BANKGUAM HOLDING CO

FORM 10-Q
(Quarterly Report)

Filed 11/20/17 for the Period Ending 09/30/17

Telephone	671-472-5271
CIK	0001527383
Symbol	BKGM
SIC Code	6029 - Commercial Banks, Not Elsewhere Classified
Industry	Banks
Sector	Financials
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

or

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

For the transition period from to .

Commission file number: 000-54483

BankGuam Holding Company
(Exact name of registrant as specified in its charter)

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

P.O. Box BW
Hagåtña, Guam 96932
(671) 472-5300
(Address, including Zip Code, and telephone number, including area code, of the registrant's principal executive offices)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registration was required to submit and post such files). Yes ☒ 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 small 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. ☐

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

As of November 20, 2017, the registrant had outstanding 9,342,494 shares of common stock.

BANKGUAM HOLDING COMPANY
FORM 10-Q
QUARTERLY REPORT

TABLE OF CONTENTS

Exhibit Index

Exhibit 31.01 Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley At of 2002

Exhibit 31.02 Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.01 Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 101.INS XBRL Instance Document.

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document.

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

Exhibit 101.LAB XBRL Taxonomy Extension Labels Linkbase Document.

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

Cautionary Note Regarding Forward-Looking Statements

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

- Competition for loans and deposits and failure to attract or retain deposits and loans;
- Local, regional, national and global economic conditions and events, and the impact they may have on us and our customers, and our assessment of that impact on our estimates, including the allowance for loan losses;
- Risks associated with concentrations in real estate related loans;
- Changes in the level of nonperforming assets and charge-offs and other credit quality measures, and their impact on the adequacy of our allowance for loan losses and our provision for loan losses;
- The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;
- Stability of funding sources and continued availability of borrowings;
- The effect of changes in laws and regulations with which the Company, Bank of Guam and BankGuam Investment and Insurance Services must comply, including any increase in Federal Deposit Insurance Corporation insurance premiums;
- Our ability to raise capital or incur debt on reasonable terms;
- Regulatory limits on Bank of Guam's ability to pay dividends to the Company;
- The impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and its implementing regulations;
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as the Financial Accounting Standards Board and other accounting standard setting bodies;
- Changes in the deferred tax asset valuation allowance in future quarters;
- The costs and effects of legal and regulatory developments, including resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;
- The ability to increase market share and control expenses; and,
- Our success in managing the risks involved in the foregoing items, as well as other statements regarding our future operations, financial condition and prospects, and business strategies.

We are not able to predict all of the factors that may affect future results. Forward-looking statements may be preceded by, followed by or include the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "will," "is designed to" and similar expressions. We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about our businesses and the environment in which they operate that could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in "Risk Factors" included in filings we make from time to time with the U.S. Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for our fiscal year ended 2016, and our other Quarterly Reports on Form 10-Q filed by us in fiscal 2017. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements. New information, future events or risks could cause the forward-looking statements we discuss in this Quarterly Report not to occur. You should not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this Quarterly Report.

PART I. FINANCIAL INFOR MATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

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

BankGuam Holding C ompany

Unaudited Condensed Consolidated Statements of Condition

(in Thousands, Except Par Value)

	September 30, 2017	December 31, 2016
ASSETS		
Cash and due from banks	$ 25,209	$ 25,738
Interest bearing deposits in banks	141,260	150,913
Total cash and cash equivalents	166,469	176,651
Restricted cash	400	400
Investment in unconsolidated subsidiary	3,092	3,025
Investment securities available-for-sale, at fair value	502,075	419,880
Investment securities held-to-maturity, at amortized cost	91,296	96,167
Federal Home Loan Bank stock, at cost	2,303	1,855
Loans, net of allowance for loan losses ($15,215 and $15,435, respectively)	1,174,528	1,158,045
Accrued interest receivable	5,985	4,758
Premises and equipment, net	18,020	17,825
Other assets	52,521	42,946
Total assets	$ 2,016,689	$ 1,921,552
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 522,135	$ 469,451
Interest bearing	1,342,908	1,309,219
Total deposits	1,865,043	1,778,670
Accrued interest payable	116	122
Other liabilities	12,784	10,558
Total liabilities	1,877,943	1,789,350
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock $0.2083 par value; 48,000 shares authorized; 9,312 and 9,300 shares issued and 9,280 and 9,268 shares outstanding at 9/30/17 and 12/31/16, respectively	1,942	1,938
Preferred stock $100.00 par value; 300 shares authorized; 9.8 shares issued and outstanding	980	980
Additional paid-in capital, Common stock	20,093	19,917
Additional paid-in capital, Preferred stock	8,803	8,803
Retained earnings	110,227	104,626
Accumulated other comprehensive loss	(3,009)	(3,772)
Common stock in treasury, at cost (32 shares)	(290)	(290)
Total stockholders' equity	138,746	132,202
Total liabilities and stockholders' equity	$ 2,016,689	$ 1,921,552

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

BankGuam Holding Com pany

Unaudited Condensed Consolidated Statements of Income

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest income:				
Loans	$ 18,457	$ 17,362	$ 53,688	$ 52,110
Investment securities	2,246	1,245	5,939	3,696
Deposits with banks	423	163	854	369
Total interest income	21,126	18,770	60,481	56,175
Interest expense:				
Savings deposits	525	473	1,531	1,341
Time deposits	35	35	111	107
Other borrowed funds	-	72	-	106
Total interest expense	560	580	1,642	1,554
Net interest income	20,566	18,190	58,839	54,621
Provision for loan losses	1,186	385	3,553	2,715
Net interest income, after provision for loan losses	19,380	17,805	55,286	51,906
Non-interest income:				
Service charges and fees	1,489	1,427	4,339	4,391
Gain (loss) on sale of investment securities	-	272	(13)	401
Income from merchant services, net	646	751	1,834	1,518
Cardholders income, net	-	268	359	963
Trustee fees	257	240	712	598
Other income	854	798	2,232	2,264
Total non-interest income	3,246	3,756	9,463	10,135
Non-interest expense:				
Salaries and employee benefits	8,696	8,170	25,621	23,665
Occupancy	1,733	1,561	4,984	4,679
Equipment and depreciation	2,219	1,983	6,357	5,490
Insurance	432	406	1,241	1,218
Telecommunications	444	421	1,293	1,222
FDIC assessment	377	327	1,116	973
Professional services	494	475	1,431	1,640
Contract services	467	370	1,424	1,302
Other real estate owned	7	84	73	101
Stationery and supplies	210	217	628	702
Training and education	273	263	941	777
General, administrative and other	2,497	2,085	7,152	6,213
Total non-interest expense	17,849	16,362	52,261	47,982
Income before income taxes	4,777	5,199	12,488	14,059
Income tax expense	1,597	1,587	3,754	4,123
Net income	3,180	3,612	8,734	9,936
Preferred stock dividend	(138)	-	(414)	-
Net income attributable to common stockholders	$ 3,042	$ 3,612	$ 8,320	$ 9,936
Earnings per common share:				
Basic	$ 0.34	$ 0.39	$ 0.94	$ 1.07
Diluted	$ 0.34	$ 0.39	$ 0.94	$ 1.07
Dividends declared per common share	$ 0.10	$ 0.10	$ 0.30	$ 0.30
Basic weighted average common shares	9,281	9,257	9,274	9,250
Diluted weighted average common shares	9,281	9,257	9,274	9,250

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

BankG uam H olding Company
Unaudited Condensed Consolidated Statements of Comprehensive Income
(in Thousands)

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Net income	$ 3,180	$ 3,612	$ 8,734	$ 9,936
Other comprehensive income (loss):				
Unrealized holding gain on available-for-sale securities arising during the period, net of tax	(3)	(257)	429	2,430
Reclassification for loss (gain) realized on available-for-sale securities	-	(272)	13	(401)
Amortization of post-transfer unrealized holding loss on held-to-maturity securities during the period, net of tax	107	118	322	337
Total other comprehensive income	104	(411)	764	2,366
Total comprehensive income	$ 3,284	$ 3,201	$ 9,498	$ 12,302

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

BankGuam H olding Company

Unaudited Condensed Consolidated Statements of Cash Flows

(in Thousands)

	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Cash flows from operating activities:		
Net income	$ 8,734	$ 9,936
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,553	2,715
Depreciation	2,476	2,541
Amortization of fees, discounts and premiums	996	1,110
Loss on sales of other real estate owned, net	49	29
Proceeds from sales of loans held for sale	4,922	14,965
Origination of loans held for sale	(4,922)	(14,965)
Increase in mortgage servicing rights	(28)	(68)
Realized loss (gain) on sale of available-for-sale securities	13	(401)
Realized gain on sale of premises and equipment	(23)	(18)
Income from equity investment in unconsolidated subsidiary	(203)	-
Dividends received from unconsolidated subsidiary	199	-
Net change in operating assets and liabilities:		
Accrued interest receivable	(1,227)	(835)
Other assets	(5,541)	(8,077)
Accrued interest payable	(6)	68
Other liabilities	2,226	6,751
Net cash provided by operating activities	11,218	13,751
Cash flows from investing activities:		
Acquisition of an unconsolidated subsidiary	-	(3,075)
Purchases of available-for-sale securities	(140,411)	(173,619)
Purchases of held-to-maturity securities	-	(4,037)
Proceeds from sales of available-for-sale securities	12,896	39,950
Maturities, prepayments and calls of available-for-sale securities	40,033	18,252
Maturities, prepayments and calls of held-to-maturity securities	4,912	6,235
Loan originations and principal collections, net	(19,860)	(69,879)
(Costs of) proceeds from FHLB stock (purchase) redemption	(448)	(93)
Proceeds from sales of other real estate owned	769	1,492
Proceeds from sales of premises and equipment	23	18
Purchases of premises and equipment	(2,670)	(2,438)
Net cash used in investing activities	(104,756)	(187,194)
Cash flows from financing activities:		
Net increase in deposits	86,373	273,359
Proceeds from issuance of common stock	179	182
Proceeds from issuance of preferred stock	-	1,733
Dividends paid	(3,196)	(2,774)
Net cash provided by financing activities	83,356	272,500
Net change in cash and cash equivalents	(10,182)	99,057
Cash and cash equivalents at beginning of period	176,651	100,799
Cash and cash equivalents at end of period	$ 166,469	$ 199,856
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,648	$ 832
Income taxes	5,965	6,226
Supplemental disclosure of noncash investing and financing activities:		
Transfer proceeds from a called AFS security to Other Assets	5,000	-
Net change in unrealized loss on held-to-maturity securities, net of tax	322	337
Other real estate owned transferred from loans, net	521	442
Other real estate owned transferred to loans, net	(345)	(197)

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

Note 1 – Nature of Business

Organization

The accompanying condensed consolidated financial statements include the accounts of BankGuam Holding Company ("Company") and its wholly- owned subsidiaries, Bank of Guam ("Bank") and BankGuam Investment Services ("BGIS", formerly "BankGuam Investment and Insurance Services, "BGIIS", before a change of name on July 24, 2017). The Company is a Guam corporation organized on October 29, 2010, to act as a holding company of the Bank, a Guam banking corporation, a 23-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), the Republic of Palau (ROP), and San Francisco, California. BankGuam Investment Services was incorporated in Guam in 2015 and initially capitalized during the first quarter of 2016. The Company executed an agreement to purchase up to 70% of ASC Trust Corporation through 2021, including its initial investment of 25% made in July 2016.

Other than holding the shares of the Bank, BGIS and ASC Trust Corporation, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company's operations are conducted and substantially all of the assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank provides a variety of financial services to individuals, businesses and governments through its branches. The Bank's headquarters is located in Hagåtña, Guam. The Bank currently has twelve branches in Guam, one of which will be consolidated into another during December, 2017, four in the CNMI, four in the FSM, one in the RMI, one in the ROP, and one in San Francisco, California. Its primary deposit products are demand deposits, savings and time certificate accounts, and its primary lending products are consumer, commercial and real estate loans.

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

Note 2 – Summary of Significant Accounting Policies and Recent Accounting Pronouncements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all footnotes that would be required for a full presentation of financial condition, results of operations, changes in cash flows and comprehensive income in accordance with generally accepted accounting principles in the United States ("GAAP"). However, these interim financial statements reflect all adjustments (consisting of normal recurring adjustments and accruals) which, in the opinion of our management, are necessary for a fair presentation of our financial condition, results of operations and cash flows for the interim periods presented.

These unaudited condensed consolidated financial statements have been prepared on a basis consistent with prior periods, and should be read in conjunction with our audited consolidated financial statements as of and for the year ended December 31, 2016, and the notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 on March 14, 2017.

Our condensed consolidated financial condition at September 30, 2017, and the condensed consolidated results of operations for the three and nine months ended September 30, 2017, are not necessarily indicative of what our financial condition will be as of December 31, 2017, or of the results of our operations that may be expected for the full year ending December 31, 2017.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of income and expenses during the periods presented. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications of prior year balances have been made to conform to the current year presentation. These reclassifications had no impact on the Company's consolidated financial position, results of operations or net change in cash and cash equivalents. The reclassification relates to an allocation of the allowance for loan losses to impaired loans individually evaluated for impairment from the allowance associated with loans collectively evaluated for impairment.

Recent Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, *"Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting"* , which simplifies the principles applied to income taxes on stock compensation, including the timing of recognition, the classification of tax benefits or deficiencies on the statement of cash flows, the treatment of those taxes on the income statement, and the measurement of liability-classified awards at fair value or intrinsic value. Although this standard was adopted effective January 1, 2017, the Company has issued no stock options or phantom stock options to date, so this update has had no impact on our consolidated financial position or results of operation at this time.

In January 2017, the FASB issued ASU 2017-04, *"Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment"* , which amends ASU 2014-02 by eliminating Step 2 from the goodwill impairment test, which had require d a quantitative measure of each reporting unit's goodwill by comparing the implied fair value to the carrying amount of that goodwill. As the Company has never had to conduct a Step 2 evaluation of goodwill, this update had no effect on our consolidated financial position or results of operations. Although adoption of this standard is not required of the Company until January 1, 2020, we adopted the update effective March 31, 2017.

Recently Issued but Not Yet Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *"Revenue from Contracts with Customers"* . Among other objectives, it is intended to provide more useful information to the users of financial statements by making the definition and recognition of revenue more comparable across reporting entities, industries, jurisdictions and capital markets. As deferred by ASU No. 2015-14, this Standard is effective January 1, 2018, upon which date we will implement it. We are currently reviewing contracts with customers that would be subject to this update, and as we do so we will continue to evaluate the prospective impact of ASU 2014-09 on our consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *"Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities"* , to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information and to address certain aspects of the recognition, measurement, presentation and disclosure of the fair value, including impairment assessments, of financial instruments. We are currently evaluating the impact of ASU 2016-01 on the presentation of and disclosure related to our consolidated financial statements which is effective beginning January 1, 2018.

In February 2016, the FASB issued ASU 2016-02, *"Leases (Topic 842)",* a new Topic which is effective beginning January 1, 2019, and is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements on the basis that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities. The Company is anticipating electing an accounting policy to not recognize lease assets and lease liabilities for leases with a term of twelve months or less. Upon adoption of this ASU, the Company will recognize, in the statement of financial position, a liability representing the present value of future lease payments (the lease liability) and an asset representing its right to use the underlying asset for the lease term. We are reviewing the outstanding lease documents and will continue to evaluate the impact of ASU 2016-02 on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *"Financial Instruments – Credit Losses (Topic 326)"* , to amend the standards for the measurement of credit losses on financial instruments by replacing the historical incurred loss impairment methodology of determining the level of the allowance for loan and lease losses (ALLL), including losses associated with held-to-maturity securities, with a more decision-useful methodology that reflects expected credit losses over the life of a financial instrument based upon historical experience, current conditions, and reasonable and supportable forecasts in determining the ALLL level, as well as the reserve for off-balance-sheet credit exposures. The Company is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on our Consolidate Financial Statements, and has taken steps for the implementation when it becomes effective beginning January 1, 2020, such as gathering pertinent data, consulting with outside professionals and evaluating its current IT systems. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the one-time adjustment or the overall impact of the new guidance on the Company's financial position, results of operations or cash flows.

In March 2017, the FASB issued ASU 2017-07, *"Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"* . This update requires that the service cost component of the Bank's Supplemental Executive Retirement Program (SERP) be recorded and reported separately from the other cost component(s), in the same line item as other compensation costs related to services rendered by the beneficiary employees during the reporting period. The Company currently reports both the service cost and the other cost component(s) as a portion of General, administrative and other expense, whereas this update will require that the service cost component be reported as a portion of Salaries and employee benefits. This update also requires that the details of the components of the SERP be reported for the interim periods, in addition to the annual reporting of these costs. We are currently evaluating the impact of ASU 2017-07 on our consolidated financial statements which is effective beginning January 1, 2018.

Also in March 2017, the FASB issued ASU 2017-08, *"Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities"* . This update shortens the amortization period of a callable security that is held at a premium to the earliest call date of that security instead of the contractual life of the security. Although the Company does not currently hold any callable securities at a premium, we may do so in the future. Unless such securities are purchased by us, we do not believe that ASU 2017-08 will have an impact on our consolidated financial statements effective beginning January 1, 2019.

In May 2017, the FASB issued ASU 2017-09, *"Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting"* , which clarifies the application of the guidance in Topic 718 on stock compensation in order to reduce the diversity in practice and to reduce the cost and complexity of applying the Topic to a change in the terms or conditions of a share-based payment award. Although this standard will be adopted effective January 1, 2018, the Company has issued no stock options or phantom stock options to date, so this update is expected to have no impact on our consolidated financial position or results of operation at this time.

Note 3 – Earnings Per Common Share

Basic earnings per common share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Potential common shares that may be issued by the Company relate to shares subscribed but not yet issued in 2017 and 2016 under the Employee Stock Purchase Plan, and are reported as dilutive options. No shares were subscribed but not issued at the end of the nine months ended September 30, 2017 and 2016.

Earnings per common share are computed based on reported net income, preferred stock dividends and the following common share data:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	$ 3,180	$ 3,612	$ 8,734	$ 9,936
Less preferred stock dividends	(138)	-	(414)	-
Net income available for common stockholders	3,042	3,612	8,320	9,936
Weighted average number of common shares outstanding	9,281	9,257	9,274	9,250
Effect of dilutive options	-	-	-	-
Weighted average number of common shares outstanding - used to calculate diluted earnings per common share	9,281	9,257	9,274	9,250
Earnings per common share:			-	
Basic	$ 0.34	$ 0.39	$ 0.94	$ 1.07
Diluted	$ 0.34	$ 0.39	$ 0.94	$ 1.07

Note 4 – Investment Securities

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

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 105,384	$ 22	$ (633)	$ 104,773
U.S. government agency pool securities	319,124	58	(1,418)	317,764
U.S. government agency or GSE residential mortgage-backed securities	80,158	42	(662)	79,538
Total	$ 504,666	$ 122	$ (2,713)	$ 502,075
Securities Held-to-Maturity				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 45,111	$ 850	$ (48)	$ 45,913
U.S. government agency pool securities	12,330	34	(38)	12,326
U.S. government agency or GSE residential mortgage-backed securities	33,855	411	(212)	34,054
Total	$ 91,296	$ 1,295	$ (298)	$ 92,293

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 125,476	$ 6	$ (1,051)	$ 124,431
U.S. government agency pool securities	238,615	124	(1,613)	237,126
U.S. government agency or GSE residential mortgage-backed securities	59,049	36	(762)	58,323
Total	$ 423,140	$ 166	$ (3,426)	$ 419,880
Securities Held-to-Maturity				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 44,909	$ 956	$ (36)	$ 45,829
U.S. government agency pool securities	13,591	14	(91)	13,514
U.S. government agency or GSE residential mortgage-backed securities	37,667	373	(320)	37,720
Total	$ 96,167	$ 1,343	$ (447)	$ 97,063

At September 30, 2017, and December 31, 2016, investment securities with a carrying value of $368.9 million and $319.5 million, respectively , were pledged to secure various government deposits and to meet other public requirements.

Proceeds and gross realized gains (losses) from the sales or calls of investment securities for the three- and nine-month periods ended September 30, 2017 and 2016, are shown below:

	Three Months Ended September 30,	
	2017	2016
Proceeds from sales	$ -	$ 15,237
Gross realized gains from sales	$ -	$ 272
Gross realized losses from sales	$ -	$ -

	Nine Months Ended September 30,	
	2017	2016
Proceeds from sales	$ 12,896	$ 39,950
Gross realized gains from sales	$ 1	$ 406
Gross realized losses from sales	$ (14)	$ (5)

The amortized cost and estimated fair value of investment securities by contractual maturity at September 30, 2017, and December 31, 2016, are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or borrowers the right to prepay obligations with or without call or prepayment penalties. At September 30, 2017, obligations of U.S. government corporations and agencies with amortized costs totaling $ 596.0 million consist predominantly of Small Business Administration agency pool securities totaling $331.5 million and residential mortgage-backed securities totaling $114.0 million whose contractual maturity, or principal repayment, will follow the repayment of the underlying small business loans or mortgages. For purposes of the following table, the entire outstanding balance of these SBA Pools and mortgage-backed securities issued by U.S. government corporations and agencies is categorized based on final maturity date. At September 30, 2017, the Bank estimates the average remaining life of these SBA Pools and mortgage-backed securities to be approximately 5.50 years and 3.86 years, respectively.

	September 30, 2017			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ 431	$ 433	$ 4,500	$ 4,492
Due after one but within five years	111,618	110,969	56,179	57,300
Due after five but within ten years	51,809	51,549	19,063	19,094
Due after ten years	340,808	339,124	11,554	11,407
Total	$ 504,666	$ 502,075	$ 91,296	$ 92,293

	December 31, 2016			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ -	$ -	$ -	$ -
Due after one but within five years	131,023	129,943	57,761	58,831
Due after five but within ten years	44,787	44,627	14,427	14,609
Due after ten years	247,330	245,310	23,979	23,623
Total	$ 423,140	$ 419,880	$ 96,167	$ 97,063

Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2017, and December 31, 2016.

	September 30, 2017					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (299)	$ 52,089	$ (334)	$ 47,711	$ (633)	$ 99,800
U.S. government agency pool securities	(461)	149,410	(957)	123,259	(1,418)	272,669
U.S. government agency or GSE residential mortgage-backed securities	(463)	47,168	(199)	18,704	(662)	65,872
Total	$ (1,223)	$ 248,667	$ (1,490)	$ 189,674	$ (2,713)	$ 438,341
Securities Held to Maturity						
U.S. government agency and GSE debt securities	$ (48)	$ 16,068	$ -	$ -	$ (48)	$ 16,068
U.S. government agency pool securities	(9)	4,899	(29)	3,412	(38)	8,311
U.S. government agency or GSE residential mortgage-backed securities	(117)	10,193	(95)	2,207	(212)	12,400
Total	$ (174)	$ 31,160	$ (124)	$ 5,619	$ (298)	$ 36,779

	December 31, 2016					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (1,051)	$ 116,516	$ -	$ -	$ (1,051)	$ 116,516
U.S. government agency pool securities	(597)	174,370	(1,016)	34,222	(1,613)	208,592
U.S. government agency or GSE residential mortgage-backed securities	(693)	42,997	(69)	9,225	(762)	52,222
Total	$ (2,341)	$ 333,883	$ (1,085)	$ 43,447	$ (3,426)	$ 377,330
Securities Held to Maturity						
U.S. government agency and GSE debt securities	$ (36)	$ 16,052	$ -	$ -	$ (36)	$ 16,052
U.S. government agency pool securities	(9)	2,748	(82)	10,144	(91)	12,892
U.S. government agency or GSE residential mortgage-backed securities	(320)	16,990	-	-	(320)	16,990
Total	$ (365)	$ 35,790	$ (82)	$ 10,144	$ (447)	$ 45,934

The investment securities that were in an unrealized loss position as of September 30, 2017, which comprised a total of 152 securities, were not other-than-temporarily impaired. Specifically, the 152 securities are comprised of the following: 93 Small Business Administration (SBA) Pool securities, 22 mortgage-backed securities issued by the Government National Mortgage Association (GNMA), 18 U.S. Treasuries, 8 mortgage-backed securities, 7 agency securities issued by the Federal Home Loan Bank (FHLB) and 1 agency security issued by the Federal National Mortgage Association (FNMA), 1 mortgage-backed security and 1 step up bond issued by Federal Home Loan Mortgage Corporation (FHLMC), and 1 agency security issued by Federal Farm Credit Banks (FFCB).

Total gross unrealized losses were primarily attributable to changes in market interest rates, relative to when the investment securities were purchased, and not due to any change in the credit quality of the investment securities. In addition, these securities and their repayment are sponsored by the U.S. Government or its various agencies and therefore, it is unlikely that they will ever be settled for less than par. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not likely that the Company will be required to sell the investment securities before recovery of their amortized cost, which may be at maturity.

Investment in Unconsolidated Subsidiary

In May 2016, the Company entered into a Stock Purchase Agreement to acquire 25% of ASC Trust Corporation, a Guam trust company. In July 2016, subsequent to the approval of the Federal Reserve Bank of San Francisco in June 2016, the purchase was executed. The Agreement provides for the acquisition of an additional 20% of the stock of ASC Trust Corporation in April 2019, and another 25% in April 2021, with both future purchases subject to regulatory approval. The Agreement contains customary warranties, representations and indemnification provisions. The ASC Trust Corporation stock is subject to the equity method of accounting in our Statements of Condition. During the nine months ended September 30, 2017, the Company's recorded investment in ASC Trust increased by $67 thousand, based upon the earnings of ASC that are attributed to the Company's ownership, less of the amount of dividends received during the first nine months of the year.

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

Loans Held for Sale

In its normal course of business, the Bank originates mortgage loans held for sale to the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac"). The Bank has elected to measure its residential mortgage loans held for sale at cost. Origination fees and costs are recognized in earnings at the time of origination. Loans are sold to Freddie Mac at par.

For the three months ended September 30, 2017 and 2016, the Bank originated and sold approximately $4.9 million and $6.0 million in FHLMC mortgage loans, respectively. During the nine months ended September 30, 2017 and 2016, the Bank originated and sold approximately $13.4 million and $15.0 million, respectively, of these loans.

Mortgage loans serviced for others are not included in the accompanying condensed consolidated statements of condition. The unpaid principal balances of mortgage loans serviced for others were $206.8 million and $211.0 million at September 30, 2017, and December 31, 2016, respectively. The decrease of $4.2 million (2.0 %) during the first three quarters of 2017 was due to scheduled principal payments and prepayments.

We retain mortgage servicing rights (MSRs) on mortgage loans that we sell. Such rights represent the net positive cash flows generated from the servicing of such mortgage loans and we recognize such rights as assets on our statements of financial condition based on their estimated fair values. We receive servicing fees, less any subservicing costs, on the unpaid principal balances of such mortgage loans. Those fees are collected from the monthly payments made by the mortgagors or from the proceeds of the sale or foreclosure and liquidation of the underlying real property collateralizing the loans. At September 30, 2017, and December 31, 2016, mortgage servicing rights totaled $1.5 million and $1.5 million, respectively, and are included in other assets in the accompanying consolidated statements of condition. The Bank accounts for mortgage servicing rights at fair value with changes in fair value recorded in the condensed consolidated statements of income, subject to annual updates in our prepayment speed assumptions.

Loans

Outstanding loan balances are presented net of unearned income, deferred loan fees, and unamortized discount and premium. Loans acquired with evidence of deteriorated quality at the time of purchase are presented net of the related accretable yield.

The loan portfolio consisted of the following at:

	September 30, 2017		December 31, 2016	
	Amount	Percent	Amount	Percent
Commercial				
Commercial & industrial	$ 253,206	21.2%	$ 248,059	21.1%
Commercial mortgage	541,796	45.4%	552,272	47.0%
Commercial construction	13,596	1.1%	6,421	0.5%
Commercial agriculture	724	0.1%	747	0.1%
Total commercial	809,322	67.9%	807,499	68.7%
Consumer				
Residential mortgage	137,697	11.5%	143,951	12.2%
Home equity	436	0.0%	480	0.0%
Automobile	30,779	2.6%	30,798	2.6%
Other consumer loans [1]	214,406	18.0%	193,279	16.4%
Total consumer	383,318	32.1%	368,508	31.3%
Gross loans	1,192,640	100.0%	1,176,007	100.0%
Deferred loan (fees) costs, net	(2,897)		(2,527)	
Allowance for loan losses	(15,215)		(15,435)	
Loans, net	$ 1,174,528		$ 1,158,045	

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

Allowance for Loan Losses

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

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

Set forth below is a summary of the Bank's activity in the allowance for loan losses during the three and nine months ended September 30, 2017 and 2016, and the year ended December 31, 2016:

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016	Year Ended December 31, 2016
Balance, beginning of period	$ 15,371	$ 15,949	$ 15,435	$ 14,159	$ 14,159
Provision for loan losses	1,186	385	3,553	2,715	3,900
Recoveries on loans previously charged off	390	347	1,188	2,642	3,007
Charged off loans	(1,732)	(1,322)	(4,961)	(4,157)	(5,631)
Balance, end of period	$ 15,215	$ 15,359	$ 15,215	$ 15,359	$ 15,435

Set forth below is information regarding loan balances and the related allowance for loan losses, by portfolio type, for the three and nine months ended September 30, 2017 and 2016, and the year ended December 31, 2016, respectively.

	Commercial	Residential Mortgages	Consumer	Total
	(Dollars in thousands)			
Nine Months Ended September 30, 2017				
Allowance for loan losses:				
Balance at beginning of period	$ 8,599	$ 1,878	$ 4,958	$ 15,435
Charge-offs	(9)	(145)	(4,807)	$ (4,961)
Recoveries	38	5	1,145	$ 1,188
Provision	352	36	3,165	$ 3,553
Balance at end of period	$ 8,980	$ 1,774	$ 4,461	$ 15,215
Three Months Ended September 30, 2017				
Allowance for loan losses:				
Balance at beginning of period	$ 8,829	$ 1,857	$ 4,685	$ 15,371
Charge-offs	(9)	(115)	(1,608)	$ (1,732)
Recoveries	7	2	381	$ 390
Provision	153	30	1,003	$ 1,186
Balance at end of period	$ 8,980	$ 1,774	$ 4,461	$ 15,215
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	$ 40	$ 6	$ 1,507	$ 1,553
Loans collectively evaluated for impairment	8,940	1,768	2,954	13,662
Ending Balance	$ 8,980	$ 1,774	$ 4,461	$ 15,215
Loan balances at end of period:				
Loans individually evaluated for impairment	$ 6,304	$ 5,876	$ 1,958	$ 14,138
Loans collectively evaluated for impairment	803,018	132,257	243,227	1,178,502
Ending Balance	$ 809,322	$ 138,133	$ 245,185	$ 1,192,640
Nine Months Ended September 30, 2016				
Allowance for loan losses:				
Balance at beginning of period	$ 6,890	$ 1,853	$ 5,416	$ 14,159
Charge-offs	(270)	(121)	(3,766)	$ (4,157)
Recoveries	1,667	3	972	$ 2,642
Provision	184	249	2,282	$ 2,715
Balance at end of period	$ 8,471	$ 1,984	$ 4,904	$ 15,359
Three Months Ended September 30, 2016				
Allowance for loan losses:				
Balance at beginning of period	$ 8,421	$ 2,010	$ 5,518	$ 15,949
Charge-offs	(64)	(30)	(1,228)	$ (1,322)
Recoveries	10	1	336	$ 347
Provision	104	3	278	$ 385
Balance at end of period	$ 8,471	$ 1,984	$ 4,904	$ 15,359
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	$ 11	$ 16	$ 1,098	$ 1,125
Loans collectively evaluated for impairment	8,460	1,968	3,806	14,234
Ending Balance	$ 8,471	$ 1,984	0$ 4,904	$ 15,359
Loan balances at end of period:				
Loans individually evaluated for impairment	$ 8,241	$ 6,556	$ 1,465	$ 16,262
Loans collectively evaluated for impairment	775,231	138,619	209,433	1,123,283
Ending Balance	$ 783,472	$ 145,175	$ 210,898	$ 1,139,545

Year Ended December 31, 2016				
Allowance for loan losses:				
Balance at beginning of year	$ 6,890	$ 1,853	$ 5,416	$ 14,159
Charge-offs	(276)	(121)	(5,234)	(5,631)
Recoveries	1,691	6	1,310	3,007
Provision	294	140	3,466	3,900
Balance at end of year	$ 8,599	$ 1,878	$ 4,958	$ 15,435
Allowance balance at end of year related to:				
Loans individually evaluated for impairment	$ 2	$ 15	$ 1,422	$ 1,439
Loans collectively evaluated for impairment	8,597	1,863	3,536	13,996
Ending Balance	$ 8,599	$ 1,878 0	$ 4,958	$ 15,435
Loan balances at end of year:				
Loans individually evaluated for impairment	$ 7,577	$ 6,208	$ 1,897	$ 15,682
Loans collectively evaluated for impairment	799,922	138,223	222,180	1,160,325
Ending Balance	$ 807,499	$ 144,431	$ 224,077	$ 1,176,007

Impairment is measured on a loan-by-loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral (if the loan is collateral-dependent). Large groups of smaller-balance homogeneous loans, such as consumer loans, are collectively evaluated for impairment. Impairment reserves for these groups of consumer loans are determined using historical loss given default rates for similar loans.

Credit Quality

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater	Total Past Due	Current	Total Loans Outstanding
September 30, 2017						
Commercial						
Commercial & industrial	$ 1,774	$ 401	$ -	$ 2,175	$ 251,031	$ 253,206
Commercial mortgage	-	1,009	262	1,271	540,525	541,796
Commercial construction	-	-	-	-	13,596	13,596
Commercial agriculture	-	-	-	-	724	724
Total commercial	1,774	1,410	262	3,446	805,876	809,322
Consumer						
Residential mortgage	4,362	3,415	2,323	10,100	127,597	137,697
Home equity	97	8	-	105	331	436
Automobile	1,264	432	97	1,793	28,986	30,779
Other consumer [1]	3,360	2,032	1,826	7,218	207,188	214,406
Total consumer	9,083	5,887	4,246	19,216	364,102	383,318
Total	$ 10,857	$ 7,297	$ 4,508	$ 22,662	$ 1,169,978	$ 1,192,640
December 31, 2016						
Commercial						
Commercial & industrial	$ 610	$ 269	$ 119	$ 998	$ 247,061	$ 248,059
Commercial mortgage	-	770	691	1,461	550,811	552,272
Commercial construction	-	-	-	-	6,421	6,421
Commercial agriculture	-	-	-	-	747	747
Total commercial	610	1,039	810	2,459	805,040	807,499
Consumer						
Residential mortgage	6,277	3,457	3,211	12,945	131,006	143,951
Home equity	-	102	-	102	378	480
Automobile	1,288	239	104	1,631	29,167	30,798
Other consumer [1]	2,521	1,149	1,771	5,441	187,838	193,279
Total consumer	10,086	4,947	5,086	20,119	348,389	368,508
Total	$ 10,696	$ 5,986	$ 5,896	$ 22,578	$ 1,153,429	$ 1,176,007

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

Generally, the accrual of interest on a loan is discontinued when principal or interest payments become more than 90 days past due, unless management believes the loan is adequately collateralized and is in the process of collection, with the exception of automobile and other consumer loans which, rather than being placed on non-accrual status, are charged off once they become 120 days delinquent. When a loan is placed on non-accrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of cash are applied as principal reductions when received, except when the ultimate collectability of principal is probable, in which case interest payments are credited to income. Non-accrual loans may be restored to accrual status when principal and interest become current and full repayment is expected.

The following table provides information as of September 30, 2017, and December 31 , 2016, with respect to loans on non-accrual status, by portfolio type:

	September 30, 2017	December 31, 2016
	(Dollars in thousands)	
Non-accrual loans:		
Commercial		
Commercial & industrial	$ 230	$ 1,094
Commercial mortgage	5,955	6,390
Commercial construction	-	-
Commercial agriculture	-	-
Total commercial	6,185	7,484
Consumer		
Residential mortgage	$ 6,276	$ 6,353
Home equity	-	35
Automobile	-	-
Other consumer [1]	150	174
Total consumer	6,426	6,562
Total non-accrual loans	$ 12,611	$ 14,046

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

Credit Quality Indicators

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

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

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

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

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

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

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

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

Formula Classified: Formula Classified loans are all loans and credit cards delinquent 90 days and over which have yet to be formally classified Special Mention, Substandard or Doubtful by the Ba nk's Loan Committee. In most instances, the monthly formula total is comprised primarily of residential real estate loans, consumer loans, credit cards and commercial loans under $250 thousand. However, commercial loans are typically formally classified by the Loan Committee no later than their 90-day delinquency, and those do not become part of the formula classification. Real estate loans 90-days delinquent that are in the foreclosure process, which is typically completed within another 60 days, are not f ormally classified during this period.

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

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

The Bank classifies its loan portfolios using internal credit quality ratings, as discussed above under *Allowance for Loan Losses* . The following table provides a summary of loans by portfolio type and the Bank's internal cred it quality ratings as of September 30, 2017, and December 31, 2016:

	September 30, 2017	December 31, 2016	Increase (Decrease)
		(Dollars in thousands)	
Pass:			
Commercial & industrial	$ 224,462	$ 231,553	$ (7,091)
Commercial mortgage	504,418	538,471	(34,053)
Commercial construction	13,596	6,422	7,174
Commercial agriculture	724	747	(23)
Residential mortgage	131,284	137,446	(6,162)
Home equity	436	445	(9)
Automobile	30,683	30,714	(31)
Other consumer	212,545	191,467	21,078
Total pass loans	$ 1,118,148	$ 1,137,265	$ (19,117)
Special Mention:			
Commercial & industrial	$ 23,974	$ 14,710	$ 9,264
Commercial mortgage	31,088	6,055	25,033
Commercial construction	-	-	-
Commercial agriculture	-	-	-
Residential mortgage	144	152	(8)
Home equity	-	-	-
Automobile	-	-	-
Other consumer	-	-	-
Total special mention loans	$ 55,206	$ 20,917	$ 34,289
Substandard:			
Commercial & industrial	$ 4,765	$ 1,790	$ 2,975
Commercial mortgage	6,085	7,521	(1,436)
Commercial construction	-	-	-
Commercial agriculture	-	-	-
Residential mortgage	627	431	196
Home equity	-	-	-
Automobile	-	-	-
Other consumer	-	-	-
Total substandard loans	$ 11,477	$ 9,742	$ 1,735
Formula Classified:			
Commercial & industrial	$ 5	$ 6	$ (1)
Commercial mortgage	205	224	(19)
Commercial construction	-	-	-
Commercial agriculture	-	-	-
Residential mortgage	5,641	5,922	(281)
Home equity	-	35	(35)
Automobile	97	84	13
Other consumer	1,861	1,812	49
Total formula classified loans	$ 7,809	$ 8,083	$ (274)
Doubtful:			
Commercial & industrial	$ -	$ -	$ -
Commercial mortgage	-	-	-
Commercial construction	-	-	-
Commercial agriculture	-	-	-
Residential mortgage	-	-	-
Home equity	-	-	-
Automobile	-	-	-
Other consumer	-	-	-
Total doubtful loans	$ -	$ -	$ -
Total outstanding loans, gross	$ 1,192,640	$ 1,176,007	$ 16,633

As the above table indicates, the Bank's total gross loans approximated $1.19 billion at September 30, 2017, up from $1.18 billion at December 31, 2016. The disaggregation of the portfolio by risk rating in the table reflects the following changes between December 31, 2016, and September 30, 2017:

- Loans rated "pass" decreased by $19.1 million to $1.12 billion at September 30, 2017, down from $1.14 billion at December 31, 2016. The decrease was primarily in commercial mortgage loans, which decreased by $34.1 million, commercial & industrial loans, which fell by $7.1 million, and residential mortgage loans, which decreased by $6.2 million. These decreases were partially offset by increases in other consumer loans by $21.1 million and in commercial construction loans by $7.2 million. The decreases are primarily attributed to: (i) commercial mortgage loans, due to one loan payoff of $60 million, (ii) commercial & industrial loans, due to payoffs, paydowns and three loan relationships reclassified to "special mention" totaling $15.0 million, and (iii) residential mortgage loans, due to payoffs and paydowns, net of new originations. The increase in other consumer loans was primarily due to consumer loan promotions. The increase in commercial construction loans was primarily due to new construction loans of $7.0 million in Guam.
- The "special mention" category, at $55.2 million, was $34.3 million higher at September 30, 2017, than at December 31, 2016. This is attributed to an increase in special mention commercial mortgage loans by $25.0 million, primarily as a result of two loan relationships reclassified from "pass" to "special mention." Additionally there was an increase in special mention commercial & industrial loans by $9.3 million, principally due to $15.0 million in three loan relationships being reclassified from "pass" to "special mention."
- Loans classified "substandard" increased by $1.7 million, to $11.5 million at September 30, 2017, from $9.7 million at December 31, 2016. The increase in substandard commercial & industrial loans was mainly the result of the reclassification of one $3.9 million loan relationship to "substandard" from "special mentio n," partially offset by $197 thousand in loan paydowns and one loan payoff by $795 thousand. This was partially offset by a decrease in commercial mortgage loans due to $830 thousand (two loans) in payoffs, $188 thousand in one loan relationship upgraded from "substandard" to "special mention," and one loan foreclosed and transferred to OREO in the amount of $118 thousand.
- The "formula classified" category decreased by $274 thousand, to $7.8 million from $8.1 million, primarily due to a decrease of $281 thousand in residential mortgage loans. This decrease is due to $616 thousand in payoffs and $603 thousand in paydowns, partially offset by $1.3 million of these loans that were transferred into "formula classified."
- There were no loans classified as "doubtful" or "loss" at either September 30, 2017, or December 31, 2016.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due according to the original contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impaired loans include loans that are in non-accrual status and other loans that have been modified in Troubled Debt Restructurings (TDRs), where economic concessions have been granted to borrowers experiencing financial difficulties. These concessions typically result from the Bank's loss mitigation actions, and could include reductions in the interest rate, payment extensions, forbearance, or other actions taken with the intention of maximizing collections.

The following table sets forth information regarding non-accrual loans and restructured loans, at September 30, 2017, and December 31, 2016:

	September 30, 2017	December 31, 2016
	(Dollars in thousands)	
Impaired loans:		
Restructured loans:		
Non-accruing restructured loans	$ 5,365	$ 6,589
Accruing restructured loans	322	265
Total restructured loans	5,687	6,854
Other non-accruing impaired loans	8,451	8,828
Total impaired loans	$ 14,138	$ 15,682
Impaired loans less than 90 days delinquent and included in total impaired loans	$ 10,095	$ 9,913

The table below contains additional information with respect to impaired loans, by portfolio type, at September 30, 2017, and December 31, 2016:

	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
September 30, 2017, With no related allowance recorded:				
Commercial & industrial	$ 224	$ 224	$ 604	$ 1
Commercial mortgage	5,491	5,491	5,560	-
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	235	235	240	-
Home equity	-	-	-	-
Automobile	-	-	-	-
Other consumer	-	-	-	-
Total impaired loans with no related allowance	$ 5,950	$ 5,950	$ 6,404	$ 1
September 30, 2017, With a related allowance recorded:				
Commercial & industrial	$ 174	$ 345	$ 90	$ 1
Commercial mortgage	415	441	283	-
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	5,641	5,654	5,715	-
Home equity	-	-	-	-
Automobile	97	97	77	3
Other consumer	1,861	1,861	1,493	21
Total impaired loans with a related allowance	$ 8,188	$ 8,398	$ 7,658	$ 25
December 31, 2016, With no related allowance recorded:				
Commercial & industrial	$ 1,274	$ 2,904	$ 1,135	$ 25
Commercial mortgage	6,073	6,299	7,052	-
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	250	250	252	-
Home equity	-	-	-	-
Automobile	-	-	-	-
Other consumer	-	-	-	-
Total impaired loans with no related allowance	$ 7,597	$ 9,453	$ 8,439	$ 25
December 31, 2016, With a related allowance recorded:				
Commercial & industrial	$ 6	$ 10	$ 57	$ -
Commercial mortgage	224	224	233	-
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	5,923	5,934	6,519	2
Home equity	35	35	35	-
Automobile	85	84	73	2
Other consumer	1,812	1,813	1,613	17
Total impaired loans with a related allowance	$ 8,085	$ 8,100	$ 8,530	$ 21

Impairment is measured on a loan-by-loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price, or the fair value of the collateral (if the loan is collateral-dependent). Large groups of smaller-balance, homogeneous loans are collectively evaluated for impairment. For the large groups of smaller-balance, homogenous loans, the Bank will allocate a specific reserve for these loans and not write-down the impairment at the end of each reporting period. The Bank performs direct write-downs of impaired loans with a charge to the allocated component of the allowance for loan losses, thereby reducing the allocated component of the allowance to zero at the end of each reporting period.

Troubled Debt Restructurings

The Bank had $5.7 million of troubled debt restructurings (TDRs) as of September 30, 2017, down by $1.2 million from $6.9 million at December 31, 2016, and entirely in commercial mortgage loans, with a decrease of $6.3 million in nonperforming loans in this category partially offset by an increase of $5.1 million in performing commercial mortgages. The restructured loans recorded with the Bank have been modified for the purpose of alleviating temporary impairments to the borrower's financial condition. The modifications that the Bank has extended to borrowers have come in the form of a change in the amortization terms, a reduction in the interest rate, and interest-only payments. The workout plan between the borrower and the Bank is designed to provide a bridge for cash flow shortfalls in the near term. As the borrower works through the near-term issues, in most cases, the original contractual terms will be reinstated.

Additional information regarding performing and nonperforming TDRs at September 30, 2017, and December 31, 2016, is set forth in the following table:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Principal Modifications	Post-Modification Outstanding Recorded Investment	Outstanding Balance September 30, 2017	Outstanding Balance December 31, 2016
Performing						
Residential mortgage	-	$ -	$ -	$ -	$ -	$ -
Commercial mortgage	2	369	-	369	322	265
Automobile	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total Performing	2	$ 369	$ -	$ 369	$ 322	$ 265
Nonperforming						
Residential mortgage	-	$ -	$ -	$ -	$ -	$ -
Commercial mortgage	8	7,939	-	7,939	5,365	6,589
Automobile	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total Nonperforming	8	$ 7,939	$ -	$ 7,939	$ 5,365	$ 6,589
TDRs	10	$ 8,308	$ -	$ 8,308	$ 5,687	$ 6,854

Principal modification includes principal forgiveness at the time of modification, contingent principal forgiveness granted over the life of the loan based on borrower performance, and principal that has been legally separated and deferred to the end of the loan, with zero percent contractual interest rate.

During the nine-month periods ended September 30, 2017 and 2016, no loans were modified as troubled debt restructurings.

There were no defaults on troubled debt restructurings within twelve months following the modification, nor were there any charge-offs or impacts to ALLL from loans identified as troubled debt restructurings during the nine months ended September 30, 2017 and 2016.

Note 6 – Commitments and Contingencies

The Bank is involved in certain legal actions and claims that arise in the ordinary course of business. Management believes that, as a result of its legal defenses and insurance arrangements, none of these matters is expected to have a material adverse effect on the Bank's, BGIS's or the Company's financial condition, results of operations or cash flows.

Note 7 – Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the United States federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's, BGIS's and the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). As of September 30, 2017, and December 31, 2016, the Bank met all capital adequacy requirements to which it is subject.

In December 2010, the Basel Committee on Bank Supervision ("Basel Committee") released its final framework for strengthening international capital and liquidity regulation, now officially identified as "Basel III," which, when fully phased-in, would require bank holding companies and their bank subsidiaries to maintain substantially more capital than had previously been required, with a greater emphasis on common equity.

In July 2013, the U.S. banking regulatory agencies approved the U.S. version of Basel III. The agencies-adopted version of Basel III revises the ri sk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Although many of the rules contained in these final regulations are ap plicable only to large, internationally active banks, some of them apply on a phased-in basis to all banking organizations, including the Company and the Bank. Among other things, the rules establish a new minimum common equity Tier 1 ratio (4.5% of risk-w eighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00%, eliminating a 3.00% exception for higher rated banks). The new additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios is being phased in from 2016 to 2019 (1.25% in 2017 and 0.625% in 2016) and must be met to avoid limitations on the ability of the Company and the Bank to pay dividends, repurchase s hares or pay discretionary bonuses. An additional “countercyclical capital buffer” is required for larger and more complex institutions. At September 30, 2017, the actual capital conservation buffer was 5.23% and 4.87% for the Company and the Bank, respect ively, and the minimum conservation buffer requirement was 1.25%. The rules, including alternative requirements for smaller community financial institutions like the Company and the Bank, will be phased in through 2019.

As of September 30, 2017, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum Total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank’s category. The Bank’s actual capital amounts and ratios as of September 30, 2017, and December 31, 2016, are also presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2017:						
Total capital (to Risk Weighted Assets)	$ 151,022	12.865%	$ 108,583	9.250%	$ 117,387	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 136,342	11.615%	$ 85,106	7.250%	$ 93,910	8.000%
Tier 1 capital (to Average Assets)	$ 136,342	6.878%	$ 91,680	4.625%	$ 99,113	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 131,342	11.189%	$ 67,498	5.750%	$ 76,302	6.500%
At December 31, 2016:						
Total capital (to Risk Weighted Assets)	$ 144,827	12.610%	$ 99,023	8.625%	$ 114,809	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 130,463	11.360%	$ 76,061	6.625%	$ 91,847	8.000%
Tier 1 capital (to Average Assets)	$ 130,463	7.060%	$ 73,937	4.000%	$ 92,421	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 125,463	10.930%	$ 58,839	5.125%	$ 74,626	6.500%

In addition, the Company's actual capital amounts and ratios as of September 30, 2017, and December 31, 2016, are also presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2017						
Total capital (to Risk Weighted Assets)	$ 155,693	13.227%	$ 108,881	9.250%	$ 117,709	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 140,972	11.976%	$ 85,339	7.250%	$ 94,167	8.000%
Tier 1 capital (to Average Assets)	$ 140,972	7.100%	$ 91,825	4.625%	$ 99,270	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 131,189	11.145%	$ 67,683	5.750%	$ 76,511	6.500%
At December 31, 2016						
Total capital (to Risk Weighted Assets)	$ 149,540	12.990%	$ 106,483	9.250%	$ 115,117	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 135,138	11.739%	$ 83,460	7.250%	$ 92,093	8.000%
Tier 1 capital (to Average Assets)	$ 135,138	7.299%	$ 85,633	4.625%	$ 92,576	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 125,355	10.889%	$ 66,192	5.750%	$ 74,826	6.500%

Stock Purchase Plan

Under the Bank's 2011 Employee Stock Purchase Plan, eligible employees can purchase, through payroll deductions, shares of common stock at a discount. The right to purchase stocks is granted to eligible employees during a quarterly offer period that is established from time to time by the Board of Directors of the Company. Eligible employees cannot accrue the right to purchase more than $25 thousand worth of stock at the fair market value at the beginning of each offer period. Eligible employees also may not purchase more than one thousand five hundred (1,500) shares of stock in any one offer period. The shares are purchased at 85% of the fair market price of the stock on the enrollment date. Proceeds from the issuance of common stock under this Plan were $99 thousand during the first nine months of 2017, compared to proceeds of $88 thousand during the year-earlier period.

Non-Cumulative Perpetual Preferred Stock

Commencing September 15, 2016, the Company offered a private placement of securities for the issuance and sale of an aggregate of 10,000 shares of its new, non-voting Series A Non-Cumulative Perpetual Preferred Stock (the "Series A Preferred Stock"). These securities were offered to various accredited and a limited number of non-accredited investors for total proceeds of up to $10 million (the "Offering"). Each subscriber could purchase a minimum number of Series A Preferred Stock equivalent to at least $250,000 (250 shares). This offering carried a subscription price of $1 thousand per share and an initial fixed yield of 5.5% per annum, but the yield becomes floating at June 30, 2021, after which the annual yield will be the three-month LIBOR rate plus 4.825%. The Series A Preferred Stock carries a liquidation preference of $1 thousand per share. The Offering agreement contains customary warranties, representations and indemnification provisions, and expired on December 31, 2016. At September 30, 2017, 9,783 of these shares were issued and outstanding.

Note 8 – Off-Balance-Sheet Activities

The Bank is a party to credit-related financial instruments with off-balance-sheet risk to meet the financing needs of its customers in the normal course of business. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in addition to the amount reflected in the condensed consolidated financial statements.

The Bank's exposure to credit loss, in the event of nonperformance by the other parties to financial instruments for loan commitments and letters of credit, is represented by the contractual amount of these instruments. The Bank follows the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of financial instruments with off-balance-sheet risk at September 30, 2017, and December 31, 2016, is as follows:

	September 30, 2017	December 31, 2016
Commitments to extend credit	$ 166,140	$ 152,585
Letters of credit:		
Standby letters of credit	$ 54,365	$ 52,396
Commercial letters of credit	2,711	3,045
Total	$ 57,076	$ 55,441

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for some lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party or the shipment of merchandise from a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. The majority of all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers, and similar credit underwriting standards are applied. The Bank generally holds collateral supporting those commitments.

The Bank considers its standby and other letters of credit to be payment guarantees. At September 30, 2017, the maximum undiscounted future payments that the Bank could be required to make for all outstanding letters of credit were $57.1 million. All of these arrangements mature within one year. The Bank has recourse to recover from the customer any amounts paid under these guarantees. Most of the guarantees are fully collateralized; however, several are unsecured. The Bank had recorded $22.5 thousand and $18.0 thousand in reserve liabilities associated with these guarantees at September 30, 2017, and December 31, 2016, respectively.

Note 9 – Income Taxes

We record an amount equal to the tax credits, tax loss carry-forwards and tax deductions ("tax benefits") that we believe will be available to us to offset or reduce the amounts of our income taxes in future periods as a deferred tax asset on our Statements of Condition. Under applicable federal and state income tax laws and regulations in the United States, such tax benefits will expire if not used within specified periods of time. Accordingly, the ability to fully use our deferred tax asset depends on the amount of taxable income that we generate during those time periods. At least once each year, or more frequently if warranted, we make estimates of future taxable income that we believe we are likely to generate during those future periods. If we conclude, on the basis of those estimates and the amount of the tax benefits available to us, that it is more likely than not that we will be able to fully utilize those tax benefits prior to their expiration, we recognize the deferred tax asset in full on our balance sheet. On the other hand, if we conclude on the basis of those estimates and the amount of the tax benefits available to us that it has become more likely than not that we will be unable to utilize those tax benefits in full prior to their expiration, then we would establish a (or increase any existing) valuation allowance to reduce the deferred tax asset on our balance sheet to the amount which we believe we are more likely than not to be able to utilize. Such a reduction is implemented by recognizing a non-cash charge that would have the effect of increasing the provision, or reducing any credit, for income taxes that we would otherwise have recorded in our statements of income. The determination of whether and the extent to which we will be able to utilize our deferred tax asset involves significant management judgments and assumptions that are subject to period-to-period changes as a result of changes in tax laws, changes in the market, or economic conditions that could affect our operating results or variances between our actual operating results and our projected operating results, as well as other factors.

A valuation allowance of $3.2 million has been provided at September 30, 2017, and December 31, 2016, to reduce the deferred tax asset because, in management's opinion, it is more likely than not that less than the entire amount will be realized. The portion of the deferred tax asset with valuation allowance is attributable to a cumulative net operating loss carry forward from the Bank's CNMI operations, which losses management anticipates will continue. The charge from the net operating loss has already been realized in the accompanying statements of income as a result of the Guam income tax code.

The difference between the effective income tax expense and the income tax expense computed at the Guam statutory rate was due to nontaxable interest income earned on loans to the Government of Guam and its autonomous agencies.

In addition to filing a federal income tax return in Guam, the Bank files income tax returns in the CNMI and the State of California. The Bank is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2010.

Note 10 – Fair Value Measurements

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with ASC Topic 820 *"Fair Value Measurements and Disclosures"* , the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The fair value guidance of ASC Topic 820 provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the m easurement date under then-current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. I n such instances, determining the price at which willing market participants would transact at the measurement date under then-current market conditions depends on the facts and circumstances, and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under then-current market conditions.

Fair Value Hierarchy

In accordance with the guidance of ASC Topic 820, the Bank groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market, as well as certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Financial assets measured at fair value on a recurring basis as of September 30, 2017, and December 31, 2016, are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
At September 30, 2017				
U.S. treasury notes and bonds	$ 59,582	$ -	$ -	$ 59,582
U.S. government agency and sponsored enterprise (GSE) debt securities	-	45,191	-	45,191
U.S. government agency pool securities	-	317,764	-	317,764
U.S. government agency or GSE	-	79,538	-	79,538
Other assets:				
MSRs	-	-	1,499	1,499
Total fair value	$ 59,582	$ 442,493	$ 1,499	$ 503,574
At December 31, 2016				
U.S. treasury notes and bonds	$ 72,378	$ -	$ -	$ 72,378
U.S. government agency and sponsored enterprise (GSE) debt securities	-	52,053	-	52,053
U.S. government agency pool securities	-	237,126	-	237,126
U.S. government agency or GSE	-	58,323	-	58,323
Other assets:				
MSRs	-	-	1,527	1,527
Total fair value	$ 72,378	$ 347,502	$ 1,527	$ 421,407

There were no liabilities measured at fair value on a recurring basis as of September 30, 2017, and December 31, 2016.

During the nine months ended September 30, 2017 and 2016, the changes in Level 3 assets measured at fair value on a recurring basis are as follows:

	Nine Months Ended September 30,	
	2017	2016
Beginning balance	$ 1,527	$ 1,462
Realized and unrealized net gains:		
Included in net income	(28)	68
Included in other comprehensive income	-	-
Purchases, issuance and settlements		
Purchases	-	-
Issuances	-	-
Settlements	-	-
Ending balance	$ 1,499	$ 1,530

The valuation technique used for Level 3 MSRs is their discounted cash flow. Inputs considered in determining Level 3 pricing include the anticipated prepayment rates, discount rates, and cost to service. Significant increases or decreases in any of those inputs in isolation would result in a significantly lower or higher fair value measurement.

The following table presents quantitative information about the valuation technique and unobservable inputs applied to Level 3 fair value measurements for financial instruments measured at fair value on a recurring basis:

	Estimated Fair Value	Valuation Technique	Unobservable Inputs	Range of Inputs	Weighted Average Rate
September 30, 2017					
Financial instrument:					
MSRs	$ 1,499	Discounted Cash Flow	Discount Rate	6.50% - 9.25%	8.00%
			Weighted Average Prepayment Rate (Public Securities Association)	125%	
December 31, 2016					
Financial instrument:					
MSRs	$ 1,527	Discounted Cash Flow	Discount Rate	6.08% - 9.25%	7.80%
			Weighted Average Prepayment Rate (Public Securities Association)	125%	

There were no transfers into or out of the Bank's Level 3 financial instruments for the periods ended September 30, 2017, and December 31, 2016.

Nonrecurring Fair Value Measurements

Under certain circumstances, the Bank makes adjustments to fair value for assets and liabilities even though they are not measured at fair value on an ongoing basis. The following table presents the assets carried on the consolidated statements of condition by caption and by level in the fair value hierarchy at September 30, 2017, and December 31, 2016, for which a nonrecurring change in fair value has been recorded:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
September 30, 2017				
Other assets				
Other real estate owned	$ -	$ -	$ 2,417	$ 2,417
December 31, 2016				
Other assets				
Other real estate owned	$ -	$ -	$ 2,746	$ 2,746

The fair value of loans and other real estate owned subject to write downs is estimated using the appraised value of the underlying collateral, discounted as necessary due to management's estimates of changes in economic conditions.

Additionally, the Bank also makes adjustments to nonfinancial assets and liabilities even though they are not measured at fair value on an ongoing basis. With the exception of other real estate owned, the Bank does not have nonfinancial assets or liabilities for which a nonrecurring change in fair value has been recorded during the periods ended September 30, 2017, and December 31, 2016.

The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amount of cash and short-term instruments approximates fair value based on the short-term nature of the assets.

Interest-Bearing Deposits in Banks

Fair values for other interest-bearing deposits are estimated using discounted cash flow analyses based on current interest rates or yields for similar types of deposits.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank of Des Moines ("FHLB"). As a member, we are required to own stock of the FHLB, the amount of which is based primarily on the level of our borrowings from that institution. We also have the right to acquire additional shares of stock in the FHLB; however, to date, we have not done so. It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability, so it is recorded at its carrying value.

Investment Securities

When quoted prices are available in an active market, the Bank classifies the securities within Level 1 of the valuation hierarchy. Level 1 securities include U.S. Treasury notes and bonds.

If quoted market prices are not available, the Bank estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include U.S. GSE obligations, U.S. government agency pool securities, and other securities. Mortgage-backed securities are included in Level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, the Bank would classify those securities in Level 3. At September 30, 2017, and December 31, 2016, the Bank did not have any Level 3 investment securities.

Loans

For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, based upon interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable. Loans are classified in Level 3.

Mortgage Servicing Rights

The fair value of MSRs is determined using models which depend on estimates of prepayment rates, discount rates and costs to service. MSRs are classified in Level 3.

Deposit Liabilities

The fair values disclosed for demand deposits (for example, interest and non-interest checking, passbook savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies current market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits. Deposit liabilities are classified in Level 3.

Short-Term Borrowings

The carrying amounts of federal funds purchased and Federal Home Loan Bank (FHLB) advances maturing within ninety days approximate their fair values.

Long-Term Borrowings

The fair value of FHLB advances maturing after ninety days is determined based on expected present value techniques using current market interest rates for advances with similar terms and remaining maturities.

Accrued Interest

The carrying amount of accrued interest approximates fair value.

Off-Balance Sheet Commitments and Contingent Liabilities

Management does not believe it is practicable to provide an estimate of fair value for off-balance sheet commitments or contingent liabilities because of the uncertainty involved in attempting to assess the likelihood and timing of a commitment being drawn upon, coupled with a lack of an established market for these instruments and the wide diversity of fee structures.

Fair Value of Other Financial Instruments

The estimated fair values of the Bank's financial instruments, excluding those assets recorded at fair value on a recurring basis on the Bank's consolidated statements of condition, are as follows:

		Estimated fair value		
	Carrying Amount	Level 1	Level 2	Level 3
September 30, 2017		(Dollars in thousands)		
Financial assets:				
Cash and cash equivalents	$ 166,469	$ 166,469	$ -	$ -
Restricted cash	400	400	-	-
Federal Home Loan Bank stock	2,303	N/A	N/A	N/A
Investment securities held-to-maturity	91,296	-	92,293	-
Loans, net	1,174,528	-	-	1,166,391
Total	$ 1,434,996	$ 166,869	$ 92,293	$ 1,166,391
Financial liabilities:				
Deposits	1,865,043	-	-	1,856,756
Total	$ 1,865,043	$ -	$ -	$ 1,856,756
December 31, 2016				
Financial assets:				
Cash and cash equivalents	$ 176,651	$ 176,651	$ -	$ -
Restricted cash	400	400	-	-
Federal Home Loan Bank stock	1,855	N/A	N/A	N/A
Investment securities held-to-maturity	96,167	-	97,063	-
Loans, net	1,158,045	-	-	1,149,937
Total	$ 1,433,118	$ 177,051	$ 97,063	$ 1,149,937
Financial liabilities:				
Deposits	$ 1,778,670	$ -	$ -	$ 1,767,345
Total	$ 1,778,670	$ -	$ -	$ 1,767,345

Note 11 – Comprehensive Income

The components of accumulated other comprehensive income, including stockholders' equity, are as follows:

	Nine Months Ended September 30,	
	2017	2016
Net unrealized (loss) gain on available for sale securities	$ (2,604)	$ 569
Amounts reclassified from AOCI for (loss) gain on sale of investment securities available for sale included in net income	13	(401)
Tax effect	880	(57)
Unrealized holding (loss) gain on available for sale securities, net of tax	(1,711)	111
Gross unrealized holding loss on held to maturity securities	(1,620)	(2,065)
Amortization of unrealized holding loss on held to maturity during the period	322	337
Unrealized holding loss on held to maturity securities	(1,298)	(1,728)
Accumulated other comprehensive income	$ (3,009)	$ (1,617)

Item 2. Management's D iscussion and Analysis of Financial Condition and Results of Operations

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of the Company and its wholly-owned subsidiaries, the Bank and BGIS. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations. This discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the accompanying notes presented elsewhere in this Quarterly Report.

Overview

BankGuam Holding Company (the "Company") is a Guam corporation organized on October 29, 2010, to act as a holding company of Bank of Guam (the "Bank"), a 23-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), the Republic of Palau (ROP), and San Francisco, California. On August 15, 2011, the Company acquired all of the outstanding common stock of the Bank in a holding company formation transaction.

In August 2015, the Company chartered a second subsidiary, BankGuam Investment and Insurance Services (now BankGuam Investment Services, "BGIS"), in an effort to enhance the options and opportunities of our customers to build future income and wealth. BGIS was capitalized in the amount of $300 thousand during the first quarter of 2016, and was in full operation by the end of May 2016.

In May 2016, the Company entered into a Stock Purchase Agreement to acquire 25% of ASC Trust Corporation, a Guam trust company. In July 2016, subsequent to the approval of the Federal Reserve Bank of San Francisco in June 2016, the purchase was executed. The Agreement provides for the acquisition of an additional 20% of the stock of ASC Trust Corporation in April 2019, and another 25% in April 2021, with both future purchases subject to regulatory approval. The Agreement contains customary warranties, representations and indemnification provisions.

Other than holding the shares of the Bank, BGIS and ASC Trust Corporation, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System, to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company's operations are conducted and substantially all of its assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank's headquarters is located in Hagåtña, Guam, and the Bank provides a variety of financial services to individuals, businesses and government entities through its branch network. The Bank's primary deposit products are demand deposits, savings and time certificates of deposit, and its primary lending products are consumer, commercial and real estate loans. The Bank also provides many other financial services to its customers. BGIS is a registered investment company, primarily involved in providing investment advisory services and trading securities for its customers. ASC Trust Corporation is primarily involved in administering 401(k) retirement plans and other employee benefit programs for its customers.

Summary of Operating Results

The following table provides unaudited comparative information with respect to our results of operations for the three and nine months ended September 30, 2017 and 2016, respectively:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017 Amount	2016 Amount	% Change	2017 Amount	2016 Amount	% Change
Interest income	$ 21,126	$ 18,770	12.6%	$ 60,481	$ 56,175	7.7%
Interest expense	560	580	-3.4%	1,642	1,554	5.7%
Net interest income before provision for loan losses	20,566	18,190	13.1%	58,839	54,621	7.7%
Provision for loan losses	1,186	385	208.1%	3,553	2,715	30.9%
Net interest income after provision for loan losses	19,380	17,805	8.8%	55,286	51,906	6.5%
Non-interest income	3,246	3,756	-13.6%	9,463	10,135	-6.6%
Non-interest expense	17,849	16,362	9.1%	52,261	47,982	8.9%
Income before income taxes	4,777	5,199	-8.1%	12,488	14,059	-11.2%
Income tax expense	1,597	1,587	0.6%	3,754	4,123	-8.9%
Net income	$ 3,180	$ 3,612	-12.0%	$ 8,734	$ 9,936	-12.1%
Net income per common share						
Basic net income	$ 0.34	$ 0.39		$ 0.94	$ 1.07	
Diluted net income	$ 0.34	$ 0.39		$ 0.94	$ 1.07	

As the above table indicates, our net income decreased in the three months ended September 30, 2017, as compared to the corresponding period in 2016. In the three months ended September 30, 2017, we recorded net income after taxes of $3.2 million, a decrease of $432 thousand (or 12.0%) as compared to the same period in 2016. These results were most significantly impacted by higher non-interest expense, which increased by $1.5 million, and lower non-interest income, which fell by $510 thousand, but were largely offset by an increase of $1.6 million in net interest income after provision for loan losses. The increase in non-interest expense in the three months ended September 30, 2017, as compared to the same period in 2016, was largely attributed to an increase in salaries and employee benefits expenses, which went up by $526 thousand, and increase in general administrative and other expense of $412 thousand, and an increase of $236 thousand in equipment and depreciation expenses. The increase in net interest income was due to an increase in total interest income of $2.4 million, generated primarily by an increase of $1.1 million in income from our loan portfolio, higher earnings $1.0 million from our investment portfolio and an increase of $260 thousand in our earnings from our deposits with other banks, including the Federal Reserve Bank of San Francisco, supplemented by the decrease in total interest expense of $20 thousand. The increase in net interest income after provision for loan losses of $1.6 million was attenuated by the $801 thousand increase in the provision for loan losses to a more normal level after a temporary reduction in the provision during the third quarter of 2016.

During the nine months ended September 30, 2017, our net income after taxes decreased by $1.2 million (12.1%) in comparison to the first nine months of 2016, primarily due to an increase of $4.3 million in non-interest expense, an increase of $838 thousand in the provision for loan losses and a decrease of $672 thousand in non-interest income, only partially offset by an increase of $4.2 million in net interest income, and a decrease of $369 thousand in income tax expense. The rise in non-interest expense was due to an increase of the $2.0 million in salaries and employee benefits that resulted primarily from annual merit increases, and increase of $939 thousand in general, administrative and other expense, an increase of $867 thousand in equipment and depreciation expense, and a higher occupancy expense, which rose by $305 thousand, partly offset by a reduction of $209 thousand in professional service expense. The decrease in income tax expense was due to our lower income before income taxes, while the increase in net interest income was the result of the growth of $234.4 million in our average interest-earning assets, attenuated by a decrease of 0.26% in our net interest margin.

The following table shows the increase in our net interest margin during the three months ended September 30, 2017, in comparison to the same period in 2016, but a decrease in net interest margin during the nine months ended September 30, 2017. It also indicates the impact that the decrease in our net income had on our annualized returns on average assets and average equity during that period, as compared to the corresponding three- and nine-month periods of 2016:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net interest margin	4.31%	4.26%	4.20%	4.46%
Return on average assets	0.64%	0.81%	0.60%	0.77%
Return on average equity	9.20%	11.81%	8.57%	11.19%

Critical Accounting Policies

The Company's significant accounting policies are set forth in Note 2 in the Notes to the Company's Annual Report on Form 10-K for 2016 filed with the SEC on March 14, 2017, and Note 2 of Item 1 in this report. Our unaudited condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and general practices in the banking industry. Certain of those accounting policies are considered critical accounting policies because they require us to make assumptions and judgments regarding circumstances or trends that could affect the carrying values of our material assets, such as assumptions regarding economic conditions or trends that could impact our ability to fully collect our outstanding loans or ultimately realize the carrying values of certain of our other assets, such as securities that are available for sale. If adverse changes were to occur in the events, trends or other circumstances on which our assumptions or judgments have been based, or other unanticipated events were to happen that might affect our operating results, it could become necessary under GAAP for us to reduce the carrying values of the affected assets in our Statement of Condition. In addition, because reductions in the carrying values of assets are sometimes effectuated by or require charges to income, such reductions also may have the effect of reducing our income.

Results of Operations

Net Interest Income

Net interest income, the primary component of the Bank's income, refers to the difference between the interest earned on loans, investment securities and other interest-earning assets, and the interest paid on deposits and other borrowed funds. Our interest income and interest expense are affected by a number of factors, some of which are outside of our control, including national and local economic conditions, the monetary policies of the Federal Reserve's Open Market Committee which affect interest rates, competition in the marketplace for loans and deposits, the demand for loans and the ability of borrowers to meet their payment obligations. Net interest income, when expressed as a percentage of average earning assets, is a banking organization's "net interest margin."

The following table sets forth our interest income, interest expense and net interest income, and our annualized net interest margin for the three and nine months ended September 30, 2017 and 2016, respectively:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017	2016	% Change	2017	2016	% Change
Interest income	$ 21,126	$ 18,770	12.55%	60,481	$ 56,175	7.67%
Interest expense	560	580	-3.45%	1,642	1,554	5.66%
Net interest income	$ 20,566	$ 18,190	13.06%	$ 58,839	$ 54,621	7.72%
Net interest margin	4.31%	4.26%	0.05%	4.20%	4.46%	-0.26%

Net interest income increased by 13.1% for the three months ended September 30, 2017, as compared to the corresponding period in 2016. In the nine months ended September 30, 2017, net interest income increased by 7.7% in comparison to the nine months ended September 30, 2016.

For the three months ended September 30, 2017, net interest income rose by $2.4 million as compared to the same period in 2016. Total interest income also increased by $2.4 million, principally because of a $1.1 million increase in earnings on our loan portfolio and a $1.0 million increase in our investment securities income, supplemented by a $260 thousand increase in interest earned on our deposits with other banks, including the Federal Reserve Bank of San Francisco. The increase in our net interest margin was primarily the result of a 0.34% increase in the average yield on a significantly larger average balance in our investment portfolio and a 0.16% increase in the yield on our growing loan portfolio, as well as the 0.71% increase in the yield on our term investments. The effect of those increases on our net interest income was supplemented by a decrease of 0.03% in the average rate on our average interest-bearing liabilities.

During the nine months ended September 30, 2017, net interest income was $4.2 million higher than in the year-earlier period due to an increase of $4.3 million in total interest income. The rise in interest income was due primarily to a $2.2 million increase in earnings on our investment securities portfolio, supplemented by $1.6 million more in income from our loan portfolio and an increase of $485 thousand in returns on our short term investments, comprised mostly of deposits with other banks. The decrease in our net interest margin was the result of a 0.13% decrease in the average yield on a significantly larger average balance in our loan portfolio that was partially offset by a higher average yield on a substantially larger investment securities portfolio and an increase of 0.45% in the average yield on our more modest short term investments. The average rate on our average interest-bearing liabilities decreased by 0.02%.

Average Balances

Distribution, Rate and Yield

The following table sets forth information regarding our average balance sheet, annualized yields on interest-earning assets and interest rates on interest-bearing liabilities, the interest rate spread and the interest rate margin for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,					
	2017			2016		
	Average Balance	Interest Earned/Paid	Average Yield/Rate	Average Balance	Interest Earned/Paid	Average Yield/Rate
Interest earning assets:						
Short term investments [1]	$ 149,909	$ 423	1.13%	$ 156,485	$ 163	0.42%
Investment Securities[2]	577,791	2,246	1.55%	410,833	1,245	1.21%
Loans[3]	1,181,265	18,457	6.25%	1,139,783	17,362	6.09%
Total earning assets	1,908,965	21,126	4.43%	1,707,101	18,770	4.40%
Noninterest earning assets	89,221			80,094		
Total Assets	$ 1,998,186			$ 1,787,195		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 273,384	$ 82	0.12%	$ 230,943	$ 65	0.11%
Money market and savings accounts	1,013,796	443	0.17%	914,041	408	0.18%
Certificates of deposit	39,577	35	0.35%	40,854	35	0.34%
Other borrowings	-	-	0.00%	3,452	72	2.09%
Total interest-bearing liabilities	1,326,757	560	0.17%	1,189,290	580	0.20%
Non-interest bearing liabilities	533,102			475,613		
Total Liabilities	1,859,859			1,664,903		
Stockholders' equity	138,327			122,292		
Total Liabilities and Stockholders' Equity	$ 1,998,186			$ 1,787,195		
Net interest income		$ 20,566			$ 18,190	
Interest rate spread			4.26%			4.20%
Net interest margin			4.31%			4.26%

	Nine Months Ended September 30,					
	2017			2016		
	Average Balance	Interest Earned/Paid	Average Yield/Rate	Average Balance	Interest Earned/Paid	Average Yield/Rate
Interest earning assets:						
Short term investments [1]	$ 139,125	$ 854	0.82%	$ 132,162	$ 369	0.37%
Investment Securities[2]	542,255	5,939	1.46%	375,487	3,696	1.31%
Loans[3]	1,186,115	53,688	6.04%	1,125,467	52,110	6.17%
Total earning assets	1,867,495	60,481	4.32%	1,633,116	56,175	4.59%
Noninterest earning assets	85,648			78,322		
Total Assets	$ 1,953,143			$ 1,711,438		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 274,114	$ 245	0.12%	$ 204,889	$ 174	0.11%
Money market and savings accounts	987,111	1,286	0.17%	867,622	1,167	0.18%
Certificates of deposit	46,981	111	0.32%	42,186	107	0.34%
Other borrowings	-	-	0.00%	2,050	106	6.89%
Total interest-bearing liabilities	1,308,206	1,642	0.17%	1,116,747	1,554	0.19%
Non-interest bearing liabilities	509,024			476,293		
Total Liabilities	1,817,230			1,593,040		
Stockholders' equity	135,913			118,398		
Total Liabilities and Stockholders' Equity	$ 1,953,143			$ 1,711,438		
Net interest income		$ 58,839			$ 54,621	
Interest rate spread			4.15%			4.40%
Net interest margin			4.20%			4.46%

(1) Short term investments consist of interest-bearing deposits that we maintain with other financial institutions.
(2) Includes all investment securities in the Available-for-Sale and the Held-to-Maturity classifications.

(3) Loans include the average balance of non-accrual loans that provide no interest income. Loan interest income includes loan fees net of costs that have been accreted into income.

For the three months ended September 30, 2017, our total average earning assets increased by $201.9 million as compared to the same period in 2016, attributable to the $167.0 million increase in our average investment securities portfolio and the $41.5 million increase in our average loan portfolio, partially offset by the $6.6 million decrease in average short-term investments. Average non-interest earning assets increased by $9.1 million, principally due to a $9.1 million increase in other assets and a $1.1 million increase in accrued interest receivable, partially offset by a $1.1 million decrease in cash and remittances due from banks. The overall year-over-year growth of 11.8% in our average earning assets was the result of continued growth in our deposit base and an increase in non-interest bearing liabilities, supplemented by growth in our average stockholders' equity. In the three months ended September 30, 2017, average total interest-bearing liabilities increased by $137.5 million in comparison to the three months ended September 30, 2016, comprised of a $99.8 million increase in average interest-bearing money market and savings accounts and an increase in average interest-bearing checking accounts by $42.4 million that resulted from improvements in the level of economic activity in the island markets that we serve, but those increases were partially offset by the decrease of $1.3 million in average interest-bearing certificates of deposit. The additional increase of $57.5 million in average non-interest bearing liabilities, primarily in traditional checking accounts, resulted in an overall increase of $195.0 million in average total liabilities. During the third quarter of 2017, average stockholders' equity increased by $16.0 million (13.1%) in comparison to the year-earlier period, which included the issuance of $9.8 million in non-cumulative perpetual preferred stock during the fourth quarter of 2016.

Our interest rate spread increased by 0.06% and our net interest margin rose by 0.05% in the three months ended September 30, 2017, as compared to the same period in 2016. The increase in our interest rate spread is primarily attributed to the 0.03% rise in the average yield on our interest earning assets, which was reinforced by a 0.03% decrease in the average interest rate on our interest-bearing liabilities. The 0.05% increase in our net interest margin resulted from the 11.8% increase in our average total interest-earning assets being less than the 13.1% increase in our net interest income.

During the nine months ended September 30, 2017, our average earning assets increased by $234.4 million (14.4%) from the average for the nine months ended September 30, 2016, due to an increase of $166.8 million in our average holdings of investment securities, growth of $60.6 million in our average loan portfolio and a rise of $7.0 million in our average short term investments. In the nine months ended September 30, 2017, our average noninterest earning assets increased by $7.3 million in comparison to the nine months ended September 30, 2016, notably because of a rise of $9.1 million in other assets, a $1.1 million increase in accrued interest receivable and $247 thousand more in net premises and equipment, partially offset by a $1.1 million decrease in cash and due from banks, raising our total average assets to $1.95 billion, an increase of $241.7 million (14.1%) from the same period during the previous year. The increase in average total assets during the nine months ended September 30, 2017, compared to the previous year was funded by an increase in total average liabilities of $224.2 million, supplemented by the growth in our average stockholders' equity of $17.5 million (14.8%). In addition to the growth of $32.7 million in average non-interest bearing liabilities, which are primarily traditional checking account balances, the $191.5 million increase in our average total interest-bearing liabilities was comprised of an expansion of $119.5 million in our average money market and savings account balances, a $69.2 million increase in average interest-bearing checking accounts and an increase of $4.8 million in average certificate of deposit balances, partially offset by the elimination of $2.1 million in other borrowings.

Our interest rate spread and net interest margin decreased by 0.25% and 0.26%, respectively, during the first nine months ended September 30, 2017, when compared to the same period of 2016. The reduction in our interest rate spread was the result of a decrease of 0.27% in the yield on our average total earning assets, while the cost of our average interest-bearing liabilities was reduced by just 0.02%. The lower yield on our average total earning assets was primarily caused by a drop of 0.13% in the yield on our average loan balances, but this was partially offset by the 0.45% and 0.15% increases in yield on our average short-term investments and on our average holdings of investment securities, respectively, the impacts of which were much smaller because of their lower balances relative to our loan portfolio. Our lower net interest margin during the nine months ended September 30, 2017, in comparison to the previous year resulted from the 7.7% growth in our net interest income being significantly less than the 14.4% expansion of our average total earning assets. (Some of the figures in this and the previous three paragraphs may appear to differ from the preceding table due to rounding.)

The following table provides information regarding the changes in interest income and interest expense, attributable to changes in rates and changes in volumes, that contribute to the total chan ge in net interest income for the three- and nine-month periods ending September 30, 2017, in comparison to the same periods ending September 30, 2016. Variances attributable to both rate and volume changes are equal to the change in rate times the change in average balance and are included below in the average volume column.

	Three Months Ended September 30, 2017 vs. 2016 (In thousands)		
		Attributable to:	
	Net Change in Interest Income/Expense	Change in Rate	Change in Volume
Interest income:			
Short term investments	$ 260	$ 1,114	$ (854)
Investment Securities	1,001	1,408	(407)
Loans	1,095	1,787	(692)
Total interest income	$ 2,356	$ 4,309	$ (1,953)
Interest expense:			
Interest-bearing checking accounts	$ 17	$ 17	$ -
Money market and savings accounts	35	(34)	69
Certificates of deposit	-	5	(5)
Other borrowings	(72)	(72)	-
Total interest expense	$ (20)	$ (84)	$ 64
Net interest income	$ 2,376	$ 4,393	$ (2,017)

	Nine Months Ended September 30, 2017 vs. 2016 (In thousands)		
		Attributable to:	
	Net Change in Interest Income/Expense	Change in Rate	Change in Volume
Interest income:			
Short term investments	$ 485	$ 590	$ (105)
Investment Securities	2,243	555	1,688
Loans	1,578	(1,556)	3,134
Total interest income	$ 4,306	$ (411)	$ 4,717
Interest expense:			
Interest-bearing checking accounts	$ 71	$ 12	$ 59
Money market and savings accounts	119	(49)	168
Certificates of deposit	4	(10)	14
Other borrowings	(106)	(141)	35
Total interest expense	$ 88	$ (188)	$ 276
Net interest income	$ 4,218	$ (223)	$ 4,441

Provision for Loan Losses

We maintain allowances for probable loan losses that are incurred as a normal part of the banking business. As more fully discussed in Note 5 of the notes to the unaudited condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q, an allowance for loan losses has been established by management in order to provide for those loans which, for a variety of reasons, may not be repaid in their entirety. The allowance is maintained at a level considered by management to be adequate to provide for probable losses that are anticipated as of the balance sheet date and is based on methodologies applied on a consistent basis with the prior year. Management's review of the adequacy of the allowance includes, among other things, loan growth, changes in the composition of the loan portfolio, a statistical analysis of past loan loss experience and management's evaluation of the loan portfolio under current economic conditions.

The allowance for loan losses is based on estimates, and ultimate losses may vary from current estimates. The Bank recognizes that credit losses will be experienced and the risk of loss will vary with, among other things: general economic conditions; the type of loan being made; the credit worthiness of the borrower over the term of the loan; and, in the case of a collateralized loan, the quality and valuation of the collateral for such loan. The allowance for loan losses represents the Bank's best estimate of the allowance necessary to provide for probable incurred losses in the portfolio as of the balance sheet date.

If management determines that it is necessary to increase the allowance for loan losses, a provision for loan losses is recorded. For the three and nine months ended Sept ember 30, 2017, the Bank's provision for loan losses was $1.2 million and $3.6 million, respectively, which was $801 thousand and $838 thousand higher than during the corresponding periods of 2016.

Management believes that the provision recorded was sufficient to mitigate the risk of loss inherent in our gross loan portfolio of $1.19 billion at September 30, 2017, up by $16.6 million from $1.18 billion at December 31, 2016, and to replenish the allowance for net loan charge-offs of $3.8 million recorded during the same period. The allowance for loan losses at September 30, 2017, stood at $15.2 million or 1.28% of total gross loans outstanding as of the balance sheet date, a decrease of $220 thousand (1.4%) from December 31, 2016. We recorded net loan charge-offs of $1.3 million and $975 thousand for the three-month periods ended September 30, 2017 and 2016, respectively, and net loan charge-offs of $3.8 million during the first nine months of 2017, compared to $1.5 million in net charge-offs for the first nine months of 2016. See "Analysis of Allowance for Loan Losses" in the Financial Condition Section of Management's Discussion and Analysis of Financial Condition and Results of Operations for more detailed information.

Non-Interest Income

The table below represents the major components of non-interest income and the changes therein for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017 Amount	2016 Amount	Amount Change	Percent Change	2017 Amount	2016 Amount	Amount Change	Percent Change
Non-interest Income								
Service charges and fees	$ 1,489	$ 1,427	$ 62	4.3%	$ 4,339	$ 4,391	$ (52)	-1.2%
Investment securities gains (losses), net	-	272	(272)	-100.0%	(13)	401	(414)	-103.2%
Income from merchant services	646	751	(105)	-14.0%	1,834	1,518	316	20.8%
Income from cardholders, net	-	268	(268)	-100.0%	359	963	(604)	-62.7%
Trustee fees	257	240	17	7.1%	712	598	114	19.1%
Other income	854	798	56	7.0%	2,232	2,264	(32)	-1.4%
Total Non-Interest Income	$ 3,246	$ 3,756	$ (510)	-13.6%	$ 9,463	$ 10,135	$ (672)	-6.6%

For the three months ended September 30, 2017, non-interest income totaled $3.2 million, which represented a decrease of $510 thousand (13.6%) as compared to the same period in 2016. The reduction is primarily attributed to lack of investment securities gains or losses, a decrease of $272 thousand from the previous year, and the $268 thousand decrease in income from cardholders, supplemented and attenuated by normal fluctuations in other elements of non-interest income. The decrease in net income from cardholders was primarily the result of an increase in card processing fees.

Our non-interest income decreased by $672 thousand (6.6%) during the nine months ended September 30, 2017, from the same period a year earlier. Much of this decrease, in the amount of $604 thousand, was due to a drop in income from cardholders that resulted from an increase in card processing fees, as mentioned in the previous paragraph. There was also a net loss of $13 thousand on sales of investment securities, for a decrease of $414 thousand from the previous year's net gain of $401 thousand, partially offset by the increase of $316 thousand in our income from merchant services that resulted from a reduction in cross-border fees charged by one card company, an increase in the number of merchants serviced, and the discontinuation of services to a merchant for which our costs of providing the services exceeded our revenues from the merchant.

Non-interest Expense

The table below represents the major components of non-interest expense and the changes for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017 Amount	2016 Amount	Amount Change	Percent Change	2017 Amount	2016 Amount	Amount Change	Percent Change
Non-Interest Expense:								
Salaries & employee benefits	$ 8,696	$ 8,170	$ 526	6.4%	$ 25,621	$ 23,665	$ 1,956	8.3%
Occupancy	1,733	1,561	172	11.0%	4,984	4,679	305	6.5%
Equipment and depreciation	2,219	1,983	236	11.9%	6,357	5,490	867	15.8%
Insurance	432	406	26	6.4%	1,241	1,218	23	1.9%
Telecommunications	444	421	23	5.5%	1,293	1,222	71	5.8%
FDIC insurance assessment	377	327	50	15.3%	1,116	973	143	14.7%
Professional services	494	475	19	4.0%	1,431	1,640	(209)	-12.7%
Contract services	467	370	97	26.2%	1,424	1,302	122	9.4%
Other real estate owned	7	84	(77)	-91.7%	73	101	(28)	-27.7%
Stationery & supplies	210	217	(7)	-3.2%	628	702	(74)	-10.5%
Training & education	273	263	10	3.8%	941	777	164	21.1%
General, administrative & other	2,497	2,085	412	19.8%	7,152	6,213	939	15.1%
Total Non-Interest Expense	$ 17,849	$ 16,362	$ 1,487	9.1%	$ 52,261	$ 47,982	$ 4,279	8.9%

For the three months ended September 30, 2017, non-interest expense totaled $17.8 million, which represented a $1.5 million (9.1%) increase as compared to the same period in 2016. The increase is primarily attributed to the $526 thousand rise in salaries and employee benefits, the $412 thousand increase in general, administrative and other expense, and the $236 thousand increase in equipment and depreciation expense, and the $172 thousand increase in occupancy expense. The increase in salaries and employee benefits was due to normal, recurring merit increases in salaries and a small increase in the number of full-time equivalent (FTE) employees needed to accommodate the growth of $180.8 million (9.8%) in the assets of the Bank from September 30, 2016. The Company's FTE count at September 30, 2017, December 31, 2016, and September 30, 2016 were 617, 604, and 597, respectively. The increase in general, administrative and other expense was primarily the result of increases in advertising and public relations expenses. The increase in equipment and depreciation expense was primarily due to an increase in computer equipment maintenance expense, and the increase in occupancy expense was due to increases in utilities costs and the expense of repairs to buildings, partially offset by a decrease in rental income.

For the nine months ended September 30, 2017, total non-interest expense increased by $4.3 million (8.9%) from the year-earlier period, a large part of which was due to an increase of $2.0 million in salaries and employee benefits, which was in part due to normal, recurring employee salaries increases, but also reflects the need for additional FTE personnel to accommodate the increased activity associated with our growth in assets from September 30, 2016. We also experienced a $939 thousand increase in general, administrative and other expense, a $867 thousand increase in equipment and depreciation expense, and a rise of $305 thousand in occupancy expense, partially offset by a reduction in professional services expense of $209 thousand. The increase in general, administrative and other expense was primarily due to an increase in public relations expense associated with the Bank's 45 th anniversary celebration events, and the rise in equipment and depreciation expense was due to an increase in computer equipment maintenance expense. These increases were partially offset by the decrease of $209 thousand in professional services expense that resulted from additional audit fees incurred in the prior year.

Income Tax Expense

For the three months ended September 30, 2017, the Bank recorded an income tax expense of $1.6 million, $10 thousand higher than the income tax expense recorded for the corresponding period in 2016, despite a $422 thousand decrease in income before taxes. The primary cause of this increase was the payoff of a large government loan for which the interest income was tax exempt, replaced by taxable earning assets .

During the nine months ended September 30, 2017, our income tax expense was $3.8 million, 8.9% lower than during the year-earlier period. This was primarily due to the 11.2% decrease in our income before income taxes. The effective tax rate was 30.1% and 29.3% for the nine months ended September 31, 2017 and 2016, respectively.

Financial Condition

Assets

As of September 30, 2017, total assets were $2.02 billion, an increase of 5.2% from the $1.92 billion at December 31, 2016. This $95.1 million increase was comprised of the $77.4 million increase in our investment portfolio, including our investment is an unconsolidated subsidiary, the $16.5 million increase in our net loans, the $9.6 million increase in other assets, the $1.2 million increase in accrued interest receivable and the rise of $448 thousand in our holdings of Federal Home Loan Bank stock, which facilitates our mortgage lending. The increase in other assets was primarily comprised of a $6.0 million increase in receivable income due to a security called on September 30, 2017, for which funds were not received until two days later, a $1.3 million increase in prepaid income taxes, a $666 thousand increase in our deferred tax asset and a $663 thousand increase in our bank-owned life insurance (BOLI). The increases those asset categories were partially offset by the $10.2 million decrease in cash and cash equivalents. Because our net loans increased at a slower rate than our total assets during the period, the proportion of net loans to total assets decreased from 60. 3% to 58.2% from December 31, 2016, to September 30, 2017.

Interest-Earning Assets

The following table sets forth the composition of our interest-earning assets at September 30, 2017, as compared to December 31, 2016:

	September 30, 2017	December 31, 2016	Variance
Interest-earning deposits with financial institutions (including restricted cash)	$ 141,660	$ 151,313	$ (9,653)
Federal Home Loan Bank stock, at cost	2,303	1,855	448
Investment securities available for sale	502,075	419,880	82,195
Investment securities held to maturity	91,296	96,167	(4,871)
Loans, gross	1,192,640	1,176,007	16,633
Total interest-earning assets	$ 1,929,974	$ 1,845,222	$ 84,752

Loans

Commercial & industrial loans are loans to businesses to finance capital purchases and improvements, or to provide cash flow for operations. Commercial mortgage loans include loans secured by real property for purposes such as the purchase or improvement of that property, wherein repayment is derived from the income generated by the real property or from business operations. Residential mortgage loans are loans to consumers to finance the purchase, improvement, or refinance of real property secured by 1-4 family housing units. Consumer loans include loans to individuals to finance personal needs and are either closed- or open-ended loans. Automobile loans fall under the consumer loan category, but the bulk of consumer loans is typically unsecured extensions of credit such as credit card debt and personal signature loans.

A summary of the balances of loans at September 30, 2017, and December 31, 2016, follows:

	September 30, 2017		December 31, 2016	
	Amount	Percent	Amount	Percent
Commercial				
Commercial & industrial	$ 253,206	21.2%	$ 248,059	21.1%
Commercial mortgage	541,796	45.4%	552,272	47.0%
Commercial construction	13,596	1.1%	6,421	0.5%
Commercial agriculture	724	0.1%	747	0.1%
Total commercial	809,322	67.9%	807,499	68.7%
Consumer				
Residential mortgage	137,697	11.5%	143,951	12.2%
Home equity	436	0.0%	480	0.0%
Automobile	30,779	2.6%	30,798	2.6%
Other consumer loans [1]	214,406	18.0%	193,279	16.4%
Total consumer	383,318	32.1%	368,508	31.3%
Gross loans	1,192,640	100.0%	1,176,007	100.0%
Deferred loan (fees) costs, net	(2,897)		(2,527)	
Allowance for loan losses	(15,215)		(15,435)	
Loans, net	$ 1,174,528		$ 1,158,045	

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

At September 30, 2017, total gross loans increased by $16.6 million to $1.19 billion from $1.18 billion at December 31, 2016. The increase in loans was largely attributed to a $14.8 million increase in consumer loans to $383.3 million at September 30, 2017, from $368.5 million at December 31, 2016. The increase in consumer loans was due to the $21.1 million increase in other consumer loans that resulted from a series of installment loan promotions, partially offset by the $6.3 million decrease in residential mortgage loans due to normal paydowns and large principal reductions. The effect of the increase in consumer loans was supplemented by a $1.8 million increase in commercial loans to $809.3 million at September 30, 2017, up from $807.5 million at December 31, 2016. The increase in commercial loans was due to the $7.2 million increase in commercial construction loans and the $5.1 million increase in commercial & industrial loans, but these increases were partially offset by the decline of $10.5 million in commercial mortgage loans.

At September 30, 2017, loans outstanding were comprised of approximately 66.42% variable rate loans and 33.58% fixed rate loans, compared to 67.37% variable and 32.63% fixed rate at December 31, 2016, and 67.71% variable rate and 32.29% fixed rate loans at September 30, 2016.

Since it first opened in 1972, the Bank has expanded its operations and its branch network, first in Guam, then in the other islands of our region and in San Francisco, California. In the interests of enhancing performance and stability through market and industry diversification, the Bank has increased its focus o n growth in the San Francisco area in recent years, adding personnel with experience and expertise in the Bay Area. The following table provides figures for loans, net of allowance and deferred fees, in the Bank's administrative regions for December 31, 20 15 and 2016, and September 30, 2017:

	December 31, 2015	December 31, 2016	September 30, 2017
Guam	$ 671,579	$ 709,715	$ 671,850
Commonwealth of the Northern Mariana Islands	$ 71,975	$ 74,379	$ 73,167
The Freely Associated States of Micronesia *	$ 56,301	$ 75,324	$ 89,868
California	$ 254,395	$ 298,627	$ 339,643
Total	$ 1,054,250	$ 1,158,045	$ 1,174,528

* The Freely Associated States (FAS) are comprised of the Federated States of Micronesia (Chuuk, Kosrae, Pohnpei and Yap), the Republic of Palau and the Republic of the Marshall Islands.

As the table indicates, the Bank's total net loans increased by 1.4% during the nine months ended September 30, 2017, after increasing by 9.8% during 2016. By way of comparison, loans in the California region increased by 13.7% during the first three quarters of 2017 and by 17.4% in 2016. Loans in the Freely Associated States of Micronesia increased by 19.3% during the first nine months of 2017 and by 33.8% during 2016. The reduction of loan balances by $37.9 million, or 5.3%, in Guam during the first nine months of 2017 was primarily due to the payoff of one large commercial loan during the second quarter of the year, after having grown by $38.1 million (5.7%) in 2016. Our net loans in the Commonwealth of the Northern Mariana Islands decreased by $1.2 million (1.6%) during the first nine months of 2017 after having grown by $2.4 million (3.3%) in 2016. Since the Company was established in 2011, the California region has provided continued support for the expansion of the Bank.

Interest-Earning Deposits and Investment Securities

In the current lending and interest rate environment, and in order to maintain sufficient liquidity in the ordinary course of business and in anticipation of one large withdrawal, the Bank held $141.3 million in unrestricted interest-earning deposits with financial institutions at September 30, 2017, a decrease of $9.7 million, or 6.4%, from the $150.9 million in such deposits at December 31, 2016. From December 31, 2016, to September 30, 2017, the Company's combined investment portfolio increased by $77.3 million, or 15.0%, from $516.0 million to $593.4 million. The growth in the investment portfolio was comprised of an $82.2 million increase in the available-for-sale securities, which rose by 19.6%, from $419.9 million to $502.1 million, partially offset by a $4.9 million decrease in held-to-maturity securities, which declined from $96.2 million to $91.3 million.

Nonperforming Loans and Other Nonperforming Assets

Nonperforming loans consist of (i) loans on non-accrual status because we have ceased accruing interest on these loans; (ii) loans 90 days or more past due and still accruing interest; and (iii) restructured loans. Other nonperforming assets consist of real estate properties (OREO) that have been acquired through foreclosure or similar means and which management intends to offer for sale. Loans are placed on non-accrual status when, in the opinion of management, the full and timely collection of principal or interest is in doubt. Generally, the accrual of interest is discontinued when principal or interest payment becomes 90 days past due, unless the loan is adequately collateralized and the loan is in the process of collection. When a loan is placed in non-accrual status, accrued but unpaid interest is reversed against current income. Subsequently, when payments are received on such loans, the amounts are applied to reduce principal, except when the ultimate collectability of principal is probable, in which case accrued loans may be restored to accrual status when principal and interest becomes current and full repayment is expected. Interest income is recognized on an accrual basis for impaired loans not meeting the non-accrual criteria.

The following table contains information regarding our nonperforming assets as well as restructured loans as of September 30, 2017, and December 31, 2016:

		September 30, 2017		December 31, 2016
Non-accrual loans:				
Commercial & industrial	$	230	$	1,094
Commercial mortgage		5,955		6,390
Residential mortgage		6,276		6,353
Home equity		-		35
Other consumer [1]		150		174
Total non-accrual loans	$	12,611	$	14,046
Loans past due 90 days and still accruing:				
Commercial & industrial	$	-	$	1
Commercial mortgage		-		-
Commercial construction		-		-
Residential mortgage		-		137
Home equity		-		-
Automobile		97		104
Other consumer [1]		1,710		1,640
Total loans past due 90 days and still accruing	$	1,807	$	1,882
Total nonperforming loans	$	14,418	$	15,928
Other real estate owned (OREO):				
Commercial real estate	$	2,075	$	2,078
Residential real estate		342		668
Total other real estate owned	$	2,417	$	2,746
Total nonperforming assets	$	16,835	$	18,674
Restructured loans:				
Accruing loans	$	322	$	265
Non-accruing loans (included in nonaccrual loans above)		5,365		6,589
Total restructured loans	$	5,687	$	6,854

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

The above table indicates that nonperforming loans decreased by $1.5 million during the first nine months of 2017, which resulted from the decrease in total non-accrual loans by $1.4 million, from $14.0 million to $12.6 million, and the decrease in total loans past due 90 days and still accruing by $75 thousand to $1.8 million, down from $1.9 million at December 31, 2016. The decrease in total loans past due 90 days and still accruing was primarily due to the $137 thousand reduction in other residential mortgage loans in this category. The reduction in total non-accrual loans is primarily attributed to the decreases in this category of commercial & industrial loans by $864 thousand and of commercial mortgage loans by $435 thousand. In addition, the Bank's holdings of other real estate owned (OREO) decreased by $328 thousand during the period due to a $702 thousand in sales, partially offset by additions of $521 thousand, and total restructured loans fell by $1.2 million as one loan was paid off and refinanced.

At September 30, 2017, the Bank's largest nonperforming loans are two commercial real estate mortgage loan relationships totaling $5.1 million, both of which are secured by real estate located in Guam. These loans were placed on non-accrual due to deficiencies in the underlying cash flow to service the monthly loan payments and meet operating expenses. At this time, management believes that the collateral and the allowance for loan losses are adequate to cover these loans; however, should property values deteriorate, additional write-downs or additional provisions may be necessary.

Analysis of Allowance for Loan Losses

The allowance for loan losses was $15.2 million, or 1.28% of outstanding gross loans as of September 30, 2017, as compared to $15.4 million, or 1.31% of outstanding gross loans at December 31, 2016. Of the $15.2 million allowance for loan losses at September 30, 2017, $13.7 million was reserved for loans collectively evaluated for impairment totaling $1.18 billion, or 1.16% of gross loans. Of the $15.4 million allowance for loan losses at December 31, 2016, $14.0 million was reserved for loans collectively evaluated for impairment totaling $1.16 billion, or 1.21% of gross loans.

Management maintains an allowance for loan losses to absorb estimated credit losses associated with the loan portfolio. The adequacy of the allowance is determined by management through ongoing quarterly loan quality assessments.

Management assesses the estimated credit losses inherent in the non-classified and classified portions of our loan portfolio by considering a number of factors or elements including:

- Management's evaluation of the collectability of the loan portfolio;
- Historical loss experience in the loan portfolio;
- Levels of and trending in delinquency, classified assets, non-performing and impaired loans;
- Effects of changes in underwriting standards and other changes in lending policies, procedures and practices;
- Experience, ability, and depth of lending management and other relevant staff;
- Local, regional, and national trends and conditions, including industry-specific conditions;
- The effect of changes in credit concentration; and
- External factors such as competition, legal and regulatory conditions, as well as typhoon and other natural disasters.

Management determines the allowance for the classified loan portfolio and for non-classified loans by applying a percentage loss estimate that is calculated based on the above noted factors and trends. Management normally writes down impaired loans after determining the loans' credit and collateral fair value. Our analysis of the adequacy of the allowance incorporates the provisions made for our non-classified loans and classified loans.

While management believes it uses the best information available for calculating the allowance, the results of operation could be significantly affected if circumstances differ substantially from the assumptions used in determining the allowance. The current qualitative and quantitative factors used to calculate the allowance are inherently subjective. The estimates and assumptions are subject to changes in economic prospects and regulatory guidelines, and other circumstances over which management has no control. The allowance may prove in the future to be insufficient to cover all of the losses the Bank may incur and it may be necessary to increase the allowance from time to time as a result of monitoring its adequacy.

The following table summarizes the changes in our allowance for loan losses:

	Commercial	Residential Mortgages	Consumer	Total
		(Dollars in thousands)		
Nine Months Ended September 30, 2017				
Allowance for loan losses:				
Balance at beginning of period	$ 8,599	$ 1,878	$ 4,958	$ 15,435
Charge-offs	(9)	(145)	(4,807)	$ (4,961)
Recoveries	38	5	1,145	$ 1,188
Provision	352	36	3,165	$ 3,553
Balance at end of period	$ 8,980	$ 1,774	$ 4,461	$ 15,215
Three Months Ended September 30, 2017				
Allowance for loan losses:				
Balance at beginning of period	$ 8,829	$ 1,857	$ 4,685	$ 15,371
Charge-offs	(9)	(115)	(1,608)	$ (1,732)
Recoveries	7	2	381	$ 390
Provision	153	30	1,003	$ 1,186
Balance at end of period	$ 8,980	$ 1,774	$ 4,461	$ 15,215
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	$ 40	$ 6	$ 1,507	$ 1,553
Loans collectively evaluated for impairment	8,940	1,768	2,954	13,662
Ending Balance	$ 8,980	$ 1,774	$ 4,461	$ 15,215
Loan balances at end of period:				
Loans individually evaluated for impairment	$ 6,304	$ 5,876	$ 1,958	$ 14,138
Loans collectively evaluated for impairment	803,018	132,257	243,227	1,178,502
Ending Balance	$ 809,322	$ 138,133	$ 245,185	$ 1,192,640
Nine Months Ended September 30, 2016				
Allowance for loan losses:				
Balance at beginning of period	$ 6,890	$ 1,853	$ 5,416	$ 14,159
Charge-offs	(270)	(121)	(3,766)	$ (4,157)
Recoveries	1,667	3	972	$ 2,642
Provision	184	249	2,282	$ 2,715
Balance at end of period	$ 8,471	$ 1,984	$ 4,904	$ 15,359
Three Months Ended September 30, 2016				
Allowance for loan losses:				
Balance at beginning of period	$ 8,421	$ 2,010	$ 5,518	$ 15,949
Charge-offs	(64)	(30)	(1,228)	$ (1,322)
Recoveries	10	1	336	$ 347
Provision	104	3	278	$ 385
Balance at end of period	$ 8,471	$ 1,984	$ 4,904	$ 15,359
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	$ 11	$ 16	$ 1,098	$ 1,125
Loans collectively evaluated for impairment	8,460	1,968	3,806	14,234
Ending Balance	$ 8,471	$ 1,984	0$ 4,904	$ 15,359
Loan balances at end of period:				
Loans individually evaluated for impairment	$ 8,241	$ 6,556	$ 1,465	$ 16,262
Loans collectively evaluated for impairment	775,231	138,619	209,433	1,123,283
Ending Balance	$ 783,472	$ 145,175	$ 210,898	$ 1,139,545

<u>Year Ended December 31, 2016</u>				
Allowance for loan losses:				
Balance at beginning of year	$ 6,890	$ 1,853	$ 5,416	$ 14,159
Charge-offs	(276)	(121)	(5,234)	(5,631)
Recoveries	1,691	6	1,310	3,007
Provision	294	140	3,466	3,900
Balance at end of year	$ 8,599	$ 1,878	$ 4,958	$ 15,435
Allowance balance at end of year related to:				
Loans individually evaluated for impairment	$ 2	$ 15	$ 1,422	$ 1,439
Loans collectively evaluated for impairment	8,597	1,863	3,536	13,996
Ending Balance	$ 8,599	$ 1,878	0$ 4,958	$ 15,435
Loan balances at end of year:				
Loans individually evaluated for impairment	$ 7,577	$ 6,208	$ 1,897	$ 15,682
Loans collectively evaluated for impairment	799,922	138,223	222,180	1,160,325
Ending Balance	$ 807,499	$ 144,431	$ 224,077	$ 1,176,007

Management evaluates all impaired loans for impairment not less than quarterly in conjunction with our calculation and determination of the adequacy of the allowance for loan losses. As of September 30, 2017, the Bank had 485 impaired loans totaling $14.1 million with a specific allocation of our allowance for loan losses totaling $1.5 million. There were 19 impaired loans in the commercial loan category totaling $6.3 million, of which 12 loans totaling $5.7 million had adequate collateral securing the carrying value of the loan, resulting in no specific allocation being required. Management's evaluation of the remaining seven commercial loans, totaling a combined $589 thousand, identified the need for $40 thousand in a specific loan loss allocation.

There were 81 impaired loans totaling $5.9 million in the real estate loan category that were evaluated for impairment as of September 30, 2017, and for which a specific allocation totaling $6 thousand was made. The collateral securing one loan was determined to be sufficient to cover the carrying balance of that loan, which totaled $235 thousand. The $6 thousand allowance allocation, or 0.11% of the outstanding balance, was for the remaining 80 impaired real estate loans, which totaled $5.6 million.

Generally, consumer loans are considered impaired when they become more than 90 days past due. There were 385 impaired loans in the consumer loan category as of September 30, 2017, totaling $2.0 million, in which $1.5 million in allowances were allocated. The allocation rate on these consumer loans totaled 76.97% at September 30, 2017, as repayment from most consumer loans are based on support from the borrower's cash flows and are not secured by collateral.

As of December 31, 2016, the Bank had 384 impaired loans totaled $15.7 million, with a specific allowance allocation totaling $1.4 million. The number of impaired loans in the commercial loan category was 22, totaling $7.6 million, of which 16 loans totaling $6.2 million had adequate collateral securing the carrying value of the loan, resulting in no specific reserves being required. Management's evaluation of the remaining six commercial loans, totaling a combined $1.4 million, identified the need for $2 thousand in a specific allowance allocation.

There were 83 impaired loans totaling $6.2 million in the real estate loan category that were evaluated for impairment as of December 31, 2016, and for which a specific allocation totaling $15 thousand was made. The collateral securing one loan was determined to be sufficient to cover the carrying balance of the loan, which totaled $250 thousand. The $15 thousand allowance allocation, or 0.25% of the outstanding balance, was for the remaining 82 impaired real estate loans totaling $6.0 million.

There were 279 impaired loans in the consumer loan category as of December 31, 2016, totaling $1.9 million, for which $1.4 million in a specific allowance was allocated. The allocation rate for these consumer loans totaled 74.96% at December 31, 2016.

As of September 30, 2016, the Bank had 332 impaired loans, totaling $16.3 million, with a specific allowance allocation totaling $1.1 million. The number of impaired loans in the commercial loan category was 24, totaling $8.2 million, of which 21 loans totaling $7.9 million had adequate collateral securing the carrying value of the loan, resulting in no specific allocation being required. Management's evaluation of the remaining three commercial loans, totaling a combined $315 thousand, identified the need for $11 thousand in a specific allowance allocation.

There were 88 impaired loans totaling $6.6 million in the real estate loan category that were evaluated for impairment as of September 30, 2016, and for which a specific allocation totaling $16 thousand was made. The collateral securing one loan was determined to be sufficient to cover the carrying balance of the loan, which totaled $252 thousand. The $16 thousand allowance allocation, or 0.25% of the outstanding balance, was for the remaining 87 impaired real estate loans totaling $6.3 million.

There were 220 impaired loans in the consumer loan category as of September 30, 2016, totaling $1.5 million, for which $1.1 million in a specific allocation was made. The allocation rate on these consumer loans totaled 74.95% at September 30, 2016.

Total Cash and Cash Equivalents

Total cash and cash equivalents were $166.5 million and $176.7 million at September 30, 2017, and December 31, 2016, respectively. This balance, which is comprised of cash and due from bank balances and interest-bearing deposits that we maintain at other financial institutions (including the Federal Reserve Bank of San Francisco, but excepting restricted cash), will vary depending on daily cash settlement activities, the amount of highly liquid assets needed based on known future events such as the repayment of borrowings and scheduled withdrawals, and actual cash on hand in the Bank's branches. The decrease in the balance during the period was primarily attributed to conversion of interest bearing deposits in banks to higher yielding assets.

The following table sets forth the composition of our cash and cash equivalent balances at September 30, 2017, and December 31, 2016:

	September 30, 2017	December 31, 2016	Variance
Cash and due from banks	$ 25,209	$ 25,738	$ (529)
Interest-bearing deposits with financial institutions	141,260	150,913	(9,653)
Total cash and cash equivalents	$ 166,469	$ 176,651	$ (10,182)

Investment Securities

The Bank manages its securities portfolio to provide a source of both liquidity and earnings. The Bank has an Asset/Liability Committee (ALCO) that develops and recommends current investment policies to the Board of Directors based on its operating needs and market circumstances. The Bank's overall investment policy is formally reviewed and approved annually by the Board of Directors, and the Asset/Liability Committee is responsible for monitoring and reporting compliance with the investment policy. Investment portfolio reports are provided to the Board of Directors on a monthly basis.

At September 30, 2017, the carrying value of the investment securities portfolio (excluding ASC Trust Corporation investme nt and Federal Home Loan Bank stock) totaled $593.4 million, which represents a $77.3 million increase from the portfolio balance of $516.0 million at December 31, 2016. The table below sets forth the amortized cost and fair value of our investment securit ies portfolio, with gross unrealized gains and losses, at September 30, 2017, and December 31, 2016:

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 105,384	$ 22	$ (633)	$ 104,773
U.S. government agency pool securities	319,124	58	(1,418)	317,764
U.S. government agency or GSE residential mortgage-backed securities	80,158	42	(662)	79,538
Total	$ 504,666	$ 122	$ (2,713)	$ 502,075
Securities Held-to-Maturity				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 45,111	$ 850	$ (48)	$ 45,913
U.S. government agency pool securities	12,330	34	(38)	12,326
U.S. government agency or GSE residential mortgage-backed securities	33,855	411	(212)	34,054
Total	$ 91,296	$ 1,295	$ (298)	$ 92,293

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 125,476	$ 6	$ (1,051)	$ 124,431
U.S. government agency pool securities	238,615	124	(1,613)	237,126
U.S. government agency or GSE residential mortgage-backed securities	59,049	36	(762)	58,323
Total	$ 423,140	$ 166	$ (3,426)	$ 419,880
Securities Held-to-Maturity				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 44,909	$ 956	$ (36)	$ 45,829
U.S. government agency pool securities	13,591	14	(91)	13,514
U.S. government agency or GSE residential mortgage-backed securities	37,667	373	(320)	37,720
Total	$ 96,167	$ 1,343	$ (447)	$ 97,063

At September 30, 2017, and December 31, 2016, investment securities with a carrying value of $368.9 million and $319.5 million, respectively, were pledged to secure various government deposits and other public requirements.

The amortized cost, estimated fair value and weighted average yields of investment securities by contractual maturity at September 30, 2017, and December 31, 2016, are show n below. Actual maturities may differ from contractual maturities because issuers may have the right to call or borrowers the right to prepay obligations with or without call or prepayment penalties. At September 30, 2017, obligations of U.S. government corporations and agencies totaling $593.4 million consist predominantly of Small Business Administration agency pool securities totaling $330.1 million and residential mortgage-backed securities totaling $113.4 million whose contractual maturity, or princi pal repayment, will follow the repayment of the underlying small business loans or mortgages. For purposes of the following table, the entire outstanding balance of these SBA pools and mortgage-backed securities issued by U.S. government corporations and agencies is categorized based on final maturity date. At September 30, 2017, the Bank estimates the average remaining life of these SBA pools and mortgage-backed securities to be approximately 5.50 years and 3.86 years, respectively. The weighted average yield on the entire portfolio increased by 28 basis points, to 1.62% at September 30, 2017, from 1.34% at December 31, 2016. This increase was primarily the result of higher market interest rates.

	September 30, 2017				
	Available-for-Sale		Held-to-Maturity		
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Weighted Average Yield
Due within one year	$ 431	$ 433	$ 4,500	$ 4,492	1.16%
Due after one but within five years	111,618	110,969	56,179	57,300	1.42%
Due after five but within ten years	51,809	51,549	19,063	19,094	1.74%
Due after ten years	340,808	339,124	11,554	11,407	1.71%
Total	$ 504,666	$ 502,075	$ 91,296	$ 92,293	1.62%

	December 31, 2016				
	Available-for-Sale		Held-to-Maturity		
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Weighted Average Yield
Due within one year	$ -	$ -	$ -	$ -	0.00%
Due after one but within five years	131,023	129,943	57,761	58,831	1.34%
Due after five but within ten years	44,787	44,627	14,427	14,609	1.38%
Due after ten years	247,330	245,310	23,979	23,623	1.33%
Total	$ 423,140	$ 419,880	$ 96,167	$ 97,063	1.34%

Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position at September 30, 2017, and December 31, 2016:

	September 30, 2017					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (299)	$ 52,089	$ (334)	$ 47,711	$ (633)	$ 99,800
U.S. government agency pool securities	(461)	149,410	(957)	123,259	(1,418)	272,669
U.S. government agency or GSE residential mortgage-backed securities	(463)	47,168	(199)	18,704	(662)	65,872
Total	$ (1,223)	$ 248,667	$ (1,490)	$ 189,674	$ (2,713)	$ 438,341
Securities Held to Maturity						
U.S. government agency and GSE debt securities	$ (48)	$ 16,068	$ -	$ -	$ (48)	$ 16,068
U.S. government agency pool securities	(9)	4,899	(29)	3,412	(38)	8,311
U.S. government agency or GSE residential mortgage-backed securities	(117)	10,193	(95)	2,207	(212)	12,400
Total	$ (174)	$ 31,160	$ (124)	$ 5,619	$ (298)	$ 36,779

	December 31, 2016					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (1,051)	$ 116,516	$ -	$ -	$ (1,051)	$ 116,516
U.S. government agency pool securities	(597)	174,370	(1,016)	34,222	(1,613)	208,592
U.S. government agency or GSE residential mortgage-backed securities	(693)	42,997	(69)	9,225	(762)	52,222
Total	$ (2,341)	$ 333,883	$ (1,085)	$ 43,447	$ (3,426)	$ 377,330
Securities Held to Maturity						
U.S. government agency and GSE debt securities	$ (36)	$ 16,052	$ -	$ -	$ (36)	$ 16,052
U.S. government agency pool securities	(9)	2,748	(82)	10,144	(91)	12,892
U.S. government agency or GSE residential mortgage-backed securities	(320)	16,990	-	-	(320)	16,990
Total	$ (365)	$ 35,790	$ (82)	$ 10,144	$ (447)	$ 45,934

The Company does not believe that any of the investment securities that were in an unrealized loss position as of September 30, 2017, which included a total of 152 securities, were other-than-temporarily impaired. Specifically, the 152 securities are comprised of the following: 93 Small Business Administration (SBA) Pool securities, 22 mortgage-backed securities issued by the Government National Mortgage Association (GNMA), 18 U.S. Treasury securities, 8 mortgage-backed securities, 7 agency securities issued by the Federal Home Loan Bank (FHLB) and 1 agency security issued by the Federal National Mortgage Association (FNMA), 1 mortgage-backed security and 1 step up bond issued by Federal Home Loan Mortgage Corporation (FHLMC), and 1 agency security issued by Federal Farm Credit Banks (FFCB).

Total gross unrealized losses were primarily attributable to changes in interest rates relative to when the investment securities were purchased, and not due to changes in the credit quality of the investment securities. In addition, these securities and their repayment are sponsored by the U.S. Government or its various agencies and therefore, it is unlikely that they will ever be settled for less than par. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not likely that the Company will be required to sell the investment securities before recovery of their amortized cost, which may be at maturity.

Deposits

At September 30, 2017, total deposit liabilities increased by $86.4 million, to $1.87 billion, as compared to $1.78 billion in total deposits at December 31, 2016. Non-interest bearing deposits increased by $52.7 million, to $522.1 million at September 30, 2017, from $469.5 million at December 31, 2016, while interest-bearing deposits increased by $33.7 million, to $1.34 billion at September 30, 2017, from $1.31 billion at December 31, 2016. The 4.9% increase in total deposits was primarily due to an increase in government deposits. At September 30, 2017, and December 31, 2016, the ratio of non-interest bearing deposits to interest-bearing deposits was 38.9% and 35.9%, respectively.

The following table sets forth the composition of our interest-bearing deposit portfolio with the balances and average interest rates at September 30, 2017 and 2016, respectively:

	September 30, 2017		December 31, 2016	
	Balance	Average rate	Balance	Average rate
Interest-bearing checking accounts	$ 277,196	0.12%	$ 346,922	0.11%
Money market and savings accounts	1,031,023	0.17%	904,215	0.18%
Certificates of deposit	34,689	0.32%	58,082	0.33%
Total interest-bearing deposits	$ 1,342,908	0.17%	$ 1,309,219	0.17%

As mentioned earlier, the Bank has expanded its operations and its branch network since it first opened in 1972, first in Guam, then in the other islands of our region and in San Francisco, California. As time has passed, the Bank has gathered market share in each of the islands. In recent years, in order to diversify its geographic market, the Bank has increased its focus on growth in the California region. The following table provides figures for deposits in the Bank's administrative regions at year end December 31, 2015 and 2016, and at September 30, 2017:

	December 31, 2015	December 31, 2016	September 30, 2017
Guam	$ 824,661	$ 975,526	$ 994,202
Commonwealth of the Northern Mariana Islands	$ 234,336	$ 319,895	$ 356,904
The Freely Associated States of Micronesia *	$ 314,603	$ 431,865	$ 462,703
California	$ 49,071	$ 51,384	$ 51,234
Total	$ 1,422,671	$ 1,778,670	$ 1,865,043

* The Freely Associated States (FAS) are comprised of the Federated States of Micronesia (Chuuk, Kosrae, Pohnpei and Yap), the Republic of Palau and the Republic of the Marshall Islands.

During the nine months ended September 30, 2017, the Bank's deposits increased by $86.4 million, or 4.9%, while in the full year of 2016, deposits increased by a total of $356.0 million. Our branches in CNMI experienced an increase of $37.0 million in deposits during the first three quarters of 2017, our branches in the FAS provided an additional $30.8 million, and the deposits in our branches in Guam grew by $18.7 million. Our California region deposits decreased by $150 thousand during the first nine months of 2017.

Borrowed Funds

The Bank has a variety of sources from which it may obtain secondary funding. These sources include, among others, the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank-Des Moines, and credit lines established with our correspondent banks. Borrowings are obtained for a variety of reasons which include, but are not limited to, funding loan growth, the purchase of investments in the absence of core deposits, and to provide additional liquidity to meet the demands of depositors.

At September 30, 2017, and at December 31, 2016, the Company had no short-term borrowings.

Liquidity

We actively manage our liquidity to ensure that sufficient funds are available to meet our needs for cash, including cash needed to fund new loans and to accommodate deposit withdrawals and other transactions by our customers. We project future sources and uses of funds, and maintain additional liquid funds for unanticipated events. Our primary sources of cash include cash we have in deposits at other financial institutions, the repayment of loans, proceeds from the sale or maturity of investment securities, and increases in deposits. The primary uses of cash include funding new loans and making advances on existing lines of credit, purchasing investments, funding new residential mortgage loans, funding deposit withdrawals, and paying operating expenses. From time to time, we may maintain funds in overnight Federal Funds and other short-term investments to provide for short-term liquidity needs. We also have established, for contingency funding purposes, credit lines with the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank-Seattle, and correspondent commercial banks in the U.S.

At September 30, 2017, our liquid assets, which include cash and due from banks, interest-earning deposits with financial institutions (excluding restricted cash), and investment securities available for sale totaled $668.5 million, up $72.0 million from $596.5 million at December 31, 2016. This increase is due to the $82.2 million rise in available-for-sale securities, partially offset by a decrease of $9.7 million in interest bearing deposits in banks and the reduction of $529 thousand in cash and due from banks.

Contractual Obligations

The Bank utilizes facilities, equipment and land under various operating leases with terms, including renewal options, ranging from 1 to 99 years. Some of these leases include scheduled rent increases. The total amount of the rent is being debited to expense on the straight-line method over the lease terms in accordance with ASU Topic 840 *"Leases"* . The Bank has recorded a deferred obligation of $972 thousand and $926 thousand as of September 30, 2017, and December 31, 2016, respectively, which has been included within other liabilities to reflect the excess of rent expense over cash paid on the leases.

At September 30, 2017, annual lease commitments under the above non-cancelable operating leases were as follows:

Years ending December 31,		
2017	$	574
2018		1,986
2019		1,763
2020		1,678
2021 and thereafter		23,817
Total lease commitments	$	29,818

The Bank leases certain facilities from two separate entities in which two of its directors have separate ownership interests. Lease payments made to these entities during the nine months ended September 30, 2017, and September 30, 2016, approximated $250 thousand and $250 thousand, respectively. For the three months ended September 30, 2017, and September 30, 2016, lease payments made to these entities approximated to $99 thousand and $95 thousand, respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 3 to 5 years with option periods ranging up to 15 years. At September 30, 2017, minimum future rents to be received under non-cancelable operating sublease agreements were $13 thousand, $45 thousand, and $16 thousand for the periods ending December 31, 2017, 2018 and 2019, respectively.

A summary of rental activities for the three and nine months ended September 30, 2017 and 2016, respectively, is as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
Rent expense	$	713	$	657	$	2,086	$	1,978
Less: sublease rentals		44		76		176		215
Net rent expense	$	669	$	581	$	1,910	$	1,763

Off-Balance Sheet Arrangements

The Bank is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in our condensed consolidated financial statements.

The Bank's exposure to credit loss, in the event of nonperformance by the other parties to financial instruments for loan commitments and letters of credit, is represented by the contractual amount of these instruments. The Bank follows essentially the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of financial instruments with off-balance-sheet risk at September 30, 2017, and December 31, 2016, is as follows:

	September 30, 2017		December 31, 2016	
Commitments to extend credit	$	166,140	$	152,585
Letters of credit:				
Standby letters of credit	$	54,365	$	52,396
Commercial letters of credit		2,711		3,045
Total	$	57,076	$	55,441

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses, and may require payment of a fee. The commitments for certain lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to g uarantee the performance of a customer to a third party or the shipment of merchandise from a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Almost all letters of credit issued have expiratio n dates within one year. The credit risk involved in issuing letters of credit is effectively the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments.

The Bank considers its standby and commercial letters of credit to be guarantees. At September 30, 2017, the maximum undiscounted future payments that the Bank could be required to make was $57.1 million. Almost all of these arrangements mature within one year. The Bank generally has recourse to recover from the customer any amounts paid under these guarantees. Most of the guarantees are fully collateralized; however, several that are extended to the Bank's most creditworthy customers are unsecured. The Bank has recorded $22.5 thousand in reserve liabilities associated with commitments to extend credit and letters of credit at September 30, 2017.

Mortgage loans serviced for others are not included in the accompanying condensed consolidated statements of condition. The unpaid principal balances of mortgage loans serviced for others were $206.8 million and $211.0 million at September 30, 2017, and December 31, 2016, respectively. On September 30, 2017, and December 31, 2016, the Bank recorded mortgage servicing rights at their fair value of $1.5 million and $1.5 million, respectively.

Capital Resources

The Company and the Bank are subject to various regulatory capital requirements administered by the United States federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's condensed consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet or exceed specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and Common Equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes that, as of September 30, 2017, and December 31, 2016, the Bank met all capital adequacy requirements to which it is subject.

In December 2010, the Basel Committee on Bank Supervision ("Basel Committee") released its final framework for strengthening international capital and liquidity regulation, now officially identified as "Basel III," which, when fully phased-in, would require bank holding companies and their bank subsidiaries to maintain substantially more capital than had previously been required, with a greater emphasis on common equity.

In July 2013, the U.S. banking regulatory agencies approved the U.S. version of Basel III. The version of Basel III adopted revises the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Many of the rules apply on a phased-in basis to all banking organizations, including the Company and the Bank. Among other things, the rules establish a new minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.00%). An additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios will be phased in from 2016 to 2019 (1.25% in 2017 and 0.625% in 2016) and must be met to avoid limitations on the ability of the Company and the Bank to pay dividends, repurchase shares or pay discretionary bonuses. At September 30, 2017, the actual capital conservation buffer was 5.23% and 4.87% for the Company and the Bank, respectively, and the minimum conservation buffer requirement was 1.25%. The new rules assign higher risk weighting to credit exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The rules also change the permitted composition of Tier 1 capital to exclude trust preferred securities, mortgage servicing rights and certain deferred tax assets, and include unrealized gains and losses on available-for-sale debt and equity securities (through a one-time opt out option for Standardized Banks (banks with less than $250 billion of total consolidated assets and less than $10 billion of foreign exposures) which the Company and the Bank elected at March 31, 2015). The rules, including alternative requirements for smaller community financial institutions like the Company and the Bank, will be phased in through 2019.

As of September 30, 2017, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There have been no conditions or events since the FDIC notification that management believes have changed the Bank's category. The Ban k's actual capital amounts and ratios as of September 30, 2017, and December 31, 2016, are also presented in the table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2017:						
Total capital (to Risk Weighted Assets)	$ 151,022	12.865%	$ 108,583	9.250%	$ 117,387	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 136,342	11.615%	$ 85,106	7.250%	$ 93,910	8.000%
Tier 1 capital (to Average Assets)	$ 136,342	6.878%	$ 91,680	4.625%	$ 99,113	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 131,342	11.189%	$ 67,498	5.750%	$ 76,302	6.500%
At December 31, 2016:						
Total capital (to Risk Weighted Assets)	$ 144,827	12.610%	$ 99,023	8.625%	$ 114,809	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 130,463	11.360%	$ 76,061	6.625%	$ 91,847	8.000%
Tier 1 capital (to Average Assets)	$ 130,463	7.060%	$ 73,937	4.000%	$ 92,421	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 125,463	10.930%	$ 58,839	5.125%	$ 74,626	6.500%

The Company's required and actual capital amounts and ratios as of September 30, 2017, and December 31, 2016, were as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2017						
Total capital (to Risk Weighted Assets)	$ 155,693	13.227%	$ 108,881	9.250%	$ 117,709	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 140,972	11.976%	$ 85,339	7.250%	$ 94,167	8.000%
Tier 1 capital (to Average Assets)	$ 140,972	7.100%	$ 91,825	4.625%	$ 99,270	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 131,189	11.145%	$ 67,683	5.750%	$ 76,511	6.500%
At December 31, 2016						
Total capital (to Risk Weighted Assets)	$ 149,540	12.990%	$ 106,483	9.250%	$ 115,117	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 135,138	11.739%	$ 83,460	7.250%	$ 92,093	8.000%
Tier 1 capital (to Average Assets)	$ 135,138	7.299%	$ 85,633	4.625%	$ 92,576	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 125,355	10.889%	$ 66,192	5.750%	$ 74,826	6.500%

Since the formation of BankGuam Holding Company in 2011, our assets have grown by 82.8% ($913.5 million), while our stockholders' equity has grown by 56.4% ($50.0 million, including $38.3 million in retained earnings). The difference between these growth rates has challenged our ability to maintain our historically strong capital ratios. In order to support the Company's continued growth and to provide sufficient resources to expand our subsidiary holdings, the Board approved the issuance of up to $10.0 million in non-cumulative perpetual preferred stock, issued to various accredited and a limited number of non-accredited investors, of which $9.8 million was issued during the year ended December 31, 2016, when the offering was closed. On September 27, 2017, the Company filed a Form S-1/A, an amended general form for registration of securities, for the issuance of up to $20.0 million in additional common stock, subscriptions for which it began accepting in October 2017.

Stock Purchase Plan

The Bank's 2011 Employee Stock Purchase Plan (the "2011 Plan") was adopted by the Bank's Board of Directors and approved by the Bank's Stockholders on May 2, 2011, to replace the Bank's 2001 Non-Statutory Stock Option Plan. This plan was subsequently adopted by the Company after the Reorganization. The 2011 Plan is open to all employees of the Company and the Bank who have met certain eligibility requirements.

Under the 2011 Plan, as amended and restated as of July 1, 2012, eligible employees can purchase, through payroll deductions, shares of common stock at a discount. The right to purchase stocks is granted to eligible employees during a quarterly offer period that is established from time to time by the Board of Directors of the Company. Eligible employees cannot accrue the right to purchase more than $25 thousand worth of stock at the fair market value at the beginning of each offer period. Eligible employees also may not purchase more than one thousand five hundred (1,500) shares of stock in any one offer period. The shares are purchased at 85% of the fair market price of the stock on the enrollment date.

Contingency Planning and Cybersecurity

The services provided by banks are crucial to the continuing performance of the economy, so it is very important that banks are able to conduct business as usual on an ongoing basis. In light of this, the Bank has developed a comprehensive business continuity plan to address whatever disruptions may directly affect customers or change internal processes, whether caused by man-made or natural events. Training in the plan components is conducted annually, and risk-based testing of the major processes and procedures within the Bank occur on a regular basis. In modern banking, technology has taken on an increasingly important role, and the Bank also has a technology recovery component incorporated into the business continuity plan that provides specific, detailed procedures for recovering quickly from any technology failure. The technology recovery procedures are actively tested, and are also implemented from time to time. The recovery time objectives for all major technological processes range from eight hours to 80 hours, enabling the Bank to maintain or resume operations with a minimum impact on its customers. As the results of testing are analyzed and as technology continues to advance, improvements are made in the Bank's processes and procedures as the plan evolves.

The rapid advances in computing and telecommunications technology over the past several decades have brought with them increasingly sophisticated methods of delivering financial services through electronic channels. Along with these advances, though, have come risks regarding the integrity and privacy of data, and these risks apply to banking, perhaps more than any other industry, falling into the general classification of cybersecurity. The Bank has made substantial investments in multiple systems to ensure both the integrity of its data and the protection of the privacy of its customers' personal financial and identity information. While it is not possible for anyone to give an absolute guarantee that data will not be compromised, the Bank is confident that its systems provide a reasonable assurance that the financial and personal data that it holds are secure.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rules 13a-15 and 15d-15 under the Exchange Act, in connection with the filing of this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2017. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2017, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's Rules and forms and is accumulated and communicated to management, including our Chief Executive and Chief Financial Officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three and nine months ended September 30, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER IN FORMATION

Item 1A. Risk Factors

Our business, financial condition and results of operations are subject to various risks, including those discussed below and in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016. Other than as reflected below, there have been no material changes from the risks contained in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016.

Our business may be adversely affected by conditions in the financial markets and economic conditions generally.

The United States economy is recovering, moderately, from a downturn that started in 2007, but business activity and growth across industries and regions have not yet been fully restored. There are indications that the recovery is accelerating, and the decision of the Federal Open Market Committee, which guides current monetary policy actions on behalf of the Federal Reserve System in carrying out its broader monetary policies, to raise its target interest rate on December 14, 2016, expressed its confidence in the sustainability of recent economic growth in the United States. Consumer spending, liquidity and availability of credit are modestly improving, and the unemployment rate in the United States has fallen by more than half since October 2009, and the Federal Open Market Committee has raised its target Fed Funds rate twice since the beginning of 2017. Nonetheless, the unemployment rate is still relatively high in the principal island markets we serve.

The financial services industry was materially and adversely affected by the weakened economy and by the monetary policy responses intended to correct that weakness. The negative effect of historically low market interest rates reduced our interest rate margin despite us having established minimum rate levels on our variable rate loans. In order to retain core deposits and as a reputational matter, our consumer savings account rates have been higher than many of our competitors' offerings for the past eight years. The slow recovery of the economy and continued elevated unemployment may negatively impact our operating results; however, the Bank has not experienced any adverse liquidity issues in recent years. Additionally, adverse changes in the economy may have a negative effect on the ability of our borrowers to make timely repayments of their loans. These factors could expose us to an increased risk of loan defaults and losses, and have an adverse impact on our earnings.

Recent legislative and required regulatory initiatives will impose restrictions and requirements on financial institutions that could have an adverse effect on our business.

Current and future legal and regulatory requirements, restrictions, and regulations, including those imposed under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was enacted in response to the 2008 financial crisis and subsequent economic weakness, may adversely impact our profitability, financial condition and operations; may require us to invest significant management attention and resources to evaluate and make any changes required by the legislation and related regulations; and may make it more difficult for us to attract and retain qualified executive officers and employees. Few provisions of the Dodd-Frank Act were effective immediately, with various provisions becoming effective in stages. Many of the provisions required governmental agencies to implement rules that have increased regulation of the banking industry. As examples, these rules impact the ability of banks to charge certain fees and impose new restrictions on lending practices. The Dodd-Frank Act created a new financial consumer protection agency, known as the Consumer Financial Protection Bureau (the "Bureau"), that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer compliance, which may increase our regulatory compliance burden and costs, and may restrict the financial products and services we offer to our customers.

The Dodd-Frank Act prohibits new trust preferred issuances from counting as Tier 1 capital. These restrictions limit our future capital strategies. Although neither the Bank nor the Company use derivative transactions, the Dodd-Frank Act also increases regulation of derivatives and hedging transactions, which could limit our ability in the future to enter into, or increase the costs associated with, interest rate and other hedging transactions. Although certain provisions of the Dodd-Frank Act, such as direct supervision by the Bureau, will not apply to banking organizations with less than $10 billion of assets, such as the Company, the changes resulting from the legislation will impact our business nonetheless. These and future changes may have a material, adverse effect on our business, our financial condition and the results of our operations.

Implementation of the new Basel III capital rules adopted by the federal bank regulatory agencies will require increased capital levels that could impede our growth and profitability.

The federal bank regulatory agencies adopted new capital requirements in mid-2013 that increased the minimum Tier 1 risk-based capital ratio, added a new minimum common equity Tier 1 capital ratio, established a new capital conservation buffer and changed the risk-weighting of certain assets. These requirements, initially implemented beginning in January 2015, are being phased in through 2019, providing banks with adequate time to adjust their balance sheets. Management has assessed the effects of the new rules on the Company and the Bank's capital position. Although we currently exceed the new minimum requirements, they could have a material and adverse effect on our liquidity, capital resources, financial performance and financial condition in the future.

Any future FDIC insurance premium increases w ill adversely affect our earnings.

FDIC-insured financial institutions, including the Bank, are charged premiums to maintain the FDIC Deposit Insurance Fund at a certain level. In 2009, the FDIC collected a special assessment and revised its risk-based assessment system to replenish the FDIC Deposit Insurance Fund, which had been depleted by rising levels of bank failures and associated costs. In recent years, deposit premiums have decreased as the level of bank failures has returned to historical norms. However, if the costs of future bank failures increase, deposit insurance premiums may also increase, and there can be no assurance that assessments will not be changed in the future. Our FDIC deposit insurance expense for the year ended December 31, 2016, was $1.3 million and $1.1 million for the nine months ended September 30, 2017.

Our profitability is dependent upon the economic conditions of the markets in which we operate.

We operate on ten relatively remote Pacific islands and in San Francisco, California, and, as a result, our financial condition and results of operations are affected by changes in the economic conditions in those areas. Our success depends upon the business activity, population, income levels, deposits and lending activity in these markets. Because some of our customers' business and financial interests may extend well beyond these market areas, adverse economic conditions that affect those other market areas could reduce our growth rate, affect the ability of those customers to repay their loans, and generally affect our financial condition and results of operations. Other than in San Francisco, our lending operations are located in market areas dependent on tourism and fishing, along with a military presence and other federal government activities in Guam. Although the Commonwealth of the Northern Mariana Islands suffered setbacks in recent years because of a decline in its visitor industry, the failure of its garment industry and widespread typhoon damage, new construction activity and increased visitor arrivals are supporting a more rapid expansion of the economy. The other island economies have remained relatively stable. However, because of the magnified influence of external events, these small island economies tend to be somewhat more volatile than larger economic systems. Thus, our borrowers could be adversely impacted by a downturn in these sectors of the economy that could reduce the demand for loans and adversely impact the borrowers' ability to repay their loans, which would, in turn, increase our nonperforming assets. Because of our geographic concentration in several relatively small island economies, we are less able than many regional or national financial institutions to diversify our credit risks across multiple dissimilar markets. In recent years, we have taken the initiative to expand our operations in California in an effort to increase and help to stabilize our profitability.

Our loan portfolio has a large concentration of real estate loans in Guam and in San Francisco, which involves risks specific to real estate values.

A downturn in our real estate markets could adversely affect our business because many of our loans are secured by real estate. Real estate lending (including commercial and construction) is a large portion of our loan portfolio. At September 30, 2017, and December 31, 2016, approximately $693.5 million (58.2%) and $703.1 million (59.8%), respectively, of our loan portfolio, was secured by various forms of real estate, including residential and commercial real estate. The real estate securing our loan portfolio is concentrated in Guam and San Francisco. From time to time, there have been adverse developments affecting real estate values in one or more of our markets, and the market value of real estate can fluctuate significantly in a short period of time as a result of changing market conditions. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature, such as earthquakes and typhoons. Additionally, commercial real estate lending typically involves larger loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. If real estate values decline, the value of the collateral securing some of our loans could be significantly reduced. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and we would be more likely to suffer losses on defaulted loans.

If we fail to maintain an effective system of internal controls and disclosure controls and procedures, we may not be able to accurately report our financial results or prevent fraud.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports, effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and business would be harmed. In addition, failure in our internal control over financial reporting and disclosure controls and procedures could cause us to fail to meet the requirements of Rules 13a-15 and 15d-15 under the Exchange Act and, as a result, risk errors in our financial reporting to the Securities and Exchange Commission.

Each calendar quarter, management conducts an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Our performance depends on attracting and retaining key employees and skilled personnel to operate our business effectively, and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Our success is dependent on our ability to recruit and retain qualified, skilled management, loan origination, finance, administrative, marketing and technical personnel to operate our business effectively. Competition for qualified employees and personnel in the banking industry is intense and there is a limited number of persons with knowledge of, and experience in, the community banking industry in the markets we serve. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our Chief Executive Officer, our Chief Operating Officer, our Chief Financial Officer, and certain other key employees. Failure to maintain adequate staffing in key positions could adversely impact our operations and our ability to compete. We have implemented a succession plan to help mitigate this risk, including the appointment of two Executive Vice Presidents who will ultimately assume critical exe cutive level positions.

We are subject to credit risk.

There are inherent risks associated with our lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where we operate, as well as those within our region, across the United States and abroad. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing those loans. We are also subject to various laws and regulations that affect our lending activities. Failure to comply with applicable laws and regulations could subject us to regulatory enforcement action, which could result in the assessment of significant civil money penalties against us.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting standards, and these losses may exceed the amounts set aside as reserves in our allowance for loan losses. Due to economic conditions in the recent past, many lending institutions, including the Bank, experienced declines in the performance of their loans, including consumer and commercial loans. The value of real estate collateral supporting some commercial loans declined and may decline again in the future. Developments in the financial industry and credit markets may adversely impact our financial condition and results of operations.

Our allowance for loan losses may not be adequate to cover actual loan losses, which could adversely affect our earnings.

We maintain an allowance for loan losses for possible defaults and other reductions in the principal value of the Bank's loan portfolio. The allowance is established through a provision for loan losses based on management's evaluation of the risks inherent in the loan portfolio and the general economy. The allowance is also appropriately increased for new loan growth. The allowance is based upon a number of factors, including the size of the loan portfolio, asset classifications, economic trends, industry experience and trends, industry and geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience and loan underwriting policies.

We strive to carefully manage and monitor credit quality and to identify deteriorating loans, and adjust the allowance for loan losses accordingly. However, because future events are uncertain and because we may not successfully identify all deteriorating loans in a timely manner, there may be loans that deteriorate in an accelerated time frame. As a result, future additions to the allowance may be necessary. Further, because the loan portfolio contains some commercial real estate, construction, and land development loans with relatively large balances, deterioration in the credit quality of one or more of these loans may require a significant increase to the allowance for loan losses. Future additions to the allowance may also be required due to changes in the financial condition of borrowers, such as changes resulting from potentially worsening economic conditions, or as a result of incorrect assumptions by management in determining the allowance for loan losses. Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by making additional provisions for loan losses, charged as an expense, or to decrease our allowance for loan losses by recognizing loan charge-offs, net of recoveries. Any such additional provisions for loan losses or charge-offs, whether required by regulatory agencies or not, could have a material adverse effect on our financial condition and results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

At September 30, 2017, and December 31, 2016, nonperforming loans were 0.45% and 0.56%, respectively, of the total loan portfolio, and 0.27% and 0.34%, respectively, of total assets, as compared to 0.54% and 0.78% at December 31, 2015, respectively, indicating a reduced level of risk. Nonperforming assets adversely affect our earnings in various ways. Depending upon economic and market conditions, we may incur losses relating to an increase in nonperforming assets. We do not record interest income on non-accrual loans or other real estate owned, thereby adversely affecting our income, and increasing our loan administration costs. Upon foreclosure or similar proceedings, we record the foreclosed asset at the fair value of the asset, reduced by estimated selling costs, which may result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the increased risk profile. While we reduce problem assets through collection efforts, asset sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, our results of operations and our financial condition.

In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can hinder the performance of their other responsibilities. If economic and market conditions worsen, it is possible that we will experience future increases in nonperforming assets, particularly if we are unsuccessful in ou r efforts to reduce our classified assets, which would have an adverse effect on our business.

We may be required to make additional provisions for loan losses and charge off additional loans in the future, which could adversely affect our results of operations.

At September 30, 2017, and December 31, 2016, we recorded a $3.6 million and $3.9 million, respectively, of provision for loan losses, charged off $5.0 million and $5.6 million, respectively, of loans, and recovered $1.2 million and $3.0 million of loans, respectively, previously charged off. During those same periods, we had $693.5 million and $703.1 million, respectively, in commercial and residential real estate loans and construction loans, of which $12.2 million and $12.8 million, respectively, was on non-accrual. Construction loans and commercial real estate loans comprise a substantial portion of our nonperforming assets. Deterioration in the real estate market in Guam, San Francisco and/or the Commonwealth of the Northern Mariana Islands could affect the ability of our loan customers to service their debt, which could result in additional loan charge-offs and provisions for loan losses in the future, and could have a material adverse effect on our financial condition, results of operations and capital.

Our business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Our earnings and cash flows are highly dependent upon net interest income. Net interest income is the difference between interest income earned on interest-bearing assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Our net interest income (including net interest spread and margin) and ultimately our earnings are impacted by changes in interest rates and monetary policy. Changes in interest rates and monetary policy can impact the demand for new loans, the credit profile of our borrowers, the yields earned on loans and securities, and the rates paid on deposits and borrowings. Given our current volume and mix of interest-bearing liabilities and interest-earning assets, we expect our interest rate spread (the difference in the rates paid on interest-bearing liabilities and the yields earned on interest-earning assets) as well as net interest income to increase as interest rates rise and, conversely, to decline if interest rates fall. Additionally, increasing levels of in-market and out-of-market competition in the banking and financial services business may decrease our net interest spread as well as net interest margin by forcing us to offer lower lending interest rates and pay higher deposit interest rates. Although we believe our current level of interest rate sensitivity is reasonable, significant fluctuations in interest rates (such as a sudden and substantial increase in Prime and Fed Funds rates) as well as increasing competition may require us to increase rates on deposits at a faster pace than the yield we receive on interest-earning assets increases. The impact of any sudden and substantial move in interest rates and/or increased competition may have an adverse effect on our business, financial condition and results of operations, as our net interest income may be adversely affected.

Additionally, a sustained decrease in market interest rates could negatively affect our earnings. When interest rates decline, borrowers tend to refinance higher-rate, fixed-rate loans at lower rates, prepaying their existing loans. Under those circumstances, we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on the prepaid loans or at all if the borrower refinances with another lender. In addition, our commercial loans, which carry variable interest rates that generally adjust in accordance with changes in the prime rate, will adjust to lower rates as we place funds in lower-yielding investments. Because of this, we have established minimum interest rates on those loans to mitigate our interest rate risk and potential reductions in income.

We are also significantly affected by the level of loan demand available in our markets. The inability to make sufficient loans directly affects the interest income we earn. Lower loan demand will generally result in lower interest income realized as we place funds in lower-yielding investments.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn in markets in which our loans are concentrated, a change in our financial condition or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

If we lost a significant portion of our low-cost deposits, it would negatively impact our liquidity and profitability.

Our profitability depends in part on our success in attracting and retaining a stable base of low-cost deposits. At September 30, 2017, and December 31, 2016, 28.0% and 26.4%, respectively, of our deposit base was comprised of non-interest bearing deposits, and the average rate on our interest-bearing deposits during 2016 and the first nine months of 2017 was 0.17%. While we generally do not believe these core deposits are very sensitive to interest rate fluctuations, the competition for these deposits in our markets is strong. If we were to lose a significant portion of our low-cost deposits, it could negatively impact our liquidity and profitability. To help to mitigate this risk, we actively monitor our competitors' deposit interest rates and will adjust our rates accordingly in order to maintain our deposit base.

We may be the subject of litigation, which could result in legal liability and damage to our business and reputation.

From time to time, we may be subject to claims or legal action from customers, employees or others. Financial institutions like the Company and the Bank are facing a growing number of significant class actions, including those based on the manner of calculation of interest on loans and the assessment of overdraft fees. Future litigation could include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. We are also involved from time to time in other reviews, investigations and proceedings (both formal and informal) by governmental and other agencies regarding our business. These matters also could result in adverse judgments, settlements, fines, penalties, injunctions or other relief. Like other large financial institutions, we are also subject to risk from potential employee misconduct, including non-compliance with policies and improper use or disclosure of confidential information.

Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Should the ultimate judgments or settlements in any litigation exceed our insurance coverage, they could have a material adverse effect on our financial condition and results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, nor may we be able to obtain adequate replacement policies with acceptable terms, if at all.

If we are limited in our ability to originate loans secured by commercial real estate we may face greater risk in our loan portfolio.

Federal banking agencies have issued guidance regarding high concentrations of commercial real estate loans within bank loan portfolios. The guidance requires financial institutions that exceed certain levels of commercial real estate lending compared with their total capital to maintain heightened risk management practices that address the following key elements: board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. If there is any deterioration in our commercial real estate portfolio or if our regulators conclude that we have not implemented appropriate risk management practices, it could adversely affect our business, and could result in the requirement to maintain increased capital levels. Such capital may not be available at that time, and may result in our regulators requiring us to reduce our concentration in commercial real estate loans.

If because of our concentration of commercial real estate loans, or for any other reasons, we are limited in our ability to originate loans secured by commercial real estate, our results of operations may be negatively impacted and we may incur greater risk in our loan portfolio.

The laws and regulations, including the Dodd-Frank Act, applicable to the banking industry could change at any time, and these changes may adversely affect our business and profitability.

We are subject to extensive federal and state regulation. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably. The increased scope, complexity, and cost of corporate governance, reporting, and disclosure practices are proportionately higher for a company of our size and will affect our profitability more than that of some of our larger competitors. We expect to experience increasing compliance costs related to this supervision and regulation.

Also, the 2016 national election results and new administration have introduced additional uncertainty into future implementation and enforcement of the Dodd-Frank Act and other financial sector regulatory requirements. Such additional regulation and supervision may increase our costs and limit our ability to pursue business opportunities. The effects of any such recently enacted, or proposed, legislation and regulatory programs on us cannot reliably be determined at this time.

The Consumer Financial Protection Bureau (the "CFPB") recently issued "ability-to-repay" and "qualified mortgage" rules that may have a negative impact on our loan origination process and foreclosure proceedings, which could adversely affect our business, operating results and financial condition.

On January 10, 2013, the CFPB issued a final rule to implement the "qualified mortgage" provisions of the Dodd-Frank Act requiring mortgage lenders to consider consumers' ability to repay home loans before extending them credit. The CFPB's "qualified mortgage" rule, which became effective on January 10, 2014, describes certain minimum requirements for lenders making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. Lenders will be presumed to have complied with the ability-to-repay rule if they issue "qualified mortgages," which are generally defined as mortgage loans prohibiting or limiting certain risky features. Loans that do not meet the ability-to-repay standard can be challenged in court by borrowers who default, and the absence of ability-to-repay status can be used against a lender in foreclosure proceedings. Any loans that we make outside of the "qualified mortgage" criteria could expose us to an increased risk of liability and reduce or delay our ability to foreclose upon the underlying property. Any decreases in loan origination volume or increases in compliance and foreclosure costs caused by the rule could negatively affect our business, operating results and financial condition. The CFPB also has adopted a number of additional requirements and issued additional guidance, including with respect to appraisals, escrow accounts and servicing, each of which ent ails increased compliance costs. In addition, the CFPB likely will continue to make rules relating to consumer protection, and it is difficult to predict which of our products and services will be subject to these rules or how these rules will be implement ed.

Compliance with the Dodd-Frank Act has increased our regulatory compliance burdens, and may increase our operating costs and may adversely impact our earnings or capital ratios, or both.

Signed into law on July 21, 2010, the Dodd-Frank Act has represented a significant overhaul of many aspects of the regulation of the financial services industry. Among other things, the Dodd-Frank Act created the CFPB, tightened capital standards, imposed clearing and margining requirements on many derivatives activities and generally increased oversight and regulation of financial institutions and financial activities.

In addition to the self-implementing provisions of the statute, the Dodd-Frank Act calls for over 200 administrative rulemakings by numerous federal agencies to implement various parts of the legislation. While many rules have been finalized or issued in proposed form, additional rules have yet to be proposed. It is not possible at this time to predict when all such additional rules will be issued, their final form or requirements, their applicability to the Company or the Bank, or when they will be implemented.

The cost of complying with the new consumer protection regulations and policies could adversely affect our business.

The Dodd-Frank Act created the CFPB, a new regulatory entity with broad powers to supervise and enforce consumer protection laws. The CFPB has extensive rulemaking authority for a wide range of consumer protection laws that apply to banks and other types of lenders, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. It also has examination and enforcement authority over all banks with more than $10 billion in assets. Institutions with less than $10 billion in assets, like us, are examined for compliance with consumer protection laws by their primary bank regulators, but these regulators defer to the CFPB’s rules and interpretations in evaluating a bank’s compliance with consumer protection laws. Therefore, although the CFPB does not directly supervise us, the actions of the CFPB significantly impact our operations.

The CFPB has set forth numerous rules and guidance documents since its inception concerning a wide range of consumer protection laws, many of which are directly applicable to our operations. For example, the CFPB recently imposed new requirements regarding the origination and servicing of residential mortgage loans, limitations on the manner in which loan originators may be compensated, mandatory disclosures on documentation given to borrowers, and an obligation on the part of lenders to verify a borrower’s “ability to repay” a residential mortgage loan before extending credit, among others. The CFPB likely will continue to make rules relating to consumer protection, and it is difficult to predict which of our products and services will be subject to these rules or how these rules will be implemented. However, compliance with CFPB regulations likely will result in additional operating and compliance costs that could have a material adverse effect on our business, consolidated financial condition, results of operations, or cash flows.

We have the ability to borrow from the Federal Home Loan Bank, and there can be no assurance their programs will continue in their current manner.

We have access to funding by the Federal Home Loan Bank of Des Moines for term advances; we also borrow from correspondent banks under our Fed Funds lines of credit from time to time, primarily to test the continuing availability of those lines. The amount loaned to us is generally dependent on the value of the collateral pledged. These lenders could reduce the percentages loaned against various collateral categories, could eliminate their acceptance of certain types of collateral, and could otherwise modify or even terminate their loan programs, particularly to the extent they are required to do so because of capital adequacy or other balance sheet concerns. Any change or termination of the programs under which we borrow from the Federal Home Loan Bank of Des Moines or correspondent banks could have an adverse effect on our liquidity and profitability.

Our results of operations may be adversely affected by other-than-temporary impairment charges relating to our securities portfolio.

We may be required to record future impairment charges on our securities, including our stock in the Federal Home Loan Bank of Des Moines, if they suffer declines in value that we consider other-than-temporary. Numerous factors, including the lack of liquidity for re-sale of certain securities, the absence of reliable pricing information for securities, adverse changes in the business climate, adverse regulatory actions or unanticipated changes in the competitive environment, could have a negative effect on our securities portfolio in future periods. Significant impairment charges could also negatively impact our regulatory capital ratios and result in the Bank not being classified as “well-capitalized” for regulatory purposes.

We may need to raise additional capital in the future and such capital may not be available when needed or at all.

We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet regulatory requirements, our commitments or our business needs. Our ability to raise additional capital, if needed, will depend, among other things, on conditions in the capital markets at that time, which are outside of our control, and our financial performance. The loss of confidence in financial institutions may increase our cost of funding and limit our access to some of our customary funding sources, including, but not limited to, inter-bank borrowings and borrowings from the discount window of the Federal Reserve.

We cannot provide assurances that such capital will be available to us on a cceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of the Bank or counterparties participating in the capital markets, may adversely affect our capi tal costs and our ability to raise capital and, in turn, our liquidity.

We must effectively manage our growth strategy.

As part of our general growth strategy, we may expand into additional communities or attempt to strengthen our position in our current markets by opening new offices. To the extent that we are able to open additional offices, we are likely to temporarily experience the effects of higher operating expenses relative to operating income from the new operations for a period of time, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Our current growth strategies involve internal growth from our current offices and the addition of new offices over time, so that the additional overhead expenses associated with recent openings are absorbed prior to opening other new offices.

We have a nominal amount of deferred tax asset and cannot assure that it will be fully realized.

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax basis of assets and liabilities computed using enacted tax rates. If we determine that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we are required under generally accepted accounting principles to establish a full or partial valuation allowance. If we determine that a valuation allowance is necessary, we are required to incur a charge to operations. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax asset will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires estimates that cannot be made with certainty. At December 31, 2016, we had a net deferred tax asset of $8.1 million. For the year ended December 31, 2016, we established a partial valuation allowance of $3.2 million to reduce the net deferred tax asset of $12.8 million because, in management's opinion, it is more likely than not that only the remaining $8.1 million will be realized. If we were to determine at some point in the future that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we would be required, under generally accepted accounting principles, to establish a full or increase any partial valuation allowance, which would require us to incur a charge to operations for the period in which the determination was made.

We face strong competition from financial service companies and other companies that offer banking services.

We face substantial competition in all phases of our operations from a variety of different competitors. Our competitors, including larger commercial banks, community banks, savings and loan associations, credit unions, consumer finance companies, insurance companies, brokers, investment advisors and other financial institutions, compete with the lending and deposit-gathering services we offer. Increased competition in our markets may result in reduced loans and deposits.

Many of these competing institutions have much greater financial and marketing resources than we have. Due to their size, many competitors can achieve larger economies of scale in a broader range of products and services than we can. If we are unable to offer competitively priced products and services, our business may be negatively affected.

Some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions, and are not subject to increased supervisory oversight arising from regulatory examinations. As a result, these non-bank competitors have certain advantages over us in accessing funding and in providing various services. The banking business in our primary market areas is very competitive, and the level of competition facing us may increase further, which may limit our asset growth and financial results.

In the future, the Bank and/or the Company may become subject to supervisory actions and/or enhanced regulation that could have a material adverse effect on our business, operating flexibility, financial condition and the value of our common stock.

Under federal, state and local laws and regulations pertaining to the safety and soundness of insured depository institutions, various state or local regulators (for non-federally chartered banks), the Federal Reserve Board (for bank holding companies and member banks), the local financial industry regulators of the various jurisdictions in which the Bank operates and, separately, the FDIC as the insurer of bank deposits, each have the authority to compel or restrict certain activities on our part if they determine that we have insufficient capital or are otherwise operating in a manner that may be deemed to be inconsistent with safe and sound banking practices. Under their respective authority, our bank regulators can require us to enter into informal or formal enforcement orders, including board resolutions, memoranda of understanding, written agreements, and consent or cease and desist orders, pursuant to which we may be required to take identified corrective actions to address cited concerns or to refrain from taking certain actions. Neither the Bank nor the Company is currently operating under any regulatory enforcement orders.

Technology is continually changing and we must effectively implement new technologies.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables us to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy their demands for convenience, as well as to create additional efficiencies in our operations as we c ontinue to grow and expand our geographic and product markets. In order to anticipate and develop new technology, we employ a qualified staff of internal information system specialists and consider this area a core part of our business. We do not develop o ur own software products, but have been able to respond to technological changes in a timely manner through association with leading technology vendors. We must continue to make substantial investments in technology, which may affect our results of operati ons. If we are unable to make such investments, or we are unable to respond to technological changes in a timely manner, our operating costs may increase, which could adversely affect our operating results.

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

The computer systems and network infrastructure we use could be vulnerable to 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 malicious parties. 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 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. We employ external auditors to conduct auditing and testing for weaknesses in our systems, controls, firewalls and encryption to reduce the likelihood of any security failures or breaches, as well as both internal and external monitoring systems to detect and report any attempt to overcome our electronic defenses. Although we, with the help of third-party service providers and auditors, intend to continue to implement effective security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will ultimately 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 would present a reputational risk, and could have a material adverse effect on our financial condition and results of operations.

Breaches of third parties' network security could subject us to increased operating costs and other liabilities.

In recent years, there have been numerous highly publicized breaches of customer databases maintained by both public and private entities, often compromising personally identifiable information. The Bank has established systems to mitigate the possibility that some of this information could be used fraudulently to open deposit and/or loan accounts. Despite all reasonable efforts, though, we are unable to be absolutely certain that the risk of that form of fraud is entirely eliminated.

Further, some of these third party data breaches have compromised credit card information, creating an opportunity to defraud the Bank and its credit card customers by initiating fraudulent charges using the compromised card information. Although efforts are being made in the U.S. Congress to reassign the liability for these fraudulent charges to the third parties whose systems have been breached, unless and until that reassignment is made, the Bank retains potential liabilities associated with those fraudulent charges. Also, when it is known that a credit card has been compromised, the Bank incurs costs in replacing the card. As a result, a third-party network security breach could have a material adverse effect on our financial condition and the results of our operations.

Managing operational risk is important to attracting and maintaining customers, investors and employees.

Operational risk represents the risk of loss resulting from our operations, including but not limited to, the risk of fraud by employees or persons outside the Bank, the execution of unauthorized transactions by employees, transaction processing errors and breaches of the internal control system, and failure to effectively meet compliance requirements. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. Operational risk is inherent in all business activities and the management of this risk is important to the achievement of our business objectives. In the event of a breakdown in our internal control system, improper operation of systems or improper employee actions, we could suffer financial loss, face regulatory action and suffer damage to our reputation. We have a stringent code of ethics and attendant procedures in place to protect our reputation and promote ethical conduct, but these policies and procedures might not be fully effective. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased regulatory oversight.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events or conditions could have a significant impact on our ability to conduct business. Such events or conditions 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. For example, our primary market areas in Guam and the CNMI are subject to typhoons, earthquakes and wildland fires. Operations in our market could be disrupted by both the evacuation of large portions of the population as well as damage and/or lack of access to our banking and operational facilities. While we have experienced severe weather and strong earthquakes in the past and resumed our operations promptly, a recurrence of these, along with acts of war, terrorism or other adverse external events or conditions, may occur in the future. Although management has established a business continuity pl an, disaster recovery policies and corresponding procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Uncertain geopolitical conditions could have a material adverse effect on our business and the markets which we serve, which could cause the market price of our common stock to decline.

Our business is subject to geopolitical conditions in the western Pacific, including concerns over North Korea's nuclear weapons program. In recent months, there have been heightened security concerns regarding North Korea's nuclear weapons and long-range ballistic missile programs. This has resulted in increased uncertainty regarding both North Korea's actions and those of the United States. If North Korea were to take an aggressive action, including acts of war, the markets we serve may be disrupted and our business operations could be affected as well. Any of these events could result in a decline in the market price of shares of our common stock.

Item 6. Exhibits

Exhibit No.	Exhibit
31.01	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley At of 2002
31.02	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Unaudited Condensed Consolidated Statements of Condition as of September 30, 2017, and December 31, 2016, (ii) Unaudited Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2017 and 2016, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2017 and 2016, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2017 and 2016, and (v) Notes to Unaudited Condensed Consolidated Financial Statements

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, BankGuam Holding Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	BANKGUAM HOLDING COMPANY
Date: November 20, 2017	By: /s/ LOURDES A. LEON GUERRERO Lourdes A. Leon Guerrero, President and Chief Executive Officer
Date: November 20, 2017	By: /s/ FRANCISCO M. ATALIG Francisco M. Atalig, Senior Vice President and Chief Financial Officer

Exhibit 31.01

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a) AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Lourdes A. Leon Guerrero, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BankGuam Holding Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 20, 2017

/s/ LOURDES A. LEON GUERRERO
Lourdes A. Leon Guerrero
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.02

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a) AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Francisco M. Atalig, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BankGuam Holding Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 20, 2017

/s/ FRANCISCO M. ATALIG
Francisco M. Atalig
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.01

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT

The certification set forth below is being submitted in connection with the report on Form 10-Q of BankGuam Holding Company for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Lourdes A. Leon Guerrero, the President and Chief Executive Officer of BankGuam Holding Company, and Francisco M. Atalig, the Senior Vice President and Chief Financial Officer of BankGuam Holding Company, each certifies that, to the best of his or her knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of BankGuam Holding Company.

Date: November 20, 2017	By: /s/ LOURDES A. LEON GUERRERO Lourdes A. Leon Guerrero President and Chief Executive Officer
Date: November 20, 2017	By: /s/ FRANCISCO M. ATALIG Francisco M. Atalig Senior Vice President and Chief Financial Officer