal Home Loan Bank of Seattle stopped paying dividends during the fourth quarter of 2008, and would be prohibited from paying dividends in the future so long as it fails to meet any of its regulatory capital requirements. The failure of the Federal Home Loan Bank of Seattle to pay dividends for any quarter will reduce our earnings during that quarter.

Non-residential real estate loans increase our exposure to credit risks.

At December 31, 2009, our portfolio of commercial real estate, construction and other non-residential real estate loans totaled $20.8 million, or 3.4% of total loans. These loans generally expose us to a greater risk of non-payment 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 negatively impact these businesses, our results of operations and financial condition may be adversely affected.

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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 and elsewhere. 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 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 0.3% of total loans at December 31, 2009, material additions to our allowance could materially decrease our net income.

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.

Concentration of loans in our primary market area, which has recently experienced an economic downturn, 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 local 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, a significant weakening in general economic conditions such as inflation, recession, unemployment or other factors beyond our control could negatively affect our financial results.

On the island of Oahu, the primary real estate market in Hawaii, sales of existing single-family homes totaled 2,658 units during the year ended December 31, 2009, a decrease of 3.0% compared to similar sales during the year ended December 31, 2008. The number of condominium sales (which was greater than the number of single-family home resales) declined by 10.0% during the year ended December 31, 2009 compared to the year ended December 31, 2008.

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On the island of Maui, the second largest real estate market, sales of existing single-family homes totaled 693 units for 2009, a decrease of 23.9% compared to 2008, while the median price for the year ended December 31, 2009 declined by 15.0% compared to the median price for the year ended December 31, 2008. The number of condominium sales increased by 4.3% between 2008 and 2009.

The slowing Hawaiian economy also resulted in a rise in delinquency and foreclosure rates. The number of foreclosures in the State of Hawaii has recently increased from an average of approximately 630 foreclosure filings per month for the six months ended June 2009 to 1,534 foreclosures during December 2009. Approximately one in twenty-one Hawaii homeowners was delinquent in their mortgage payments as of September 2009.

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

Tourism is one of the two largest components of Hawaii s economy. The Hawaii Department of Business, Economic Development and Tourism reported a 2.6% increase in tourists for the month of December 2009 compared to December 2008. Tourism, however, declined 4.1% when comparing the first 11 months of 2009 to the first 11 months of 2008. Similarly, the unemployment rate in the State of Hawaii increased to 6.5% as of December 2009, compared to 5.1% as of December 2008. Continued downturns 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.

We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.

We are subject to extensive regulation, supervision, and examination by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation. Such regulators govern the activities in which we may engage, primarily for the protection of depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the classification of assets by a bank, and the adequacy of a bank s allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulation, or legislation, could have a material impact on us and our operations. Because our business is highly regulated, the laws, rules and applicable regulations are subject to regular modification and change. There can be no assurance that proposed laws, rules and regulations, or any other laws, rules or regulations, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

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

Because all of our office locations are located in the State of Hawaii, severe weather or natural disasters, such as tsunamis, 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. Accordingly, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could adversely affect our financial condition and results of operations.

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Higher Federal Deposit Insurance Corporation insurance premiums and special assessments will adversely affect our earnings.

On May 22, 2009, the Federal Deposit Insurance Corporation adopted a final rule levying a five basis point special assessment on each insured depository institution s assets minus Tier 1 capital as of June 30, 2009. We recorded an expense of $689,000 during the quarter ended June 30, 2009, to reflect the special assessment. Any further special assessments that the Federal Deposit Insurance Corporation levies will be recorded as an expense during the appropriate period. In addition, the Federal Deposit Insurance Corporation increased the general deposit insurance assessment rate and, therefore, our Federal Deposit Insurance Corporation insurance premium expense will increase compared to prior periods.

The Federal Deposit Insurance Corporation also adopted a rule pursuant to which all insured depository institutions were required to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. The prepayment amount was collected on December 30, 2009. The assessment rate for the fourth quarter of 2009 and for 2010 is based on each institution s total base assessment rate for the third quarter of 2009, modified to assume that the assessment rate in effect on September 30, 2009 had been in effect for the entire third quarter, and the assessment rate for 2011 and 2012 will be equal to the modified third quarter assessment rate plus an additional three basis points. In addition, each institution s base assessment rate for each period will be calculated using its third quarter assessment base, adjusted quarterly for an estimated 5% annual growth rate in the assessment base through the end of 2012. We recorded the pre-payment as a prepaid expense, which will be amortized to expense over three years. Based on our deposits and assessment rate as of September 30, 2009, our prepayment amount was $4.3 million.

Legislative proposals have been introduced that would eliminate the Office of Thrift Supervision, which would require Territorial Bancorp Inc. to become a bank holding company.

Legislation has been proposed that would implement sweeping changes to the current bank regulatory structure, including eliminating our current primary federal regulator, the Office of Thrift Supervision, by merging the Office of Thrift Supervision into the Comptroller of the Currency (the primary federal regulator for national banks). The proposed legislation would also establish a Financial Services Oversight Council and grant the Board of Governors of the Federal Reserve System exclusive authority to regulate all bank and thrift holding companies. As a result, Territorial Bancorp Inc. would become a holding company subject to supervision by the Federal Reserve Board as opposed to the Office of Thrift Supervision, and would become subject to the Federal Reserve s regulations, including holding company capital requirements, that Territorial Bancorp Inc. would not be subject to as a savings and loan holding company. In addition, compliance with new regulations and being supervised by one or more new regulatory agencies could increase our expenses.

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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, there can be no assurance that these security measures will 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.

Our stock value may be negatively affected by federal regulations that restrict takeovers.

For three years following our stock offering, Office of Thrift Supervision regulations prohibit any person from acquiring or offering to acquire more than 10% of our common stock without the prior written approval of the Office of Thrift Supervision.

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.

ITEM 1B. Unresolved Staff Comments

Not applicable.

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ITEM 2. Properties

We operate from our corporate office in Honolulu, Hawaii, and from our 25 full-service branches located in the State of Hawaii. The net book value of our premises, land and equipment was $4.5 million at December 31, 2009. The following table sets forth information with respect to our full-service banking offices, including the expiration date of leases with respect to leased facilities.

ALA MOANA CENTER 1450 Ala Moana Boulevard Honolulu, Oahu 96814 12/31/2017	**KAIMUKI** 1108 12th Avenue Honolulu, Oahu 96816 12/31/2018	**KIHEI** Azeka Shopping Center 1279 South Kihei Road Kihei, Maui 96753 1/31/2019	**PEARLRIDGE** 98-084 Kamehameha Highway Aiea, Oahu 96701 6/30/2012
DOWNTOWN 1000 Bishop Street Honolulu, Oahu 96813 12/31/2015	**KALIHI-KAPALAMA** 1199 Dillingham Boulevard Honolulu, Oahu 96817 8/31/2012	**KONA** Crossroads Shopping Center 75-1027 Henry Street Kailua-Kona, Hawaii 96740 8/31/2015	**SALT LAKE** Salt Lake Shopping Center 848 Ala Lilikoi Street Honolulu, Oahu 96818 1/31/2011
HAWAII KAI Hawaii Kai Shopping Center 377 Keahole Street Honolulu, Oahu 96825 9/30/2013	**KAMEHAMEHA SHOPPING CENTER** 1620 North School Street Honolulu, Oahu 96817 9/30/2015	**LAHAINA** Old Lahaina Center 170 Papalaua Street Lahaina, Maui 96761 3/31/2013	**WAIPAHU** Waipahu Town Center 94-050 Farrington Highway Waipahu, Oahu 96797 12/31/2014
HILO Waiakea Center 315 Makaala Street Hilo, Hawaii 96720 12/31/2018	**KANEOHE** 46-005 Kawa Street Kaneohe, Oahu 96744 12/31/2014	**McCULLY** 1111 McCully Street Honolulu, Oahu 96826 5/31/2013	**WAIPIO** Laniakea Plaza 94-1221 Ka Uka Boulevard Waipahu, Oahu 96797 9/30/2016
KAHALA 4819 Kilauea Avenue Honolulu, Oahu 96816 3/16/2015	**KAPAHULU** Kilohana Square 1016 Kapahulu Avenue Honolulu, Oahu 96816	**MILILANI** Town Center of Mililani 95-1249 Meheula Parkway Mililani, Oahu 96789	

	11/14/2013	10/11/2014
KAHULUI	**KAPOLEI**	**NUUANU**
Kaahumanu Center	Ace Center at Kapolei	Nuuanu Shopping Center
275 W. Kaahumanu Avenue	480 Kamokila Boulevard	1613 Nuuanu Avenue
Kahului, Maui 96732	Kapolei, Oahu 96707	Honolulu, Oahu 96817
12/31/2019	7/31/2014	7/22/2016
KAILUA	**KAUAI**	**PEARL CITY**
19 Oneawa Street	Kukui Grove Shopping Center	Pearl City Shopping Center
Kailua, Oahu 96734	4393 Kukui Grove Street	850 Kamehameha Highway
	Lihue, Kauai 96766	Pearl City, Oahu 96782
	2/28/2013	9/22/2014

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. Except as previously disclosed, at December 31, 2009, we were not involved in any legal proceedings, the outcome of which would be material to our financial condition or results of operations.

ITEM 4. [Reserved]

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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, 2010 was 1,438. 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. The following table presents quarterly market information for Territorial Bancorp Inc. s common stock for the period beginning July 10, 2009 (the date of completion of our initial public offering) and ended December 31, 2009. The following information with respect to trading prices was provided by the NASDAQ Global Select Market.

	High	Low	Dividends Declared
Year Ended December 31, 2009			
Quarter ended December 31, 2009	$ 18.85	$ 15.69	
Quarter ended September 30, 2009	$ 16.23	$ 10.00	

Dividend payments by Territorial Bancorp Inc. are dependent on dividends it receives from Territorial Savings Bank, because Territorial Bancorp Inc. has no source of income other than dividends from Territorial Savings Bank, earnings from the investment of proceeds from the sale of shares of common stock retained by Territorial Bancorp Inc. and interest payments with respect to Territorial Bancorp Inc. s loan to the Employee Stock Ownership Plan. See Item 1. Business Supervision and Regulation Federal Banking Regulation Capital Distributions.

(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.*** Not applicable.

(f) ***Stock Performance Graph.*** Set forth hereunder is a stock performance graph comparing (a) the cumulative total return on our shares of common stock between July 13, 2009 and December 31, 2009, (b) the cumulative total return on stocks included in the Total Return Index for the Nasdaq Stock Market (US) over such period, and (c) the cumulative total return on stocks included in the Nasdaq Bank Index over such period. Cumulative return assumes the reinvestment of dividends, and is expressed in dollars based on an assumed investment of $100.

There can be no assurance that the Company s stock performance will continue in the future with the same or similar trend depicted in the graph. The Company will not make or endorse any predictions as to future stock performance.

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	Period Ending					
	7/13/09	8/31/09	9/30/09	10/31/09	11/30/09	12/31/09
Territorial Bancorp Inc.	100.00	106.67	104.60	110.01	113.28	120.41
SNL Bank and Thrift	100.00	122.92	122.73	113.14	117.32	114.18
NASDAQ Composite	100.00	112.04	118.36	114.05	119.60	126.54

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ITEM 6. Selected Financial Data

The following selected consolidated financial and other data has been derived, in part, from the consolidated financial statements and notes appearing elsewhere in this annual report.

	At December 31,				
	2009	2008	2007	2006	2005
	(In thousands)				
Selected Financial Condition Data:					
Total assets	$ 1,389,612	$ 1,224,446	$ 1,162,018	$ 1,299,783	$ 1,244,834
Cash and cash equivalents	135,953	11,216	19,755	88,512	15,085
Investment securities held to maturity	598,394	527,767	538,025	621,339	669,853
Loans receivable, net	597,700	633,160	554,795	546,201	516,090
Bank owned life insurance	28,249	27,107	26,068	20,026	19,301
Federal Home Loan Bank of Seattle stock, at cost	12,348	12,348	12,348	12,348	12,348
Deposits	1,014,668	923,914	892,316	981,354	1,016,051
Federal Home Loan Bank of Seattle advances		35,791	72,000	100,000	100,317
Securities sold under agreements to repurchase	130,200	115,200	55,200	60,545	
Subordinated debentures		24,221	24,199	24,178	24,156
Stockholders equity	219,671	99,381	92,479	86,829	79,367

	Years Ended December 31,				
	2009	2008	2007	2006	2005
	(In thousands)				
Selected Operating Data:					
Interest and dividend income	$ 61,525	$ 61,220	$ 60,947	$ 61,887	$ 61,230
Interest expense	19,984	25,247	32,368	28,836	21,842
Net interest income	41,541	35,973	28,579	33,051	39,388
Provision (reversal of allowance) for loan losses	1,198	149	25	6	(15)
Net interest and dividend income after provision (reversal of allowance) for loan losses	40,343	35,824	28,554	33,045	39,403
Non-interest income	2,505	2,173	3,876	4,013	4,143
Non-interest expense	29,545	27,003	24,047	25,100	22,666
Income before income taxes	13,303	10,994	8,383	11,958	20,880
Income taxes	4,639	3,794	2,615	4,247	7,912
Net income	$ 8,664	$ 7,200	$ 5,768	$ 7,711	$ 12,968

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	At or For the Years Ended December 31,				
	2009	2008	2007	2006	2005
Selected Financial Ratios and Other Data:					
Performance Ratios:					
Return on average assets (ratio of net income to average total assets)	0.66%	0.60%	0.48%	0.62%	1.04%
Return on average equity (ratio of net income to average equity)	5.50%	7.37%	6.35%	8.93%	17.42%
Interest rate spread (1)	3.04%	2.95%	2.25%	2.60%	3.20%
Net interest margin (2)	3.26%	3.14%	2.48%	2.78%	3.30%
Efficiency ratio (3)	67.08%	70.79%	74.09%	67.72%	52.07%
Non-interest expense to average total assets	2.24%	2.25%	2.01%	2.03%	1.82%
Average interest-earning assets to average interest-bearing liabilities	114.30%	108.71%	108.16%	107.18%	105.55%
Average equity to average total assets	11.93%	8.15%	7.58%	6.99%	5.99%
Basic earnings per share	$ 0.77	N/A	N/A	N/A	N/A
Diluted earnings per share	$ 0.77	N/A	N/A	N/A	N/A
Dividend payout ratio	N/A	N/A	N/A	N/A	N/A
Asset Quality Ratios:					
Non-performing assets to total assets	0.05%	0.02%	0.01%	0.05%	0.01%
Non-performing loans to total loans	0.09%	0.02%	0.02%	0.11%	0.02%
Allowance for loan losses to non-performing loans	323.27%	603.36%	724.53%	129.51%	712.96%
Allowance for loan losses to total loans	0.28%	0.14%	0.14%	0.14%	0.15%
Capital Ratios (bank-level only):					
Total capital (to risk-weighted assets)	37.18%	24.97%	25.33%	23.57%	23.60%
Tier I capital (to risk-weighted assets)	36.85%	24.82%	25.17%	23.41%	23.43%
Tier I capital (to total assets)	13.67%	9.89%	9.83%	8.39%	8.11%
Other Data:					
Number of full service offices	25	24	24	24	22
Full time equivalent employees	256	250	244	226	220

(1) The average interest rate spread represents the difference between the weighted-average yield on interest-earning assets and the weighted-average cost of 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 non-interest expense divided by the sum of net interest income and non-interest income.

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 the annual report.

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, reverse repurchase agreements and Federal Home Loan Bank advances. This has resulted in our being particularly 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 low levels of non-performing assets at a time when many financial institutions are experiencing significant asset quality issues. Our non-performing assets totaled $1.0 million, or 0.05% of total assets at December 31, 2009, compared to $280,000 or

0.02% of total assets at December 31, 2008, and $106,000 or 0.01% of total assets at December 31, 2007. As of December 31, 2009, we had $159,000 of real estate owned and one delinquent mortgage loan for $274,000. Total loan delinquencies as of December 31, 2009 were $278,000. Our non-performing loans and 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 provision for loan losses was $1.2 million, $149,000 and $25,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

Other than our loans for the construction of one- to four-family residential mortgage loans, we do not offer 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 non-conforming loans having less than full documentation). We also do not own any private label mortgage-backed securities that are collateralized by ALT-A, low or no documentation or subprime mortgage loans.

Our operations in 2008 and 2007 have been affected by our efforts to manage our interest rate risk position. Specifically, in 2007, we sold $43.0 million of 10-, 15- and 20-year fixed-rate mortgage loans and $21.7 million of fixed-rate mortgage-backed securities classified as held to maturity where we had already received a substantial portion (at least 85%) of the principal outstanding at the acquisition date due to prepayments or scheduled repayments (as permitted by the Investments Debt and Equity Securities topic of the FASB ASC), and used the net proceeds of the sales to repay short-term borrowings. The loan sales resulted in a loss on loan sales during 2007 of $1.1 million, while the securities sales resulted in gains on securities sales during 2007 of $731,000. In 2007 we also obtained $55.2 million of long-term fixed-rate reverse repurchase agreements to reduce our interest rate risk. We continued our efforts to reduce interest rate risk in 2008 and 2009 by obtaining an additional $60.0 million and $15.0 million, respectively, of long-term, fixed-rate reverse repurchase agreements and through the purchase of $36.8 million and $91.4 million, respectively, of shorter-duration mortgage-backed securities. In 2009 we also sold $85.2 million of fixed-rate mortgage loan originations and raised $122.3 million of capital in a stock conversion to reduce our interest rate risk. See Management of Market Risk for a discussion of all of the actions we took in 2007, 2008 and 2009 in managing interest rate risk.

All of the Bank s mortgage-backed securities and collateralized mortgage obligations have been issued by Freddie Mac, Fannie Mae or Ginnie Mae, U.S. government-sponsored enterprises. 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, 2009, our available credit line at the Federal Home Loan Bank of Seattle has not been reduced compared to levels from December 31, 2008 or 2007.

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. We establish specific allowances for impaired loans, and general allowances for the remaining loans in our loan portfolio. 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 appropriate level.

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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, various regulatory agencies, as an integral part of their examination processes, periodically review our allowance for loan losses. Such agencies may require that we recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination. Accordingly, actual results could differ 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 one or more of our securities. Our securities, all of which are classified as held to maturity, consist primarily of debt securities for which we have a positive intent and ability to hold to maturity, and are carried at amortized cost. 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 quoted market prices or dealer quotes. However, if there are no observable market inputs (for securities such as trust preferred securities), we estimate the fair value using unobservable inputs. We obtain estimates of the fair value of trust preferred securities from pricing services and by discounting projected cash flows using a risk-adjusted discount rate in accordance with the Fair Value Measurements and Disclosures topic of the FASB ASC. As discussed in greater detail below, the fair value of the trust preferred securities for disclosure purposes is estimated by considering the reasonableness of the range of fair value estimates provided by a pricing service and the discounted cash values.

On April 9, 2009, the Financial Accounting Standards Board revised the Investments Debt and Equity Securities and the Fair Value Measurements topics of the FASB ASC. The revisions amend the other-than-temporary impairment guidance for U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in a company s financial statements. Before these recent revisions, to conclude that an impairment was not other than temporary an entity was required, among other considerations, to assert that it had the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value in accordance with Securities and Exchange Commission Staff Accounting Bulletin Topic 5M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities, and other authoritative literature. As a result of these recent revisions, an entity should assess whether the entity (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery (for example, if its cash or working

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capital requirements or contractual or regulatory obligations indicate that the debt security will be required to be sold before the forecasted recovery occurs). The revisions also change the trigger used to assess the collectability of cash flows from probable that the investor will be unable to collect all amounts due to the entity does not expect to recover the entire amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis of the security, an other-than-temporary impairment shall have occurred. We adopted the two revisions to the FASB ASC for the quarter ended March 31, 2009.

We had previously considered our investment in one of the trust preferred securities (PreTSL XXIV) other-than-temporarily impaired as of December 31, 2008, and we recorded a $2.5 million impairment charge during the quarter ended December 31, 2008. In addition, effective January 1, 2009, the cumulative effect of our adoption of the revisions to the FASB ASC resulted in the reclassification of $1.5 million of securities impairment from retained earnings to accumulated other comprehensive loss. In subsequent quarters, we determined that PreTSL XXIV was other-than-temporarily impaired and recorded an additional impairment charge of $1.0 million in 2009, of which $3.5 million was a credit loss recorded through our income statement as a charge to non-interest income, and $2.5 million was recorded as an increase to other comprehensive loss. The $3.5 million impairment charge for 2009 includes the $2.5 million that was previously reflected as a charge against income in the last quarter of 2008, but due to the revisions in accounting pronouncements, the Company was required to once again charge income in the amount of $2.5 million for the year ended December 31, 2009 for the same security. Our investment in PreTSL XXIII is not other-than-temporarily impaired because it is not more likely than not that we will be required to sell this security before recovering the amortized cost basis of $3.5 million.

The trust preferred securities market is considered to be inactive as only five sales transactions of similarly rated PreTSL securities have occurred in 2009. In addition, there have been no new issues of pooled trust preferred securities since 2007. Because the trust preferred securities market is inactive, we use a discounted cash flow model to determine the estimated fair value of the trust preferred securities and to determine whether they are other-than-temporarily impaired.

As stated above, the fair value of the trust preferred securities for disclosure purposes is estimated by considering the reasonableness of the range of fair value estimates provided by a pricing service and the discounted cash values. The primary difference between the fair value estimates prepared by our pricing service and our estimates is the discount rate assumption. As of December 31, 2009, we utilized a yield on corporate bonds issued by banks and thrifts plus a 4.69% liquidity premium to arrive at a risk-adjusted discount rate of 18.72%. Our discounted cash flow determined fair value to be $3.74 per $100 of par value. Our pricing service uses a discount rate of 21.00% and determined fair value to be $2.41 per $100 of par value.

Management considered the range of values and decided that our pricing service s estimate of value should be assigned a 70% weight and our discounted cash flow estimate should be assigned a 30% weight, which, as of December 31, 2009, resulted in a fair value estimate for PreTSL XXIII of $2.81 per $100 of par value. We give a greater weighting to the value established by the pricing service because of its experience in these matters as an independent third-party service provider.

At December 31, 2009, PreTSL XXIII has a book value of $3.5 million and a fair value of $100,000. PreTSL XXIV is other-than temporarily impaired and has a book value of $0.

We evaluated our $12.3 million investment in FHLB stock for other-than-temporary impairment as of December 31, 2009. Considering the long-term nature of this investment, the liquidity position of the FHLB of Seattle, the actions taken by the FHLB of Seattle to meet its regulatory capital requirement, and our intent and ability to hold this investment for a period of time sufficient to recover the par value,

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our FHLB stock was not considered other-than-temporarily impaired. As of December 31, 2009, the FHLB of Seattle has met all of its regulatory capital requirements. Moody s Investor Services and Standard and Poor s have given the FHLB of Seattle a long-term credit rating of AAA. Even though we did not recognize an other-than-temporary impairment loss on our investment in FHLB stock in 2009, continued deterioration in the FHLB of Seattle s financial position may result in future impairment losses.

Deferred Tax Assets. Deferred tax assets and liabilities are recognized for the estimated future tax effects attributable to temporary differences and carryforwards. 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 and debt securities, 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. Asset returns are based upon the anticipated average rate of earnings expected on the invested funds of the plans.

At December 31, 2009, we used weighted-average discount rates of 6.30% and 6.20% for calculating annual pension expense and projected plan liabilities, respectively, and an expected long-term rate of return on plan assets of 8.00% for calculating annual pension expense. At December 31, 2008, we used a weighted-average discount rate of 6.00% and 6.30% for calculating annual pension expense and projected plan liabilities, respectively, and an expected long-term rate of return on plan assets of 8.00% 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.

An increase in the discount rate or asset return rate would reduce pension expense in 2009, while a decrease in the discount rate or asset return rate would have the opposite effect. A 25 basis point decrease in the discount rate assumptions would increase 2009 pension expense by $4,000 and year-end 2009 pension liability by $325,000, while a 25 basis point decrease in the asset return rate would increase 2009 pension expense by $21,000.

Balance Sheet Analysis

Assets. At December 31, 2009, our assets were $1.390 billion, an increase of $165.2 million, or 13.5%, from $1.224 billion at December 31, 2008. The increase was caused by an increase in cash and cash equivalents of $124.7 million, or 1,112.1% due primarily to the receipt of net proceeds from our stock offering, which closed on July 10, 2009. In addition, investment securities increased by $70.6 million, or 13.4%, as we invested the increase in deposits and loan repayments into Freddie Mac and Ginnie Mae mortgage-backed securities and collateralized mortgage obligations. This was partially offset by a $35.5 million, or 5.6% decrease in the loan portfolio. The decrease was caused primarily by an increase in loan repayments and the sale of mortgage loans which resulted in a $25.8 million or 4.4% decrease in one- to four-family residential real estate loans and a $8.2 million or 27.3% decrease in home equity loans and lines of credit.

Cash and Cash Equivalents. At December 31, 2009, we had $136.0 million of cash and cash equivalents, which primarily represents the proceeds from our stock offering.

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

	At December 31,									
	2009		2008		2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Real estate loans:										
First mortgage:										
One- to four-family residential	$ 555,473	91.25%	$ 581,251	90.52%	$ 506,410	90.21%	$ 516,554	93.26%	$ 498,809	95.69%
Multi-family residential	3,807	0.63	3,756	0.58	4,488	0.80	4,983	0.90	4,759	0.91
Construction, commercial and other	20,762	3.41	21,042	3.28	17,041	3.04	14,784	2.67	8,625	1.65
Home equity loans and lines of credit	21,789	3.58	29,956	4.67	26,828	4.78	12,763	2.30	5,879	1.13
Other loans	6,895	1.13	6,097	0.95	6,579	1.17	4,830	0.87	3,232	0.62
Total loans	608,726	100.00%	642,102	100.00%	561,346	100.00%	553,914	100.00%	521,304	100.00%
Other items:										
Unearned fees and discounts, net	(5,255)		(5,100)		(4,375)		(4,415)		(4,095)	
Undisbursed loan funds	(4,090)									