

OCEANFIRST FINANCIAL CORP  
Form 10-Q  
August 08, 2014  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2014**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-11713**

**OceanFirst Financial Corp.**

**(Exact name of registrant as specified in its charter)**

|   |  |
|---|--|
| <b>Delaware</b><br><b>(State or other jurisdiction of</b>                                   | <b>22-3412577</b><br><b>(I.R.S. Employer</b> |
| <b>incorporation or organization)</b>   | <b>Identification No.)</b>                   |
| <b>975 Hooper Avenue, Toms River, NJ</b><br><b>(Address of principal executive offices)</b> | <b>08753</b><br><b>(Zip Code)</b>            |
| <b>Registrant's telephone number, including area code: (732) 240-4500</b>                   |  |

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 Website, 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 registrant was required to submit and post such files). YES  NO .

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

|  |   |
|--|---|
| Large Accelerated Filer <input type="checkbox"/> | Accelerated Filer <input checked="" type="checkbox"/> |
| Non-accelerated Filer <input type="checkbox"/>   | Smaller Reporting Company <input type="checkbox"/>    |

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

As of August 1, 2014 there were 17,143,993 shares of the Registrant's Common Stock, par value \$.01 per share, outstanding.

**Table of Contents****OceanFirst Financial Corp.****INDEX TO FORM 10-Q**

|   | PAGE |
|---|------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>   |      |
| Item 1. Consolidated Financial Statements (unaudited)   |      |
| <u>Consolidated Statements of Financial Condition as of June 30, 2014 (unaudited) and December 31, 2013</u>                   | 10   |
| <u>Consolidated Statements of Income (unaudited) for the three and six months ended June 30, 2014 and 2013</u>                | 11   |
| <u>Consolidated Statements of Comprehensive Income (unaudited) for the three and six months ended June 30, 2014 and 2013</u>  | 12   |
| <u>Consolidated Statements of Changes in Stockholders' Equity (unaudited) for the six months ended June 30, 2014 and 2013</u> | 13   |
| <u>Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2014 and 2013</u>                      | 14   |
| <u>Notes to Unaudited Consolidated Financial Statements</u>   | 16   |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                          | 1    |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 9    |
| Item 4. <u>Controls and Procedures</u>  | 9    |
| <b><u>PART II. OTHER INFORMATION</u></b>  |      |
| Item 1. <u>Legal Proceedings</u>  | 33   |
| Item 1A. <u>Risk Factors</u>  | 34   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 34   |
| Item 3. <u>Defaults Upon Senior Securities</u>  | 34   |
| Item 4. <u>Mine Safety Disclosures</u>  | 34   |
| Item 5. <u>Other Information</u>  | 34   |
| Item 6. <u>Exhibits</u>   | 34   |
| <u>Signatures</u>   | 35   |

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****FINANCIAL SUMMARY**

| (dollars in thousands, except per share amounts)                     | At or for the Quarter Ended |                |                  |
|--|-----------------------------|----------------|------------------|
|  | June 30,<br>2014            | March 31, 2014 | June 30,<br>2013 |
| <b><u>SELECTED FINANCIAL CONDITION DATA:</u></b>                     |                             |                |                  |
| Total assets   | \$ 2,329,141                | \$ 2,281,711   | \$ 2,305,664     |
| Loans receivable, net  | 1,631,819                   | 1,570,969      | 1,505,680        |
| Deposits   | 1,705,510                   | 1,720,131      | 1,703,746        |
| Stockholders' equity   | 215,841                     | 216,190        | 216,278          |
| <b><u>SELECTED OPERATING DATA:</u></b>                               |                             |                |                  |
| Net interest income  | 18,159                      | 18,065         | 17,544           |
| Provision for loan losses  | 275                         | 530            | 800              |
| Other income   | 4,847                       | 3,855          | 4,617            |
| Operating expenses   | 14,847                      | 14,120         | 13,600           |
| Net income   | 5,117                       | 4,707          | 4,987            |
| Diluted earnings per share   | 0.30                        | 0.28           | 0.29             |
| <b><u>SELECTED FINANCIAL RATIOS:</u></b>                             |                             |                |                  |
| Stockholders' equity per common share                                | 12.59                       | 12.45          | 12.29            |
| Cash dividend per share  | 0.12                        | 0.12           | 0.12             |
| Stockholders' equity to total assets                                 | 9.27%                       | 9.47%          | 9.38%            |
| Return on average assets (1)   | 0.90                        | 0.83           | 0.87             |
| Return on average stockholders' equity (1)                           | 9.45                        | 8.72           | 9.06             |
| Average interest rate spread   | 3.28                        | 3.31           | 3.13             |
| Net interest margin  | 3.35                        | 3.36           | 3.21             |
| Operating expenses to average assets (1)                             | 2.60                        | 2.49           | 2.36             |
| Efficiency ratio   | 64.54                       | 64.42          | 61.37            |
| <b><u>ASSET QUALITY:</u></b>   |                             |                |                  |
| Non-performing loans   | \$ 40,699                   | \$ 45,321      | \$ 45,900        |
| Non-performing assets  | 45,667                      | 49,778         | 49,320           |
| Allowance for loan losses as a percent of total loans receivable     | 1.26%                       | 1.31%          | 1.36%            |
| Allowance for loan losses as a percent of total non-performing loans | 51.44                       | 46.19          | 45.36            |
| Non-performing loans as a percent of total loans receivable          | 2.44                        | 2.83           | 3.00             |
| Non-performing assets as a percent of total assets                   | 1.96                        | 2.18           | 2.14             |
| <b><u>Wealth Management</u></b>                                      |                             |                |                  |
| Assets under administration  | \$ 229,289                  | \$ 216,508     | \$ 175,846       |

(1) Ratios are annualized

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**Table of Contents****Summary**

OceanFirst Financial Corp. is the holding company for OceanFirst Bank (the **Bank**), a community bank serving Ocean and Monmouth Counties in New Jersey. The term the **Company** refers to OceanFirst Financial Corp., OceanFirst Bank and all of the **Bank**'s subsidiaries on a consolidated basis. The **Company**'s results of operations are primarily dependent on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investments, and the interest expense on interest-bearing liabilities, such as deposits and borrowings. The **Company** also generates non-interest income such as income from bankcard services, wealth management services, deposit accounts, the sale of investment products, loan originations, loan servicing, loan sales, and other fees. The **Company**'s operating expenses primarily consist of compensation and employee benefits, occupancy and equipment, marketing, federal deposit insurance, data processing and general and administrative expenses. The **Company**'s results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

Interest-earning assets, both loans and securities, are generally priced against longer-term indices, while interest-bearing liabilities, primarily deposits and borrowings, are generally priced against shorter-term indices. The **Company**'s net interest margin has expanded over the past year as the **Company** has succeeded in growing commercial loans resulting in a shift in asset mix from lower-yielding short-term investments and securities into higher-yielding loans. The net interest margin also benefited from the prepayment of \$159.0 million of Federal Home Loan Bank (**FHLB**) advances in the fourth quarter of 2013 and from the rising interest rate environment in 2013 which steepened the yield curve, slowed loan refinance activity and improved yields on newly originated loans and investments. Based upon current economic conditions, the Federal Reserve has indicated that it anticipates that short-term interest rates will remain at current levels for a considerable time, especially if projected inflation continues to run below the 2% longer-run goal, and provided that longer-term inflation expectations remain well-anchored. Additionally, the Federal Reserve has decided to taper its monthly bond buying program, with further reductions expected throughout 2014. The increase in longer-term rates and related reduction in loan refinance activity has caused a decrease in the **Company**'s loan sale volume and therefore lower income from the net gain on the sale of loans.

In addition to the interest rate environment, the **Company**'s results are affected by economic conditions. Recent economic indicators point to some improvement in the economy, which expanded modestly in 2013 and is expected to show growth for the remainder of 2014. Labor market conditions improved as the national and local unemployment rates in the first half of 2014 both decreased over prior year levels. Despite these signs, the economic recovery remains weak.

Highlights of the **Company**'s financial results for the three and six months ended June 30, 2014 were as follows:

Total assets increased to \$2.329 billion at June 30, 2014, from \$2.250 billion at December 31, 2013. Loans receivable, net increased \$90.4 million at June 30, 2014, as compared to December 31, 2013 primarily due to growth in commercial loans of \$62.8 million and in residential construction loans, net of loans in process, which increased \$11.6 million.

Net income for the three months ended June 30, 2014 was \$5.1 million, or \$0.30 per diluted share, as compared to net income of \$5.0 million, or \$0.29 per diluted share for the corresponding prior year period. Net income benefited from higher net interest income, lower provision for loan losses and higher other income, partly offset by higher operating expenses. Additionally earnings per share benefited from a reduction in average shares outstanding.

Net interest income for the three months ended June 30, 2014 increased to \$18.2 million, as compared to \$17.5 million in the same prior year period, reflecting a higher net interest margin partly offset by lower interest-earning assets. The

net interest margin increased to 3.35% for the three months ended June 30, 2014, as compared to 3.21% for the corresponding prior year period.

The provision for loan losses was \$275,000 for the three months ended June 30, 2014, as compared to \$800,000 in the same prior year period primarily due to a reduction in net charge-offs and lower non-performing loans.

Other income increased to \$4.8 million for the three months ended June 30, 2014 as compared to \$4.6 million in the same prior year period. The increase was due to higher fees and service charges, gain on sale of investment securities and wealth management revenue partially offset by lower gain on sales of loans. Operating expenses increased \$1.2 million primarily due to personnel additions in revenue producing areas and higher marketing costs related to promotional campaigns to attract retail checking accounts and incent bankcard usage. Additionally, operating expenses for the three months ended June 30, 2014 includes \$196,000 in non-recurring severance related expenses due to the Company's strategic decision to improve efficiency in the residential mortgage loan area. The related personnel reduction is expected to lower compensation and benefits expense by \$650,000 annually.

The Company remains well-capitalized with a tangible common equity ratio of 9.27%. On July 24, 2014, the Company announced the completion of its 2012 common stock repurchase program and the subsequent authorization of the Board of Directors to repurchase up to 5% of the Company's outstanding common stock, or 867,923 shares.

Return on average stockholders' equity was 9.45% for the three months ended June 30, 2014, as compared to 9.06% for the corresponding prior year period.

**Table of Contents****Analysis of Net Interest Income**

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends upon the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

The following table sets forth certain information relating to the Company for the three and six months ended June 30, 2014 and 2013. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown except where noted otherwise. Average balances are derived from average daily balances. The yields and costs include certain fees which are considered adjustments to yields.

|  | <b>FOR THE THREE MONTHS ENDED JUNE 30,</b> |          |   |                    |          |                           |
|--|--|----------|---|--------------------|----------|---------------------------|
|  | 2014                                       |          |   | 2013               |          |                           |
|  | AVERAGE<br>BALANCE                         | INTEREST | AVERAGE<br>YIELD/<br>COST<br>(dollars in thousands) | AVERAGE<br>BALANCE | INTEREST | AVERAGE<br>YIELD/<br>COST |
| <b>Assets</b>  |  |          |   |                    |          |                           |
| Interest-earning assets:                             |  |          |   |                    |          |                           |
| Interest-earning deposits and short-term investments | \$ 26,563                                  | \$ 4     | 0.06%   | \$ 36,601          | \$ 19    | 0.21%                     |
| Securities (1) and FHLB stock                        | 552,851                                    | 2,364    | 1.71  | 648,697            | 2,714    | 1.67                      |
| Loans receivable, net (2)                            | 1,588,815                                  | 17,530   | 4.41  | 1,500,980          | 17,428   | 4.64                      |
| Total interest-earning assets                        | 2,168,229                                  | 19,898   | 3.67  | 2,186,278          | 20,161   | 3.69                      |
| Non-interest-earning assets                          | 118,551                                    |          |   | 119,416            |          |                           |
| Total assets   | \$ 2,286,780                               |          |   | \$ 2,305,694       |          |                           |
| <b>Liabilities and Stockholders Equity</b>           |  |          |   |                    |          |                           |
| Interest-bearing liabilities:                        |  |          |   |                    |          |                           |
| Transaction deposits                                 | \$ 1,257,291                               | 247      | 0.08  | \$ 1,318,230       | 438      | 0.13                      |
| Time deposits  | 215,148                                    | 739      | 1.37  | 215,917            | 737      | 1.37                      |
| Total  | 1,472,439                                  | 986      | 0.27  | 1,534,147          | 1,175    | 0.31                      |
| Borrowed funds                                       | 330,933                                    | 753      | 0.91  | 326,720            | 1,442    | 1.77                      |
| Total interest-bearing liabilities                   | 1,803,372                                  | 1,739    | 0.39  | 1,860,867          | 2,617    | 0.56                      |
| Non-interest-bearing deposits                        | 252,395                                    |          |   | 208,915            |          |                           |
| Non-interest-bearing liabilities                     | 14,530                                     |          |   | 15,719             |          |                           |
| Total liabilities                                    | 2,070,297                                  |          |   | 2,085,501          |          |                           |
| Stockholders equity                                  | 216,483                                    |          |   | 220,193            |          |                           |

|   |              |              |
|---|--------------|--------------|
| Total liabilities and stockholders equity | \$ 2,286,780 | \$ 2,305,694 |
| Net interest income                       | \$ 18,159    | \$ 17,544    |
| Net interest rate spread (3)              | 3.28%        | 3.13%        |
| Net interest margin (4)                   | 3.35%        | 3.21%        |

**FOR THE SIX MONTHS ENDED JUNE 30,**  
2014

|  | AVERAGE<br>BALANCE | INTEREST | AVERAGE<br>YIELD/<br>COST<br>(dollars in thousands) | AVERAGE<br>BALANCE | INTEREST | AVERAGE<br>YIELD/<br>COST |
|--|--------------------|----------|---|--------------------|----------|---------------------------|
|  |                    |          |   | 2013               |          |                           |
| <b>Assets</b>  |                    |          |   |                    |          |                           |
| Interest-earning assets:                             |                    |          |   |                    |          |                           |
| Interest-earning deposits and short-term investments | \$ 27,940          | \$ 10    | 0.07%   | \$ 61,140          | \$ 45    | 0.15%                     |
| Securities (1) and FHLB stock                        | 557,573            | 4,857    | 1.74  | 607,178            | 5,077    | 1.67                      |
| Loans receivable, net (2)                            | 1,573,135          | 34,776   | 4.42  | 1,512,501          | 35,091   | 4.64                      |
| Total interest-earning assets                        | 2,158,648          | 39,643   | 3.67  | 2,180,819          | 40,213   | 3.69                      |
| Non-interest-earning assets                          | 117,212            |          |   | 118,786            |          |                           |
| Total assets   | \$ 2,275,860       |          |   | \$ 2,299,605       |          |                           |
| <b>Liabilities and Stockholders Equity</b>           |                    |          |   |                    |          |                           |
| Interest-bearing liabilities:                        |                    |          |   |                    |          |                           |
| Transaction deposits                                 | \$ 1,289,760       | 610      | 0.09  | \$ 1,324,466       | 1,003    | 0.15                      |
| Time deposits  | 215,427            | 1,472    | 1.37  | 218,544            | 1,498    | 1.37                      |
| Total  | 1,505,187          | 2,082    | 0.28  | 1,543,010          | 2,501    | 0.32                      |
| Borrowed funds                                       | 307,227            | 1,337    | 0.87  | 323,202            | 2,979    | 1.84                      |
| Total interest-bearing liabilities                   | 1,812,414          | 3,419    | 0.38  | 1,866,212          | 5,480    | 0.59                      |
| Non-interest-bearing deposits                        | 231,631            |          |   | 196,990            |          |                           |
| Non-interest-bearing liabilities                     | 15,604             |          |   | 16,279             |          |                           |
| Total liabilities                                    | 2,059,649          |          |   | 2,079,481          |          |                           |
| Stockholders equity                                  | 216,211            |          |   | 220,124            |          |                           |
| Total liabilities and stockholders equity            | \$ 2,275,860       |          |   | \$ 2,299,605       |          |                           |



|                              |           |           |
|------------------------------|-----------|-----------|
| Net interest income          | \$ 36,224 | \$ 34,733 |
| Net interest rate spread (3) | 3.29%     | 3.10%     |
| Net interest margin (4)      | 3.36%     | 3.19%     |

- (1) Amounts are recorded at average amortized cost.
- (2) Amount is net of deferred loan fees, undisbursed loan funds, discounts and premiums and estimated loss allowances and includes loans held for sale and non-performing loans.
- (3) Net interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
- (4) Net interest margin represents net interest income divided by average interest-earning assets.

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**Table of Contents****Comparison of Financial Condition at June 30, 2014 and December 31, 2013**

Total assets increased by \$79.4 million to \$2.329 billion at June 30, 2014, from \$2.250 billion at December 31, 2013. Securities, in the aggregate, decreased by \$28.7 million, to \$510.7 million at June 30, 2014, as compared to \$539.4 million at December 31, 2013. Loans receivable, net, increased by \$90.4 million, an annualized growth rate of 11.7%, to \$1.632 billion at June 30, 2014 from \$1.541 billion at December 31, 2013, primarily due to growth in commercial loans of \$62.8 million and in residential construction loans, net of loans in process, which increased \$11.6 million. Additionally, on June 30, 2014, the Company purchased a pool of performing, locally originated, one-to-four family, non-conforming mortgage loans for \$20.6 million. The growth in commercial loans was primarily due to the strategic expansion of the commercial lending group and the successful recruitment of several experienced commercial lenders.

Deposits decreased by \$41.3 million, to \$1.706 billion at June 30, 2014, from \$1.747 billion at December 31, 2013, despite strong growth in retail and business checking accounts. All of the decrease was related to a reduction in government deposits. Non-interest bearing deposit accounts increased \$63.6 million during the first half of 2014 due to a revised fee and product structure. To fund loan growth and deposit outflows, FHLB advances increased \$130.0 million, to \$305.0 million at June 30, 2014, from \$175.0 million at December 31, 2013.

Stockholders' equity increased to \$215.8 million at June 30, 2014, as compared to \$214.4 million at December 31, 2013. Net income for the period was offset by the repurchase of 301,766 shares of common stock for \$5.0 million (average cost per share of \$16.64) and the cash dividends on common stock of \$4.1 million. At June 30, 2014, there were no shares available for repurchase under the stock repurchase program adopted in the fourth quarter of 2012, although 867,923 shares are available for repurchase under the new repurchase program announced on July 24, 2014.

**Comparison of Operating Results for the Three and Six months Ended June 30, 2014 and June 30, 2013***General*

Net income for the three months ended June 30, 2014 increased to \$5.1 million, or \$0.30 per diluted share, as compared to net income of \$5.0 million, or \$0.29 per diluted share for the corresponding prior year period. Net income for the six months ended June 30, 2014 increased to \$9.8 million, or \$0.58 per diluted share, as compared to net income of \$9.4 million, or \$0.55 per diluted share for the corresponding prior year period. The increases were primarily due to higher net interest income, a reduction in the provision for loan losses and higher other income, partly offset by higher operating expenses. Additionally, earnings per share benefited from a reduction in average shares outstanding.

*Interest Income*

Interest income for the three and six months ended June 30, 2014 was \$19.9 million and \$39.6 million, respectively, as compared to \$20.2 million and \$40.2 million for the corresponding prior year periods. The yield on interest-earning assets declined to 3.67% for both the three and six months ended June 30, 2014, as compared to 3.69% for both the three and six months ended June 30, 2013. Average interest-earning assets decreased by \$18.0 million and \$22.2 million, respectively, for the three and six months ended June 30, 2014, as compared to the same prior year periods as excess liquidity was allowed to run-off. Despite the two basis point decline, the asset yield benefited from a shift in the mix of interest-earning assets as average loans receivable, net increased \$87.8 million and \$60.6 million, respectively, for the three and six months ended June 30, 2014, while average interest-earning securities decreased \$95.8 million and \$49.6 million, respectively, as compared to the same prior year periods.

*Interest Expense*

Interest expense for the three and six months ended June 30, 2014 was \$1.7 million and \$3.4 million, respectively, as compared to \$2.6 million and \$5.5 million, respectively, in the corresponding prior year periods. The cost of interest-bearing liabilities decreased to 0.39% and 0.38%, respectively, for the three and six months ended June 30, 2014, as compared to 0.56% and 0.59%, respectively, in the same prior year periods. The decrease was partly due to the prepayment of \$159.0 million of FHLB advances with a weighted average cost of 2.31% in the fourth quarter of 2013. Average interest-bearing liabilities decreased by \$57.5 million and \$53.8 million, respectively, for the three and six months ended June 30, 2014 primarily due to a decline in average interest-bearing deposits of \$61.7 million and \$37.8 million, respectively. This interest-bearing funding was partly replaced by an increase of \$43.5 million and \$34.6 million, respectively, in average non-interest-bearing deposits for the three and six months ended June 30, 2014, as compared to the same prior year periods.

*Net Interest Income*

Net interest income for the three and six months ended June 30, 2014 increased to \$18.2 million and \$36.2 million, respectively, as compared to \$17.5 million and \$34.7 million, respectively, in the same prior year periods, reflecting a higher net interest margin partly offset by lower interest-earning assets. The net interest margin increased to 3.35% and 3.36%, respectively, for the three and six months ended June 30, 2014, from 3.21% and 3.19%, respectively, in the same prior year periods primarily due to a reduction in the cost of average interest-bearing liabilities.

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**Table of Contents***Provision for Loan Losses*

For the three and six months ended June 30, 2014, the provision for loan losses was \$275,000 and \$805,000, respectively, as compared to \$800,000 and \$1.9 million, respectively, for the corresponding prior year periods. The decreases for the three and six months ended June 30, 2014 were primarily due to reductions in net charge-offs of \$201,000 and \$791,000, respectively, as compared to the same prior year periods. Non-performing loans decreased \$4.7 million at June 30, 2014, as compared to December 31, 2013, and by \$5.2 million, as compared to June 30, 2013.

*Other Income*

For the three and six months ended June 30, 2014, other income increased to \$4.8 million and \$8.7 million, respectively, as compared to \$4.6 million and \$7.9 million, respectively, in the same prior year periods. For the three and six months ended June 30, 2014, wealth management revenue increased \$80,000 and \$193,000, respectively, as compared to the same prior year periods, partly due to an increase in assets under administration to \$229.3 million at June 30, 2014 from \$175.8 million at June 30, 2013. For the three and six months ended June 30, 2014, fees and service charges increased \$467,000 and \$578,000, respectively, as compared to the same prior year periods primarily due to higher deposit fees from a revised fee and product structure. For the three and six months ended June 30, 2014, the net gain on the sale of loans amounted to \$219,000 and \$351,000, respectively, as compared to \$735,000 and \$561,000, respectively, in the same prior year periods. The gain on the sale of loans for the six months ended June 30, 2013 was adversely impacted by a provision of \$975,000 added to the reserve for repurchased loans and loss sharing obligations, as compared to no provision in the current period. The prior year provision was related to loans sold to the FHLB as part of its Mortgage Partnership Finance program. Compared to prior periods, the gain on sale of loans was adversely impacted by decreases in the gain-on-sale margin and reductions in loans sold to \$10.9 million and \$21.2 million, respectively, for the three and six months ended June 30, 2014, as compared to \$32.3 million and \$69.1 million, respectively, for the corresponding prior year periods, as increasing longer-term interest rates reduced one-to-four family loan refinance activity. For both the three and six months ended June 30, 2014, the Company recognized a gain of \$348,000 on the sale of equity securities, as compared to a gain of \$42,000 in the corresponding prior year periods.

*Operating Expenses*

Operating expenses amounted to \$14.8 million and \$29.0 million, respectively, for the three and six months ended June 30, 2014, as compared to \$13.6 million and \$26.2 million, respectively, in the same prior year periods. Compensation and employee benefits expense increased \$1.1 million and \$2.2 million, respectively, for the three and six months ended June 30, 2014, as compared to the same prior year periods, primarily due to personnel additions in revenue producing areas. Additionally, compensation and employee benefits expense for the three and six months ended June 30, 2014 includes \$196,000 in non-recurring severance related expenses due to the Company's strategic decision to improve efficiency in the residential mortgage loan area. The related personnel reduction is expected to lower compensation and benefits expense by \$650,000 annually. Marketing expenses increased \$163,000 and \$445,000, respectively, as compared to the same prior year periods, primarily due to promotional campaigns to attract retail checking accounts and incent bankcard usage. These increases were partly offset by reductions in professional fees of \$180,000 and \$416,000, respectively, for the three and six months ended June 30, 2014, as compared to the corresponding prior year periods.

*Provision for Income Taxes*

The provision for income taxes was \$2.8 million and \$5.3 million, respectively, for the three and six months ended June 30, 2014, as compared to \$2.8 million and \$5.2 million, respectively, for the same prior year periods. The

effective tax rate was 35.1% and 35.2%, respectively, for the three and six months ended June 30, 2014, as compared to 35.7% and 35.4% in the same prior year periods.

### **Liquidity and Capital Resources**

The Company's primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, proceeds from the sale of loans, FHLB and other borrowings and, to a lesser extent, investment maturities. While scheduled amortization of loans is a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by interest rates, economic conditions and competition. The Company has other sources of liquidity if a need for additional funds arises, including various lines of credit.

At June 30, 2014 the Company had \$85.0 million in outstanding overnight borrowings from the FHLB compared to \$35.0 million outstanding at December 31, 2013. The Company periodically utilizes overnight borrowings to fund short-term liquidity needs. The Company had total FHLB borrowings, including the overnight borrowings, of \$305.0 million and \$175.0 million, respectively, at June 30, 2014 and December 31, 2013.

The Company's cash needs for the six months ended June 30, 2014 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale, proceeds from maturities of investment securities and increased total borrowings. The cash was principally utilized for loan originations, the purchase of investment and mortgage-backed securities and to fund deposit outflows. The Company's cash needs for the six months ended June 30, 2013 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale, proceeds from maturities of investment securities and short-term borrowings. The cash was principally utilized for loan originations, the purchase of investment and mortgage-backed securities and to fund deposit outflows.

**Table of Contents**

In the normal course of business, the Company routinely enters into various off-balance-sheet commitments. At June 30, 2014, outstanding undrawn lines of credit totaled \$282.9 million; outstanding commitments to originate loans totaled \$100.7 million; and outstanding commitments to sell loans totaled \$15.3 million. The Company expects to have sufficient funds available to meet current commitments arising in the normal course of business.

Time deposits scheduled to mature in one year or less totaled \$122.2 million at June 30, 2014. Based upon historical experience management estimates that a significant portion of such deposits will remain with the Company.

The Company has a detailed contingency funding plan and comprehensive reporting of funding trends on a monthly and quarterly basis which is reviewed by management. Management also monitors cash on a daily basis to determine the liquidity needs of the Bank. Additionally, management performs multiple liquidity stress test scenarios on a quarterly basis. The Bank continues to maintain significant liquidity under all stress scenarios.

Under the Company's common stock repurchase program, shares of OceanFirst Financial Corp. common stock may be purchased in the open market and through other privately-negotiated transactions, from time-to-time, depending on market conditions. The repurchased shares are held as treasury stock for general corporate purposes. For the six months ended June 30, 2014, the Company repurchased 301,766 shares of common stock at a total cost of \$5.0 million, compared with repurchases of 314,961 shares at a cost of \$4.5 million for the six months ended June 30, 2013. At June 30, 2014, there were no shares remaining to be repurchased under the repurchase program adopted in the fourth quarter of 2012. On July 24, 2014, the Company announced the completion of its 2012 common stock repurchase program and the subsequent authorization of the Board of Directors to repurchase up to 5% of the Company's outstanding common stock, or 867,923 shares.

Cash dividends on common stock declared and paid during the first six months of 2014 were \$4.1 million, as compared to \$4.2 million in the same prior year period. On July 24, 2014, the Board of Directors declared a quarterly cash dividend of twelve cents (\$0.12) per common share. The dividend is payable on August 15, 2014 to stockholders of record at the close of business on August 4, 2014.

The primary sources of liquidity specifically available to OceanFirst Financial Corp., the holding company of OceanFirst Bank, are capital distributions from the banking subsidiary and the issuance of preferred and common stock and long-term debt. In December 2013, as part of its capital plan, the Company submitted notice to the Federal Reserve Bank of Philadelphia requesting a total payment of \$16.0 million in dividends from the Bank to the Holding Company over the next four quarters (including the fourth quarter of 2013). The Federal Reserve did not object to the payments, although it reserved the right to revoke the approval at any time if a safety and soundness concern arises throughout the period. For the six months ended June 30, 2014, the Company received a dividend payment of \$8.0 million from the Bank and \$4.0 million remained to be paid over the next quarter. The Company's ability to continue to pay dividends will be largely dependent upon capital distributions from the Bank, which may be adversely affected by capital constraints imposed by the applicable regulations. The Company cannot predict whether the Bank will be permitted under applicable regulations to pay a dividend to the Company. If the Bank is unable to pay dividends to the Company, the Company may not have the liquidity necessary to pay a dividend in the future or pay a dividend at the same rate as historically paid, or be able to meet current debt obligations. At June 30, 2014, OceanFirst Financial Corp. held \$16.3 million in cash and \$7.2 million in investment securities available-for-sale.

As of June 30, 2014, the Bank exceeded all regulatory capital requirements as follows (in thousands):

|  | Actual | Required |
|--|--------|----------|
|--|--------|----------|

|                   | Amount     | Ratio | Amount    | Ratio |
|-------------------|------------|-------|-----------|-------|
| Tangible          | \$ 220,587 | 9.45% | \$ 35,006 | 1.50% |
| Tier 1 leverage   | 220,587    | 9.45  | 93,350    | 4.00  |
| Tier 1 risk-based | 220,587    | 14.22 | 62,053    | 4.00  |
| Total risk-based  | 239,998    | 15.47 | 124,106   | 8.00  |

The Bank is considered a well-capitalized institution under the Prompt Corrective Action Regulations.

In July 2013 the Federal Deposit Insurance Corporation and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on non-accrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real

**Table of Contents**

property. The final rule also requires unrealized gains and losses on certain available-for-sale securities holdings to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints will also be imposed on the inclusion in regulatory capital of mortgage-servicing assets, deferred tax assets and minority interests. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a capital conservation buffer consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

At June 30, 2014, the Company maintained tangible common equity of \$215.8 million, for a tangible common equity to assets ratio of 9.27%.

**Off-Balance-Sheet Arrangements and Contractual Obligations**

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate and liquidity risk or to optimize capital. Customer transactions are used to manage customers' requests for funding. These financial instruments and commitments include undrawn lines of credit and commitments to extend credit. The Company also has outstanding commitments to sell loans amounting to \$15.3 million.

The following table shows the contractual obligations of the Company by expected payment period as of June 30, 2014 (in thousands):

| Contractual Obligation                      | Total      | Less than<br>one year | 1-3<br>years | 3-5 years  | More than<br>5 years |
|---|------------|-----------------------|--------------|------------|----------------------|
| Debt Obligations                            | \$ 394,841 | \$ 197,341            | \$ 35,000    | \$ 140,000 | \$ 22,500            |
| Commitments to Fund Undrawn Lines of Credit | 282,915    | 282,915               |              |            |                      |
| Commitments to Originate Loans              | 100,741    | 100,741               |              |            |                      |

Commitments to fund undrawn lines of credit and commitments to originate loans 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. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company's exposure to credit risk is represented by the contractual amount of the instruments.

**Non-Performing Assets**

The following table sets forth information regarding the Company's non-performing assets consisting of non-performing loans and other real estate owned. It is the policy of the Company to cease accruing interest on loans 90 days or more past due or in the process of foreclosure.



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|   | June 30,<br>2014       | December 31,<br>2013 |
|---|------------------------|----------------------|
|   | (dollars in thousands) |                      |
| <b>Non-performing loans:</b>  |                        |                      |
| Real estate one-to-four family  | \$ 25,313              | \$ 28,213            |
| Commercial real estate  | 12,094                 | 12,304               |
| Consumer  | 3,128                  | 4,328                |
| Commercial and industrial   | 164                    | 515                  |
| <br>  |                        |                      |
| Total non-performing loans  | 40,699                 | 45,360               |
| Other real estate owned   | 4,968                  | 4,345                |
| <br>  |                        |                      |
| Total non-performing assets   | \$ 45,667              | \$ 49,705            |
| <br>  |                        |                      |
| Delinquent loans 30-89 days   | \$ 8,923               | \$ 9,147             |
| <br>  |                        |                      |
| Allowance for loan losses as a percent of total loans<br>receivable     | 1.26%                  | 1.33%                |
| Allowance for loan losses as a percent of total<br>non-performing loans | 51.44                  | 46.14                |
| Non-performing loans as a percent of total loans<br>receivable          | 2.44                   | 2.88                 |
| Non-performing assets as a percent of total assets                      | 1.96                   | 2.21                 |

Included in the non-performing loan total at June 30, 2014 was \$7.0 million of troubled debt restructured loans, as compared to \$9.7 million of troubled debt restructured loans at December 31, 2013. Non-performing loans are concentrated in one-to-four family loans, which comprise 62.2% of the total at June 30, 2014. At June 30, 2014, the

**Table of Contents**

average weighted loan-to-value ratio of non-performing one-to-four family loans, after any related charge-offs, was 73% using recently updated appraisal values. Appraisals are updated for all non-performing residential loans secured by real estate and subsequently updated annually if the loan remains delinquent. The Company's non-performing loans remain at elevated levels partly due to the protracted foreclosure process in the State of New Jersey. This process delays the Company's ability to resolve non-performing loans through the sale of the underlying collateral.

The largest non-performing loan relationship consists of two commercial real estate loans to a hotel, golf and banquet facility for \$6.5 million, criticized due to delinquent payments, continual losses and covenant violations. The most recent appraisal values the real estate collateral, which is currently marketed for sale, at \$7.4 million, net of past due real estate taxes.

The Company classifies loans and other assets in accordance with regulatory guidelines as follows (in thousands):

|   | June 30,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| Loans and other assets excluding investment securities: |                  |                      |
| Special Mention   | \$ 9,142         | \$ 5,843             |
| Substandard   | 63,618           | 66,246               |
| Doubtful  |                  | 859                  |

The largest Special Mention loan at June 30, 2014 is a \$4.6 million commercial real estate loan to a single borrower operating several fitness/health club facilities. The borrower has filed Chapter XI bankruptcy relating to another bank's legal proceedings on an unrelated property. The borrower is current as to payments and the loan is well collateralized. The largest Substandard loan relationship consists of the two non-performing commercial real estate loans mentioned above.

**Critical Accounting Policies**

Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 (the 2013 Form 10-K), as supplemented by this report, contains a summary of significant accounting policies. Various elements of these accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Certain assets are carried in the consolidated statements of financial condition at fair value or the lower of cost or fair value. Policies with respect to the methodologies used to determine the allowance for loan losses, the reserve for repurchased loans and loss sharing obligations, and the valuation of Mortgage Servicing Rights and judgments regarding securities impairment are the most critical accounting policies because they are important to the presentation of the Company's financial condition and results of operations. These judgments and policies involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material differences in the results of operations or financial condition. These critical accounting policies and their application are reviewed periodically and, at least annually, with the Audit Committee of the Board of Directors.

**Private Securities Litigation Reform Act Safe Harbor Statement**

In addition to historical information, this quarterly report contains certain forward-looking statements within the meaning of the Private Securities Reform Act of 1995 which are based on certain assumptions and describe future

plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project, will, should, may, view, similar expressions or expressions of confidence. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, levels of unemployment in the Bank's lending area, real estate market values in the Bank's lending area, future natural disasters and increases to flood insurance premiums, the level of prepayments on loans and mortgage-backed securities, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government including policies of the U.S. Treasury and the Board of Governors of the Federal Reserve System, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. These risks and uncertainties are further discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and subsequent securities filings and should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Further description of the risks and uncertainties to the business are included in Item 1, Business, and Item 1A, Risk Factors, of the Company's 2013 Form 10-K and Item 1A, Risk Factors, of this 10-Q.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company's interest rate sensitivity is monitored through the use of an interest rate risk ( IRR ) model. The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at June 30, 2014, which were anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown.

At June 30, 2014, the Company's one-year gap was negative 5.0% as compared to negative 10.8% at December 31, 2013. The change from December 31, 2013 was primarily due to the term extension of new and existing FHLB Advances.

| At June 30, 2014<br>(dollars in thousands)                                 | 3 Months<br>or Less | More than<br>3 Months<br>to<br>1 Year | More<br>than<br>1 Year to<br>3 Years | More<br>than<br>3 Years<br>to<br>5 Years | More<br>than<br>5 Years | Total             |
|--|---------------------|---------------------------------------|--------------------------------------|--|-------------------------|-------------------|
| <b>Interest-earning assets: (1)</b>  |                     |                                       |                                      |  |                         |                   |
| <b>Interest-earning deposits and short-term investments</b>                |                     |                                       |                                      |  |                         |                   |
| Investment securities  | \$ 1,753            | \$                                    | \$                                   | \$                                       | \$                      | \$ 1,753          |
| Investment securities  | 71,355              | 35,635                                | 69,645                               | 6,376                                    | 7,582                   | 190,593           |
| Mortgage-backed securities   | 44,923              | 34,663                                | 84,779                               | 74,682                                   | 92,721                  | 331,768           |
| FHLB stock   |                     |                                       |                                      |  | 20,246                  | 20,246            |
| Loans receivable (2)   | 288,636             | 341,132                               | 421,131                              | 295,664                                  | 304,031                 | 1,650,594         |
| <b>Total interest-earning assets</b>                                       | <b>406,667</b>      | <b>411,430</b>                        | <b>575,555</b>                       | <b>376,722</b>                           | <b>424,580</b>          | <b>2,194,954</b>  |
| <b>Interest-bearing liabilities:</b>                                       |                     |                                       |                                      |  |                         |                   |
| <b>Money market deposit accounts</b>                                       |                     |                                       |                                      |  |                         |                   |
| Money market deposit accounts  | 18,715              | 10,655                                | 23,574                               | 17,939                                   | 36,482                  | 107,365           |
| Savings accounts   | 64,406              | 25,152                                | 49,975                               | 37,862                                   | 117,738                 | 295,133           |
| <b>Interest-bearing checking accounts</b>                                  |                     |                                       |                                      |  |                         |                   |
| Interest-bearing checking accounts   | 406,289             | 56,222                                | 105,614                              | 86,180                                   | 162,780                 | 817,085           |
| Time deposits  | 44,882              | 77,302                                | 52,450                               | 37,383                                   | 2,702                   | 214,719           |
| FHLB advances  | 115,941             | 22,848                                | 37,788                               | 128,423                                  |                         | 305,000           |
| <b>Securities sold under agreements to repurchase and other borrowings</b> |                     |                                       |                                      |  |                         |                   |
| Securities sold under agreements to repurchase and other borrowings        | 84,841              |                                       | 5,000                                |  |                         | 89,841            |
| <b>Total interest-bearing liabilities</b>                                  | <b>735,074</b>      | <b>192,179</b>                        | <b>274,401</b>                       | <b>307,787</b>                           | <b>319,702</b>          | <b>1,829,143</b>  |
| <b>Interest sensitivity gap (3)</b>  | <b>\$ (328,407)</b> | <b>\$ 219,251</b>                     | <b>\$ 301,154</b>                    | <b>\$ 68,935</b>                         | <b>\$ 104,878</b>       | <b>\$ 365,811</b> |
| <b>Cumulative interest sensitivity gap</b>                                 | <b>\$ (328,407)</b> | <b>\$ (109,156)</b>                   | <b>\$ 191,998</b>                    | <b>\$ 260,933</b>                        | <b>\$ 365,811</b>       | <b>\$ 365,811</b> |

Cumulative interest  
sensitivity gap as a percent  
of total interest-earning  
assets

(14.96)%      (4.97)%      8.75%      11.89%      16.67%      16.67%

- (1) Interest-earning assets are included in the period in which the balances are expected to be redeployed and/or repriced as a result of anticipated prepayments, scheduled rate adjustments, and contractual maturities.
- (2) For purposes of the gap analysis, loans receivable includes loans held for sale and non-performing loans gross of the allowance for loan losses, unamortized discounts and deferred loan fees.
- (3) Interest sensitivity gap represents the difference between interest-earning assets and interest-bearing liabilities. Additionally, the table below sets forth the Company's exposure to interest rate risk as measured by the change in economic value of equity ( EVE ) and net interest income under varying rate shocks as of June 30, 2014 and December 31, 2013. All methods used to measure interest rate sensitivity involve the use of assumptions, which may tend to oversimplify the manner in which actual yields and costs respond to changes in market interest rates. The Company's interest rate sensitivity should be reviewed in conjunction with the financial statements and notes thereto contained in the 2013 Form 10-K.

| Change in Interest Rates in<br>Basis Points (Rate Shock)<br>(dollars in thousands) | June 30, 2014            |          |       | December 31, 2013 |        |                          |          |              |           |          |
|--|--------------------------|----------|-------|-------------------|--------|--------------------------|----------|--------------|-----------|----------|
|  | Economic Value of Equity |          | Ratio | Net Interest      |        | Economic Value of Equity |          | Net Interest |           |          |
|  | Amount                   | % Change |       | Income            | Income | Amount                   | % Change | Ratio        | Amount    | % Change |
|  |                          |          |       |                   |        |                          |          |              |           |          |
| 300  | \$ 251,351               | (12.4)%  | 11.5% | \$ 63,794         | (8.9)% | \$ 249,034               | (15.4)%  | 11.8%        | \$ 58,521 | (14.6)%  |
| 200  | 266,945                  | (7.0)    | 11.9  | 66,566            | (4.9)  | 267,316                  | (9.2)    | 12.4         | 62,558    | (8.7)    |
| 100  | 280,240                  | (2.4)    | 12.2  | 68,458            | (2.2)  | 282,633                  | (4.0)    | 12.8         | 65,691    | (4.2)    |
| Static   | 287,017                  |          | 12.2  | 70,028            |        | 294,381                  |          | 13.0         | 68,554    |          |
| (100)  | 285,543                  | (0.5)    | 11.9  | 67,461            | (3.7)  | 299,481                  | 1.7      | 12.9         | 66,487    | (3.0)    |

#### Item 4. Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective. Disclosure controls and procedures are the controls and other procedures that are designed to ensure that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission ( SEC ) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, based on that evaluation, there were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



**Table of Contents****OceanFirst Financial Corp.****Consolidated Statements of Financial Condition**

(dollars in thousands, except per share amounts)

|   | June 30,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|---|---------------------------------|----------------------|
| <b>Assets</b>   |                                 |                      |
| Cash and due from banks   | \$ 43,817                       | \$ 33,958            |
| Securities available-for-sale, at estimated fair value  | 32,303                          | 43,836               |
| Securities held-to-maturity, net (estimated fair value of \$485,124 at June 30, 2014 and \$495,082 at December 31, 2013)  | 478,389                         | 495,599              |
| Federal Home Loan Bank of New York stock, at cost   | 20,246                          | 14,518               |
| Loans receivable, net   | 1,631,819                       | 1,541,460            |
| Mortgage loans held for sale  | 1,295                           | 785                  |
| Interest and dividends receivable   | 5,317                           | 5,380                |
| Other real estate owned   | 4,968                           | 4,345                |
| Premises and equipment, net   | 24,430                          | 23,684               |
| Servicing asset   | 3,772                           | 4,178                |
| Bank Owned Life Insurance   | 55,286                          | 54,571               |
| Deferred tax asset  | 15,417                          | 15,239               |
| Other assets  | 12,082                          | 12,158               |
| <b>Total assets</b>   | <b>\$ 2,329,141</b>             | <b>\$ 2,249,711</b>  |
| <b>Liabilities and Stockholders Equity</b>  |                                 |                      |
| Deposits  | \$ 1,705,510                    | \$ 1,746,763         |
| Securities sold under agreements to repurchase with retail customers  | 62,341                          | 68,304               |
| Federal Home Loan Bank advances   | 305,000                         | 175,000              |
| Other borrowings  | 27,500                          | 27,500               |
| Advances by borrowers for taxes and insurance   | 6,896                           | 6,471                |
| Other liabilities   | 6,053                           | 11,323               |
| <b>Total liabilities</b>  | <b>2,113,300</b>                | <b>2,035,361</b>     |
| Stockholders equity:  |                                 |                      |
| Preferred stock, \$.01 par value, \$1,000 liquidation preference, 5,000,000 shares authorized, no shares issued   |                                 |                      |
| Common stock, \$.01 par value, 55,000,000 shares authorized, 33,566,772 shares issued and 17,144,693 and 17,387,049 shares outstanding at June 30, 2014 and December 31, 2013, respectively | 336                             | 336                  |
| Additional paid-in capital  | 264,592                         | 263,319              |
| Retained earnings   | 211,819                         | 206,201              |
| Accumulated other comprehensive loss  | (6,902)                         | (6,619)              |

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|   |              |              |
|---|--------------|--------------|
| Less: Unallocated common stock held by Employee Stock Ownership Plan                                  | (3,458)      | (3,616)      |
| Treasury stock, 16,422,079 and 16,179,723 shares at June 30, 2014 and December 31, 2013, respectively | (250,546)    | (245,271)    |
| Common stock acquired by Deferred Compensation Plan   | (315)        | (665)        |
| Deferred Compensation Plan Liability  | 315          | 665          |
| Total stockholders' equity  | 215,841      | 214,350      |
| Total liabilities and stockholders' equity  | \$ 2,329,141 | \$ 2,249,711 |

See accompanying Notes to Unaudited Consolidated Financial Statements.



**Table of Contents****OceanFirst Financial Corp.****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

|   | For the three months<br>ended June 30, |               | For the six months<br>ended June 30, |               |
|---|--|---------------|--------------------------------------|---------------|
|   | 2014                                   | 2013          | 2014                                 | 2013          |
|   | (unaudited)                            |               | (unaudited)                          |               |
| <b>Interest income:</b>                                       |  |               |                                      |               |
| Loans   | \$ 17,530                              | \$ 17,428     | \$ 34,776                            | \$ 35,091     |
| Mortgage-backed securities                                    | 1,731                                  | 2,026         | 3,494                                | 3,675         |
| Investment securities and other                               | 637                                    | 707           | 1,373                                | 1,447         |
| <b>Total interest income</b>                                  | <b>19,898</b>                          | <b>20,161</b> | <b>39,643</b>                        | <b>40,213</b> |
| <b>Interest expense:</b>                                      |  |               |                                      |               |
| Deposits  | 986                                    | 1,175         | 2,082                                | 2,501         |
| Borrowed funds  | 753                                    | 1,442         | 1,337                                | 2,979         |
| <b>Total interest expense</b>                                 | <b>1,739</b>                           | <b>2,617</b>  | <b>3,419</b>                         | <b>5,480</b>  |
| <b>Net interest income</b>                                    | <b>18,159</b>                          | <b>17,544</b> | <b>36,224</b>                        | <b>34,733</b> |
| Provision for loan losses                                     | 275                                    | 800           | 805                                  | 1,900         |
| <b>Net interest income after provision for loan losses</b>    | <b>17,884</b>                          | <b>16,744</b> | <b>35,419</b>                        | <b>32,833</b> |
| <b>Other income:</b>  |  |               |                                      |               |
| Bankcard services revenue                                     | 897                                    | 921           | 1,689                                | 1,731         |
| Wealth management revenue                                     | 608                                    | 528           | 1,148                                | 955           |
| Fees and service charges                                      | 2,278                                  | 1,811         | 4,134                                | 3,556         |
| Loan servicing income   | 226                                    | 172           | 454                                  | 328           |
| Net gain on sales of investment securities available-for-sale | 348                                    | 42            | 348                                  | 42            |
| Net gain on sales of loans available-for-sale                 | 219                                    | 735           | 351                                  | 561           |
| Net (loss) gain from other real estate operations             | (107)                                  | 74            | (139)                                | 77            |
| Income from Bank Owned Life Insurance                         | 377                                    | 332           | 715                                  | 647           |
| Other   | 1                                      | 2             | 2                                    | 18            |
| <b>Total other income</b>                                     | <b>4,847</b>                           | <b>4,617</b>  | <b>8,702</b>                         | <b>7,915</b>  |
| <b>Operating expenses:</b>                                    |  |               |                                      |               |
| Compensation and employee benefits                            | 8,131                                  | 7,039         | 15,816                               | 13,617        |
| Occupancy   | 1,364                                  | 1,376         | 2,828                                | 2,739         |
| Equipment   | 768                                    | 690           | 1,524                                | 1,328         |
| Marketing   | 610                                    | 447           | 1,142                                | 697           |

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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Federal deposit insurance                | 538      | 536      | 1,083    | 1,060    |
| Data processing                          | 987      | 962      | 2,057    | 1,935    |
| Check card processing                    | 494      | 423      | 940      | 834      |
| Professional fees                        | 523      | 703      | 898      | 1,314    |
| Other operating expense                  | 1,432    | 1,424    | 2,679    | 2,630    |
| Total operating expenses                 | 14,847   | 13,600   | 28,967   | 26,154   |
| Income before provision for income taxes | 7,884    | 7,761    | 15,154   | 14,594   |
| Provision for income taxes               | 2,767    | 2,774    | 5,330    | 5,170    |
| Net income                               | \$ 5,117 | \$ 4,987 | \$ 9,824 | \$ 9,424 |
| Basic earnings per share                 | \$ 0.31  | \$ 0.29  | \$ 0.58  | \$ 0.55  |
| Diluted earnings per share               | \$ 0.30  | \$ 0.29  | \$ 0.58  | \$ 0.55  |
| Average basic shares outstanding         | 16,740   | 17,105   | 16,812   | 17,194   |
| Average diluted shares outstanding       | 16,822   | 17,144   | 16,946   | 17,233   |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**OceanFirst Financial Corp.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(in thousands)

|   | For the three<br>months<br>ended June 30, |          | For the six months<br>ended June 30, |          |
|---|---|----------|--------------------------------------|----------|
|   | 2014                                      | 2013     | 2014                                 | 2013     |
|   | (unaudited)                               |          | (unaudited)                          |          |
| Net income  | \$ 5,117                                  | \$ 4,987 | \$ 9,824                             | \$ 9,424 |
| Other comprehensive income:   |   |          |                                      |          |
| Unrealized loss on securities (net of tax benefit of \$209 and \$286 in 2014 and \$3,900 and \$3,361 in 2013)               | (303)                                     | (5,646)  | (414)                                | (4,866)  |
| Accretion of unrealized loss on securities reclassified to held-to-maturity (net of tax expense of \$125 and \$233 in 2014) | 181                                       |          | 337                                  |          |
| Reclassification adjustment for gains included in net income (net of tax expense of \$142 in 2014 and \$17 in 2013)         | (206)                                     | (25)     | (206)                                | (25)     |
| Total comprehensive income (loss)   | \$ 4,789                                  | \$ (684) | \$ 9,541                             | \$ 4,533 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**OceanFirst Financial Corp.****Consolidated Statements of****Changes in Stockholders Equity (Unaudited)**

(in thousands, except per share amounts)

|  | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Gain (Loss) | Employee<br>Stock<br>Ownership<br>Plan | Treasury<br>Stock | Common<br>Stock<br>Acquired<br>by<br>Deferred<br>Compensation<br>Plan | Deferred<br>Compensation<br>Plan<br>Liability | Total      |
|--|--------------------|-----------------|----------------------------------|----------------------|--|--|-------------------|---|---|------------|
| Balance at<br>December 31,<br>2012                               | \$                 | \$ 336          | \$ 262,704                       | \$ 198,109           | \$ 49  | \$ (3,904)                             | \$ (237,502)      | \$ (647)  | \$ 647  | \$ 219,792 |
| Net income   |                    |                 |                                  | 9,424                |  |  |                   |   |   | 9,424      |
| Other<br>comprehensive<br>income, net of<br>tax                  |                    |                 |                                  |                      | (4,891)  |  |                   |   |   | (4,891)    |
| Stock awards   |                    |                 | 328                              |                      |  |  |                   |   |   | 328        |
| Treasury stock<br>allocated to<br>restricted stock<br>plan       |                    |                 | (259)                            | 4                    |  |  | 255               |   |   |            |
| Purchased<br>314,961 shares<br>of common<br>stock                |                    |                 |                                  |                      |  |  | (4,512)           |   |   | (4,512)    |
| Allocation of<br>ESOP stock                                      |                    |                 | 98                               |                      |  | 144                                    |                   |   |   | 242        |
| Cash dividend<br>\$0.24 per share                                |                    |                 |                                  | (4,151)              |  |  |                   |   |   | (4,151)    |
| Exercise of<br>stock options                                     |                    |                 |                                  | (6)                  |  |  | 52                |   |   | 46         |
| Purchase of<br>stock for the<br>deferred<br>compensation<br>plan |                    |                 |                                  |                      |  |  |                   | (9)   | 9   |            |
| Balance at<br>June 30, 2013                                      | \$                 | \$ 336          | \$ 262,871                       | \$ 203,380           | \$ (4,842)   | \$ (3,760)                             | \$ (241,707)      | \$ (656)  | \$ 656  | \$ 216,278 |

|  |    |        |            |            |            |            |              |          |        |            |
|--|----|--------|------------|------------|------------|------------|--------------|----------|--------|------------|
| Balance at<br>December 31,<br>2013                         | \$ | \$ 336 | \$ 263,319 | \$ 206,201 | \$ (6,619) | \$ (3,616) | \$ (245,271) | \$ (665) | \$ 665 | \$ 214,350 |
| Net income   |    |        |            | 9,824      |            |            |              |          |        | 9,824      |
| Other<br>comprehensive<br>income, net of<br>tax            |    |        |            |            | (283)      |            |              |          |        | (283)      |
| Tax benefit of<br>stock plans                              |    |        | 50         |            |            |            |              |          |        | 50         |
| Stock awards   |    |        | 429        |            |            |            |              |          |        | 429        |
| Treasury stock<br>allocated to<br>restricted stock<br>plan |    |        | 661        | (97)       |            |            | (564)        |          |        |            |
| Purchased<br>301,766 shares<br>of common<br>stock          |    |        |            |            |            |            | (5,020)      |          |        | (5,020)    |
| Allocation of<br>ESOP stock                                |    |        | 133        |            |            | 158        |              |          |        | 291        |
| Cash dividend<br>\$0.24 per share                          |    |        |            | (4,065)    |            |            |              |          |        | (4,065)    |
| Exercise of<br>stock options                               |    |        |            | (44)       |            |            | 309          |          |        | 265        |
| Sale of stock<br>for the deferred<br>compensation<br>plan  |    |        |            |            |            |            |              | 350      | (350)  |            |
| Balance at<br>June 30, 2014                                | \$ | \$ 336 | \$ 264,592 | \$ 211,819 | \$ (6,902) | \$ (3,458) | \$ (250,546) | \$ (315) | \$ 315 | \$ 215,841 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

**Table of Contents****OceanFirst Financial Corp.****Consolidated Statements of Cash Flows**

(dollars in thousands)

|  | For the six months<br>ended June 30, |               |
|--|--------------------------------------|---------------|
|  | 2014                                 | 2013          |
|  | (Unaudited)                          |               |
| <b>Cash flows from operating activities:</b>   |                                      |               |
| Net income   | \$ 9,824                             | \$ 9,424      |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                                      |               |
| Depreciation and amortization of premises and equipment                                  | 1,412                                | 1,406         |
| Allocation of ESOP stock   | 291                                  | 242           |
| Stock awards   | 429                                  | 328           |
| Amortization of servicing asset  | 594                                  | 752           |
| Net premium amortization in excess of discount accretion on securities                   | 1,472                                | 1,912         |
| Net amortization of deferred costs and discounts on loans                                | 35                                   | 301           |
| Provision for loan losses  | 805                                  | 1,900         |
| Provision for repurchased loans and loss sharing obligations                             |                                      | 975           |
| Net gain on sale of other real estate owned  | (44)                                 | (157)         |
| Net gain on sales of investment securities available-for-sale                            | (348)                                | (42)          |
| Net gain on sales of loans   | (351)                                | (1,536)       |
| Proceeds from sales of mortgage loans held for sale                                      | 21,368                               | 69,067        |
| Mortgage loans originated for sale   | (21,715)                             | (64,228)      |
| Increase in value of Bank Owned Life Insurance   | (715)                                | (647)         |
| Decrease (increase) in interest and dividends receivable                                 | 63                                   | (334)         |
| Increase in other assets   | 93                                   | 884           |
| Decrease in other liabilities  | (5,271)                              | (171)         |
| <b>Total adjustments</b>   | <b>(1,882)</b>                       | <b>10,652</b> |
| <b>Net cash provided by operating activities</b>   | <b>7,942</b>                         | <b>20,076</b> |
| <b>Cash flows from investing activities:</b>   |                                      |               |
| Net (increase) decrease in loans receivable  | (72,377)                             | 13,823        |
| Purchase of loans receivable   | (20,574)                             |               |
| Purchase of investment securities available-for-sale                                     | (651)                                | (27,088)      |
| Purchase of mortgage-backed securities available-for-sale                                |                                      | (127,582)     |
| Purchase of mortgage-backed securities held-to-maturity                                  | (10,134)                             |               |
| Purchase of investment securities held-to-maturity                                       | (5,003)                              |               |
| Proceeds from maturities of investment securities available-for-sale                     | 10,000                               |               |
| Proceeds from the sale of investment securities available-for-sale                       | 1,402                                | 603           |
| Proceeds from maturities of investment securities held-to-maturity                       | 4,350                                | 13,176        |

|   |          |          |
|---|----------|----------|
| Principal repayments on mortgage-backed securities available-for-sale |          | 58,874   |
| Principal repayments on mortgage-backed securities held-to-maturity   | 27,178   |          |
| Increase in Federal Home Loan Bank of New York stock                  | (5,728)  | (1,829)  |
| Proceeds from sales of other real estate owned                        | 1,173    | 1,443    |
| Purchases of premises and equipment                                   | (2,158)  | (2,192)  |
| Net cash used in investing activities                                 | (72,522) | (70,772) |

Continued

**Table of Contents****OceanFirst Financial Corp.****Consolidated Statements of Cash Flows (Continued)**

(dollars in thousands)

|  | For the six months<br>ended June 30,<br>2014          2013<br>(Unaudited) |               |
|--|---|---------------|
| <b>Cash flows from financing activities:</b>                           |   |               |
| Decrease in deposits   | \$ (41,253)   | \$ (15,925)   |
| (Decrease) increase in short-term borrowings                           | (5,963)   | 90,650        |
| Proceeds from Federal Home Loan Bank advances                          | 190,000   | 10,000        |
| Repayments of Federal Home Loan Bank advances                          | (60,000)  | (46,000)      |
| Increase in advances by borrowers for taxes and insurance              | 425   | 421           |
| Exercise of stock options  | 265   | 46            |
| Purchase of treasury stock   | (5,020)   | (4,512)       |
| Dividends paid   | (4,065)   | (4,151)       |
| Tax benefit of stock plans   | 50  |               |
| <b>Net cash provided by financing activities</b>                       | <b>74,439</b>   | <b>30,529</b> |
| Net increase (decrease) in cash and due from banks                     | 9,859   | (20,167)      |
| Cash and due from banks at beginning of period                         | 33,958  | 62,544        |
| Cash and due from banks at end of period                               | \$ 43,817   | \$ 42,377     |
| <b>Supplemental Disclosure of Cash Flow Information:</b>               |   |               |
| Cash paid during the period for:                                       |   |               |
| Interest   | \$ 3,229  | \$ 5,528      |
| Income taxes   | 6,601   | 5,461         |
| Non-cash activities:   |   |               |
| Loans charged-off, net   | 799   | 1,590         |
| Transfer of loans receivable to other real estate owned                | 1,752   | 1,496         |
| See accompanying Notes to Unaudited Consolidated Financial Statements. |   |               |



**Table of Contents****OceanFirst Financial Corp.****Notes To Unaudited Consolidated Financial Statements****Note 1. Basis of Presentation**

The accompanying unaudited consolidated financial statements include the accounts of OceanFirst Financial Corp. (the Company) and its wholly-owned subsidiary, OceanFirst Bank (the Bank), and its wholly-owned subsidiaries, OceanFirst REIT Holdings, Inc., OceanFirst Services, LLC, 975 Holdings, LLC and Columbia Home Loans, LLC (Columbia). The operations of Columbia were shuttered in 2007 and the company is now in dissolution.

The interim consolidated financial statements reflect all normal and recurring adjustments which are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results of operations that may be expected for all of 2014. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statements of financial condition and the results of operations for the period. Actual results could differ from these estimates.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC).

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report to Stockholders on Form 10-K for the year ended December 31, 2013.

**Note 2. Earnings per Share**

The following reconciles shares outstanding for basic and diluted earnings per share for the three and six months ended June 30, 2014 and 2013 (in thousands):

|  | Three months ended<br>June 30, |        | Six months ended<br>June 30, |        |
|--|--------------------------------|--------|------------------------------|--------|
|  | 2014                           | 2013   | 2014                         | 2013   |
| Weighted average shares issued net of Treasury shares                            | 17,258                         | 17,649 | 17,327                       | 17,740 |
| Less: Unallocated ESOP shares  | (416)                          | (450)  | (420)                        | (455)  |
| Unallocated incentive award shares and shares held by deferred compensation plan | (102)                          | (94)   | (95)                         | (91)   |
| Average basic shares outstanding   | 16,740                         | 17,105 | 16,812                       | 17,194 |
| Add: Effect of dilutive securities:  |                                |        |                              |        |
| Stock options  | 61                             |        | 109                          |        |
| Shares held by deferred compensation plan  | 21                             | 39     | 25                           | 39     |

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|                                    |        |        |        |        |
|------------------------------------|--------|--------|--------|--------|
| Average diluted shares outstanding | 16,822 | 17,144 | 16,946 | 17,233 |
|------------------------------------|--------|--------|--------|--------|

For the three months ended June 30, 2014 and 2013, antidilutive stock options of 914,000 and 1,149,000, respectively, were excluded from earnings per share calculations. For the six months ended June 30, 2014 and 2013, antidilutive stock options of 756,000 and 1,129,000, respectively, were excluded from earnings per share calculations.

**Table of Contents****Note 3. Securities**

The amortized cost and estimated fair value of securities available-for-sale and held-to-maturity at June 30, 2014 and December 31, 2013 are as follows (in thousands):

|   | At June 30, 2014  |                              |                               | Estimated<br>Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|----------------------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| <b>Available-for-sale:</b>                            |                   |                              |                               |                            |
| Investment securities:                                |                   |                              |                               |                            |
| U.S. agency obligations                               | \$ 25,045         | \$ 49                        | \$                            | \$ 25,094                  |
| Equity investments                                    | 6,355             | 875                          | (21)                          | 7,209                      |
| <b>Total investment securities available-for-sale</b> | <b>\$ 31,400</b>  | <b>\$ 924</b>                | <b>\$ (21)</b>                | <b>\$ 32,303</b>           |
| <b>Held-to-maturity:</b>                              |                   |                              |                               |                            |
| Investment securities:                                |                   |                              |                               |                            |
| U.S. agency obligations                               | \$ 86,900         | \$ 181                       | \$ (57)                       | \$ 87,024                  |
| State and municipal obligations                       | 17,293            | 55                           | (8)                           | 17,340                     |
| Corporate debt securities                             | 55,000            |                              | (7,910)                       | 47,090                     |
| <b>Total investment securities</b>                    | <b>159,193</b>    | <b>236</b>                   | <b>(7,975)</b>                | <b>151,454</b>             |
| <b>Mortgage-backed securities:</b>                    |                   |                              |                               |                            |
| FHLMC   | 143,496           | 607                          | (2,218)                       | 141,885                    |
| FNMA  | 187,596           | 5,136                        | (1,758)                       | 190,974                    |
| GNMA  | 676               | 135                          |                               | 811                        |
| <b>Total mortgage-backed securities</b>               | <b>331,768</b>    | <b>5,878</b>                 | <b>(3,976)</b>                | <b>333,670</b>             |
| <b>Total held-to-maturity</b>                         | <b>\$ 490,961</b> | <b>\$ 6,114</b>              | <b>\$ (11,951)</b>            | <b>\$ 485,124</b>          |
| <b>Total securities</b>                               | <b>\$ 522,361</b> | <b>\$ 7,038</b>              | <b>\$ (11,972)</b>            | <b>\$ 517,427</b>          |

|                            | At December 31, 2013 |                              |                               | Estimated<br>Fair<br>Value |
|----------------------------|----------------------|------------------------------|-------------------------------|----------------------------|
|                            | Amortized<br>Cost    | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| <b>Available-for-sale:</b> |                      |                              |                               |                            |
| Investment securities:     |                      |                              |                               |                            |
| U.S. agency obligations    | \$ 35,128            | \$ 161                       | \$                            | \$ 35,289                  |
| Equity investments         | 6,757                | 1,790                        |                               | 8,547                      |

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|  |            |          |             |            |
|--|------------|----------|-------------|------------|
| Total investment securities available-for-sale | \$ 41,885  | \$ 1,951 | \$          | \$ 43,836  |
| Held-to-maturity:                              |            |          |             |            |
| Investment securities:                         |            |          |             |            |
| U.S. agency obligations                        | \$ 82,406  | \$ 153   | \$ (144)    | \$ 82,415  |
| State and municipal obligations                | 21,784     | 36       | (35)        | 21,785     |
| Corporate debt securities                      | 55,000     |          | (10,750)    | 44,250     |
| Total investment securities                    | 159,190    | 189      | (10,929)    | 148,450    |
| Mortgage-backed securities:                    |            |          |             |            |
| FHLMC  | 148,759    | 447      | (4,552)     | 144,654    |
| FNMA   | 200,070    | 4,659    | (3,607)     | 201,122    |
| GNMA   | 721        | 135      |             | 856        |
| Total mortgage-backed securities               | 349,550    | 5,241    | (8,159)     | 346,632    |
| Total held-to-maturity                         | \$ 508,740 | \$ 5,430 | \$ (19,088) | \$ 495,082 |
| Total securities                               | \$ 550,625 | \$ 7,381 | \$ (19,088) | \$ 538,918 |

**Table of Contents**

During the third quarter 2013 the Bank transferred \$536.0 million of previously-designated available-for-sale securities to a held-to-maturity designation at estimated fair value. The securities transferred had an unrealized net loss of \$13.3 million at the time of transfer which continues to be reflected in accumulated other comprehensive loss on the consolidated balance sheet, net of subsequent amortization, which is being recognized over the life of the securities. The carrying value of the held-to-maturity investment securities at June 30, 2014 is as follows (in thousands):

|  |            |
|--|------------|
| Amortized cost                                       | \$ 490,961 |
| Net loss on date of transfer from available-for-sale | (13,347)   |
| Amortization of net unrealized loss                  | 775        |
| Carrying value                                       | \$ 478,389 |

Net realized gains on the sale of securities for both the three and six months ended June 30, 2014 and 2013 were \$348,000 and \$42,000, respectively.

The amortized cost and estimated fair value of investment securities, excluding equity investments, at June 30, 2014 by contractual maturity, are shown below (in thousands). Actual maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. At June 30, 2014, corporate debt securities with an amortized cost and estimated fair value of \$55.0 million and \$47.1 million, respectively, were callable prior to the maturity date.

|  | Amortized<br>Cost | Estimated<br>Fair<br>Value |
|--|-------------------|----------------------------|
| June 30, 2014                          |                   |                            |
| Less than one year                     | \$ 51,990         | \$ 52,106                  |
| Due after one year through five years  | 76,021            | 76,126                     |
| Due after five years through ten years | 1,227             | 1,226                      |
| Due after ten years                    | 55,000            | 47,090                     |
|  | \$ 184,238        | \$ 176,548                 |

Mortgage-backed securities are excluded from the above table since their effective lives are expected to be shorter than the contractual maturity date due to principal prepayments.

The estimated fair value and unrealized loss of securities available-for-sale and held-to-maturity at June 30, 2014 and December 31, 2013, segregated by the duration of the unrealized loss, are as follows (in thousands):

|                     |                     | At June 30, 2014 |            | Total     |            |
|---------------------|---------------------|------------------|------------|-----------|------------|
| Less than 12 months | 12 months or longer | Estimated        | Unrealized | Estimated | Unrealized |
| Estimated           | Unrealized          | Fair             | Losses     | Fair      | Losses     |
| Fair                | Losses              |                  |            |           |            |

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|                                  | Value      |            | Value     |            | Value      |             |
|----------------------------------|------------|------------|-----------|------------|------------|-------------|
| Available-for-sale:              |            |            |           |            |            |             |
| Investment securities:           |            |            |           |            |            |             |
| Equity investments               | \$ 1,032   | \$ (21)    | \$        | \$         | \$ 1,032   | \$ (21)     |
| Held-to-maturity:                |            |            |           |            |            |             |
| Investment securities:           |            |            |           |            |            |             |
| U.S. agency obligations          | \$         | \$         | \$ 20,446 | \$ (57)    | \$ 20,446  | \$ (57)     |
| State and municipal obligations  | 1,037      | (1)        | 2,047     | (7)        | 3,084      | (8)         |
| Corporate debt securities        |            |            | 47,090    | (7,910)    | 47,090     | (7,910)     |
| Total investment securities      | 1,037      | (1)        | 69,583    | (7,974)    | 70,620     | (7,975)     |
| Mortgage-backed securities:      |            |            |           |            |            |             |
| FHLMC                            | 104,591    | (2,218)    |           |            | 104,591    | (2,218)     |
| FNMA                             | 69,656     | (1,758)    |           |            | 69,656     | (1,758)     |
| Total mortgage-backed securities | 174,247    | (3,976)    |           |            | 174,247    | (3,976)     |
| Total held-to-maturity           | \$ 175,284 | \$ (3,977) | \$ 69,583 | \$ (7,974) | \$ 244,867 | \$ (11,951) |
| Total securities                 | \$ 176,316 | \$ (3,998) | \$ 69,583 | \$ (7,974) | \$ 245,899 | \$ (11,972) |

**Table of Contents**

|   | At December 31, 2013       |                      |                            |                      |                            |                      |
|---|----------------------------|----------------------|----------------------------|----------------------|----------------------------|----------------------|
|   | Less than 12 months        |                      | 12 months or longer        |                      | Total                      |                      |
|   | Estimated<br>Fair<br>Value | Unrealized<br>Losses | Estimated<br>Fair<br>Value | Unrealized<br>Losses | Estimated<br>Fair<br>Value | Unrealized<br>Losses |
| <b>Held-to-maturity:</b>                |                            |                      |                            |                      |                            |                      |
| <b>Investment securities:</b>           |                            |                      |                            |                      |                            |                      |
| U.S. agency obligations                 | \$ 35,747                  | \$ (144)             | \$                         | \$                   | \$ 35,747                  | \$ (144)             |
| State and municipal obligations         | 3,526                      | (31)                 | 1,153                      | (4)                  | 4,679                      | (35)                 |
| Corporate debt securities               |                            |                      | 44,250                     | (10,750)             | 44,250                     | (10,750)             |
| <b>Total investment securities</b>      | <b>39,273</b>              | <b>(175)</b>         | <b>45,403</b>              | <b>(10,754)</b>      | <b>84,676</b>              | <b>(10,929)</b>      |
| <b>Mortgage-backed securities:</b>      |                            |                      |                            |                      |                            |                      |
| FHLMC                                   | 122,365                    | (4,552)              |                            |                      | 122,365                    | (4,552)              |
| FNMA                                    | 84,467                     | (3,607)              |                            |                      | 84,467                     | (3,607)              |
| <b>Total mortgage-backed securities</b> | <b>206,832</b>             | <b>(8,159)</b>       |                            |                      | <b>206,832</b>             | <b>(8,159)</b>       |
| <b>Total held-to-maturity</b>           | <b>\$ 246,105</b>          | <b>\$ (8,334)</b>    | <b>\$ 45,403</b>           | <b>\$ (10,754)</b>   | <b>\$ 291,508</b>          | <b>\$ (19,088)</b>   |

At June 30, 2014, the amortized cost, estimated fair value and credit rating of the individual corporate debt securities in an unrealized loss position for greater than one year are as follows (in thousands):

| Security Description | Amortized<br>Cost | Estimated<br>Fair Value | Credit Rating<br>Moody s/S&P |
|----------------------|-------------------|-------------------------|------------------------------|
| BankAmerica Capital  | \$ 15,000         | \$ 12,750               | Ba1/BB+                      |
| Chase Capital        | 10,000            | 8,740                   | Baa2/BBB                     |
| Wells Fargo Capital  | 5,000             | 4,300                   | A3/A-                        |
| Huntington Capital   | 5,000             | 4,175                   | Baa3/BB+                     |
| Keycorp Capital      | 5,000             | 4,250                   | Baa3/BBB-                    |
| PNC Capital          | 5,000             | 4,300                   | Baa2/BBB                     |
| State Street Capital | 5,000             | 4,300                   | A3/BBB+                      |
| SunTrust Capital     | 5,000             | 4,275                   | Baa3/BB+                     |
|                      | <b>\$ 55,000</b>  | <b>\$ 47,090</b>        |                              |

At June 30, 2014, the estimated fair value of each corporate debt security was below cost. However, the estimated fair value of the corporate debt securities increased as compared to December 31, 2013. The corporate debt securities are issued by other financial institutions with credit ratings ranging from a high of A3 to a low of Ba1 as rated by one of the internationally-recognized credit rating services. These floating-rate securities were purchased in 1998 and have paid coupon interest continuously since issuance. Floating-rate debt securities such as these pay a fixed interest rate spread over 90-day LIBOR. Following the purchase of these securities, the required spread increased for these types of securities causing a decline in the market price. The Company concluded that unrealized losses on corporate debt securities were only temporarily impaired at June 30, 2014. In concluding that the impairments were only temporary, the Company considered several factors in its analysis. The Company noted that each issuer made all the contractually

due payments when required. There were no defaults on principal or interest payments and no interest payments were deferred. All of the financial institutions are also considered well-capitalized. Credit spreads have decreased for these types of securities and market prices have improved. Based on management's analysis of each individual security, the issuers appear to have the ability to meet debt service requirements over the life of the security. Furthermore, the Company does not have the intent to sell these securities and it is more likely than not that the Company will not be required to sell the securities. The Company has held the securities continuously since 1998 and expects to receive its full principal at maturity in 2028 or prior if called by the issuer. The Company has historically not actively sold investment securities and has not utilized the securities portfolio as a source of liquidity. The Company's long range liquidity plans indicate adequate sources of liquidity outside the securities portfolio.

The mortgage-backed securities are issued and guaranteed by either the Federal Home Loan Mortgage Corporation ( FHLMC ) or Federal National Mortgage Association ( FNMA ), corporations which are chartered by the United States Government and whose debt obligations are typically rated AA+ by one of the internationally-recognized credit rating services. The Company considers the unrealized losses to be the result of changes in interest rates which over time can have both a positive and negative impact on the estimated fair value of the mortgage-backed securities. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell the securities before recovery of their amortized cost. As a result, the Company concluded that these securities were only temporarily impaired at June 30, 2014.



**Table of Contents****Note 4. Loans Receivable, Net**

Loans receivable, net at June 30, 2014 and December 31, 2013 consisted of the following (in thousands):

|   | June 30,<br>2014    | December 31,<br>2013 |
|---|---------------------|----------------------|
| <b>Real estate:</b>                           |                     |                      |
| One-to-four family                            | \$ 765,466          | \$ 750,585           |
| Commercial real estate, multi family and land | 577,061             | 528,945              |
| Residential construction                      | 46,092              | 30,821               |
| Consumer                                      | 201,839             | 200,683              |
| Commercial and industrial                     | 75,215              | 60,545               |
| <b>Total loans</b>                            | <b>1,665,673</b>    | <b>1,571,579</b>     |
| Loans in process                              | (16,374)            | (12,715)             |
| Deferred origination costs, net               | 3,456               | 3,526                |
| Allowance for loan losses                     | (20,936)            | (20,930)             |
| <b>Loans receivable, net</b>                  | <b>\$ 1,631,819</b> | <b>\$ 1,541,460</b>  |

At June 30, 2014 and December 31, 2013, loans in the amount of \$40,699,000 and \$45,360,000, respectively, were three or more months delinquent or in the process of foreclosure and the Company was not accruing interest income on these loans. There were no loans ninety days or greater past due and still accruing interest. Non-accrual loans include both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified impaired loans.

The Company defines an impaired loan as all non-accrual commercial real estate, multi-family, land, construction and commercial loans in excess of \$250,000. Impaired loans also include all loans modified as troubled debt restructurings. At June 30, 2014, the impaired loan portfolio totaled \$42,382,000 for which there was a specific allocation in the allowance for loan losses of \$4,069,000. At December 31, 2013, the impaired loan portfolio totaled \$39,903,000 for which there was a specific allocation in the allowance for loan losses of \$3,647,000. The average balance of impaired loans for the three and six months ended June 30, 2014 was \$42,835,000 and \$42,402,000, respectively, and \$37,549,000 and \$38,228,000, respectively, for the same prior year periods.

An analysis of the allowance for loan losses for the three and six months ended June 30, 2014 and 2013 is as follows (in thousands):

|                                 | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|---------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                 | 2014                           | 2013      | 2014                         | 2013      |
| Balance at beginning of period  | \$ 20,934                      | \$ 20,494 | \$ 20,930                    | \$ 20,510 |
| Provision charged to operations | 275                            | 800       | 805                          | 1,900     |
| Charge-offs                     | (419)                          | (938)     | (1,158)                      | (2,299)   |
| Recoveries                      | 146                            | 464       | 359                          | 709       |

|                          |           |           |           |           |
|--------------------------|-----------|-----------|-----------|-----------|
| Balance at end of period | \$ 20,936 | \$ 20,820 | \$ 20,936 | \$ 20,820 |
|--------------------------|-----------|-----------|-----------|-----------|

**Table of Contents**

The following table presents an analysis of the allowance for loan losses for the three and six months ended June 30, 2014 and 2013 and the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2014 and December 31, 2013 (in thousands):

|  | Residential<br>Real Estate | Commercial<br>Real<br>Estate | Commercial<br>Consumer | Commercial<br>and Industrial | Unallocated | Total     |
|--|----------------------------|------------------------------|------------------------|------------------------------|-------------|-----------|
| <b><u>For the three months ended June 30, 2014</u></b> |                            |                              |                        |                              |             |           |
| Allowance for loan losses:                             |                            |                              |                        |                              |             |           |
| Balance at beginning of period                         | \$ 4,290                   | \$ 11,413                    | \$ 1,369               | \$ 1,044                     | \$ 2,818    | \$ 20,934 |
| Provision (benefit) charged to operations              | 207                        | (337)                        | 80                     | 128                          | 197         | 275       |
| Charge-offs  | (205)                      |                              | (204)                  | (10)                         |             | (419)     |
| Recoveries   | 105                        | 1                            | 39                     | 1                            |             | 146       |
| Balance at end of period                               | \$ 4,397                   | \$ 11,077                    | \$ 1,284               | \$ 1,163                     | \$ 3,015    | \$ 20,936 |
| <b><u>For the three months ended June 30, 2013</u></b> |                            |                              |                        |                              |             |           |
| Allowance for loan losses:                             |                            |                              |                        |                              |             |           |
| Balance at beginning of period                         | \$ 5,185                   | \$ 9,286                     | \$ 2,148               | \$ 1,094                     | \$ 2,781    | \$ 20,494 |
| Provision (benefit) charged to operations              | 19                         | 463                          | (13)                   | (2)                          | 333         | 800       |
| Charge-offs  | (739)                      |                              | (199)                  |                              |             | (938)     |
| Recoveries   | 435                        | 25                           | 3                      | 1                            |             | 464       |
| Balance at end of period                               | \$ 4,900                   | \$ 9,774                     | \$ 1,939               | \$ 1,093                     | \$ 3,114    | \$ 20,820 |
| <b><u>For the six months ended June 30, 2014</u></b>   |                            |                              |                        |                              |             |           |
| Allowance for loan losses:                             |                            |                              |                        |                              |             |           |
| Balance at beginning of period                         | \$ 4,859                   | \$ 10,371                    | \$ 1,360               | \$ 1,383                     | \$ 2,957    | \$ 20,930 |
| Provision (benefit) charged to operations              | 25                         | 697                          | 196                    | (171)                        | 58          | 805       |
| Charge-offs  | (795)                      |                              | (313)                  | (50)                         |             | (1,158)   |
| Recoveries   | 308                        | 9                            | 41                     | 1                            |             | 359       |
| Balance at end of period                               | \$ 4,397                   | \$ 11,077                    | \$ 1,284               | \$ 1,163                     | \$ 3,015    | \$ 20,936 |
| <b><u>For the six months ended June 30, 2013</u></b>   |                            |                              |                        |                              |             |           |
| Allowance for loan losses:                             |                            |                              |                        |                              |             |           |
| Balance at beginning of period                         | \$ 5,241                   | \$ 8,937                     | \$ 2,264               | \$ 1,348                     | \$ 2,720    | \$ 20,510 |
| Provision (benefit) charged to operations              | 849                        | 787                          | (107)                  | (23)                         | 394         | 1,900     |
| Charge-offs  | (1,689)                    |                              | (375)                  | (235)                        |             | (2,299)   |
| Recoveries   | 499                        | 50                           | 157                    | 3                            |             | 709       |

|                          |          |          |          |          |          |           |
|--------------------------|----------|----------|----------|----------|----------|-----------|
| Balance at end of period | \$ 4,900 | \$ 9,774 | \$ 1,939 | \$ 1,093 | \$ 3,114 | \$ 20,820 |
|--------------------------|----------|----------|----------|----------|----------|-----------|

June 30, 2014

Allowance for loan losses:

Ending allowance balance attributed to loans:

|                                       |        |          |        |    |    |          |
|---------------------------------------|--------|----------|--------|----|----|----------|
| Individually evaluated for impairment | \$ 131 | \$ 3,493 | \$ 445 | \$ | \$ | \$ 4,069 |
|---------------------------------------|--------|----------|--------|----|----|----------|

|                                       |       |       |     |       |       |        |
|---------------------------------------|-------|-------|-----|-------|-------|--------|
| Collectively evaluated for impairment | 4,266 | 7,584 | 839 | 1,163 | 3,015 | 16,867 |
|---------------------------------------|-------|-------|-----|-------|-------|--------|

|                                |          |           |          |          |          |           |
|--------------------------------|----------|-----------|----------|----------|----------|-----------|
| Total ending allowance balance | \$ 4,397 | \$ 11,077 | \$ 1,284 | \$ 1,163 | \$ 3,015 | \$ 20,936 |
|--------------------------------|----------|-----------|----------|----------|----------|-----------|

**Table of Contents**

|   | Residential<br>Real<br>Estate | Commercial<br>Real<br>Estate | Consumer   | Commercial<br>and Industrial | Unallocated | Total        |
|---|-------------------------------|------------------------------|------------|------------------------------|-------------|--------------|
| <b>Loans:</b>                               |                               |                              |            |                              |             |              |
| Loans individually evaluated for impairment | \$ 18,856                     | \$ 20,885                    | \$ 2,365   | \$ 276                       | \$          | \$ 42,382    |
| Loans collectively evaluated for impairment | 792,702                       | 556,176                      | 199,474    | 74,939                       |             | 1,623,291    |
| Total ending loan balance                   | \$ 811,558                    | \$ 577,061                   | \$ 201,839 | \$ 75,215                    | \$          | \$ 1,665,673 |

**December 31, 2013**

## Allowance for loan losses:

## Ending allowance balance

## attributed to loans:

|                                       |          |           |          |          |          |           |
|---------------------------------------|----------|-----------|----------|----------|----------|-----------|
| Individually evaluated for impairment | \$ 2     | \$ 3,612  | \$ 33    | \$       | \$       | \$ 3,647  |
| Collectively evaluated for impairment | 4,857    | 6,759     | 1,327    | 1,383    | 2,957    | 17,283    |
| Total ending allowance balance        | \$ 4,859 | \$ 10,371 | \$ 1,360 | \$ 1,383 | \$ 2,957 | \$ 20,930 |

**Loans:**

|   |            |            |            |           |    |              |
|---|------------|------------|------------|-----------|----|--------------|
| Loans individually evaluated for impairment | \$ 18,192  | \$ 17,643  | \$ 2,961   | \$ 1,107  | \$ | \$ 39,903    |
| Loans collectively evaluated for impairment | 763,214    | 511,302    | 197,722    | 59,438    |    | 1,531,676    |
| Total ending loan balance                   | \$ 781,406 | \$ 528,945 | \$ 200,683 | \$ 60,545 | \$ | \$ 1,571,579 |

**Table of Contents**

A summary of impaired loans at June 30, 2014 and December 31, 2013 is as follows (in thousands):

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| Impaired loans with no allocated allowance for loan losses | \$ 27,588        | \$ 24,457            |
| Impaired loans with allocated allowance for loan losses    | 14,794           | 15,446               |
|  | \$ 42,382        | \$ 39,903            |
| Amount of the allowance for loan losses allocated          | \$ 4,069         | \$ 3,647             |

At June 30, 2014, impaired loans include troubled debt restructuring loans of \$30,047,000 of which \$23,000,000 were performing in accordance with their restructured terms for a minimum of six months and were accruing interest. At December 31, 2013, impaired loans include troubled debt restructuring loans of \$31,119,000 of which \$21,456,000 were performing in accordance with their restructured terms and were accruing interest.

The summary of loans individually evaluated for impairment by class of loans as of June 30, 2014 and December 31, 2013 and for the three months ended June 30, 2014 and 2013 follows (in thousands):

|  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
|--|--------------------------------|------------------------|--|
| <b>As of June 30, 2014</b>               |                                |                        |  |
| With no related allowance recorded:      |                                |                        |  |
| Residential real estate:                 |                                |                        |  |
| Originated by Bank                       | \$ 9,591                       | \$ 8,819               | \$   |
| Originated by mortgage company           | 7,952                          | 7,567                  |  |
| Originated by mortgage company non-prime | 1,616                          | 1,215                  |  |
| Commercial real estate:                  |                                |                        |  |
| Commercial                               | 8,093                          | 8,009                  |  |
| Construction and land                    |                                |                        |  |
| Consumer                                 | 2,231                          | 1,702                  |  |
| Commercial and industrial                | 276                            | 276                    |  |
|  | \$ 29,759                      | \$ 27,588              | \$   |
| With an allowance recorded:              |                                |                        |  |
| Residential real estate:                 |                                |                        |  |
| Originated by Bank                       | \$ 862                         | \$ 862                 | \$ 106                                       |
| Originated by mortgage company           | 393                            | 393                    | 25   |
| Originated by mortgage company non-prime |                                |                        |  |
| Commercial real estate:                  |                                |                        |  |

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|                           |           |           |          |
|---------------------------|-----------|-----------|----------|
| Commercial                | 12,591    | 12,572    | 3,417    |
| Construction and land     | 304       | 304       | 76       |
| Consumer                  | 663       | 663       | 445      |
| Commercial and industrial |           |           |          |
|                           | \$ 14,813 | \$ 14,794 | \$ 4,069 |

As of December 31, 2013

With no related allowance recorded:

Residential real estate:

|  |           |          |    |
|--|-----------|----------|----|
| Originated by Bank                       | \$ 10,537 | \$ 9,885 | \$ |
| Originated by mortgage company           | 7,762     | 7,387    |    |
| Originated by mortgage company non-prime | 1,260     | 858      |    |

Commercial real estate:

|                           |       |       |  |
|---------------------------|-------|-------|--|
| Commercial                | 2,303 | 2,292 |  |
| Construction and land     |       |       |  |
| Consumer                  | 3,435 | 2,928 |  |
| Commercial and industrial | 1,107 | 1,107 |  |

|  |           |           |    |
|--|-----------|-----------|----|
|  | \$ 26,404 | \$ 24,457 | \$ |
|--|-----------|-----------|----|

**Table of Contents**

|  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
|--|--------------------------------|------------------------|--|
| With an allowance recorded:              |                                |                        |  |
| Residential real estate:                 |                                |                        |  |
| Originated by Bank                       | \$ 62                          | \$ 62                  | \$ 2   |
| Originated by mortgage company           |                                |                        |  |
| Originated by mortgage company non-prime |                                |                        |  |
| Commercial real estate:                  |                                |                        |  |
| Commercial                               | 15,128                         | 15,042                 | 3,389  |
| Construction and land                    | 309                            | 309                    | 223  |
| Consumer                                 | 33                             | 33                     | 33   |
| Commercial and industrial                |                                |                        |  |
|  | \$ 15,532                      | \$ 15,446              | \$ 3,647                                     |

|  | Three months ended June 30,       |                                  | Three months ended June 30,       |                                  |
|--|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|  | 2014                              |                                  | 2013                              |                                  |
|  | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded:      |                                   |                                  |                                   |                                  |
| Residential real estate:                 |                                   |                                  |                                   |                                  |
| Originated by Bank                       | \$ 9,049                          | \$ 101                           | \$ 10,983                         | \$ 86                            |
| Originated by mortgage company           | 7,555                             | 65                               | 6,774                             | 57                               |
| Originated by mortgage company non-prime | 1,103                             | 3                                | 2,194                             | 5                                |
| Commercial real estate:                  |                                   |                                  |                                   |                                  |
| Commercial                               | 8,046                             | 20                               | 2,749                             | 34                               |
| Construction and land                    |                                   |                                  |                                   |                                  |
| Consumer                                 | 2,141                             | 20                               | 2,792                             | 21                               |
| Commercial and industrial                | 276                               | 3                                | 286                               | 3                                |
|  | \$ 28,170                         | \$ 212                           | \$ 25,778                         | \$ 206                           |

|  |        |      |        |       |
|--|--------|------|--------|-------|
| With an allowance recorded:              |        |      |        |       |
| Residential real estate:                 |        |      |        |       |
| Originated by Bank                       | \$ 865 | \$ 8 | \$ 824 | \$ 11 |
| Originated by mortgage company           | 394    | 7    | 776    | 9     |
| Originated by mortgage company non-prime |        |      |        |       |
| Commercial real estate:                  |        |      |        |       |
| Commercial                               | 12,417 | 26   | 8,908  | 76    |
| Construction and land                    | 304    |      | 472    |       |
| Consumer                                 | 685    | 11   | 791    | 9     |
| Commercial and industrial                |        |      |        |       |



\$ 14,665      \$      52      \$ 11,771      \$      105

24

**Table of Contents**

|  | Six months ended June 30,         |                                  |                                   |                                  |
|--|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|  | 2014                              |                                  | 2013                              |                                  |
|  | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>With no related allowance recorded:</b> |                                   |                                  |                                   |                                  |
| Residential real estate:                   |                                   |                                  |                                   |                                  |
| Originated by Bank                         | \$ 9,141                          | \$ 184                           | \$ 11,276                         | \$ 176                           |
| Originated by mortgage company             | 7,486                             | 127                              | 6,761                             | 127                              |
| Originated by mortgage company non-prime   | 981                               | 6                                | 2,221                             | 8                                |
| Commercial real estate:                    |                                   |                                  |                                   |                                  |
| Commercial                                 | 7,526                             | 70                               | 2,699                             | 65                               |
| Construction and land                      |                                   |                                  |                                   |                                  |
| Consumer                                   | 2,161                             | 41                               | 2,830                             | 40                               |
| Commercial and industrial                  | 277                               | 5                                | 287                               | 5                                |
|  | \$ 27,572                         | \$ 433                           | \$ 26,074                         | \$ 421                           |
| <b>With an allowance recorded:</b>         |                                   |                                  |                                   |                                  |
| Residential real estate:                   |                                   |                                  |                                   |                                  |
| Originated by Bank                         | \$ 869                            | \$ 18                            | \$ 826                            | \$ 21                            |
| Originated by mortgage company             | 395                               | 13                               | 779                               | 20                               |
| Originated by mortgage company non-prime   |                                   |                                  |                                   |                                  |
| Commercial real estate:                    |                                   |                                  |                                   |                                  |
| Commercial                                 | 12,584                            | 63                               | 9,250                             | 157                              |
| Construction and land                      | 304                               |                                  | 472                               |                                  |
| Consumer                                   | 678                               | 21                               | 827                               | 24                               |
| Commercial and industrial                  |                                   |                                  |                                   |                                  |
|  | \$ 14,830                         | \$ 115                           | \$ 12,154                         | \$ 222                           |

The following table presents the recorded investment in non-accrual loans by class of loans as of June 30, 2014 and December 31, 2013 (in thousands):

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| <b>Residential real estate:</b>          |                  |                      |
| Originated by Bank                       | \$ 13,669        | \$ 16,145            |
| Originated by mortgage company           | 10,462           | 10,589               |
| Originated by mortgage company non-prime | 1,182            | 1,479                |
| <b>Commercial real estate:</b>           |                  |                      |
| Commercial                               | 11,790           | 11,995               |
| Construction and land                    | 304              | 309                  |
| Consumer                                 | 3,128            | 4,328                |
| Commercial and industrial                | 164              | 515                  |

\$ 40,699      \$ 45,360

As used in these footnotes, loans Originated by mortgage company are mortgage loans originated under the Bank's underwriting guidelines by the Bank's shuttered mortgage company, and retained as part of the Bank's mortgage portfolio. These loans have significantly higher delinquency rates than similar loans originated by the Bank. Loans Originated by mortgage company non-prime are subprime or Alt-A loans which were originated for sale into the secondary market by the Bank's shuttered mortgage company.

**Table of Contents**

The following table presents the aging of the recorded investment in past due loans as of June 30, 2014 and December 31, 2013 by class of loans (in thousands):

|   | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater<br>than<br>90 Days<br>Past<br>Due | Total<br>Past<br>Due | Loans Not<br>Past Due | Total        |
|---|---------------------------|---------------------------|---|----------------------|-----------------------|--------------|
| <b>June 30, 2014</b>                        |                           |                           |   |                      |                       |              |
| Residential real estate:                    |                           |                           |   |                      |                       |              |
| Originated by Bank                          | \$ 7,851                  | \$ 1,528                  | \$ 11,628                                 | \$ 21,007            | \$ 656,085            | \$ 677,092   |
| Originated by mortgage company              | 90                        |                           | 9,796                                     | 9,886                | 75,959                | 85,845       |
| Originated by mortgage company<br>non-prime |                           |                           | 1,242                                     | 1,242                | 1,287                 | 2,529        |
| Residential construction                    |                           |                           |   |                      | 46,092                | 46,092       |
| Commercial real estate:                     |                           |                           |   |                      |                       |              |
| Commercial                                  | 483                       |                           | 11,790                                    | 12,273               | 526,811               | 539,084      |
| Construction and land                       |                           |                           | 304                                       | 304                  | 37,673                | 37,977       |
| Consumer                                    | 442                       | 504                       | 3,072                                     | 4,018                | 197,821               | 201,839      |
| Commercial and industrial                   |                           |                           | 164                                       | 164                  | 75,051                | 75,215       |
|   | \$ 8,866                  | \$ 2,032                  | \$ 37,996                                 | \$ 48,894            | \$ 1,616,779          | \$ 1,665,673 |
| <b>December 31, 2013</b>                    |                           |                           |   |                      |                       |              |
| Residential real estate:                    |                           |                           |   |                      |                       |              |
| Originated by Bank                          | \$ 6,102                  | \$ 2,526                  | \$ 13,800                                 | \$ 22,428            | \$ 632,653            | \$ 655,081   |
| Originated by mortgage Company              | 202                       | 108                       | 10,031                                    | 10,341               | 82,544                | 92,885       |
| Originated by mortgage company<br>non-prime |                           |                           | 1,465                                     | 1,465                | 1,153                 | 2,618        |
| Residential construction                    | 195                       |                           |   | 195                  | 30,626                | 30,821       |
| Commercial real estate:                     |                           |                           |   |                      |                       |              |
| Commercial                                  | 985                       | 849                       | 9,217                                     | 11,051               | 491,817               | 502,868      |
| Construction and land                       |                           |                           | 309                                       | 309                  | 25,769                | 26,078       |
| Consumer                                    | 864                       | 298                       | 4,219                                     | 5,381                | 195,302               | 200,683      |
| Commercial and industrial                   |                           |                           | 515                                       | 515                  | 60,030                | 60,545       |
|   | \$ 8,348                  | \$ 3,781                  | \$ 39,556                                 | \$ 51,685            | \$ 1,519,894          | \$ 1,571,579 |

The Company categorizes all commercial and commercial real estate loans, except for small business loans, into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation and current economic trends, among other factors. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans classified as Special Mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date.

Substandard. Loans classified as Substandard are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

**Table of Contents**

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be Pass rated loans. Loans not rated are included in groups of homogeneous loans. As of June 30, 2014 and December 31, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows (in thousands):

|                           | Pass       | Special<br>Mention | Substandard | Doubtful | Total      |
|---------------------------|------------|--------------------|-------------|----------|------------|
| <b>June 30, 2014</b>      |            |                    |             |          |            |
| Commercial real estate:   |            |                    |             |          |            |
| Commercial                | \$ 503,785 | \$ 5,057           | \$ 30,242   | \$       | \$ 539,084 |
| Construction and land     | 36,714     |                    | 1,263       |          | 37,977     |
| Commercial and industrial | 74,336     | 518                | 361         |          | 75,215     |
|                           | \$ 614,835 | \$ 5,575           | \$ 31,866   | \$       | \$ 652,276 |
| <b>December 31, 2013</b>  |            |                    |             |          |            |
| Commercial real estate:   |            |                    |             |          |            |
| Commercial                | \$ 471,435 | \$                 | \$ 30,576   | \$ 857   | \$ 502,868 |
| Construction and land     | 25,018     |                    | 1,059       |          | 26,077     |
| Commercial and industrial | 59,089     | 1,070              | 386         |          | 60,545     |
|                           | \$ 555,542 | \$ 1,070           | \$ 32,021   | \$ 857   | \$ 589,490 |

For residential and consumer loan classes, the Company evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of June 30, 2014 and December 31, 2013 (in thousands):

|                          | Residential Real Estate |                                      |   |                             |            |
|--------------------------|-------------------------|--------------------------------------|---|-----------------------------|------------|
|                          | Originated<br>by Bank   | Originated<br>by mortgage<br>company | Originated by<br>mortgage<br>company<br>non-prime | Residential<br>construction | Consumer   |
| <b>June 30, 2014</b>     |                         |                                      |   |                             |            |
| Performing               | \$ 663,423              | \$ 75,383                            | \$ 1,347  | \$ 46,092                   | \$ 198,711 |
| Non-performing           | 13,669                  | 10,462                               | 1,182   |                             | 3,128      |
|                          | \$ 677,092              | \$ 85,845                            | \$ 2,529  | \$ 46,092                   | \$ 201,839 |
| <b>December 31, 2013</b> |                         |                                      |   |                             |            |
| Performing               | \$ 638,936              | \$ 82,296                            | \$ 1,139  | \$ 30,821                   | \$ 196,355 |
| Non-performing           | 16,145                  | 10,589                               | 1,479   |                             | 4,328      |
|                          | \$ 655,081              | \$ 92,885                            | \$ 2,618  | \$ 30,821                   | \$ 200,683 |

The Company classifies certain loans as troubled debt restructurings when credit terms to a borrower in financial difficulty are modified. The modifications may include a reduction in rate, an extension in term and/or the capitalization of past due amounts. Included in the non-accrual loan total at June 30, 2014 and December 31, 2013 were \$7,047,000 and \$9,663,000, respectively, of troubled debt restructurings. At June 30, 2014 and December 31, 2013, the Company has allocated \$1,521,000 and \$1,816,000, respectively, of specific reserves to loans which are classified as troubled debt restructurings. Non-accrual loans which become troubled debt restructurings are generally returned to accrual status after six months of performance. In addition to the troubled debt restructurings included in non-accrual loans, the Company also has loans classified as troubled debt restructurings which are accruing at June 30, 2014 and December 31, 2013, which totaled \$23,000,000 and \$21,456,000, respectively. Troubled debt restructurings with six months of performance are considered in the allowance for loan losses similar to other performing loans. Troubled debt restructurings which are non-accrual or classified are considered in the allowance for loan losses similar to other non-accrual or classified loans.

**Table of Contents**

The following table presents information about troubled debt restructurings which occurred during the three and six months ended June 30, 2014 and 2013, and troubled debt restructurings modified within the previous year and which defaulted during the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

|   | Number of Loans    | Pre-modification<br>Recorded Investment    | Post-modification<br>Recorded Investment    |
|---|--------------------|--|---|
| <b>Three months ended June 30, 2014</b>                       |                    |  |   |
| Troubled Debt Restructurings:                                 |                    |  |   |
| Residential real estate:                                      |                    |  |   |
| Originated by mortgage company non-prime                      | 1                  | \$ 358                                     | \$ 358                                      |
| Consumer  | 3                  | 93   | 97  |
|   | Number<br>of Loans | Recorded<br>Investment                     |   |
| Troubled Debt Restructurings<br>Which Subsequently Defaulted: | None               | None                                       |   |
|   | Number<br>of Loans | Pre-modification<br>Recorded<br>Investment | Post-modification<br>Recorded<br>Investment |
| <b>Six months ended June 30, 2014</b>                         |                    |  |   |
| Troubled Debt Restructurings:                                 |                    |  |   |
| Residential real estate:                                      |                    |  |   |
| Originated by Bank  | 2                  | \$ 337                                     | \$ 263                                      |
| Originated by mortgage company                                | 1                  | 187  | 184   |
| Originated by mortgage company non-prime                      | 1                  | 358  | 358   |
| Consumer  | 5                  | 168  | 171   |
|   | Number<br>of Loans | Recorded<br>Investment                     |   |
| Troubled Debt Restructurings<br>Which Subsequently Defaulted: | None               | None                                       |   |
|   | Number<br>of Loans | Pre-modification<br>Recorded<br>Investment | Post-modification<br>Recorded<br>Investment |
| <b>Three months ended June 30, 2013</b>                       |                    |  |   |
| Troubled Debt Restructurings:                                 |                    |  |   |
| Residential real estate:                                      |                    |  |   |
| Originated by Bank  | 3                  | \$ 628                                     | \$ 628                                      |
| Consumer  | 1                  | 12   | 12  |
|   | Number<br>of Loans | Recorded<br>Investment                     |   |
| Troubled Debt Restructurings<br>Which Subsequently Defaulted: | 2                  | 492  |   |



|                                       | Pre-modification<br>Number of Loans | Pre-modification<br>Recorded Investment | Post-modification<br>Recorded<br>Investment |
|---------------------------------------|-------------------------------------|---|---|
| <u>Six months ended June 30, 2013</u> |                                     |   |   |
| Troubled Debt Restructurings:         |                                     |   |   |
| Residential real estate:              |                                     |   |   |
| Originated by Bank                    | 3                                   | \$ 628                                  | \$ 628                                      |
| Consumer                              | 5                                   | 97                                      | 89  |
|                                       | Number<br>of Loans                  | Recorded<br>Investment                  |   |
| Troubled Debt Restructurings          |                                     |   |   |
| Which Subsequently Defaulted:         | 2                                   | 492                                     |   |

**Table of Contents****Note 5. Reserve for Repurchased Loans and Loss Sharing Obligations**

An analysis of the reserve for repurchased loans and loss sharing obligations for the three and six months ended June 30, 2014 and 2013 is as follows (in thousands). The reserve is included in other liabilities in the accompanying statements of financial condition.

|  | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2014                           | 2013     | 2014                         | 2013     |
| Balance at beginning of period   | \$ 1,468                       | \$ 1,688 | \$ 1,468                     | \$ 1,203 |
| Provision charged to operations  |                                |          |                              | 975      |
| Loss on loans repurchased, settlements or payments under loss sharing arrangements | (163)                          |          | (163)                        | (695)    |
| Recoveries   |                                |          |                              | 205      |
| Balance at end of period   | \$ 1,305                       | \$ 1,688 | \$ 1,305                     | \$ 1,688 |

The reserve for repurchased loans and loss sharing obligations was established to provide for expected losses related to repurchase requests which may be received on residential mortgage loans previously sold to investors and other loss sharing obligations. The Company prepares a comprehensive analysis of the adequacy of the reserve for repurchased loans and loss sharing obligations at each quarter-end. The reserve includes a specific loss estimate on the outstanding loan repurchase requests based on the estimated fair value of the underlying collateral modified by the likelihood of loss which is estimated based on historical experience. The reserve also includes a general loss estimate based on an estimate of loans likely to be returned for repurchase and the estimated loss on those loans. Finally, the reserve also includes an estimate of the Bank's obligation under a loss sharing arrangement with the Federal Home Loan Bank ( FHLB ) relating to loans sold into their Mortgage Partnership Finance ( MPF ) program. Under this program, the Bank and the FHLB share credit risk for loans sold. The first loss position, equal to 1% of the aggregate amount of the loan pool, is absorbed by the FHLB through a reduction in credit enhancement fees paid to the Bank. The second loss position, generally covering the next 1.5% to 4.0% of the aggregate loan pool, is absorbed by the Bank. Loan losses above the combination of these two thresholds are fully absorbed by the FHLB. In establishing the reserve, the Company considered recent and historical experience, product type and volume of loan sales and the general economic environment.

The reserve for repurchased loans and loss sharing obligations was \$1.3 million at June 30, 2014, a \$163,000 decrease from December 31, 2013 due to incurred losses of \$143,000 relating to the FHLB loan sales and a settlement of \$20,000 with one investor relating to existing repurchase requests. The reserve was \$1.7 million at June 30, 2013, a \$485,000 increase from December 31, 2012 due to a provision of \$100,000 for repurchase requests, an additional provision of \$875,000 relating to loans sold to the FHLB, incurred losses of \$245,000 relating to the FHLB loan sales, a comprehensive settlement of \$450,000 with one investor relating to existing and anticipated loan repurchase requests, and recoveries of \$205,000 of previously charged-off amounts.

At June 30, 2014, there was one outstanding loan repurchase request on a loan with a total principal balance of \$252,000, a reduction from five outstanding loan repurchase requests on loans with a total principal balance of \$1.2 million at December 31, 2013.

**Note 6. Deposits**

The major types of deposits at June 30, 2014 and December 31, 2013 were as follows (in thousands):

| Type of Account           | June 30,<br>2014 | December 31, 2013 |
|---------------------------|------------------|-------------------|
| Non-interest-bearing      | \$ 271,208       | \$ 207,608        |
| Interest-bearing checking | 817,085          | 913,753           |
| Money market deposit      | 107,365          | 116,947           |
| Savings                   | 295,133          | 290,512           |
| Time deposits             | 214,719          | 217,943           |
| Total deposits            | \$ 1,705,510     | \$ 1,746,763      |

Included in time deposits at June 30, 2014 and December 31, 2013, is \$65,168,000 and \$64,380,000, respectively, in deposits of \$100,000 and over.

#### **Note 7. Recent Accounting Pronouncements**

In January 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-04, Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, which applies to all creditors who obtain physical possession of

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**Table of Contents**

residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The amendments in this update clarify when an in substance repossession or foreclosure occurs and requires disclosure of both (1) the amount of foreclosed residential real estate property held by a creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amendments in ASU 2014-04 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

**Note 8. Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair market measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or the most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The Company uses valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability and developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability and developed based on the best information available in the circumstances. In that regard, a fair value hierarchy has been established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Movements within the fair value hierarchy are recognized at the end of the applicable reporting period. There were no transfers between the levels of the fair value hierarchy for the three and six months ended June 30, 2014. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (for example, interest rates, volatilities, prepayment speeds, loss severities, credit risks and default rates) or inputs that are derived principally from or corroborated by observable market data by correlations or other means.

Level 3 Inputs - Significant unobservable inputs that reflect an entity's own assumptions that market participants would use in pricing the assets or liabilities.

**Assets and Liabilities Measured at Fair Value**

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. Certain financial assets and financial liabilities are measured at fair value on a non-recurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

**Securities Available-For-Sale**

Securities classified as available-for-sale are reported at fair value utilizing Level 1 and Level 2 inputs. In general, fair value is based upon quoted market prices, where available. Most of the Company's investment and mortgage-backed securities, however, are fixed income instruments that are not quoted on an exchange, but are bought and sold in active markets. Prices for these instruments are obtained through third party pricing vendors or security industry sources that actively participate in the buying and selling of securities. Prices obtained from these sources include market quotations and matrix pricing. Matrix pricing is a mathematical technique used principally to value certain securities without relying exclusively on quoted prices for the specific securities, but comparing the securities to benchmark or comparable securities.

**Table of Contents**

Fair value estimates are made at a point in time, based on relevant market data as well as the best information available about the security. Illiquid credit markets have resulted in inactive markets for certain of the Company's securities. As a result, there is limited observable market data for these assets. Fair value estimates for securities for which limited observable market data is available are based on judgments regarding current economic conditions, liquidity discounts, credit and interest rate risks, and other factors. These estimates involve significant uncertainties and judgments and cannot be determined with precision. As a result, such calculated fair value estimates may not be realizable in a current sale or immediate settlement of the security.

The Company utilizes third party pricing services to obtain market values for its corporate bonds. Management's policy is to obtain and review all available documentation from the third party pricing service relating to their market value determinations, including their methodology and summary of inputs. Management reviews this documentation, makes inquiries of the third party pricing service and makes a determination as to the level of the valuation inputs. Based on the Company's review of the available documentation from the third party pricing service, management concluded that Level 2 inputs were utilized. The significant observable inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, other market information and observations of equity and credit default swap curves related to the issuer.

**Other Real Estate Owned and Impaired Loans**

Other real estate owned and loans measured for impairment based on the fair value of the underlying collateral are recorded at estimated fair value, less estimated selling costs of 20% and 15%, respectively. Fair value is based on independent appraisals.

The following table summarizes financial assets and financial liabilities measured at fair value as of June 30, 2014 and December 31, 2013, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

|  | Fair Value Measurements at Reporting Date Using: |                |                |                |
|--|--|----------------|----------------|----------------|
|  | Total Fair Value                                 | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| <b><u>June 30, 2014</u></b>  |  |                |                |                |
| Items measured on a recurring basis:   |  |                |                |                |
| Investment securities available-for-sale:  |  |                |                |                |
| U.S. agency obligations  | \$ 25,094  | \$             | \$ 25,094      | \$             |
| Equity investments   | 7,209  | 7,209          |                |                |
| Items measured on a non-recurring basis:   |  |                |                |                |
| Other real estate owned  | 4,968  |                |                | 4,968          |
| Loans measured for impairment based on the fair value of the underlying collateral | 14,794   |                |                | 14,794         |
|  | Fair Value Measurements at Reporting Date Using: |                |                |                |
|  | Total Fair Value                                 | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| <b><u>December 31, 2013</u></b>  |  |                |                |                |

|  |           |       |           |
|--|-----------|-------|-----------|
| Items measured on a recurring basis:   |           |       |           |
| <b>Investment securities available-for-sale:</b>                                   |           |       |           |
| U.S. agency obligations  | \$ 35,289 | \$    | \$ 35,289 |
| Equity investments   | 8,547     | 8,547 |           |
| Items measured on a non-recurring basis:   |           |       |           |
| Other real estate owned  | 4,345     |       | 4,345     |
| Loans measured for impairment based on the fair value of the underlying collateral | 15,446    |       | 15,446    |
| <b><u>Assets and Liabilities Disclosed at Fair Value</u></b>                       |           |       |           |

A description of the valuation methodologies used for assets and liabilities disclosed at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy is set forth below.

#### Cash and Due from Banks

For cash and due from banks, the carrying amount approximates fair value.

#### Securities Held-to-Maturity

Securities classified as held-to-maturity are carried at amortized cost, as the Company has the positive intent and ability to hold these securities to maturity. The Company determines the fair value of the securities utilizing Level 1, Level 2 and infrequently Level 3 inputs. In general, fair value is based upon quoted market prices, where available. Most of the Company's investment and mortgage-backed securities, however, are fixed income instruments that are not quoted on an exchange, but are bought and sold in active markets. Prices for these instruments are obtained through third party pricing

## Table of Contents

vendors or security industry sources that actively participate in the buying and selling of securities. Prices obtained from these sources include market quotations and matrix pricing. Matrix pricing is a mathematical technique used principally to value certain securities without relying exclusively on quoted prices for the specific securities, but comparing the securities to benchmark or comparable securities.

Fair value estimates are made at a point in time, based on relevant market data as well as the best information available about the security. Illiquid credit markets have resulted in inactive markets for certain of the Company's securities. As a result, there is limited observable market data for these assets. Fair value estimates for securities for which limited observable market data is available are based on judgments regarding current economic conditions, liquidity discounts, credit and interest rate risks, and other factors. These estimates involve significant uncertainties and judgments and cannot be determined with precision. As a result, such calculated fair value estimates may not be realizable in a current sale or immediate settlement of the security.

The Company utilizes third party pricing services to obtain market values for its corporate bonds. Management's policy is to obtain and review all available documentation from the third party pricing service relating to their market value determinations, including their methodology and summary of inputs. Management reviews this documentation, makes inquiries of the third party pricing service and makes a determination as to the level of the valuation inputs. Based on the Company's review of the available documentation from the third party pricing service, management concluded that Level 2 inputs were utilized for all securities except for certain state and municipal obligations known as bond anticipation notes (BANs) where management utilized Level 3 inputs. In the case of the Level 2 securities, the significant observable inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, other market information and observations of equity and credit default swap curves related to the issuer. Management based its fair value estimate of the BANs on the local nature of the issuing entities, the short-term life of the security and current market conditions.

### Federal Home Loan Bank of New York Stock

The fair value for Federal Home Loan Bank of New York stock is its carrying value since this is the amount for which it could be redeemed. There is no active market for this stock and the Company is required to maintain a minimum investment based upon the outstanding balance of mortgage related assets and outstanding borrowings.

### Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as residential mortgage, construction, consumer and commercial. Each loan category is further segmented into fixed and adjustable rate interest terms.

Fair value of performing and non-performing loans was estimated by discounting the future cash flows, net of estimated prepayments, at a rate for which similar loans would be originated to new borrowers with similar terms. Fair values estimated in this manner do not fully incorporate an exit price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

### Deposits Other than Time Deposits

The fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, savings, and interest-bearing checking accounts and money market accounts are, by definition, equal to the amount payable on demand. The related insensitivity of the majority of these deposits to interest rate changes creates a significant inherent value which is not reflected in the fair value reported.



Time Deposits

The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Securities Sold Under Agreements to Repurchase with Retail Customers

Fair value approximates the carrying amount as these borrowings are payable on demand and the interest rate adjusts monthly.

Borrowed Funds

Fair value estimates are based on discounting contractual cash flows using rates which approximate the rates offered for borrowings of similar remaining maturities.

**Table of Contents**

The book value and estimated fair value of the Bank's significant financial instruments not recorded at fair value as of June 30, 2014 and December 31, 2013 are presented in the following tables (in thousands):

|   | Book<br>Value | Fair Value Measurements at Reporting Date Using: |                   |                   |
|---|---------------|--|-------------------|-------------------|
|   |               | Level 1<br>Inputs                                | Level 2<br>Inputs | Level 3<br>Inputs |
| <b>June 30, 2014</b>  |               |  |                   |                   |
| Financial Assets:   |               |  |                   |                   |
| Cash and due from banks   | \$ 43,817     | \$ 43,817  | \$                | \$                |
| Securities held-to-maturity   | 478,389       |  | 484,524           | 600               |
| Federal Home Loan Bank of New York<br>stock                             | 20,246        |  |                   | 20,246            |
| Loans receivable and mortgage loans<br>held for sale                    | 1,633,114     |  |                   | 1,652,659         |
| Financial Liabilities:  |               |  |                   |                   |
| Deposits other than time deposits                                       | 1,490,791     |  | 1,490,791         |                   |
| Time deposits   | 214,719       |  | 216,988           |                   |
| Securities sold under agreements to<br>repurchase with retail customers | 62,341        | 62,341   |                   |                   |
| Federal Home Loan Bank advances and<br>other borrowings                 | 332,500       |  | 332,380           |                   |

|   | Book<br>Value | Fair Value Measurements at Reporting Date Using: |                   |                   |
|---|---------------|--|-------------------|-------------------|
|   |               | Level 1<br>Inputs                                | Level 2<br>Inputs | Level 3<br>Inputs |
| <b>December 31, 2013</b>  |               |  |                   |                   |
| Financial Assets:   |               |  |                   |                   |
| Cash and due from banks   | \$ 33,958     | \$ 33,958  | \$                | \$                |
| Securities held-to-maturity   | 495,599       |  | 493,432           | 1,650             |
| Federal Home Loan Bank of New York<br>stock                             | 14,518        |  |                   | 14,518            |
| Loans receivable and mortgage loans<br>held for sale                    | 1,542,245     |  |                   | 1,561,208         |
| Financial Liabilities:  |               |  |                   |                   |
| Deposits other than time deposits                                       | 1,528,820     |  | 1,528,820         |                   |
| Time deposits   | 217,943       |  | 220,409           |                   |
| Securities sold under agreements to<br>repurchase with retail customers | 68,304        | 68,304   |                   |                   |
| Federal Home Loan Bank advances and<br>other borrowings                 | 202,500       |  | 201,393           |                   |

**Limitations**

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because a limited market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding

future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other significant unobservable inputs. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets, and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The Company is not engaged in any legal proceedings of a material nature at the present time. From time to time, the Company is a party to routine legal proceedings within the normal course of business. Such routine legal proceedings in the aggregate are believed by management to be immaterial to the Company's financial condition or results of operations.

**Table of Contents****Item 1A. Risk Factors**

For a summary of risk factors relevant to the Company, see Part I, Item 1A, Risk Factors, in the 2013 Form 10-K. There were no material changes to risk factors relevant to the Company's operations since December 31, 2013.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On November 27, 2012, the Company announced its intention to repurchase up to 901,002 shares or 5% of its outstanding common stock, which was completed during the second quarter of 2014. On July 24, 2014, the Company announced the authorization of the Board of Directors to repurchase up to 5% of the Company's outstanding common stock, or 867,923 shares. Information regarding the Company's common stock repurchases for the three month period ended June 30, 2014 is as follows:

| Period                               | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|--------------------------------------|----------------------------------|------------------------------|--|--|
| April 1, 2014 through April 30, 2014 | 3,799                            | \$ 16.27                     | 3,799  | 209,967  |
| May 1, 2014 through May 31, 2014     | 159,967                          | 16.48                        | 159,967  | 50,000   |
| June 1, 2014 through June 30, 2014   | 50,000                           | 15.99                        | 50,000   | 0  |

**Item 3. Defaults Upon Senior Securities**

Not Applicable

**Item 4. Mine Safety Disclosures**

Not Applicable

**Item 5. Other Information**

Not Applicable

**Item 6. Exhibits**

Exhibits:

10.30

Amended and Restated Employment Agreement between Christopher D. Maher and OceanFirst Financial Corp. dated April 23, 2014. (1)

- 10.31 Amended and Restated Employment Agreement between Christopher D. Maher and OceanFirst Bank dated April 23, 2014. (1)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.0 Certification pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002
- 101.0 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements.

(1) Incorporated herein by reference from Exhibit to Form 8-K filed on April 25, 2014.

**Table of Contents**

**SIGNATURES**

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

OceanFirst Financial Corp.  
Registrant

DATE: August 8, 2014

/s/ John R. Garbarino  
John R. Garbarino  
Chairman of the Board and Chief Executive Officer

DATE: August 8, 2014

/s/ Michael J. Fitzpatrick  
Michael J. Fitzpatrick  
Executive Vice President and Chief Financial Officer

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**Table of Contents**

## Exhibit Index

| Exhibit | Description  | Page |
|---------|--|------|
| 31.1    | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   | 37   |
| 31.2    | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   | 38   |
| 32.0    | Certification pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002   | 39   |
| 101.0   | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements. |      |