

Territorial Bancorp Inc.  
Form 10-Q  
August 08, 2018  
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended June 30, 2018

or

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

For transition period from            to

Commission File Number 1-34403

TERRITORIAL BANCORP INC.

(Exact Name of Registrant as Specified in Charter)

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Maryland  
(State or Other Jurisdiction of Incorporation) 26-4674701  
(I.R.S. Employer Identification No.)

1132 Bishop Street, Suite 2200, Honolulu, Hawaii 96813  
(Address of Principal Executive Offices) (Zip Code)

(808) 946-1400

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and formal fiscal year, if changed since last report)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)
Smaller reporting company	Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 9,739,697 shares of Common Stock, par value \$0.01 per share, were issued and outstanding as of July 31, 2018.

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TERRITORIAL BANCORP INC.

Form 10-Q Quarterly Report

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Balance Sheets (Unaudited)

(Dollars in thousands, except share data)

	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Cash and cash equivalents	\$ 27,672	\$ 32,089
Investment securities available for sale	2,658	2,851
Investment securities held to maturity, at amortized cost (fair value of \$382,962 and \$406,663 at June 30, 2018 and December 31, 2017, respectively)	392,189	404,792
Loans held for sale	—	403
Loans receivable, net	1,536,392	1,488,971
Federal Home Loan Bank stock, at cost	5,925	6,541
Federal Reserve Bank stock, at cost	3,106	3,103
Accrued interest receivable	5,195	5,142
Premises and equipment, net	5,362	5,721
Bank-owned life insurance	44,631	44,201
Income taxes receivable	1,196	1,571
Deferred income tax assets, net	4,210	4,609
Prepaid expenses and other assets	3,923	3,852
Total assets	\$ 2,032,459	\$ 2,003,846
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Deposits	\$ 1,647,183	\$ 1,597,295
Advances from the Federal Home Loan Bank	88,000	107,200
Securities sold under agreements to repurchase	30,000	30,000
Accounts payable and accrued expenses	24,418	26,390
Income taxes payable	1,459	1,483
Advance payments by borrowers for taxes and insurance	6,700	6,624
Total liabilities	1,797,760	1,768,992
Stockholders' Equity:	—	—

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Preferred stock, \$0.01 par value; authorized 50,000,000 shares, no shares issued or outstanding		
Common stock, \$0.01 par value; authorized 100,000,000 shares; issued and outstanding 9,749,697 and 9,915,058 shares at June 30, 2018 and December 31, 2017, respectively	98	99
Additional paid-in capital	67,584	73,050
Unearned ESOP shares	(5,138)	(5,383)
Retained earnings	179,044	172,782
Accumulated other comprehensive loss	(6,889)	(5,694)
Total stockholders' equity	234,699	234,854
Total liabilities and stockholders' equity	\$ 2,032,459	\$ 2,003,846

See accompanying notes to consolidated financial statements.

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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Income (Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,	2017	June 30,	2017
	2018		2018	
Interest income:				
Loans	\$ 14,884	\$ 13,527	\$ 29,791	\$ 27,040
Investment securities	3,122	3,078	6,251	6,159
Other investments	176	172	374	359
Total interest income	18,182	16,777	36,416	33,558
Interest expense:				
Deposits	2,690	1,775	5,141	3,426
Advances from the Federal Home Loan Bank	459	261	878	515
Securities sold under agreements to repurchase	126	217	251	433
Total interest expense	3,275	2,253	6,270	4,374
Net interest income	14,907	14,524	30,146	29,184
Provision (reversal of provision) for loan losses	60	(123)	69	(52)
Net interest income after provision (reversal of provision) for loan losses	14,847	14,647	30,077	29,236
Noninterest income:				
Service fees on loan and deposit accounts	487	507	902	1,063
Income on bank-owned life insurance	216	227	431	453
Gain on sale of investment securities	45	186	45	281
Gain on sale of loans	10	63	53	126
Other	79	76	148	158
Total noninterest income	837	1,059	1,579	2,081
Noninterest expense:				
Salaries and employee benefits	5,496	4,900	11,143	9,983
Occupancy	1,574	1,461	3,090	2,910
Equipment	997	882	1,939	1,748
Federal deposit insurance premiums	154	148	307	296
Other general and administrative expenses	1,153	1,363	2,288	2,524
Total noninterest expense	9,374	8,754	18,767	17,461
Income before income taxes	6,310	6,952	12,889	13,856
Income taxes	1,347	2,651	3,106	5,234
Net income	\$ 4,963	\$ 4,301	\$ 9,783	\$ 8,622

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Basic earnings per share	\$ 0.54	\$ 0.46	\$ 1.05	\$ 0.93
Diluted earnings per share	\$ 0.53	\$ 0.45	\$ 1.03	\$ 0.90
Cash dividends declared per common share	\$ 0.30	\$ 0.20	\$ 0.50	\$ 0.40
Basic weighted-average shares outstanding	9,219,859	9,255,739	9,251,999	9,235,553
Diluted weighted-average shares outstanding	9,394,031	9,539,757	9,439,618	9,539,543

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$ 4,963	\$ 4,301	\$ 9,783	\$ 8,622
Change in unrealized loss on securities, net of tax	(11)	(15)	(60)	(13)
Other comprehensive loss, net of tax	(11)	(15)	(60)	(13)
Comprehensive income	\$ 4,952	\$ 4,286	\$ 9,723	\$ 8,609

See accompanying notes to consolidated financial statements.

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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Stockholders' Equity (Unaudited)

(Dollars in thousands, except per share data)

	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balances at December 31, 2016	\$ 98	\$ 71,914	\$ (5,872)	\$ 168,962	\$ (5,316)	\$ 229,786
Net income	—	—	—	8,622	—	8,622
Other comprehensive loss	—	—	—	—	(13)	(13)
Cash dividends declared (\$0.40 per share)	—	—	—	(3,692)	—	(3,692)
Share-based compensation	—	(11)	—	—	—	(11)
Allocation of 24,466 ESOP shares	—	530	245	—	—	775
Repurchase of 59,430 shares of company common stock	(1)	(1,924)	—	—	—	(1,925)
Exercise of 110,894 options for common stock	1	1,924	—	—	—	1,925
Balances at June 30, 2017	\$ 98	\$ 72,433	\$ (5,627)	\$ 173,892	\$ (5,329)	\$ 235,467
Balances at December 31, 2017	\$ 99	\$ 73,050	\$ (5,383)	\$ 172,782	\$ (5,694)	\$ 234,854
Net income	—	—	—	9,783	—	9,783
Other comprehensive loss	—	—	—	—	(60)	(60)
Reclassification of deferred taxes	—	—	—	1,135	(1,135)	—
Cash dividends declared (\$0.50 per share)	—	—	—	(4,656)	—	(4,656)
Share-based compensation	—	135	—	—	—	135
Allocation of 24,466 ESOP shares	—	504	245	—	—	749
Repurchase of 237,570 shares of company common stock	(2)	(7,302)	—	—	—	(7,304)
Exercise of 69,008 options for common stock	1	1,197	—	—	—	1,198
Balances at June 30, 2018	\$ 98	\$ 67,584	\$ (5,138)	\$ 179,044	\$ (6,889)	\$ 234,699

See accompanying notes to consolidated financial statements.



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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 9,783	\$ 8,622
Adjustments to reconcile net income to net cash from operating activities:		
Provision (reversal of provision) for loan losses	69	(52)
Depreciation and amortization	630	513
Deferred income tax expense	421	379
Amortization of fees, discounts, and premiums, net	(235)	(235)
Origination of loans held for sale	(6,612)	(16,006)
Proceeds from sales of loans held for sale	7,068	16,568
Gain on sale of loans, net	(53)	(126)
Net gain on sale of real estate owned	(4)	—
Gain on sale of investment securities held to maturity	(45)	(281)
ESOP expense	749	775
Share-based compensation expense (benefit)	135	(11)
Increase in accrued interest receivable	(53)	(37)
Net increase in bank-owned life insurance	(430)	(453)
Net increase in prepaid expenses and other assets	(71)	(171)
Net increase (decrease) in accounts payable and accrued expenses	(2,963)	666
Net increase in advance payments by borrowers for taxes and insurance	76	257
Net decrease in income taxes receivable	375	122
Net increase (decrease) in income taxes payable	(24)	592
Net cash from operating activities	8,816	11,122
Cash flows from investing activities:		
Purchases of investment securities held to maturity	(14,983)	(19,908)
Purchases of investment securities available for sale	—	(2,970)
Principal repayments on investment securities held to maturity	23,188	27,245
Principal repayments on investment securities available for sale	106	—
Proceeds from sale of investment securities held to maturity	4,462	5,053
Loan originations, net of principal repayments on loans receivable	(47,315)	(68,203)
Purchases of Federal Home Loan Bank stock	(2,672)	(483)
Proceeds from redemption of Federal Home Loan Bank stock	3,288	415
Purchases of Federal Reserve Bank stock	(3)	(8)
Proceeds from sale of real estate owned	50	—
Purchases of premises and equipment	(271)	(1,313)

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Net cash from investing activities	(34,150)	(60,172)
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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Cash flows from financing activities:		
Net increase in deposits	\$ 49,888	\$ 39,357
Proceeds from advances from the Federal Home Loan Bank	53,000	10,375
Repayments of advances from the Federal Home Loan Bank	(72,200)	(10,375)
Repurchases of common stock	(6,106)	—
Cash dividends paid	(3,665)	(3,692)
Net cash from financing activities	20,917	35,665
Net decrease in cash and cash equivalents	(4,417)	(13,385)
Cash and cash equivalents at beginning of the period	32,089	61,273
Cash and cash equivalents at end of the period	\$ 27,672	\$ 47,888
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest on deposits and borrowings	\$ 6,475	\$ 4,308
Income taxes	2,334	4,212
Supplemental disclosure of noncash investing and financing activities:		
Company stock acquired through stock swap and net settlement transactions	\$ 1,198	\$ 1,925
Loans transferred to real estate owned	46	—
Dividends declared, not yet paid	991	—

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

(1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Territorial Bancorp Inc. (the Company) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes should be read in conjunction with the Company's consolidated financial statements and notes thereto filed as part of the Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, all adjustments necessary for a fair presentation have been made and consist only of normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year.

(2) Organization

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

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

(3) Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) amended the Revenue Recognition topic of the FASB Accounting Standards Codification (ASC). The amendment seeks to clarify the principles for recognizing revenue as well as to develop common revenue standards for U.S. generally accepted accounting principles and International Financial Reporting Standards. The Company reviewed all revenue sources to determine if the sources are in scope for this guidance. Net interest income from financial assets and liabilities are explicitly excluded from the scope of the amendment. The Company's overall assessment of key in-scope revenue sources include service charges on deposit accounts, rental income from safe deposit boxes and commissions on insurance and annuity sales. Based on the Company's analysis of these revenue sources, including the amount of revenue, the timing of services rendered and timing of payment for these services, there is no material change in the timing of revenue recognition under the amendment. The Company adopted this amendment as of January 1, 2018, using the modified retrospective approach. Since there was no material impact on the timing of revenue recognition, no adjustment to beginning retained earnings was deemed necessary. See Note 14, Revenue Recognition, for further information.

In January 2016, the FASB amended the Financial Instruments – Overall topic of the FASB ASC. The amendment addresses several aspects of recognition, measurement, presentation and disclosure of financial instruments. Included are: (a) a requirement to measure equity investments at fair value, with changes in fair value recognized in net income, (b) a simplification of the impairment assessment of equity investments without readily determinable fair values, (c) the elimination of the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet, and (d) a requirement to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company adopted this amendment as of January 1, 2018, and there was no material effect on its consolidated financial statements.



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

In June 2016, the FASB amended various sections of the FASB ASC related to the accounting for credit losses on financial instruments. The amendment changes the threshold for recognizing losses from a “probable” to an “expected” model. The new model is referred to as the current expected credit loss model and applies to loans, leases, held-to-maturity investments, loan commitments and financial guarantees. The amendment requires the measurement of all expected credit losses for financial assets as of the reporting date (including historical experience, current conditions and reasonable and supportable forecasts) and enhanced disclosures that will help financial statement users understand the estimates and judgments used in estimating credit losses and evaluating the credit quality of an organization’s portfolio. The amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company will apply the amendment’s provisions as a cumulative-effect adjustment to retained earnings at the beginning of the first period the amendment is effective. The Company is currently evaluating the effects that the adoption of this amendment will have on its consolidated financial statements by gathering the information that is necessary to make the calculations required by the amendment. This may result in increased credit losses on financial instruments recorded in the consolidated financial statements.

In March 2017, the FASB amended the Compensation – Retirement Benefits topic of the FASB ASC. The amendment requires the service cost component of net benefit cost to be reported in the same line item as other compensation costs arising from employee services. It also requires the other components of net benefit cost to be reported in the income statement separately from the service cost component. The Company adopted this amendment as of January 1, 2018, and there was no material effect on its consolidated financial statements.

In February 2018, the FASB amended the Income Statement – Reporting Comprehensive Income topic of the FASB ASC. Prior to the adoption of the amendment, deferred taxes previously included in accumulated other comprehensive income were not allowed to be adjusted for changes in tax rates. This amendment allows the reclassification of the tax effects resulting from the change in the federal corporate tax rate in the Tax Cuts and Jobs Act, which was passed in December 2017, from accumulated other comprehensive income to retained earnings. The amendment is effective for fiscal years beginning after December 15, 2018, with early adoption permitted in any period for which financial statements have not yet been issued. The Company adopted this amendment during the first quarter of 2018 with the reclassification of \$1.1 million of deferred taxes from accumulated other comprehensive income to retained earnings.

(4) Cash and Cash Equivalents

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

(Dollars in thousands)	June 30, 2018	December 31, 2017
Cash and due from banks	\$ 9,781	\$ 9,114
Interest-earning deposits in other banks	17,891	22,975
Cash and cash equivalents	\$ 27,672	\$ 32,089

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

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## (5) Investment Securities

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

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Value
June 30, 2018:				
Available-for-sale:				
U.S. government-sponsored mortgage-backed securities	\$ 2,764	\$ —	\$ (106)	\$ 2,658
Total	\$ 2,764	\$ —	\$ (106)	\$ 2,658
Held-to-maturity:				
U.S. government-sponsored mortgage-backed securities	\$ 392,059	\$ 2,049	\$ (11,877)	\$ 382,231
Trust preferred securities	130	601	—	731
Total	\$ 392,189	\$ 2,650	\$ (11,877)	\$ 382,962
December 31, 2017:				
Available-for-sale:				
U.S. government-sponsored mortgage-backed securities	\$ 2,870	\$ —	\$ (19)	\$ 2,851
Total	\$ 2,870	\$ —	\$ (19)	\$ 2,851
Held-to-maturity:				
U.S. government-sponsored mortgage-backed securities	\$ 404,365	\$ 6,056	\$ (4,603)	\$ 405,818
Trust preferred securities	427	418	—	845
Total	\$ 404,792	\$ 6,474	\$ (4,603)	\$ 406,663

The amortized cost and estimated fair value of investment securities by maturity date at June 30, 2018 are shown below. Incorporated in the maturity schedule are mortgage-backed and trust preferred securities, which are allocated using the contractual maturity as a basis. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Estimated Fair Value
Available-for-sale:		
Due within 5 years	\$ —	\$ —
Due after 5 years through 10 years	—	—
Due after 10 years	2,764	2,658
Total	\$ 2,764	\$ 2,658

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Held-to-maturity:		
Due within 5 years	\$ 7	\$ 7
Due after 5 years through 10 years	76	76
Due after 10 years	392,106	382,879
Total	\$ 392,189	\$ 382,962

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Realized gains and losses and the proceeds from sales of held-to-maturity securities are shown in the table below. All sales of securities were U.S. government-sponsored mortgage-backed securities.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Proceeds from sales	\$ 4,462	\$ 3,464	\$ 4,462	\$ 5,053
Gross gains	45	186	45	281
Gross losses	—	—	—	—

The sale of these mortgage-backed securities, for which the Company had already collected a substantial portion of the outstanding purchased principal (at least 85%), is in accordance with the Investments – Debt and Equity Securities topic of the FASB ASC and does not taint management’s assertion of intent to hold remaining securities in the held-to-maturity portfolio to maturity.

Investment securities with amortized costs of \$311.4 million and \$287.2 million at June 30, 2018 and December 31, 2017, respectively, were pledged to secure deposits made by state and local governments, securities sold under agreements to repurchase and transaction clearing accounts.

Provided below is a summary of investment securities which were in an unrealized loss position at June 30, 2018 and December 31, 2017. The Company does not intend to sell held-to-maturity and available-for-sale securities until such time as the value recovers or the securities mature and it is not more likely than not that the Company will be required to sell the securities prior to recovery of value or the securities mature.

Description of securities (Dollars in thousands)	Less Than 12 Months Fair Value	12 Months or Longer Unrealized Losses	12 Months or Longer Unrealized Losses	Total Number of Securities	Unrealized Fair Value	Unrealized Losses
Available-for-sale:						
U.S. government-sponsored mortgage-backed securities	\$ 2,658					