NEUBERGER BERMAN HIGH YIELD STRATEGIES FUND
Form PREC14A
March 23, 2009

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant [X]

Filed by a Party other than the Registrant [ ]

Check the appropriate box:

[X] Preliminary Proxy Statement
[ ] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
[ ] Definitive Proxy Statement
[ ] Definitive Additional Materials
[ ] Soliciting Material Pursuant to Section 240.14a-11(c) or Section 240.14a-12

NEUBERGER BERMAN HIGH YIELD STRATEGIES FUND

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required.

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(3) Filing Party:

(4) Date Filed:

NEUBERGER BERMAN HIGH YIELD STRATEGIES FUND
(formerly, Lehman Brothers/First Trust Income Opportunity Fund)

April __, 2009

Dear Shareholder:

The enclosed Proxy Statement discusses several Proposals to be voted upon by the shareholders of Neuberger Berman High Yield Strategies Fund (the “Fund”). Shareholders of the Fund are being asked to approve Proposals 1, 2 and 3. As a shareholder of the Fund, you are asked to review the Proxy Statement and to cast your votes. The Board of Trustees of the Fund unanimously recommends a vote “FOR” each of the Proposals.

As discussed in more detail in the enclosed Proxy Statement, Lehman Brothers Holdings Inc. (“LBHI”) has entered into an agreement to sell a controlling interest in your Fund’s investment adviser. Under the agreement, LBHI would sell substantially all of the Neuberger Berman business and the fixed income business and certain alternative asset management businesses of LBHI’s Investment Management Division (collectively, the “Acquired Businesses”) to a new company, a majority of which would be owned, directly or indirectly, by portfolio managers, Neuberger Berman’s management team and certain key members and senior professionals of the former Investment Management Division (the “Proposed Acquisition”). The Acquired Businesses include Neuberger Berman Management LLC (“NB Management”) and Lehman Brothers Asset Management LLC (“LBAM”), the investment adviser and sub-adviser to the Fund, respectively. By law, the contracts under which NB Management and LBAM provide investment advisory services to the Fund would automatically terminate upon consummation of the Proposed Acquisition. To provide for continuity of management, the shareholders of the Fund are being asked to vote “FOR” the following Proposals:

1. To approve a new Investment Advisory Agreement between the Fund and a newly formed successor entity to NB Management (New NB Management), to become effective upon consummation of the Proposed Acquisition;

2. To approve a new Sub-Advisory Agreement, with respect to the Fund, between New NB Management and LBAM, to become effective upon consummation of the Proposed Acquisition;

3. To elect five Class I Trustees to serve on the Board of Trustees of the Fund until the annual meeting of shareholders in 2012, or until their successors are elected and qualified.

It is expected that the portfolio managers and substantially all of the other employees of the Acquired Businesses would remain unchanged and would provide uninterrupted management of your Fund following the Proposed Acquisition. All material terms of the advisory agreements, including the fees, would also remain unchanged.

The Board of Trustees unanimously recommends that you vote “FOR” each of the Proposals outlined above and described in the Proxy Statement.

Please note that consummation of the Proposed Acquisition is subject to various conditions, as described more fully in the enclosed Proxy Statement. If the Proposed Acquisition is not consummated, Proposals 1 and 2, if approved, will not be implemented. Any proposal submitted to a vote at the Meeting by anyone other than the officers or Trustees of the Fund may be voted upon only in person or by written proxy.

Your vote is important to us regardless of the number of shares you own. Voting your shares early will avoid costly follow-up mail and telephone solicitation. Whether or not you plan to attend the annual shareholder meeting in person, please read the Proxy Statement and follow the instructions on the enclosed proxy card(s) for voting by mail, touch-tone telephone or on the Internet. If we do not hear from you after a reasonable amount of time, you may receive a telephone call from one of our proxy solicitors, The Altman Group, Inc., reminding you to vote your shares. If you have any questions about the Proposals or the voting instructions, please call The Altman Group, Inc. at [____________] (Monday through Friday, 9:30 a.m. to 9:00 p.m. Eastern time

and Saturday, 10:00 a.m. to 6:00 p.m. Eastern time) or call NB Management at 800-877-9700 (Monday through Saturday, 8:00 a.m. to 6:00 p.m. Eastern time). We encourage you to act promptly to ensure that your vote is cast. It is important that you vote no later than the time of the annual shareholder meeting. Thank you for continued support of the Fund.

Very truly yours,

Robert Conti
President and
Chief Executive Officer of the Fund

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NEUBERGER BERMAN HIGH YIELD STRATEGIES FUND
(formerly, Lehman Brothers/First Trust Income Opportunity Fund)

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
To be held on May __, 2009

The annual meeting of shareholders (the Meeting) of Neuberger Berman High Yield Strategies Fund (formerly, Lehman Brothers/First Trust Income Opportunity Fund), a Delaware statutory trust (the Fund), will be held at the offices of Neuberger Berman, LLC, 605 Third Avenue, 41st Floor, New York, New York 10158-3698, on May __, 2009 at _:__ _.m. Eastern time.

As discussed in more detail in the enclosed Proxy Statement, Lehman Brothers Holdings Inc. (LBHI) has entered into an agreement to sell a controlling interest in your Funds investment adviser. Under the agreement, LBHI would sell substantially all of the Neuberger Berman business and the fixed income business and certain alternative asset management businesses of LBHIs Investment Management Division (collectively, the Acquired Businesses) to a new company, a majority of which would be owned, directly or indirectly, by portfolio managers, Neuberger Bermans management team and certain key members and senior professionals of the former Investment Management Division (the Proposed Acquisition). The Acquired Businesses include Neuberger Berman Management LLC (NB Management) and Lehman Brothers Asset Management LLC (LBAM), the investment adviser and sub-adviser to the Fund, respectively. By law, the contracts under which NB Management and LBAM provide investment advisory services to the Fund would automatically terminate upon consummation of the Proposed Acquisition. To provide for continuity of management, the shareholders of the Fund are being asked to vote FOR the following Proposals:

1. To approve a new Investment Advisory Agreement between the Fund and a newly formed successor entity to NB Management (New NB Management), to become effective upon consummation of the Proposed Acquisition;

2. To approve a new Sub-Advisory Agreement, with respect to the Fund, between New NB Management and LBAM, to become effective upon consummation of the Proposed Acquisition;

3. To elect five Class I Trustees to serve on the Board of Trustees of the Fund until the annual meeting of shareholders in 2012, or until their successors are elected and qualified; and

4. To transact any other business as may properly come before the Meeting.

As described in the Proxy Statement, all material terms of the advisory agreements, including the fees, would remain unchanged. Each Proposal is discussed in greater detail in the enclosed Proxy Statement. You are entitled to vote at the Meeting if you owned shares of the Fund at the close of business on February 27, 2009 (Record Date). If you attend the Meeting, you may vote your shares in person. If you do not expect to attend the Meeting, please complete, date, sign and return the enclosed proxy card(s) in the enclosed postage-paid envelope or vote by telephone or through the Internet.

We will admit to the Meeting (1) all shareholders of record on the Record Date, (2) persons holding proof of beneficial ownership at the Record Date, such as a letter or account statement from the persons broker, (3) persons who have been granted proxies, and (4) such other persons that we, in our sole discretion, may elect to admit. **All persons wishing to be admitted to the meeting must present photo identification**. **If you plan to attend the Meeting, please contact us at 1-800-877-9700.**

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to be Held on May __, 2009: This Notice, the Proxy Statement and the form of proxy card are available on the Internet at [____________]. On this website, you will be able to access the Notice, the Proxy Statement and its accompanying materials, the form of proxy card and any amendments or supplements to the foregoing material that are required to be furnished to shareholders.

By order of the Board of Trustees,

Claudia A. Brandon
Secretary of the Fund

April __, 2009
New York, New York

YOUR VOTE IS IMPORTANT NO MATTER HOW MANY
SHARES OF THE FUND YOU OWN.

IF YOU OWN BOTH COMMON SHARES AND PREFERRED SHARES OF THE FUND,
THERE WILL BE MORE THAN ONE PROXY CARD ENCLOSED.

PLEASE FILL OUT AND RETURN THE PROXY CARD(S) PROMPTLY.

SHAREHOLDERS ARE INVITED TO ATTEND THE MEETING IN PERSON. ANY
SHAREHOLDER WHO DOES NOT EXPECT TO ATTEND THE MEETING IS URGED TO REVIEW
THE ENCLOSED MATERIALS AND FOLLOW THE INSTRUCTIONS THAT APPEAR ON THE ENCLOSED
PROXY CARD(S).

TO AVOID ADDITIONAL EXPENSE OF FURTHER SOLICITATION, WE ASK
YOUR COOPERATION IN VOTING YOUR PROXY PROMPTLY, NO MATTER HOW LARGE OR SMALL
YOUR HOLDINGS MAY BE.

It is important that you vote even if your account was closed after the February 27, 2009 Record Date.

Please indicate your voting instructions on the enclosed proxy card(s), sign and date the card(s), and return the card(s) in the envelope provided. If you sign, date and return the proxy card(s) but give no voting instructions, your shares will be voted FOR the Proposals described in the Proxy Statement.

As an alternative to using the proxy card(s) to vote, you may vote via the Internet, by telephone, or in person. To vote via the Internet, please access the website listed on the Notice of Internet Availability of Proxy Materials

or your proxy card(s). To vote by telephone, please call the toll-free number listed on the enclosed proxy card(s). Shares that are registered in your name, as well as shares held in "street name" through a broker, may be voted via the Internet or by telephone. To vote in this manner, you will need the "control" numbers that appear on your proxy card(s). However, any proposal submitted to a vote at the Meeting by anyone other than the officers or Trustees of the Fund may be voted only in person or by written proxy. If we do not receive your completed proxy card(s) within a reasonable time, you may be contacted by our proxy solicitors, The Altman Group, Inc. or MacKenzie Partners, Inc.

Unless proxy cards submitted by corporations and partnerships are signed by the appropriate persons indicated in the voting instructions on the proxy cards, they will not be voted.

IMPORTANT INFORMATION TO HELP YOU UNDERSTAND
AND VOTE ON THE PROPOSALS

While we strongly encourage you to read the full text of the enclosed Proxy Statement, we are also providing you with a brief overview of the subject of the shareholder vote. Your vote is important.

QUESTIONS AND ANSWERS

Q. What is happening?

A. Lehman Brothers Holdings Inc. ("LBHI") has entered into an agreement to sell a controlling interest in your Fund's investment adviser. Under the agreement, LBHI would sell substantially all of the Neuberger Berman business and the fixed income business and certain alternative asset management businesses of LBHI's Investment Management Division (collectively, the "Acquired Businesses") to NBSH Acquisition, LLC (the "Proposed Acquisition"). NBSH Acquisition, LLC ("NBSH") was organized by key members of Neuberger Berman's management for the purpose of facilitating the acquisition of the Acquired Businesses. As discussed more fully in the enclosed Proxy Statement, at the closing of the Proposed Acquisition, a majority interest in the Acquired Businesses will be directly or indirectly owned by portfolio managers, Neuberger Berman's management team and certain key members and senior professionals of the former Investment Management Division ("Management Members"), as well as by LBHI and certain affiliates of LBHI.

The Acquired Businesses include Neuberger Berman Management LLC ("NB Management") and Lehman Brothers Asset Management LLC ("LBAM"), the investment adviser and sub-adviser to the Fund, respectively. By law, the contracts under which NB Management and LBAM provide investment advisory services to the Fund would automatically terminate upon consummation of the Proposed Acquisition. Accordingly, shareholders of the Fund are being asked to approve new investment advisory and sub-advisory agreements with NB Management and LBAM (or with each of their successors) on the same terms and with the same compensation structure as are currently in effect. The Proxy Statement provides additional information about the Proposed Acquisition, the structure of the resulting entities and the new investment advisory and sub-advisory agreements.

Your Board of Trustees believes that approval of the new agreements is important to provide continuity of the high quality investment advisory and sub-advisory services your Fund has received in the past.

In addition, shareholders of the Fund are being asked to approve the election of five Class I Trustees to serve on the Board of Trustees of the Fund until the annual meeting of shareholders in 2012, or until their successors are elected and qualified. The Trustees serve as representatives of shareholders. In this capacity, they are fiduciaries and have an obligation to serve in the best interests of the shareholders. Trustees review Fund performance, oversee Fund activities and review contractual arrangements with service providers that provide services to the Fund. Each of the nominees currently serves as a Trustee of the Fund.

THE BOARD OF TRUSTEES UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR EACH OF THE PROPOSALS DESCRIBED IN THE PROXY STATEMENT.

Q. How does the Proposed Acquisition relate to the LBHI bankruptcy case?

A. LBHI is a debtor-in-possession under chapter 11 of the U.S. Bankruptcy Code, and, as such, the Proposed Acquisition was subject to the approval of the court in the LBHI bankruptcy case. On October 22, 2008, the

bankruptcy court approved procedures for a public auction process for the Acquired Businesses. On December 3, 2008, NBSH was selected as the successful bidder in the public auction for the Acquired Businesses. On December 22, 2008, the bankruptcy court approved the sale of the Acquired Businesses to NBSH (or its successor or assign), as the successful bidder.

Q. Why are you sending me this information?

A. You are receiving these proxy materials because you own shares of the Fund and have the right to vote on the very important Proposals concerning your investment.

Q. Why am I being asked to vote on the new agreements?

A. The consummation of the Proposed Acquisition would terminate the Fund□s investment advisory agreement with NB Management and the sub-advisory agreement with respect to the Fund between NB Management and LBAM. Accordingly, shareholders of the Fund are being asked to approve new investment advisory and sub-advisory agreements with NB Management and LBAM (or with each of their successors) (the □Advisers□) on the same terms and with the same compensation structure as are currently in effect. Your Board of Trustees believes that approval of the new agreements is important to provide continuity of the advisory and sub-advisory services your Fund has received in the past.

The Board of Trustees of your Fund has approved interim investment advisory and sub-advisory agreements with the Advisers in the event that the Proposed Acquisition closes and shareholders of the Fund have not yet approved new agreements for the Fund. If new agreements for the Fund are not approved within 150 days of the date on which the Proposed Acquisition closes, the Board of Trustees will take such action as it deems to be in the best interests of the Fund and its shareholders.

Q. What are the conditions to the consummation of the Proposed Acquisition?

A. The consummation of the Proposed Acquisition is subject to certain terms and conditions, including, among others: (1) certain Management Members each entering into a definitive employment agreement; (2) the transfer by LBHI of the Acquired Businesses in accordance with terms of the purchase agreement between LBHI and NBSH; and (3) the parties to the Proposed Acquisition obtaining certain regulatory approvals. If each of the terms and conditions is satisfied or waived, the parties to the Proposed Acquisition anticipate that the closing will take place during the second quarter of 2009.

Q. How will the Proposed Acquisition affect me as a Fund shareholder?

A. Your Fund and its investment objectives will not change as a result of the completion of the Proposed Acquisition, and you will still own the same shares in the same Fund. The new investment advisory and sub-advisory agreements are identical in all material respects to the corresponding existing agreements. The management fee rates that the Fund pays for investment management services will be the same upon completion of the Proposed Acquisition. In addition, neither LBHI nor NBSH contemplates instituting any fundamental changes to the manner in which NB Management and LBAM have historically operated their businesses with respect to providing advisory, sub-advisory and related ancillary services to the Fund. However, there can be no assurance that any key employee of NB Management or LBAM will choose to remain employed by the investment adviser or the sub-adviser (or their successors) before or after the completion of the Proposed Acquisition.

Q. Will your Fund□s name change?

A. No. The name of your Fund will not change.

Q. Will the fees payable under the new agreements increase as a result of the Proposed Acquisition?

A. No. The Proposals to approve the new investment advisory and sub-advisory agreements do not seek any increase in the fee rates. For at least two years following the Proposed Acquisition, no voluntary arrangements to waive fees of the Fund will be changed by NB Management (or its successor) so as to increase the expenses the Fund would pay without the prior approval of the Board of Trustees of the Fund. In addition, NB Management recently announced that it would voluntarily waive 0.05% of its advisory fees.

Q. How do the Trustees of my Fund recommend that I vote?

A. After careful consideration, the Trustees of your Fund unanimously recommend that you vote FOR the Proposals.

Q. Will my Fund pay for this proxy solicitation or for the costs of the Proposed Acquisition?

A. The Fund will bear costs normally associated with its annual meetings (*i.e.*, a portion of mailing, printing and production of the Proxy Statement). NB Management (or its successor) will bear all other normal and customary fees and expenses in connection with the Proposed Acquisition (including, but not limited to, Trustees fees relating to the special Board meetings, proxy solicitation costs and legal fees).

Q. How do I vote my shares?

A. For your convenience, there are several ways you can vote:

- **By Mail**: You may vote by completing the enclosed proxy card(s) by dating, signing and returning it in the postage paid envelope. Please note that if you sign and date the proxy card but give no voting instructions, your shares will be voted FOR the Proposals described above.

- **By Telephone**: You may vote by telephone by calling the number on your proxy card(s). To vote in this manner, you will need the control number that appears on your proxy card(s).
- **Via the Internet**: You may vote via the Internet by accessing the website address printed on the Notice of Internet Availability of Proxy Materials or the enclosed proxy card(s). To vote in this manner, you will need the control number that appears on your proxy card(s).
- **In Person**: Attend the Meeting as described in the Proxy Statement. If you wish to attend the Meeting, please notify us by calling 1-800-877-9700.

Q. Why are multiple proxy cards enclosed?

A. If you own common and preferred shares of the Fund, you will receive multiple proxy cards.

Q. Whom should I call for additional information about this Proxy Statement?

A. If you need any assistance, or have any questions regarding the Proposals or how to vote your shares, please call The Altman Group, Inc., one of our proxy solicitors, at [__________] (Monday through Friday, 9:30 a.m. to 9:00 p.m. Eastern time and Saturday, 10:00 a.m. to 6:00 p.m. Eastern time) or call us at 800-877-9700 (Monday through Saturday, 8:00 a.m. to 6:00 p.m. Eastern time).

NEUBERGER BERMAN HIGH YIELD STRATEGIES FUND
(formerly, Lehman Brothers/First Trust Income Opportunity Fund)

605 Third Avenue
New York, New York 10158-0180
800-877-6700

PROXY STATEMENT

For the Annual Meeting of Shareholders
to be held on May __, 2009

INTRODUCTION

These proxy materials, which include a Notice of Annual Meeting of Shareholders, a Proxy Statement, and one or more proxy cards, are being sent to the shareholders of Neuberger Berman High Yield Strategies Fund (formerly, Lehman Brothers/First Trust Income Opportunity Fund), a Delaware statutory trust (the "Fund"), on behalf of its Board of Trustees (the "Board"), in connection with the annual meeting of shareholders of the Fund to be held at the offices of Neuberger Berman, LLC, 605 Third Avenue, 41st Floor, New York, New York 10158-3698 on May __, 2009, at _:__ _.m. Eastern time and any adjournments or postponements thereof (the "Meeting").

Solicitation of Proxies

The Trustees are soliciting votes from shareholders of the Fund with respect to the proposals described in this Proxy Statement (the "Proposals"). The approximate mailing date of this Proxy Statement and the accompanying materials, or a Notice of Internet Availability of Proxy Materials, is on or about ______ __, 2009. If the accompanying proxy card is properly executed and returned in time to be voted at the Meeting, the shares represented by that proxy card will be voted in accordance with the instructions provided on the proxy card. Executed proxy cards that are unmarked will be voted to approve each Proposal.

The following Proposals will be considered and acted upon at the Meeting:

1. To approve a new Investment Advisory Agreement between the Fund and a newly formed successor entity to Neuberger Berman Management LLC ("NB Management") (such new entity, "New NB Management"), to become effective upon consummation of the Proposed Acquisition;

2. To approve a new Sub-Advisory Agreement, with respect to the Fund, between New NB Management and Lehman Brothers Asset Management LLC ("LBAM"), to become effective upon consummation of the Proposed Acquisition;

3. To elect five Class I Trustees to serve on the Board of Trustees of the Fund until the annual meeting of shareholders in 2012, or until their successors are elected and qualified; and

4. To transact any other business as may properly come before the Meeting.

The Trustees have set the close of business on February 27, 2009 as the record date ("Record Date"), and only shareholders of record on the Record Date will be entitled to vote on the Proposals at the Meeting. On that date, the Fund had [____________] common shares and [______] preferred shares ("Preferred Shares") outstanding and entitled to vote. Additional information regarding outstanding shares, voting your proxy card and attending the Meeting are included at the end of this Proxy Statement in the section entitled "Voting Information."

Each shareholder will have one vote for each dollar, and a proportionate fraction of a vote for each fraction of a dollar, of the net asset value per share of each share held on the Record Date. On the Record Date, the net asset value of the common shares was $[_____] per share and the liquidation preference of the Preferred Shares was $[_____] per share.

Holders of the common shares and Preferred Shares will vote together as a single class on all the Proposals. As to any other business that may properly come before the Meeting, holders of the common shares and Preferred Shares may vote together as a single class or separately, depending on the requirements of the Investment Company Act of 1940, as amended ("1940 Act"), applicable law governing Delaware statutory business trusts, and the Fund's Trust Instrument with respect to said item of business.

Reports to Shareholders

The Fund will furnish, without charge, a copy of its most recent annual report to any shareholder upon request. Shareholders who want to obtain a copy of the Fund's most recent annual report should direct all written requests to the attention of the Fund, at the offices of Neuberger Berman Management LLC, 605 Third Avenue, 2nd Floor, New York, New York 10158-0180, or call toll-free 1-800-877-9700.

GENERAL OVERVIEW

Introduction

Lehman Brothers Holdings Inc. ("LBHI") has entered into an agreement (the "Purchase Agreement") to sell a controlling interest in your Fund's investment adviser. Under the Purchase Agreement, LBHI would sell substantially all of the Neuberger Berman business (collectively, "Neuberger Berman") and the fixed income business and certain alternative asset management businesses of LBHI's Investment Management Division (collectively, the "Acquired Businesses") to NBSH Acquisition, LLC (the "Proposed Acquisition"). At or prior to the closing, NBSH Acquisition, LLC ("NBSH") will assign the Purchase Agreement to a newly formed entity, Neuberger Berman Group LLC ("NBG"), which will hold direct or indirect interests in the Acquired Businesses. Included in the Acquired Businesses are NB Management and LBAM, the investment adviser and sub-adviser to the Fund, respectively.

As a preliminary step in the Proposed Acquisition, NB Management has organized a subsidiary named Neuberger Berman Investments LLC ("NB Investments"). Prior to the consummation of the Proposed Acquisition, substantially all of the assets and liabilities of NB Management with respect to the investment advisory and broker-dealer businesses and related activities will be transferred to NB Investments and NB Investments will then be renamed Neuberger Berman Management LLC, referred to herein as New NB Management. As a result of that transfer, New NB Management will be, with respect to certain advisory and broker-dealer services, a successor to NB Management and will assume responsibility under the investment advisory agreement between NB Management and the Fund (the "Investment Advisory Agreement") and the sub-advisory agreement between NB Management and LBAM, with respect to the Fund (the "Sub-Advisory Agreement"). The transfer of assets to New NB Management is part of an internal reorganization of various operations of the Investment Management Division prior to the Proposed Acquisition that will not affect the manner in which the Fund is managed.

In order to effect the purchase of certain assets of Neuberger Berman Holdings LLC ("NB Holdings") and LBAM, NBG is also expected to organize two subsidiaries (expected be named Neuberger Berman Holdings LLC ("New NB Holdings") and Neuberger Berman Fixed Income Holdings LLC ("Fixed Income Holdings")). Although no successor entities are being created in connection with the purchase of LBAM (collectively, with NB Management and New NB Management, the "Advisers"), at the consummation of the Proposed Acquisition, New NB Holdings will be the parent of New NB Management and Fixed Income Holdings will be the parent of LBAM (expected to be renamed Neuberger Berman Fixed Income LLC or some other name not containing "Lehman Brothers"). At the consummation of the Proposed Acquisition, New NB Holdings will acquire the membership interests of NB Management and Fixed Income Holdings will acquire the membership interests of LBAM. The transfer to New NB Holdings and Fixed Income Holdings of the membership interests of the investment adviser or the sub-adviser could be deemed to result in an "assignment" of the Investment Advisory Agreement and the Sub-Advisory Agreement.

The acquisition of assets by the successor Neuberger Berman adviser of, as opposed to a transfer of equity interests in, the predecessor Neuberger Berman adviser, would enable the newly formed entity to begin operations as a stronger company as certain liabilities that might attach to the predecessor will not be automatically assumed by the newly formed adviser. Nevertheless, the successor Neuberger Berman adviser will assume any and all liabilities associated with the predecessor Neuberger Berman adviser's provision of services to the Fund, including advisory and administrative services.

The consummation of the Proposed Acquisition would terminate the Investment Advisory Agreement and the Sub-Advisory Agreement. Accordingly, shareholders of the Fund are being asked to approve new investment advisory and sub-advisory agreements with the Advisers on the same terms and with the same compensation structure as are currently in effect.

LBHI is a debtor-in-possession under chapter 11 of the U.S. Bankruptcy Code, and, as such, the Proposed Acquisition was subject to the approval of the court in the LBHI bankruptcy case. On October 22, 2008, the bankruptcy court approved procedures for a public auction process for the Acquired Businesses. On December 3, 2008, NBSH was selected as the successful bidder in the public auction for the Acquired Businesses. On December 22, 2008, the bankruptcy court approved of the sale of the Acquired Businesses to NBSH (or its successor or assign), as the successful bidder.

In addition, shareholders of the Fund are being asked to approve the election of five Class I Trustees to serve on the Board of Trustees of the Fund until the annual meeting of shareholders in 2012, or until their successors are elected and qualified. The Trustees serve as representatives of shareholders. In this capacity, they are fiduciaries and have an obligation to serve in the best interests of the shareholders. Trustees review Fund performance, oversee Fund activities and review contractual arrangements with service providers that provide services to the Fund. Each of the nominees currently serves as a Trustee of the Fund.

NBSH

NBSH was organized by key members of Neuberger Berman’s senior management, for the purpose of facilitating the acquisition of the Acquired Businesses. At or prior to the closing of the Proposed Acquisition, NBSH will assign the Purchase Agreement to NBG.

NBG

NBG will own, directly or indirectly, all of the Acquired Businesses. From and after the closing, NBG will be owned by LBHI, certain affiliates of LBHI and, directly or indirectly, by portfolio managers, the management team and certain key members and senior professionals of the former Investment Management Division (“Management Members”).

As of the mailing of this Proxy Statement, the structure by which Management Members will hold their interests in NBG has not been finalized. The Management Members will hold their interests in NBG through NBSH, or one or more other entities that may be created for tax or other purposes. Interests in NBG held directly or indirectly by Management Members will be subject to time vesting, which will be contingent upon the Management Member’s continued employment by NBG or its subsidiaries. Holders of unvested interests will not be entitled to any voting, distribution or other rights on their unvested units, other than the right to appoint members of NBG’s board of directors through their direct or indirect ownership of NBG interests. Management Members may enter into shareholder agreements that could affect their voting rights or other matters.

49% of the common units of NBG will be classified as Class A units and will be issued to LBHI and its subsidiaries. (Under NBG’s organizational document, LBHI will have an irrevocable proxy to vote all Class A units held by LBHI subsidiaries.) 51% of the common units of NBG will be classified as Class B units and will be issued, or reserved for issuance, (directly or indirectly) to Management Members. In addition, 93% of the preferred units will be issued to LBHI and its subsidiaries, and 7% of the preferred units will be issued, or reserved for issuance, (directly or indirectly) to Management Members. The aggregate liquidation preference of all preferred units issued will be $875,000,000 and the preferred units will pay a preferred return on this liquidation preference, in cash, at rates specified in NBG’s organizational document.

Prior to the closing of the Proposed Acquisition, management of NBG will be vested in its managing member. Immediately after the closing of the Proposed Acquisition, a seven member board of directors will be constituted for NBG. NBG’s Chief Executive Officer will become a member of NBG’s board. Holders of Class B units will be entitled to appoint four additional members of NBG’s board, at least one of whom will be a portfolio manager and at least two of whom must be independent of management within the meaning of the New York Stock Exchange’s listing requirements and Rule 10A-3 of the Securities Exchange Act of 1934, regardless of whether NBG is subject to such rules at the time of appointment. Holders of Class A units will be entitled to appoint two members of NBG’s board. Other than with respect to the appointment of directors to NBG’s board, each Class A unit and vested Class B unit will have one vote in matters requiring a vote of NBG’s common unitholders.

Although NBG’s preferred units will have no voting rights, holders of preferred units and Class A units will have the right to veto certain actions that could materially affect the financial soundness or capital structure of NBG. In addition, holders of preferred units will have the right to remove the chief executive officer of NBG and take certain other actions if dividends are not paid in cash over specified periods of time. There are restrictions on the resale of common and preferred units. In the event that assets of LBHI, as a debtor-in-possession under chapter 11 of the U.S. Bankruptcy Code, are distributed to its creditors, preferred units and Class A units of NBG may be distributed or sold to LBHI’s creditors or other parties.

Following the consummation of the Proposed Acquisition, NBG, through its subsidiaries, will offer a broad suite of investment management products, including equities, fixed income and alternative investment products, through the high net worth, institutional and retail channels.

Conditions to Closing of the Proposed Acquisition

The consummation of the Proposed Acquisition is subject to certain terms and conditions, including, among others: (1) certain Management Members each entering into a definitive employment agreement with NBG or a subsidiary; (2) the transfer by LBHI to NBG of the Acquired Businesses, whether through the transfer of equity interests in, or the assets of, the existing LBHI subsidiaries through which the Acquired Businesses are operated, in accordance with terms of the purchase agreement between LBHI and NBSH; and (3) the parties to the Proposed Acquisition obtaining certain regulatory approvals. If each of the terms and conditions is satisfied or waived, the parties to the Proposed Acquisition anticipate that the closing will take place during the second quarter of 2009.

Neither LBHI nor NBSH (including its successor or assign) contemplate instituting any fundamental changes to the manner in which NB Management and LBAM have historically operated their businesses with respect to providing advisory, sub-advisory and related ancillary services to the Fund. LBHI and NBSH (including its successor or assign) desire to retain the investment adviser's and sub-adviser's portfolio managers and key members of the management teams. In this regard, NBG has proposed retention agreements to certain key personnel of the investment adviser and the sub-adviser and it is a condition to LBHI's obligation to close the Proposed Acquisition that certain Management Members each enter into an employment agreement with NBG or a subsidiary. George Walker, who will be the chief executive officer of NBG, and Joseph V. Amato, managing director and board member of LBAM, will continue to lead the Advisers.

In addition to the Investment Advisory Agreement and Sub-Advisory Agreement, the Fund's administration agreement with NB Management will also terminate automatically upon consummation of the Proposed Acquisition. The Board has approved a new administration agreement with New NB Management, which is identical in form to the existing agreement. Shortly before the closing of the Proposed Acquisition, it is anticipated that the investment advisory, broker-dealer and related activities of NB Management will be transferred to its subsidiary, New NB Management. New NB Management will assume all of the obligations of NB Management and will provide the same investment advisory and management services to the Fund as had been provided prior to the transfer using the same portfolio personnel.

As further discussed below, NBSH (on its behalf and on behalf of its successor or assign) has agreed that, for a minimum of two years subsequent to the consummation of the Proposed Acquisition, it will use reasonable best efforts to cause the Advisers to refrain from imposing, or agreeing to impose, any "unfair burden," as defined in Section 15(f) of the Investment Company Act of 1940, as amended (the "1940 Act"), on the Fund, which includes refraining from proposing any increase in the fees paid by the Fund to the Advisers. For at least two years following the Proposed Acquisition, no voluntary arrangements to waive fees of the Fund will be changed by New NB Management so as to increase the expenses the Fund would pay without the prior approval of the Board. NB Management recently announced that it would voluntarily waive 0.05% of its fees.

Support services that were provided to the investment adviser and the sub-adviser by LBHI-related businesses that are not included with the Acquired Businesses are expected to either be provided to the Advisers by LBHI, NBG or their respective subsidiaries, contracted to third parties or continued for certain periods under the terms of a Transition Services Agreement between LBHI and Barclays Capital, which has purchased certain assets of LBHI.

Benefits of the Proposed Acquisition

The Proposed Acquisition will enable the Management Members to own a majority of the "new" Neuberger Berman business and continue to function and operate much as Neuberger Berman does today. Management Members will be able to exercise control over the investment and operational decisions as well as decisions relating to the future growth of the Acquired Businesses. Functional and operational continuity should enable the Acquired Businesses to continue to focus on their investment advisory and portfolio management responsibilities without the distractions or constraints of having new owners unfamiliar with the functions and operations of Neuberger Berman.

Proxy Solicitation and Related Costs

The Fund will bear costs normally associated with its annual meetings (*i.e.*, a portion of mailing, printing and production of the Proxy Statement). NB Management (or its successor) will bear all other normal and customary fees and expenses in connection with the Proposed Acquisition (including, but not limited to, Trustees fees relating to the special Board meetings, proxy solicitation costs and legal fees).

Information Concerning the Investment Adviser and Sub-Adviser

NB Management, 605 Third Avenue, New York, New York 10158, is currently a wholly owned subsidiary of Neuberger Berman Holdings LLC (NB Holdings). As of the closing of the Proposed Acquisition, NBG will have a direct or indirect controlling interest in New NB Management, which will be located at the current address of NB Management. NB Management currently provides investment advisory services to the Fund. Prior to the closing of the Proposed Acquisition, New NB Management will assume these responsibilities and NB Managements SEC investment adviser registration.

LBAM, 200 South Wacker Drive, Suite 2100, Chicago, Illinois 60601 is currently a wholly owned subsidiary of LBHI. As of the closing of the Proposed Acquisition, NBG will have an indirect controlling interest in LBAM, through Fixed Income Holdings. LBAM is an SEC-registered investment adviser that provides sub-advisory services to the Fund and to other registered investment companies, as well as to high-net-worth individuals, unregistered investment companies, corporations, and institutional investors.

NB Holdings, 605 Third Avenue, 2nd Floor, New York, New York 10158, is currently a wholly owned subsidiary of LBHI and the parent and 100% owner of NB Management. At the closing of the Proposed Acquisition, NB Holdings will sell all or substantially all of its assets to New NB Holdings. For 69 years, NB Holdings and its subsidiaries and predecessors have provided clients with a broad range of investment products, services and strategies for individuals, families, and taxable and non-taxable institutions. From and after the closing of the Proposed Acquisition, substantially all of these businesses will be carried out by New NB Holdings and its subsidiaries.

As discussed above, NBSH, 605 Third Avenue, 2nd Floor, New York, New York 10158, is a newly formed entity organized by key members of Neuberger Bermans senior management for the purpose of acquiring the Acquired Businesses. At or prior to the closing of the Proposed Acquisition, NBSH will assign the Purchase Agreement to NBG. NBG will directly or indirectly own New NB Management and LBAM. Upon the closing of the Proposed Acquisition, NBGs ownership will be divided between LBHI, certain affiliates of LBHI and, directly or indirectly, the Management Members. The Management Members will own a majority interest in NBG and indirectly control New NB Management and LBAM. Substantially all of the interests and assets of certain other affiliated entities of NB Holdings are also being purchased by NBG as part of the Proposed Acquisition.

LBHI, a global investment bank, is currently the parent of LBAM and NB Holdings, which is in turn the parent of NB Management. Founded in 1850, LBHI historically had, until recently, maintained leadership positions in equity and fixed-income sales, trading and research, investment banking, private equity, and private client services. LBHIs address is 745 Seventh Avenue, New York, New York 10019. Commencing on September 15, 2008, LBHI and certain of its affiliates filed voluntary petitions for bankruptcy protection under chapter 11 of the US Bankruptcy Code. NB Holdings, NB Management and LBAM are separate legal entities and were not included in LBHIs bankruptcy filing. Copies of documentation relating to the LBHI bankruptcy cases, including the Proposed Acquisition, are available on the internet at http://chapter11.epiqsystems.com/lehman or upon request at 866-841-7867.

Exhibit B to this Proxy Statement provides information regarding the principal executive officers and directors of NB Management and LBAM. These principal executive officers and directors are anticipated to have the same positions with New NB Management and LBAM.

New Investment Advisory and Sub-Advisory Agreements

NB Management serves as investment adviser to the Fund. LBAM serves as sub-adviser to the Fund. The Proposed Acquisition has been deemed to result in an "assignment" of the Fund's existing Investment Advisory Agreement and Sub-Advisory Agreement (the "Existing Agreements") under the 1940 Act. As required by the 1940 Act, the Fund's Existing Agreements provide for their automatic termination in the event of an assignment, and each will terminate upon the consummation of the Proposed Acquisition. Accordingly, shareholders of the Fund are being asked to approve a new Investment Advisory Agreement (the "New Investment Advisory Agreement") and a new Sub-Advisory Agreement (the "New Sub-Advisory Agreement," and, together with the New Investment Advisory Agreement, the "New Agreements") with the Advisers that are identical in all material respects to the Existing Agreements in order to permit the investment adviser or the sub-adviser to provide or continue to perform the advisory and sub-advisory services on the same terms and with the same compensation structure as are currently in effect. For the Fund, the Proposal to approve a New Sub-Advisory Agreement is subject to the approval of the Proposal to approve the New Investment Advisory Agreement.

In case the shareholders of the Fund do not approve the New Agreements before the Proposed Acquisition is completed, the Board has approved New NB Management's provision of advisory services, and LBAM's provision of sub-advisory services, under interim investment advisory and sub-advisory agreements (together, "Interim Agreements") pending approval of the New Agreements by shareholders of the Fund. Compensation earned by the Advisers under the Interim Agreements would be held in an interest-bearing escrow account pending shareholder approval of the New Agreements. If shareholders approve the New Agreements within 150 days from the termination of the Existing Agreements, the amount held in the escrow account, including interest, will be paid to the Advisers, as appropriate. If shareholders of the Fund do not approve the New Agreements, the Advisers will be paid the lesser of the costs incurred in performing their services under the Interim Agreements or the total amount in the escrow account, including interest earned. If at the end of 150 days following termination of the Fund's Existing Agreements the Fund's shareholders still have not approved the New Agreements, the applicable Trustees would take such actions as they deem to be in the best interests of the Fund and its shareholders, which may include negotiating a new investment advisory agreement and/or applicable new sub-advisory agreement with an advisory organization selected by the Trustees or making other arrangements.

PROPOSAL 1: APPROVAL OF THE NEW INVESTMENT ADVISORY AGREEMENT

Shareholders of the Fund are being asked to approve a New Investment Advisory Agreement between the Fund and New NB Management whereby New NB Management will provide all advisory services that NB Management currently provides pursuant to the Fund's existing Investment Advisory Agreement. As described above, the Fund's existing Investment Advisory Agreement will terminate upon consummation of the Proposed Acquisition. Therefore, approval of the New Investment Advisory Agreement is sought so that the management of the Fund can continue without interruption following the Proposed Acquisition. If the Proposed Acquisition is not completed for any reason, the existing Investment Advisory Agreement will continue in effect.

NB Management currently provides services to the Fund pursuant to an Investment Advisory Agreement dated July 24, 2003 and an Assignment and Assumption Agreement, dated February 28, 2007. Shareholders of the Fund are solely being asked to approve a New Investment Advisory Agreement and not a new Assignment and Assumption Agreement.

Board Approval and Recommendation

The Trustees who were all present in person at a meeting held on December 17, 2008, including the Trustees who are not "interested persons" of the Fund or of NB Management (as defined in the 1940 Act) ("Independent Trustees"), unanimously approved the New Investment Advisory Agreement for the Fund and unanimously recommended that shareholders approve the New Investment Advisory Agreement. A summary of the Board's considerations is provided below in the section entitled "Evaluation by the Board."

Terms of the Existing and New Investment Advisory Agreement

The form of the New Investment Advisory Agreement is attached as Exhibit C to this Proxy Statement and the description of terms in this section is qualified in its entirety by reference to Exhibit C. The date of the existing Investment Advisory Agreement is July 24, 2003 and it was last approved by the Board on September 25, 2008. It was last submitted to a vote of shareholders of the Fund on [ ]. Shareholder approval was obtained prior to

the commencement of operations for the Fund by LBAM or its affiliate as sole shareholder.

The terms of the New Investment Advisory Agreement are identical to those of the existing Investment Advisory Agreement, except for dates of execution and termination and the identity of the investment adviser. The management fee rates under the New Investment Advisory Agreement are identical to the management fee rates under the existing Investment Advisory Agreement. For at least two years following the Proposed Acquisition, no voluntary arrangements to waive fees of the Fund will be changed by New NB Management so as to increase the expenses the Fund would pay without the prior approval of the Board. NB Management has advised the Board that it does not anticipate that the Proposed Acquisition will result in any reduction in the quality of advisory services now provided to the Fund by NB Management or have any adverse effect on the ability of NB Management or New NB Management to fulfill its obligations to the Fund.

The following discussion applies to both the existing Investment Advisory Agreement and the New Investment Advisory Agreement for the Fund. Accordingly, all references in this section to the Investment Advisory Agreement and NB Management equally apply to the New Investment Advisory Agreement and New NB Management, respectively.

Investment Advisory Services. NB Management currently serves as the investment adviser to the Fund pursuant to the Investment Advisory Agreement with the Fund. In relation to providing investment advisory and portfolio management services, the Investment Advisory Agreement provides that NB Management will (1) obtain and evaluate such information relating to economies, industries, businesses, securities and commodities markets, and individual securities, commodities and indices, (2) formulate and maintain a continuous investment program in a manner consistent with and subject to: (a) the Fund's Declaration of Trust and Bylaws; (b) the Fund's investment objective, strategies, policies, and restrictions; (c) all securities, commodities, and tax laws and regulations applicable to the Fund; and (d) any other written limits or directions furnished by the Trustees, (3) determine from time to time securities, commodities, interests or other investments to be purchased, sold, retained or lent by the Fund, and to implement those decisions, including the selection of entities with or through which such purchases, sales or loans are to be effected, (4) use reasonable efforts to manage the Fund so that it will qualify as a regulated investment company under subchapter M of the Internal Revenue Code of 1986, as amended, (5) make recommendations as to the manner in which voting rights, rights to consent to Fund action, and any other rights pertaining to the Fund shall be exercised, (6) make available to the Fund promptly upon request all of the Fund's records and ledgers and any reports or information reasonably requested by the Fund, (7) to the extent required by law, furnish to regulatory authorities any information or reports relating to the services provided pursuant to the Investment Advisory Agreement, (8) negotiate the terms and conditions under which custodian services will be provided to the Fund and the fees to be paid by the Fund to its custodian (which may or may not be an affiliate of the Fund's investment adviser), in connection therewith, and (9) make such reports and recommendations to the Trustees as the Trustees reasonably request or deem appropriate. The Investment Advisory Agreement permits NB Management to effect securities transactions on behalf of the Fund through associated persons of NB Management after consummation of the Proposed Acquisition. The Investment Advisory Agreement also specifically permits NB Management to compensate, through higher commissions, brokers and dealers who provide investment research and analysis to the Fund, subject to obtaining best execution. The Fund did not pay any brokerage commissions to affiliated brokers.

Expenses. NB Management, at its own expense, shall furnish all executive and other personnel, office space, and office facilities required to render the investment advisory services set forth in the Investment Advisory Agreement. The Fund will bear expenses that are attributable solely to the organization, operation or business of the Fund. Any expense borne by the Fund which is not solely attributable to the Fund, shall be apportioned in such manner as NB Management determines is fair and appropriate, or as otherwise specified by the Trustees.

Advisory Fee. The Fund pays NB Management an advisory fee at the annual rate of 0.60% of the Fund's average daily managed assets. "Managed assets" means net assets, including assets attributable to outstanding preferred shares, plus the aggregate amount of any borrowings. The aggregate amount of advisory fees and administration fees paid by the Fund during the last fiscal year was $1,345,067 and $112,089, respectively. The Trustees of the Fund have voted to approve a new administration agreement, identical in all material respects to the current agreement described below, to take effect following the completion of the Proposed Acquisition. If the Proposed Acquisition is not completed for any reason, the current administration agreement will remain in effect for the Fund.

Pursuant to the administration agreement with the Fund, NB Management provides certain shareholder-related services not furnished by the Fund's shareholder servicing agent or third party investment providers and assists in the development and implementation of specified programs and systems to enhance overall shareholder servicing capabilities. NB Management solicits and gathers shareholder proxies, performs services connected with the qualification of Fund shares for sale in various states, and furnishes other services necessary to the operation of the Fund. Upon consummation of the Proposed Acquisition, [New NB Management or another NBG subsidiary] will provide the same services as NB Management under a substantially similar administration agreement.

NB Management has entered into voluntary arrangements to waive certain fees of the Fund. For at least two years following the Proposed Acquisition, no voluntary arrangements to waive fees of the Fund will be changed by New NB Management so as to increase the expenses the Fund would pay without the prior approval of the Board. NB Management recently announced that it would voluntarily waive 0.05% of its fees.

Retention of Sub-Adviser. As noted in Exhibit C, the Investment Advisory Agreement provides that, subject to NB Management obtaining the initial and periodic approvals required under Section 15 of the 1940 Act, NB Management may retain a sub-adviser, at NB Management's own cost and expense, for the purpose of furnishing one or more of the services under NB Management's responsibility. The Investment Advisory Agreement further provides that the retention of a sub-advisor in no way reduces the responsibilities of NB Management under the Investment Advisory Agreement and NB Management is responsible to the Fund for all acts and omissions of the sub-adviser to the same extent that NB Management is responsible for its own acts and omissions. See "Limitation of Liability," below.

Services to Other Clients. The Investment Advisory Agreement does not limit the freedom of NB Management or any of its affiliates to render investment management and administrative services to other investment companies, to act as investment adviser or investment counselor to other persons, firms or corporations, or to engage in other business activities. [NB Management acts as investment adviser or sub-adviser to other registered investment companies with similar investment objectives and policies as the Fund. Exhibit D to this Proxy Statement sets forth the name, asset size and the rate of compensation received by NB Management for providing advisory or sub-advisory services to these other funds.]

Limitation of Liability. The Investment Advisory Agreement provides that NB Management will not be liable for any error of judgment or mistake of law or for any loss sustained by reason of the purchase, sale or retention of any security, whether or not such purchase, sale or retention shall have been based upon the investigation and research made by any other individual, firm or corporation, if such recommendation shall have been selected with due care and in good faith, except loss resulting from willful misfeasance, bad faith, or gross negligence on the part of NB Management in the performance of its obligations and duties, or by reason of its reckless disregard of its obligations and duties under the Investment Advisory Agreement.

Indemnification. The Investment Advisory Agreement provides that the Fund will indemnify and hold harmless NB Management and its officers, directors, employees or agents (each, an "Indemnified Person") against any and all losses, claims, damages or liabilities, joint or several, including, without limitation, reasonable attorneys' fees and disbursements, reasonably incurred by it in connection with, or resulting from, its actions or inactions in connection with the performance of its duties under the Investment Advisory Agreement, except those losses, claims, damages or liabilities resulting from willful misfeasance, bad faith, or gross negligence in the performance by the Indemnified Persons of their duties under the Investment Advisory Agreement, or the reckless disregard of their obligations or duties under the Investment Advisory Agreement.

Term of Agreement. The existing Investment Advisory Agreement provides that it will remain in effect until October 31, 2009. The New Investment Advisory Agreement will provide that it will remain in effect for an initial term of two years. The Investment Advisory Agreement will remain in effect from year to year thereafter if approved annually by (i) the vote of the holders of a majority of the outstanding voting securities (as defined in the 1940 Act) of the Fund, or by the Board, and also by (ii) the vote, cast in person at a meeting called for such purpose, of a majority of the Independent Trustees.

Amendment or Assignment. The Investment Advisory Agreement provides that it may not be amended without the affirmative votes (i) of a majority of the Trustees, including a majority of the Independent Trustees, voting in person at a meeting called for the purpose of voting on such approval, and, to the extent required by applicable law, (ii) of a majority of the outstanding voting securities (as defined in the 1940 Act) of the Fund. The Investment Advisory Agreement provides that it will terminate automatically in the event of an assignment (as defined in the 1940 Act).

Termination. The Investment Advisory Agreement may be terminated, without penalty, at any time by either party to the Agreement upon sixty days prior written notice to the other party; provided that in the case of termination by the Fund, the termination has been authorized (i) by the Board, or (ii) by a vote of a majority of the outstanding voting securities (as defined in the 1940 Act) of the Fund.

Differences between the Existing and New Investment Advisory Agreement

The only terms of the New Investment Advisory Agreement that will be different from the terms of the existing Investment Advisory Agreement are the dates of execution and termination, as well as the entity providing the services.

THE BOARD UNANIMOUSLY RECOMMENDS THAT SHAREHOLDERS OF THE FUND VOTE FOR PROPOSAL 1.

PROPOSAL 2: APPROVAL OF A NEW SUB-ADVISORY AGREEMENT BETWEEN NEW NB MANAGEMENT AND LBAM

Shareholders of the Fund are being asked to approve a New Sub-Advisory Agreement with respect to the Fund between New NB Management and LBAM. As described above, the existing Sub-Advisory Agreement will automatically terminate upon consummation of the Proposed Acquisition. Therefore, approval of the New Sub-Advisory Agreement is sought so that the management of the Fund can continue without interruption following the Proposed Acquisition. If the Proposed Acquisition is not completed for any reason, the existing Sub-Advisory Agreement will continue in effect. LBAM currently provides services to the Fund pursuant to a Sub-Advisory Agreement dated July 24, 2003 and an Assignment and Assumption Agreement, dated February 28, 2007. Shareholders of the Fund are solely being asked to approve a New Sub-Advisory Agreement and not a new Assignment and Assumption Agreement. A discussion of the Boards approval and recommendations and the terms of the existing and new sub-advisory agreement in connection with Proposal 2 is set out below.

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Board Approvals and Recommendations in Connection with Proposal 2

The Trustees who were all present in person at a meeting held on December 17, 2008, including the Independent Trustees, unanimously approved the New Sub-Advisory Agreement for the Fund and unanimously recommended that shareholders approve the New Sub-Advisory Agreement for the Fund. A summary of the Boards considerations is provided below in the section entitled Evaluation by the Board.

Terms of the Existing and New Sub-Advisory Agreement in Connection with Proposal 2

The form of the New Sub-Advisory Agreement is attached as Exhibit E to this Proxy Statement and the description of terms in this section is qualified in its entirety by reference to Exhibit E. The date of the existing Sub-Advisory Agreement is July 24, 2003 and it was last approved by the Board on September 25, 2008. It was last submitted to a vote of shareholders of the Fund on [ ]. Shareholder approval was obtained prior to the commencement of operations for the Fund by LBAM or its affiliate as sole shareholder.

The terms of the New Sub-Advisory Agreement are identical to those of the existing Sub-Advisory Agreement, except for the dates of execution and termination. The Fund does not pay any fees under either Sub-Advisory Agreement. All payments to LBAM pursuant to the Sub-Advisory Agreement with respect to the Fund are made by NB Management. However, the bases for fees to be paid by NB Management under the New Sub-Advisory Agreement are identical to the bases for fees under the existing Sub-Advisory Agreement. NB Management and LBAM have advised the Board that they do not anticipate that the Proposed Acquisition will result in any reduction in the quality of sub-advisory services now provided to the Fund or have any adverse effect on the

ability of LBAM to fulfill its obligations under the New Sub-Advisory Agreement.

The following discussion applies to both the existing Sub-Advisory Agreement and the New Sub-Advisory Agreement for the Fund. Accordingly, all references in this section to the Sub-Advisory Agreement equally apply to the New Sub-Advisory Agreement.

Sub-Advisory Services. NB Management, with respect to the Fund, retains LBAM as sub-adviser to the Fund to provide day-to-day portfolio management services pursuant to the Sub-Advisory Agreement. The Sub-Advisory Agreement provides that LBAM will (a) manage the Fund's investment portfolio and make and implement all decisions regarding the investment and reinvestment of the assets of the Fund, (b) provide statistical, research and other factual data for use in connection with the Fund's investment program, (c) place all orders for the purchase and sale of investments by the Fund and monitor the execution of transactions for the Fund and the settlement and clearance of such transactions, (d) maintain such internal systems and controls as may be necessary to provide reasonable assurance that the investment advisory services of LBAM provided to the Fund are provided in a manner consistent with the investment objectives, policies and restrictions of the Fund and with the requirements of applicable laws and regulations, (e) provide or maintain such facilities as may be necessary in rendering its services, (f) report to NB Management and the Board on the Fund's investments and performance, and (g) provide all other services that NB Management may reasonably deem necessary or convenient to the services provided under the Sub-Advisory Agreement. Nothing in the Sub-Advisory Agreement prevents LBAM from acting as investment adviser for any other person, firm, fund, corporation or other entity.

Sub-Advisory Fee. The Sub-Advisory Agreement provides that NB Management will pay a fee at the annual rate of 0.55% of the first $25 million of the Fund's average daily managed assets, 0.45% of the next $25 million, 0.35% of the next $50 million, and 0.30% of average daily managed assets in excess of $100 million. "Managed assets" means net assets, including assets attributable to outstanding preferred shares, plus the aggregate amount of any borrowings. The aggregate amount of sub-advisory fees paid by NB Management with respect to the Fund during the last fiscal year was $[   ]. LBAM also serves as sub-adviser for other registered investment companies advised by NB Management. Exhibit F to this Proxy Statement sets forth the name, asset size and the rate of compensation received by LBAM for providing sub-advisory services to these other funds.

[*Limitation of Liability.* The Sub-Advisory Agreement provides that LBAM is not liable to the Fund or NB Management for any error of judgment or mistake of law or for any loss suffered by the Fund or NB Management in connection with the performance by LBAM of its duties under this Agreement, except a loss resulting from a breach of fiduciary duty with respect to the receipt of compensation for services, or a loss resulting from willful misfeasance, bad faith or gross negligence on the part of LBAM or any of its officers, directors, employees or agents (collectively, the "Affiliates") in the performance of their duties under the Sub-Advisory Agreement, or from reckless disregard by LBAM or its Affiliates of their obligations or duties under the Sub-Advisory Agreement.**]**

[*Indemnification.* The Sub-Advisory Agreement provides that the Fund will indemnify and hold harmless LBAM and its Affiliates (each, an "LBAM Indemnified Person") against any and all losses, claims, damages or liabilities, joint or several, including, without limitation, reasonable attorneys' fees and disbursements, reasonably incurred by them in connection with, or resulting from, their actions or inactions in connection with the performance of their duties under the Sub-Advisory Agreement, except those losses, claims, damages or liabilities resulting from willful misfeasance, bad faith or gross negligence in the performance by the LBAM Indemnified Persons of their duties under the Sub-Advisory Agreement, or the reckless disregard of their obligations or duties under the Sub-Advisory Agreement.**]**

Term of Agreement. The existing Sub-Advisory Agreement provides that it will remain in effect until October 31, 2009. The New Sub-Advisory Agreement will provide that it will remain in effect for an initial term of two years. The Sub-Advisory Agreement will remain in effect from year to year thereafter if approved annually by (i) the vote of the holders of a majority of the outstanding voting securities (as defined in the 1940 Act) of the Fund, or by the Board, and also by (ii) the vote, cast in person at a meeting called for such purpose, of a majority of the Independent Trustees.

Termination. The Sub-Advisory Agreement may be terminated, without penalty, at any time by the Fund, NB Management or LBAM upon sixty days' prior written notice to the other parties; provided that in the case of termination by the Fund, the termination has been authorized (i) by the Board or (ii) by a vote of a majority of the

outstanding voting securities (as defined in the 1940 Act) of the Fund. Furthermore, the Sub-Advisory Agreement also terminate automatically with respect to the Fund in the event of an assignment (as defined in the 1940 Act) or if the Investment Advisory Agreement terminates with respect to the Fund.

Differences between the Existing and New Sub-Advisory Agreement

The only terms of the New Sub-Advisory Agreement that will be different from the terms of the existing Sub-Advisory Agreement are the dates of execution and termination.

THE BOARD UNANIMOUSLY RECOMMENDS THAT SHAREHOLDERS OF THE FUND VOTE FOR PROPOSAL 2.

EVALUATION BY THE BOARD

Board Meetings and Considerations of the New Agreements

The Trustees of the Fund discussed the Proposed Acquisition on December 17, 2008. Prior to the submission of the NBSH bid to public auction, NB Management met telephonically with the Independent Trustees to brief them on the Proposed Acquisition. Following the public auction wherein NBSH was determined to be the successful bidder, the Independent Trustees again met telephonically with NB Management to obtain additional information about the Proposed Acquisition. The Independent Trustees, with the assistance of independent counsel, prepared due diligence requests that were presented to NB Management and appointed a Task Force of Independent Trustees to lead the due diligence effort (the Task Force).

NB Management provided written responses to the due diligence requests. After extensive review and analysis and discussions during a telephonic and in person meeting of the Independent Trustees, the Task Force submitted clarifying questions. The Independent Trustees met as a body in person to receive the report of the Task Force and consider the New Agreements. Throughout the process, the Task Force and the Independent Trustees were advised by experienced 1940 Act counsel that is independent of NB Management and NBSH. In addition, the Independent Trustees received a memorandum from independent counsel discussing the legal standards for their consideration of the New Agreements.

Consideration of the New Agreements followed shortly on the heels of the Independent Trustees annual consideration of whether to renew the Existing Agreements, carried out pursuant to Section 15(c) of the 1940 Act. In that process, which began prior to the June 2008 quarterly meeting of the Board and was concluded at the September 2008 quarterly meeting, the Independent Trustees, following an extensive review of materials submitted by NB Management and a report from an independent data service, unanimously determined that the Existing Agreements were fair and reasonable and that their renewal would be in the best interests of the Fund and its shareholders. Accordingly, in considering the New Agreements, the Independent Trustees took into account the fact that the terms of the New Agreements would be identical to those of the Existing Agreements in every respect except for the term and termination date and potentially the name of the investment adviser. The Board considerations in connection with the New Agreements and the Existing Agreements also entered into the decision by the Board to approve the Interim Agreements, which would take effect if the shareholders of the Fund do not approve the New Agreements before the Proposed Acquisition is completed. The Independent Trustees consideration of the Existing Agreements is described below.

In evaluating the proposed New Agreements, the Independent Trustees considered that they have generally been satisfied with the nature and quality of the services provided to the Fund by NB Management and LBAM, including investment advisory, administrative and support services, and that the Fund would be best served by an arrangement that appeared likely to maintain the continuity and stability of the providers of these services. Accordingly, the Independent Trustees considered very carefully the intentions of NBSH (including its successor or assign) regarding capitalization, management structure, staffing, compensation and staff retention and whether these seemed designed to provide the desired continuity and stability. They inquired specifically about staffing and resources in the areas of portfolio management, investment research, trading, fund accounting, legal and compliance, internal audit, and senior executive staff. Although at the time the Board considered the New Agreements no final decisions had been reached as to the distribution of equity interests in NBSH (or its successor or assign), the Trustees were advised that senior members of management, including the Trustee who

is employed by the Advisers, would receive equity interests in NBSH. Because of these interests, as well as any future employment arrangements with the Advisers, these persons, individually or in the aggregate, could have a material interest in the Proposed Acquisition and in shareholder approval of the New Agreements. In considering the New Agreements, the Trustees were aware of these interests.

The Independent Trustees inquired whether NBSH (or its successor or assign) had specific plans for the future structure of the Fund, whether they plan to propose to eliminate the Fund, and whether they intend to continue or alter certain expansion plans that are already underway. They also inquired whether there are plans to change the fees or expense structure of the Fund.

The Independent Trustees inquired about the long-term plans for the Advisers, including any expectations for cost savings or expense reductions. They also inquired about the capital structure and working capital likely to be available to NBSH (or its successor or assign).

The Independent Trustees considered the following factors, in addition to the factors discussed above, among others, in connection with their consideration of the New Agreements: (1) the nature, extent, and quality of the services provided by NB Management and LBAM; (2) the performance of the Fund compared to a relevant market index and a peer group of investment companies; (3) the costs of the services provided and profits or losses realized by NB Management, LBAM and their affiliates from their relationship with the Fund; (4) the extent to which economies of scale might be realized as the Fund grows; and (5) whether fee levels reflect any such potential economies of scale for the benefit of investors in the Fund. In their deliberations, the Independent Trustees did not identify any particular information that was all-important or controlling, and each Trustee may have attributed different weights to the various factors.

In unanimously approving and recommending the New Agreements, the Independent Trustees concluded that the terms of each New Agreement are fair and reasonable and that approval of the New Agreements is in the best interests of the Fund and its shareholders. In reaching this determination, the Independent Trustees considered the following factors, among others:

(1) that the terms of the New Agreements are identical in all material respects to those of the Existing Agreements;

(2) that the Advisers will maintain operational autonomy and continuity of management following the Proposed Acquisition;

(3) the favorable history, reputation, qualification, and background of NB Management and LBAM, as well as the qualifications of each entity's personnel and each entity's respective financial condition;

(4) the commitment of NBSH (or its successor or assign) to retain key personnel currently employed by NB Management and LBAM who currently provide services to the Fund;

(5) the commitment of NBSH (or its successor or assign) to maintaining the current level and quality of Fund services;

(6) the proposed division of equity in NBSH (or its successor or assign) among Management Members and other personnel upon consummation of the Proposed Acquisition;

(7) the fees and expense ratio of the Fund relative to comparable mutual funds;

(8) that the fees are identical to those paid under the Existing Agreements;

(9) that the fees and expense ratio of the Fund appear to the Board to be reasonable given the quality of services expected to be provided;

(10) the performance of the Fund relative to comparable mutual funds and unmanaged indices;

(11) the commitment of NB Management (or its successor) to pay the expenses of the Fund in connection with the Proposed Acquisition, including all expenses in connection with the solicitation of proxies with respect to the Proposed Acquisition, so that shareholders of the Fund would not have to bear such expenses;

(12) the actual and potential effects on the Advisers of the bankruptcy of LBHI, and the effects of the LBHI bankruptcy on the information considered by the Independent Trustees in their prior analyses of the principal service contracts;

(13) the provisions made to continue providing to the Advisers certain services that were previously provided to them by or through LBHI or its other affiliates;

(14) the possible benefits that may be realized by the Fund and by the Advisers as a result of the Proposed Acquisition; and

(15) that the Proposed Acquisition is expected to maintain continuity of management of the Fund and may reduce the potential for future vulnerability to changes in control of the Advisers that could be adverse to the Fund's interests and that could affect the retention of key employees providing services to the Fund.

Board Consideration of the Existing Agreements

As noted above, the Board had recently considered the continuance of the Existing Agreements for the Fund and the factors considered by the Board are discussed below. The Trustees, including the Independent Trustees, unanimously approved the continuance of those Existing Agreements for the Fund at a meeting held on September 25, 2008.

In evaluating the Existing Agreements, the Board, including the Independent Trustees, reviewed materials furnished by NB Management and LBAM in response to questions submitted by counsel to the Independent Trustees, and met with senior representatives of NB Management and LBAM regarding their personnel and operations. The Independent Trustees were advised by counsel that is experienced in 1940 Act matters and that is independent of NB Management and LBAM. The Independent Trustees received a memorandum from independent counsel discussing the legal standards for their consideration of the proposed continuance of the Existing Agreements. They met with such counsel separately from representatives of NB Management to discuss the annual contract review. The annual contract review extends over two regular meetings of the Board to ensure that NB Management and LBAM have time to respond to any questions the Independent Trustees may have on their initial review of the report and that the Independent Trustees have time to consider those responses. In addition, during this process, the Board held a separate meeting devoted primarily to reviewing and discussing Fund performance.

The Board considered the following factors, among others, in connection with its approval of the continuance of the Existing Agreements: (1) the nature, extent, and quality of the services provided by NB Management and LBAM; (2) the performance of the Fund compared to relevant market indices and a peer group of investment companies; (3) the costs of the services provided and profits or losses realized by NB Management and LBAM and their affiliates from their relationship with the Fund; (4) the extent to which economies of scale might be realized as the Fund grows; and (5) whether fee levels reflect any such potential economies of scale for the benefit of investors in the Fund. In their deliberations, the Board members did not identify any particular information that was all-important or controlling, and each Trustee may have attributed different weights to the various factors.

The Board considered the continued integrity of NB Management and LBAM as organizations, despite the bankruptcy filing by LBHI. The Board discussed the efforts made by NB Management and LBAM to retain employees, and the reported likelihood that such employees would be retained. The Board discussed the provisions that were being made for ancillary services by NB Management, LBAM and their affiliates.

The Board evaluated the terms of the Existing Agreements, the overall fairness of the Existing Agreements to the Fund and whether the Existing Agreements were in the best interests of the Fund and its shareholders.

With respect to the nature, extent and quality of the services provided, the Board considered the performance of the Fund and the experience and staffing of the portfolio management and investment research personnel who perform services for the Fund. The Board noted that NB Management also provides certain administrative services, including fund accounting and compliance oversight. In addition, the Board noted the positive compliance history of NB Management and LBAM as each firm has been free of significant compliance problems.

The Board considered the performance of the Fund on both a market return and net asset value basis relative to its benchmark and a peer group of investment companies pursuing broadly similar strategies. The Board also considered performance in relation to the degree of risk undertaken by the portfolio managers. The Board discussed with NB Management the Fund's performance and the steps that NB Management had taken, or intended to take, to improve the Fund's performance. The Board also considered NB Management's resources and responsiveness with respect to the Fund.

With respect to the overall fairness of the Existing Agreements, the Board considered the fee structure for the Fund under the Existing Agreements as compared to a peer group of comparable funds and fall-out benefits likely to accrue to the Advisers or their affiliates from their relationship with the Fund. The Board also considered the profitability of NB Management, LBAM and their affiliates from their association with the Fund.

The Board reviewed a comparison of the Fund's management fee and overall expense ratio to a peer group of broadly comparable funds. The Board considered the mean and median of the management fees and expense ratios of the peer group.

The Board considered whether there were other funds that were advised or sub-advised by NB Management or its affiliates or separate accounts managed by NB Management or LBAM or their affiliates with similar investment objectives, policies and strategies as the Fund. The Board noted that there were no comparable sub-advised funds. The Board compared the fees charged to the Fund at various asset levels to the fees charged to advised funds and a separate account, each managed in a similar style to the Fund. The Board considered the appropriateness and reasonableness of any differences between the fees charged to the Fund and the other funds and account and determined that the differences in fees were consistent with the management and other services provided.

The Board also evaluated any apparent or anticipated economies of scale in relation to the services NB Management provides to the Fund. The Board considered that the Fund is a closed-end fund that is not continuously offering shares and that, without daily inflows and outflows of capital, there are limited opportunities for significant economies of scale to be realized by NB Management in managing the Fund's assets.

In concluding that the benefits accruing to NB Management and its affiliates by virtue of their relationship to the Fund were reasonable in comparison with the costs of providing the investment advisory services and the benefits accruing to the Fund, the Board reviewed specific data as to NB Management's profit or loss on the Fund for a recent period and the trend in profit or loss over recent years. The Board also carefully examined NB Management's cost allocation methodology and in recent years had an independent consultant review the methodology. It also reviewed an analysis from an independent data service on profitability margins in the investment management industry. The Board recognized that an adviser should be entitled to earn a reasonable level of profits for services it provides to the Fund and, based on its review, concluded that NB Management's level of profitability from its relationship with the Fund was not excessive. The Board also determined that the level of profitability from the sub-advisory relationship with the Fund was not excessive.

In approving the Existing Agreements, the Board concluded that the terms of each Existing Agreement are fair and reasonable and that approval of the Existing Agreements is in the best interests of the Fund and its shareholders. In reaching this determination, the Board considered that NB Management and LBAM could be expected to provide a high level of service to the Fund; that it retained confidence in NB Management's and LBAM's capabilities to manage the Fund; that the Fund's fee structure appeared to the Board to be reasonable given the nature and quality of services provided; and that the benefits accruing to NB Management and its affiliates by virtue of their relationship to the Fund were reasonable in comparison with the benefits accruing to the Fund.

Section 15(f) of the 1940 Act

Section 15(f) of the 1940 Act permits an investment adviser of a registered investment company (or any affiliated persons of the investment adviser) to receive any amount or benefit in connection with a sale of securities or other interest in the investment adviser, provided that two conditions are satisfied.

First, an "unfair burden" may not be imposed on the investment company as a result of the sale, or any express or implied terms, conditions or understandings applicable to the sale. The term "unfair burden," as defined in the 1940 Act, includes any arrangement during the two-year period after the sale whereby the investment adviser (or predecessor or successor adviser), or any "interested person" of the adviser (as defined in the 1940 Act), receives or is entitled to receive any compensation, directly or indirectly, from the investment company or its security holders (other than fees for bona fide investment advisory or other services), or from any person in connection with the purchase or sale of securities or other property to, from or on behalf of the investment company (other than ordinary fees for bona fide principal underwriting services).

Second, during the three-year period after the sale, at least 75% of the members of the investment company's board of directors cannot be "interested persons" (as defined in the 1940 Act) of the investment adviser or its predecessor.

The Trustees have not been advised by LBHI or NBSH of any circumstances arising from the Proposed Acquisition that might result in the imposition of an "unfair burden" on any Fund as defined in Section 15(f) of the 1940 Act. Moreover, NBSH (on its behalf and on behalf of its successor or assign) has agreed that for two years after the consummation of the Proposed Acquisition, it will use its reasonable best efforts to refrain from imposing, or agreeing to impose, any unfair burden on the Fund, which includes refraining from proposing any increase in fees paid by the Fund to the Advisers. For at least two years following the Proposed Acquisition, no voluntary arrangements to waive fees of the Fund will be changed by New NB Management so as to increase the expenses the Fund would pay without the prior approval of the Board. At the present time, over 80% of the Trustees are classified as Independent Trustees and expect to remain so classified following the sale of the Acquired Businesses. NBSH (on its behalf and on behalf of its successor or assign) has agreed to continue to comply with the Board's current policy that requires that at least 75% of the Trustees are classified as Independent Trustees and would not seek to change it during the three-year period after the completion of the Proposed Acquisition.

Based on their evaluation of the materials presented, the Trustees who attended the December 17, 2008 Board meeting, including all the Independent Trustees, unanimously concluded that the terms of the New Agreements are reasonable, fair and in the best interests of the Fund and its shareholders. The Trustees believe that the New Agreements will enable the Fund to continue to enjoy the high quality investment management services it has received in the past, at fee rates identical to the present rates, which the Independent Trustees deem appropriate, reasonable and in the best interests of the Fund and its shareholders. The Trustees unanimously voted to approve and to recommend to the shareholders of the Fund that they approve the New Agreements.

PROPOSAL 3: ELECTION OF TRUSTEES

The Board of the Fund is divided into three classes (Class I, Class II and Class III). The terms of office of Class I, Class II and Class III Trustees will expire at the annual meeting of shareholders held in 2009, 2010 and 2011, respectively, and at each third annual meeting of shareholders thereafter. Each Trustee shall hold office until his or her successor is elected and qualified or until his or her earlier death, resignation or removal. The classification of the Fund's Trustees helps to promote the continuity and stability of the Fund's management and policies because the majority of the Trustees at any given time will have prior experience as Trustees of the Fund.

Holders of the Fund's Preferred Shares are entitled, as a class, to the exclusion of the holders of all other classes of shares of the Fund, to elect two Trustees of the Fund (regardless of the total number of Trustees serving on the Board). These Trustees are Class II and Class III Trustees up for election in 2010 and 2011. These Trustees are not nominees to be considered at the Meeting.

The term of each current Class I Trustee expires at the Meeting, but each expressed his or her willingness to serve another term as Trustee of the Fund if nominated by the Board. In addition to these incumbents, Western Investment LLC (Western) notified the Board of its intention to nominate five candidates (the Western Candidates) to serve as Class I Trustees of the Fund at the Meeting.

The Governance and Nominating Committee of the Fund reviewed the qualifications, experience and background of each Class I incumbent Trustee and considered available information about the Western Candidates. Based upon this review and consideration, the Committee determined that nominating the incumbent Class I Trustees would be in the best interests of its Funds shareholders. The Board believes that the incumbents are well suited for service on the Board due to their familiarity with the Fund as a result of their prior service as Trustees, their knowledge of the financial services sector, and their substantial experience in serving as directors or trustees, officers or advisers of public companies and business organizations, including other investment companies.

At a meeting in February 2009, the Board received the recommendations of the Governance and Nominating Committee. After discussion and consideration of, among other things, the backgrounds of the incumbents, the Board voted to nominate Faith Colish, Michael M. Knetter, Cornelius T. Ryan, Peter P. Trapp and Robert Conti for election as Class I Trustees with a term expiring in 2012. William E. Rulon has decided to retire as a Fund Director as of March 2009. The Fund has a policy that at least three quarters of all Trustees be Independent Trustees. Independent Trustees are those who are not associated with the Funds investment adviser or sub-adviser or their affiliates, or with any broker-dealer used by the Fund, the investment adviser or the sub-adviser in the past six months.

It is the intention of the persons named on the enclosed proxy card(s) to vote in favor of the election of each nominee named in this Proxy Statement. Each nominee has consented to be named in this Proxy Statement and to serve as Trustee if elected. The Board has no reason to believe that any nominee will become unavailable for election as a Trustee, but if that should occur before the Meeting, the proxies will be voted for such other nominees as the Board may recommend.

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None of the Trustees are related to any other. The following tables set forth certain information regarding each Trustee of the Fund. Unless otherwise noted, each Trustee has engaged in the principal occupation listed in the following table for five years or more. The business address of each listed person is 605 Third Avenue, New York, New York 10158.

INFORMATION REGARDING NOMINEES FOR ELECTION

Name, (Year of June 30, 2018	June 30, 2017					
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
	(dollars in thousands)					
Assets:						
Interest-earning assets:						
Interest-earning deposits and short-term investments	$ 115,724	$ 280	0.97 %	$ 114,019	$ 211	0.74 %
Securities (1)	1,119,354	6,663	2.39	786,964	4,060	2.07

Loans receivable, net [2]						
Commercial	3,109,313	38,805	5.01	1,850,737	22,057	4.78
Residential	1,951,075	19,642	4.04	1,718,413	17,304	4.04
Home Equity	369,054	4,564	4.96	283,124	3,225	4.57
Other	7,604	124	6.54	1,161	22	7.60
Allowance for loan loss net of deferred loan fees	(11,076)	—	—	(12,518)	—	—
Loans Receivable, net	5,425,970	63,135	4.67	3,840,917	42,608	4.45
Total interest-earning assets	6,661,048	70,078	4.22	4,741,900	46,879	3.97
Non-interest-earning assets	871,920			473,736		
Total assets	$ 7,532,968			$ 5,215,636		
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
Interest-bearing checking	$ 2,372,777	2,028	0.34 %	$ 1,716,930	1,038	0.24 %
Money market	597,770	694	0.47	422,439	281	0.27
Savings	907,570	267	0.12	679,806	97	0.06
Time deposits	902,091	2,258	1.00	624,020	1,498	0.96
Total	4,780,208	5,247	0.44	3,443,195	2,914	0.34
FHLB Advances	376,527	1,900	2.02	259,291	1,118	1.73
Securities sold under agreements to repurchase	64,446	44	0.27	73,574	25	0.14
Other borrowings	99,383	1,440	5.81	56,456	648	4.60
Total interest-bearing liabilities	5,320,564	8,631	0.65	3,832,516	4,705	0.49
Non-interest-bearing deposits	1,149,764			772,739		

Non-interest-bearing liabilities	51,262			23,260		
Total liabilities	6,521,590			4,628,515		
Stockholders’ equity	1,011,378			587,121		
Total liabilities and equity	$ 7,532,968			$ 5,215,636		
Net interest income		$ 61,447			$ 42,174	
Net interest rate spread (3)			3.57 %			3.48 %
Net interest margin (4)			3.70 %			3.57 %
Total cost of deposits (including non-interest-bearing deposits)			0.35 %			0.28 %

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	For the Six Months Ended					
	June 30, 2018			June 30, 2017		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
	(dollars in thousands)					
Assets:						
Interest-earning assets:						
Interest-earning deposits and short-term investments	$108,023	$488	0.91 %	$163,815	$620	0.76 %
Securities [1]	1,088,237	12,694	2.35	745,568	7,923	2.14
Loans receivable, net [2]						
Commercial	2,942,062	72,195	4.95	1,840,745	43,197	4.73
Residential	1,897,736	38,679	4.11	1,711,263	34,643	4.08
Home Equity	355,641	8,707	4.94	285,208	6,470	4.57
Other	4,547	151	6.70	1,215	40	6.64
Allowance for loan loss net of deferred loan fees	(10,683)	—	—	(12,322)	—	—
Loans Receivable, net	5,189,303	119,732	4.65	3,826,109	84,350	4.45
Total interest-earning assets	6,385,563	132,914	4.20	4,735,492	92,893	3.96
Non-interest-earning assets	804,174			477,874		
Total assets	$7,189,737			$5,213,366		
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
Interest-bearing checking	$2,318,751	3,786	0.33 %	$1,692,820	1,913	0.23 %
Money market	562,050	1,244	0.45	433,750	591	0.27
Savings	866,535	462	0.11	677,278	227	0.07
Time deposits	861,687	4,219	0.99	632,099	2,964	0.95
Total	4,609,023	9,711	0.42	3,435,947	5,695	0.33
FHLB Advances	349,474	3,413	1.97	254,840	2,186	1.73
Securities sold under agreements to repurchase	71,649	84	0.24	74,955	52	0.14
Other borrowings	89,796	2,549	5.72	56,424	1,303	4.66
Total interest-bearing liabilities	5,119,942	15,757	0.62	3,822,166	9,236	0.49
Non-interest-bearing deposits	1,077,218			781,888		
Non-interest-bearing liabilities	53,140			26,312		
Total liabilities	6,250,300			4,630,366		
Stockholders equity	939,437			583,000		
Total liabilities and equity	$7,189,737			$5,213,366		
Net interest income		$117,157			$83,657	
Net interest rate spread [3]			3.58 %			3.47 %
Net interest margin [4]			3.70 %			3.56 %
Total cost of deposits (including non-interest-bearing deposits)			0.34 %			0.27 %

(1) Amounts represent debt and equity securities, including FHLB and Federal Reserve Bank stock, and 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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Comparison of Financial Condition at June 30, 2018 and December 31, 2017

Total assets increased by $2.321 billion, to $7.737 billion at June 30, 2018, from $5.416 billion at December 31, 2017, primarily as a result of the acquisition of Sun, which added $2.043 billion to total assets. Restricted equity investments increased by $47.3 million, to $67.0 million at June 30, 2018, from $19.7 million at December 31, 2017, primarily due to the addition of Federal Reserve Bank stock as a result of converting to a national bank charter. Loans receivable, net, increased by $1.587 billion, to $5.553 billion at June 30, 2018 from $3.966 billion at December 31, 2017, primarily due to acquired loans of $1.517 billion, as well as purchased loans totaling $121.7 million. As part of the acquisition of Sun, the Company's goodwill balance increased to $339.0 million at June 30, 2018, from $150.5 million at December 31, 2017, and the core deposit intangible increased to $18.9 million, from $8.9 million at December 31, 2017.

Deposits increased by $1.477 billion, to $5.819 billion at June 30, 2018, from $4.343 billion at December 31, 2017, due to acquired deposits of $1.616 billion. The loan-to-deposit ratio at June 30, 2018 was 95.4%, as compared to 91.3% at December 31, 2017. Federal Home Loan Bank Advances increased by $385.5 million, to $674.2 million at June 30, 2018, from $288.7 million at December 31, 2017 due to the acquisition of Sun, loan growth, and seasonal deposit outflows.

Stockholders' equity increased to $1.013 billion at June 30, 2018, as compared to $601.9 million at December 31, 2017. The acquisition of Sun added $402.6 million to stockholders' equity. At June 30, 2018, there were 1.8 million shares available for repurchase under the Company's stock repurchase programs. For the six months ended June 30, 2018, the Company did not repurchase any shares under these repurchase programs. During the second quarter of 2018, the Company contributed an additional $8.4 million to the existing Employee Stock Ownership Plan. The purchased shares will be allocated to employees over the next nine years. Tangible stockholders' equity per common share decreased to $13.56 at June 30, 2018, as compared to $13.58 at December 31, 2017.

Comparison of Operating Results for the Three and Six Months Ended June 30, 2018 and June 30, 2017

General

On January 31, 2018, the Company completed its acquisition of Sun and its results of operations from February 1, 2018 through June 30, 2018 are included in the consolidated results for the three and six months ended June 30, 2018, but are not included in the results of operations for the corresponding prior year periods.

Net income for the three months ended June 30, 2018, was $15.7 million, or $0.32 per diluted share, as compared to $7.7 million, or $0.23 per diluted share, for the corresponding prior year period. Net income for the six months ended June 30, 2018, was $21.1 million, or $0.45 per diluted share, as compared to $19.7 million and $0.59 per diluted share for the corresponding prior year period. Net income for the three and six months ended June 30, 2018, included merger related and branch consolidation expenses, which decreased net income, net of tax benefit, by $6.7 million and $21.3 million, respectively. Net income for the three and six months ended June 30, 2017 included merger related and branch consolidation expenses, which decreased net income, net of tax benefit, by $5.6 million and $6.6 million, respectively. Excluding these items, net income for the three and six months ended June 30, 2018 increased over the same prior year period, primarily due to the acquisition of Sun and the expense savings from the successful integration during 2017 of Ocean Shore, which was acquired on November 30, 2016.

Interest Income

Interest income for the three and six months ended June 30, 2018 increased to $70.1 million and $132.9 million, respectively, as compared to $46.9 million and $92.9 million, respectively, in the corresponding prior year periods. Average interest-earning assets increased by $1.919 billion and $1.650 billion for the three and six months ended June 30, 2018, respectively, as compared to the same prior year periods. The averages for the three and six months ended June 30, 2018, were favorably impacted by $1.727 billion and $1.452 billion, respectively, of interest-earning assets acquired from Sun. Average loans receivable, net, increased by $1.585 billion and $1.363 billion for the three

and six months ended June 30, 2018, respectively, as compared to the same prior year periods. The increases attributable to the acquisition of Sun were $1.461 billion and $1.226 billion, respectively. For the three and six months ended June 30, 2018, the yield on average interest-earning assets increased to 4.22% and 4.20%, respectively, from 3.97% and 3.96% in the corresponding prior periods. The yields on average interest-earning assets benefited from the accretion of purchase accounting adjustments on the Sun acquisition and to a lesser extent the impact of Federal Reserve rate increases.

Interest Expense

Interest expense for the three and six months ended June 30, 2018 was $8.6 million and $15.8 million, respectively, as compared to $4.7 million and $9.2 million, respectively, in the corresponding prior year periods. Average interest-bearing liabilities increased $1.488 billion and $1.298 billion for the three and six months ended June 30, 2018, respectively, as compared to the same prior year periods. For the three and six months ended June 30, 2018, the cost of average interest-bearing liabilities increased to 0.65% and 0.62%, respectively, from 0.49% in both corresponding prior year periods. The total cost of deposits (including non-interest

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bearing deposits) was 0.35% and 0.34% for the three and six months ended June 30, 2018, respectively, as compared to 0.28% and 0.27%, respectively, in the same prior year periods.

Net Interest Income

Net interest income for the three and six months ended June 30, 2018, increased to $61.4 million and $117.2 million, respectively, as compared to $42.2 million and $83.7 million, respectively, for the same prior year periods, reflecting an increase in interest-earning assets and a higher net interest margin. The net interest margin for both the three and six months ended June 30, 2018 increased to 3.70%, from 3.57% and 3.56%, respectively, for the same prior year periods. The net interest margin benefited from the accretion of purchase accounting adjustments on the Sun acquisition of $3.0 million and $5.3 million for the three and six months ended June 30, 2018, respectively.

Provision for Loan Losses

For the three and six months ended June 30, 2018, the provision for loan losses was $706,000 and $2.1 million, respectively, as compared to $1.2 million and $1.9 million, respectively, for the corresponding prior year periods. Net loan charge-offs were $832,000 and $1.1 million for the three and six months ended June 30, 2018, respectively, as compared to net loan charge-offs of $759,000 and $491,000, respectively, in the corresponding prior year periods. Net charge-offs for the three months ended June 30, 2018, included $946,000 of specific reserves on non-performing loans established in the prior quarter, which were separately identified in the allowance for loan losses. Non-performing loans totaled $18.1 million at June 30, 2018, as compared to $16.3 million at June 30, 2017.

Other Income

For the three and six months ended June 30, 2018, other income increased to $8.9 million and $17.8 million, respectively, as compared to $7.0 million and $13.0 million, respectively, for the corresponding prior year periods. The increases were primarily due to the impact of the Sun acquisition, which added $2.3 million and $3.7 million to other income for the three and six months ended June 30, 2018, respectively, as compared to the same prior year periods. Excluding the Sun acquisition, the decrease in other income for the three months ended June 30, 2018, was primarily due to an increase in the loss from real estate operations of $1.1 million, of which $500,000 related to a write-down attributable to the operations of a hotel, golf, and banquet facility, partially offset by increases in fees and service charges of $428,000 and in the gain on investment securities of $182,000. Excluding the Sun acquisition, the increase in other income for the six months ended June 30, 2018, was primarily due to increases in fees and service charges of $627,000, the gain on sales of loans of $566,000, mostly related to the sale of one non-performing commercial loan relationship during the first quarter of 2018, and rental income of $483,000 received primarily for January and February 2018 on the Company’s recently acquired executive office building, partially offset by the increase in the loss from real estate operations of $765,000, including the $500,000 write-down noted above.

Operating Expenses

Operating expenses increased to $50.9 million and $107.7 million for the three and six months ended June 30, 2018, respectively, as compared to $37.1 million and $68.1 million, respectively, in the same prior year periods. Operating expenses for the three and six months ended June 30, 2018, included $8.4 million and $26.7 million, respectively, of merger related and branch consolidation expenses, as compared to $8.6 million and $10.1 million, respectively, in the same prior year periods. Excluding the impact of merger and branch consolidation expenses, the increase in operating expenses over the prior year was primarily due to the Sun acquisition, which added $11.0 million and $19.2 million for the three and six months ended June 30, 2018, respectively. Excluding the Sun acquisition, the remaining increase in operating expenses for the three months ended June 30, 2018 over the prior year period was primarily due to increases in compensation and employee benefits expense of $1.7 million as a result of higher incentive and stock plan expenses, including $220,000 of accelerated stock compensation expense due to director retirements, service bureau expense of $700,000, and occupancy expense of $327,000. Excluding the Sun acquisition, the remaining increase in operating expenses for the six months ended June 30, 2018 over the prior year period was primarily due to increases in compensation and employee benefits expense of $2.3 million as a result of higher incentive and stock plan expenses, service bureau expense of $882,000 and occupancy expense of $786,000.

Provision for Income Taxes

The provision for income taxes was $3.0 million and $4.0 million for the three and six months ended June 30, 2018, respectively, as compared to $3.2 million and $7.0 million, respectively, for the same prior year periods. The effective tax rate was 16.1% and 16.0% for the three and six months ended June 30, 2018, respectively, as compared to 29.2% and 26.1%, respectively, for the same prior year periods. The lower effective tax rate for the three and six months ended June 30, 2018 primarily resulted from the Tax Cuts and Jobs Act ("Tax Reform") enacted during the fourth quarter of 2017.

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Liquidity and Capital Resources

The Company’s primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, Federal Home Loan Bank (“FHLB”) advances and other borrowings and, to a lesser extent, investment maturities and proceeds from the sale of loans. While scheduled amortization of loans is a predictable source of funds, deposit flows and loan 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, 2018, the Company had $373.0 million of outstanding overnight borrowings from the FHLB, compared to $30.0 million of outstanding overnight borrowings at December 31, 2017. The Bank utilizes overnight borrowings from time-to-time to fund short-term liquidity needs. FHLB advances, including overnight borrowings totaled $674.2 million and $288.7 million, respectively, at June 30, 2018 and December 31, 2017.

The Company’s cash needs for the six months ended June 30, 2018 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from maturities and calls of investment securities, and increased borrowings. The cash was principally utilized for the purchase of loans receivable, loan originations, the purchase of securities, and to fund deposit outflows. The Company’s cash needs for the six months ended June 30, 2017 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from maturities and calls of investment securities, and increased borrowings. The cash was principally utilized for loan originations, the purchase of loans receivable and the purchase of securities.

In the normal course of business, the Company routinely enters into various off-balance-sheet commitments. At June 30, 2018, outstanding undrawn lines of credit totaled $856.8 million and outstanding commitments to originate loans totaled $239.7 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 $493.7 million at June 30, 2018. Based upon historical experience, management estimates that a significant portion of such time 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 are 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 programs, shares of OceanFirst Financial Corp. common stock may be purchased in the open market and through privately-negotiated transactions, from time-to-time, depending on market conditions. The repurchased shares are held in treasury for general corporate purposes. For the six months ended June 30, 2018 and 2017, the Company did not repurchase any shares of common stock. At June 30, 2018, there were 1,754,804 shares available to be repurchased under the stock repurchase programs authorized in July of 2014 and April of 2017.

Cash dividends on common stock declared and paid during the first six months of 2018 were $14.3 million, as compared to $9.6 million in the same prior year period. The increase in dividends was a result of the additional shares issued in the acquisition of Sun. On July 26, 2018, the Company’s Board of Directors declared a quarterly cash dividend of fifteen cents ($0.15) per common share. The dividend is payable on August 17, 2018 to stockholders of record at the close of business on August 6, 2018.

The primary sources of liquidity specifically available to OceanFirst Financial Corp., the holding company of OceanFirst Bank N.A., are capital distributions from the bank subsidiary and the issuance of preferred and common stock and debt. For the six months ended June 30, 2018, the Company received a dividend payment of $16.0 million from the Bank. 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 applicable regulations or regulatory bodies prevent the Bank from paying a dividend 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, 2018, OceanFirst Financial Corp. held $28.9 million in cash.

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As of June 30, 2018 and December 31, 2017, the Company and the Bank exceed all regulatory capital requirements currently applicable as follows (in thousands):

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action	
As of June 30, 2018	Amount	Ratio	Amount	Ratio	Amount	Ratio
Bank:						
Tier 1 capital (to average assets)	$667,378	9.35 %	$285,430	4.000%	$ 356,788	5.00 %
Common equity Tier 1 (to risk-weighted assets)	667,378	12.60	337,562	6.375 (1)	344,181	6.50
Tier 1 capital (to risk-weighted assets)	667,378	12.60	416,988	7.875 (1)	423,607	8.00
Total capital (to risk-weighted assets)	685,076	12.94	522,890	9.875 (1)	529,509	10.00
OceanFirst Financial Corp:						
Tier 1 capital (to average assets)	$676,882	9.48 %	$285,693	4.000%	N/A	N/A
Common equity Tier 1 (to risk-weighted assets)	614,901	11.61	337,561	6.375 (1)	N/A	N/A
Tier 1 capital (to risk-weighted assets)	676,882	12.78	416,987	7.875 (1)	N/A	N/A
Total capital (to risk-weighted assets)	729,580	13.78	522,888	9.875 (1)	N/A	N/A

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action	
As of December 31, 2017	Amount	Ratio	Amount	Ratio	Amount	Ratio
Bank:						
Tier 1 capital (to average assets)	$459,031	8.75 %	$209,760	4.000%	$ 262,200	5.00 %
Common equity Tier 1 (to risk-weighted assets)	459,031	12.41	212,705	5.750 (2)	240,450	6.50
Tier 1 capital (to risk-weighted assets)	459,031	12.41	268,194	7.250 (2)	295,938	8.00
Total capital (to risk-weighted assets)	475,379	12.85	342,178	9.250 (2)	369,923	10.00
OceanFirst Financial Corp:						
Tier 1 capital (to average assets)	$465,554	8.87 %	$209,943	4.000%	N/A	N/A
Common equity Tier 1 (to risk-weighted assets)	449,991	12.15	212,907	5.750 (2)	N/A	N/A
Tier 1 capital (to risk-weighted assets)	465,554	12.57	268,448	7.250 (2)	N/A	N/A
Total capital (to risk-weighted assets)	516,902	13.96	342,502	9.250 (2)	N/A	N/A

(1) Includes the Capital Conservation Buffer of 1.875%.

(2) Includes the Capital Conservation Buffer of 1.25%.

The Bank satisfies the criteria to be “well-capitalized” under the Prompt Corrective Action Regulations.

At June 30, 2018, the Company maintained tangible common equity of $654.6 million, for a tangible common equity to assets ratio of 8.87%. At December 31, 2017, the Company maintained tangible common equity of $442.6 million, for a tangible common equity to assets ratio of 8.42%.

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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 enters into loan sale agreements with investors in the normal course of business. The loan sale agreements generally require the Company to repurchase loans previously sold in the event of a violation of various representations and warranties customary to the mortgage banking industry. The Company is also obligated under a loss sharing arrangement with the FHLB relating to loans sold into the Mortgage Partnership Finance program. In the opinion of management, the potential exposure related to the loan sale agreements and loans sold to the FHLB is adequately provided for in the reserve for repurchased loans and loss sharing obligations included in other liabilities. At June 30, 2018 and December 31, 2017, the reserve for repurchased loans and loss sharing obligations amounted to $1.5 million and $463,000, respectively.

The following table shows the contractual obligations of the Company by expected payment period as of June 30, 2018 (in thousands):

Contractual Obligations	Total	Less than one year	1-3 years	3-5 years	More than 5 years
Debt Obligations	$835,831	$514,791	$167,158	$54,989	$ 98,893
Commitments to Fund Undrawn Lines of Credit					
Commercial	522,904	522,904	—	—	—
Consumer/Construction	333,943	333,943	—	—	—
Commitments to Originate Loans	239,677	239,677	—	—	—

Debt obligations include advances from the FHLB and other borrowings and have defined terms.

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.

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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.

	June 30, 2018	December 31, 2017
	(dollars in thousands)	
Non-performing loans:		
Commercial and industrial	$1,947	$503
Commercial real estate – owner occupied	522	5,962
Commercial real estate – investor	6,364	8,281
Residential mortgage	6,858	4,190
Home equity loans and lines	2,415	1,929
Total non-performing loans	18,106	20,865
Other real estate owned	7,854	8,186
Total non-performing assets	$25,960	$29,051
Purchased credit impaired loans ("PCI")	$12,995	$1,712
Delinquent loans 30-89 days	$36,010	$20,796
Allowance for loan losses as a percent of total loans receivable	0.30 %	0.40 %
Allowance for loan losses as a percent of total non-performing loans	92.18	75.35
Non-performing loans as a percent of total loans receivable	0.33	0.52
Non-performing assets as a percent of total assets	0.34	0.54

The Company's non-performing loans totaled $18.1 million at June 30, 2018, as compared to $20.9 million at December 31, 2017. Included in the non-performing loans total was $4.2 million and $8.8 million of troubled debt restructured ("TDR") loans at June 30, 2018 and December 31, 2017, respectively. The decrease in non-performing loans was primarily due to the sale of one commercial loan relationship. Non-performing loans do not include $13.0 million of acquired PCI loans. At June 30, 2018, the allowance for loan losses totaled $16.7 million, or 0.30% of total loans, as compared to $15.7 million, or 0.40% of total loans at December 31, 2017. These ratios exclude existing fair value credit marks on acquired loans of $37.7 million and $17.5 million at June 30, 2018 and December 31, 2017, respectively. These loans were acquired at fair value with no related allowances for loan losses. Other real estate owned includes $6.0 million relating to the hotel, golf and banquet facility located in New Jersey which the Company acquired in the fourth quarter of 2015.

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

	June 30, 2018	December 31, 2017
Special Mention	$33,644	$ 25,489
Substandard	51,700	60,661

Critical Accounting Policies

Note 1 to the Company's Audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 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 estimated fair value. Policies with respect to the methodology used to determine the allowance for loan losses and judgments regarding securities 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.

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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 Litigation 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,” “opport “potential,” or 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 and the Company’s ability to successfully integrate acquired operations. These risks and uncertainties are further discussed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 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 2017 Form 10-K, as amended by its subsequent SEC filings.

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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, 2018, 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, 2018, the Company's one-year gap was positive 5.27% as compared to positive 4.62% at December 31, 2017. These results were within the approved policy guidelines.

At June 30, 2018	3 Months or Less	More than 3 Months to 1 Year	More than 1 Year to 3 Years	More than 3 Years to 5 Years	More than 5 Years	Total
(dollars in thousands)						
Interest-earning assets: (1)						
Interest-earning deposits and short-term investments	$193,115	$481	$2,223	$2,941	$—	$198,760
Debt investment securities	59,078	43,228	120,123	44,697	55,095	322,221
Debt mortgage-backed securities	72,705	75,487	192,381	141,289	225,939	707,801
Equity investments	—	—	—	—	9,539	9,539
Restricted equity investments	—	—	—	—	66,981	66,981
Loans receivable (2)	1,211,487	862,098	1,536,356	891,028	1,062,166	5,563,135
Total interest-earning assets	1,536,385	981,294	1,851,083	1,079,955	1,419,720	6,868,437
Interest-bearing liabilities:						
Interest-bearing checking accounts	739,484	127,438	286,209	224,081	888,759	2,265,971
Money market deposit accounts	41,163	38,454	89,520	73,319	331,813	574,269
Savings accounts	47,737	79,875	168,357	131,862	475,946	903,777
Time deposits	146,000	348,275	256,166	125,420	3,548	879,409
FHLB advances	388,000	64,577	166,987	54,663	—	674,227
Securities sold under agreements to repurchase and other borrowings	62,176	72,538	171	326	26,393	161,604
Total interest-bearing liabilities	1,424,560	731,157	967,410	609,671	1,726,459	5,459,257
Interest sensitivity gap (3)	$111,825	$250,137	$883,673	$470,284	$(306,739)	$1,409,180
Cumulative interest sensitivity gap	$111,825	$361,962	$1,245,635	$1,715,919	$1,409,180	$1,409,180
Cumulative interest sensitivity gap as a percent of total interest-earning assets	1.63 %	5.27 %	18.14 %	24.98 %	20.52 %	20.52 %

(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.

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Additionally, the table below sets forth the Company's exposure to IRR as measured by the change in economic value of equity ("EVE") and net interest income under varying rate shocks as of June 30, 2018 and December 31, 2017. 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 2017 Form 10-K.

	June 30, 2018					December 31, 2017				
Change in Interest Rates in Basis Points (Rate Shock)	Economic Value of Equity			Net Interest Income		Economic Value of Equity			Net Interest Income	
	Amount	% Change	EVE Ratio	Amount	% Change	Amount	% Change	EVE Ratio	Amount	% Change
(dollars in thousands)										
300	$1,339,300	3.4 %	19.1%	$270,271	3.9 %	$844,117	5.0 %	16.8%	$169,653	(2.3)%
200	1,352,763	4.5	18.7	267,810	2.9	850,511	5.8	16.5	171,758	(1.1)
100	1,338,576	3.4	18.0	264,482	1.6	838,066	4.3	15.9	173,119	(0.3)
Static	1,294,693	—	17.0	260,225	—	803,722	—	14.9	173,590	—
(100)	1,230,220	(5.0)	15.8	255,601	(1.8)	737,232	(8.3)	13.3	170,383	(1.8)

The change in interest rate sensitivity at June 30, 2018, as compared to December 31, 2017, is primarily due to the full integration of Sun into the Bank's operations.

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, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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OceanFirst Financial Corp.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except per share amounts)

	June 30, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and due from banks	$254,469	$109,613
Debt securities available-for-sale, at estimated fair value	100,369	81,581
Debt securities held-to-maturity, net (estimated fair value of $906,989 at June 30, 2018 and $761,660 at December 31, 2017)	922,756	764,062
Equity investments, at estimated fair value	9,539	8,700
Restricted equity investments, at cost	66,981	19,724
Loans receivable, net	5,553,035	3,965,773
Loans held-for-sale	919	241
Interest and dividends receivable	19,669	14,254
Other real estate owned	7,854	8,186
Premises and equipment, net	113,782	101,776
Bank Owned Life Insurance	219,853	134,847
Deferred tax asset	59,283	1,922
Assets held for sale	10,269	4,046
Other assets	40,204	41,895
Core deposit intangible	18,949	8,885
Goodwill	338,972	150,501
Total assets	$7,736,903	$5,416,006
Liabilities and Stockholders’ Equity		
Deposits	$5,819,406	$4,342,798
Federal Home Loan Bank advances	674,227	288,691
Securities sold under agreements to repurchase with retail customers	62,176	79,668
Other borrowings	99,428	56,519
Advances by borrowers for taxes and insurance	17,773	11,156
Other liabilities	51,325	35,233
Total liabilities	6,724,335	4,814,065
Stockholders’ equity:		
Preferred stock, $.01 par value, $1,000 liquidation preference, 5,000,000 shares authorized, no shares issued	—	—
Common stock, $.01 par value, 150,000,000 shares authorized, 48,283,500 shares issued and 48,283,500 and 32,596,893 shares outstanding at June 30, 2018 and December 31, 2017, respectively	482	336
Additional paid-in capital	752,223	354,377
Retained earnings	273,749	271,023
Accumulated other comprehensive loss	(3,654)	(5,349)
Less: Unallocated common stock held by Employee Stock Ownership Plan	(10,232)	(2,479)
Treasury stock, 0 and 969,879 shares at June 30, 2018 and December 31, 2017, respectively	—	(15,967)
Common stock acquired by Deferred Compensation Plan	(84)	(84)
Deferred Compensation Plan Liability	84	84
Total stockholders’ equity	1,012,568	601,941

Total liabilities and stockholders’ equity	$7,736,903	$5,416,006

See accompanying Notes to Unaudited Consolidated Financial Statements.

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OceanFirst Financial Corp.
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited)		(Unaudited)	
Interest income:				
Loans	$63,135	$42,608	$119,732	$84,350
Mortgage-backed securities	4,297	2,791	7,982	5,451
Debt securities, equity investments and other	2,646	1,480	5,200	3,092
Total interest income	70,078	46,879	132,914	92,893
Interest expense:				
Deposits	5,247	2,914	9,711	5,695
Borrowed funds	3,384	1,791	6,046	3,541
Total interest expense	8,631	4,705	15,757	9,236
Net interest income	61,447	42,174	117,157	83,657
Provision for loan losses	706	1,165	2,077	1,865
Net interest income after provision for loan losses	60,741	41,009	115,080	81,792
Other income:				
Bankcard services revenue	2,373	1,837	4,292	3,416
Wealth management revenue	595	565	1,148	1,081
Fees and service charges	5,140	3,658	9,816	7,465
Net gain on sales of loans	6	15	623	57
Net unrealized loss on equity investments	(71)	—	(212)	—
Net (loss) income from other real estate operations	(981)	105	(1,393)	(628)
Income from Bank Owned Life Insurance	1,335	783	2,476	1,555
Other	486	10	1,044	23
Total other income	8,883	6,973	17,794	12,969
Operating expenses:				
Compensation and employee benefits	23,244	15,328	44,495	31,466
Occupancy	4,572	2,641	9,139	5,409
Equipment	2,034	1,703	3,937	3,400
Marketing	893	730	1,454	1,470
Federal deposit insurance	1,000	705	1,930	1,366
Data processing	3,667	2,046	6,843	4,442
Check card processing	1,116	815	2,105	1,768
Professional fees	1,397	1,095	2,680	2,055
Other operating expense	3,546	2,951	6,561	5,595
Amortization of core deposit intangible	1,001	513	1,834	1,037
Branch consolidation expense	1,719	5,451	1,544	5,484
Merger related expenses	6,715	3,155	25,200	4,602
Total operating expenses	50,904	37,133	107,722	68,094
Income before provision for income taxes	18,720	10,849	25,152	26,667
Provision for income taxes	3,018	3,170	4,023	6,969
Net income	$15,702	$7,679	$21,129	$19,698
Basic earnings per share	$0.33	$0.24	$0.46	$0.62
Diluted earnings per share	$0.32	$0.23	$0.45	$0.59

Average basic shares outstanding	47,718	32,122	45,805	32,014
Average diluted shares outstanding	48,704	33,138	46,786	33,111

See accompanying Notes to Unaudited Consolidated Financial Statements.

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OceanFirst Financial Corp.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited)		(Unaudited)	
Net income	$15,702	$7,679	$21,129	$19,698
Other comprehensive income:				
Unrealized (loss) gain on debt securities (net of tax benefit of $74 and $159 in 2018, and net of tax expense of $15 and $58 in 2017, respectively)	(272)	22	(593)	84
Accretion of unrealized loss on debt securities reclassified to held-to-maturity (net of tax expense of $460 and $518 in 2018, and net of tax expense of $128 and $244 in 2017, respectively)	1,730	185	1,946	353
Reclassification adjustment for gains included in net income (net of tax expense of $52 and $53 in 2018)	194	—	195	—
Total comprehensive income	$17,354	$7,886	$22,677	$20,135

See accompanying Notes to Unaudited Consolidated Financial Statements.

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OceanFirst Financial Corp.
Consolidated Statements of Changes in Stockholders' Equity
(dollars in thousands, except per share amounts)
(Unaudited)
For the Six Months Ended June 30, 2018 and 2017

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Employee Stock Ownership Plan	Treasury Stock	Common Stock Acquired by Deferred Compensation Plan	Deferred Compensation Plan Liability	Total
Balance at December 31, 2016	$ —	$ 336	$ 364,433	$ 238,192	$ (5,749)	$ (2,761)	$ (22,548)	$ (313)	$ 313	$ 571,903
Net income	—	—	—	19,698	—	—	—	—	—	19,698
Other comprehensive income, net of tax	—	—	—	—	437	—	—	—	—	437
Stock awards	—	—	1,204	—	—	—	—	—	—	1,204
Effect of adopting Accounting Standards Update ("ASU") No. 2016-09	—	—	(11,129)	11,129	—	—	—	—	—	—
Treasury stock allocated to restricted stock plan	—	—	(1,544)	747	—	—	797	—	—	—
Allocation of ESOP stock	—	—	332	—	—	141	—	—	—	473
Cash dividend $0.30 per share	—	—	—	(9,557)	—	—	—	—	—	(9,557)
Exercise of stock options	—	—	—	(1,739)	—	—	4,770	—	—	3,031
Sale of stock for the deferred compensation plan	—	—	—	—	—	—	—	137	(137)	—
Balance at June 30, 2017	$ —	$ 336	$ 353,296	$ 258,470	$ (5,312)	$ (2,620)	$ (16,981)	$ (176)	$ 176	$ 587,189
Balance at December 31, 2017	$ —	$ 336	$ 354,377	$ 271,023	$ (5,349)	$ (2,479)	$ (15,967)	$ (84)	$ 84	$ 601,941
Net income	—	—	—	21,129	—	—	—	—	—	21,129
Other comprehensive	—	—	—	—	1,548	—	—	—	—	1,548

income, net of tax										
Stock awards	—	2	1,785	—	—	—	—	—	—	1,787
Effect of adopting Accounting Standards Update ("ASU") No. 2016-01	—	—	—	(147)	147	—	—	—	—	—
Acquisition of common stock by ESOP	—	—	—	—	—	(8,400)	—	—	—	(8,400)
Allocation of ESOP stock	—	—	319	—	—	647	—	—	—	966
Cash dividend $0.30 per share	—	—	—	(14,274)	—	—	—	—	—	(14,274)
Exercise of stock options	—	3	9,094	(3,982)	—	—	202	—	—	5,317
Acquisition of Sun Bancorp Inc.	—	141	386,648	—	—	—	15,765	—	—	402,554
Balance at June 30, 2018	$ —	$ 482	$ 752,223	$ 273,749	$ (3,654)	$ (10,232)	$ —	$ (84)	$ 84	$ 1,012,568

See accompanying Notes to Unaudited Consolidated Financial Statements.

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OceanFirst Financial Corp.
Consolidated Statements of Cash Flows
(dollars in thousands)

	For the Six Months Ended June 30,	
	2018	2017
	(Unaudited)	
Cash flows from operating activities:		
Net income	$21,129	$19,698
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	4,583	3,111
Allocation of ESOP stock	966	473
Stock awards	1,787	1,204
Net excess tax benefit on stock compensation	(572)	(1,543)
Amortization of servicing asset	72	47
Net premium amortization in excess of discount accretion on securities	2,065	1,190
Net amortization of deferred costs on borrowings	131	64
Amortization of core deposit intangible	1,834	1,037
Net accretion of purchase accounting adjustments	(8,804)	(4,061)
Net amortization of deferred costs and discounts on loans	295	172
Provision for loan losses	2,077	1,865
Net loss on sale of other real estate owned	689	379
Write down of fixed assets held for sale to net realizable value	786	4,982
Net (gain) loss on sale of fixed assets	(27)	7
Net unrealized loss on equity securities	212	—
Net gain on sales of loans	(623)	(57)
Proceeds from sales of mortgage loans held for sale	673	2,830
Mortgage loans originated for sale	(1,342)	(1,390)
Increase in value of Bank Owned Life Insurance	(2,476)	(1,555)
Net gain on sale of assets held for sale	(1,166)	—
Decrease (increase) in interest and dividends receivable	206	(1,047)
Decrease in other assets	8,092	3,754
Increase (decrease) in other liabilities	3,622	(961)
Total adjustments	13,080	10,501
Net cash provided by operating activities	34,209	30,199
Cash flows from investing activities:		
Net decrease (increase) in loans receivable	52,970	(48,758)
Proceeds from sale of under performing loans	4,294	—
Purchase of loans receivable	(121,690)	(16,627)
Purchase of debt investment securities available-for-sale	(28,010)	(49,812)
Purchase of debt investment securities held-to-maturity	(4,017)	(77,144)
Purchase of debt mortgage-backed securities held-to-maturity	—	(100,015)
Purchase of equity investments	(87)	—
Proceeds from maturities and calls of debt investment securities available-for-sale	13,829	—
Proceeds from maturities and calls of debt investment securities held-to-maturity	34,378	7,375
Principal repayments on debt mortgage-backed securities held-to-maturity	59,870	47,361
Proceeds from Bank Owned Life Insurance	2,708	155
Proceeds from the redemption of restricted equity investments	51,324	3,740
Purchases of restricted equity investments	(81,764)	(4,785)

Proceeds from sales of other real estate owned	283	1,500
Proceeds from sales of assets held for sale	4,631	—
Purchases of premises and equipment	(6,549)	(1,991)
Cash consideration paid for acquisition, net of cash received	(3,743)	—
Net cash used in investing activities	(21,573)	(239,001)

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Continued
OceanFirst Financial Corp.
Consolidated Statements of Cash Flows (Continued)
(dollars in thousands)

	For the Six Months Ended June 30,	
	2018	2017
	(Unaudited)	
Cash flows from financing activities:		
Decrease in deposits	$(138,626)	$(10,331)
Increase in short-term borrowings	325,508	28,114
Proceeds from Federal Home Loan Bank advances	—	5,000
Repayments of Federal Home Loan Bank advances	(41,063)	(957)
Repayments of other borrowings	(192)	—
Increase in advances by borrowers for taxes and insurance	6,617	1,006
Exercise of stock options	5,317	3,031
Payment of employee taxes withheld from stock awards	(2,667)	(1,217)
Acquisition of common stock by ESOP	(8,400)	—
Dividends paid	(14,274)	(9,557)
Net cash provided by financing activities	132,220	15,089
Net increase (decrease) in cash and due from banks	144,856	(193,713)
Cash and due from banks at beginning of period	109,613	301,373
Cash and due from banks at end of period	$254,469	$107,660
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	$16,213	$9,702
Income taxes	129	2
Non-cash activities:		
Accretion of unrealized loss on securities reclassified to held-to-maturity	2,464	565
Net loan charge-offs	1,107	491
Transfer of premises and equipment to assets held-for-sale	9,225	5,754
Transfer of loans receivable to other real estate owned	640	1,317
Acquisition:		
Non-cash assets acquired:		
Securities	$254,522	$—
Restricted equity investments	16,967	—
Loans	1,517,346	—
Premises and equipment	19,892	—
Accrued interest receivable	5,621	—
Bank Owned Life Insurance	85,238	—
Deferred tax asset	57,943	—
Other assets	5,262	—
Goodwill and other intangible assets, net	200,369	—
Total non-cash assets acquired	$2,163,160	$—
Liabilities assumed:		
Deposits	$1,616,073	$—
Borrowings	127,747	—
Other liabilities	13,042	—
Total liabilities assumed	$1,756,862	$—

See accompanying Notes to Unaudited Consolidated Financial Statements.

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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 subsidiaries, OceanFirst Bank N.A. (the "Bank") and OceanFirst Risk Management, Inc., and the Bank's wholly-owned subsidiaries, OceanFirst REIT Holdings, Inc., and its wholly-owned subsidiary OceanFirst Management Corp., and its wholly-owned subsidiary OceanFirst Realty Corp., OceanFirst Services, LLC and its wholly-owned subsidiary OFB Reinsurance, Ltd., 975 Holdings, LLC, Hooper Holdings, LLC., TRREO Holdings LLC, Casaba Real Estate Holdings Corporation, Cohensey Bridge, L.L.C., and Prosperis Financial, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts previously reported have been reclassified to conform to the current year's presentation.

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, 2018 are not necessarily indicative of the results of operations that may be expected for all of 2018. 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 on Form 10-K for the year ended December 31, 2017.

Note 2. Business Combinations

On January 31, 2018, the Company completed its acquisition of Sun Bancorp, Inc. ("Sun"), which after purchase accounting adjustments added $2.0 billion to assets, $1.5 billion to loans, and $1.6 billion to deposits. Total consideration paid for Sun was $474.9 million, including cash consideration of $72.4 million. Sun was merged with and into the Company on the date of acquisition.

The acquisition was accounted for under the acquisition method of accounting. Under this method of accounting, the purchase price has been allocated to the respective assets acquired and liabilities assumed based upon their estimated fair values, net of tax. The excess of consideration paid over the estimated fair value of the net assets acquired has been recorded as goodwill.

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OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements (Continued)

The following table summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition for Sun, net of total consideration paid (in thousands):

	At January 31, 2018 Estimated Fair Value
Total Purchase Price:	$474,930
Assets acquired:	
Cash and cash equivalents	$68,632
Securities	254,522
Loans	1,517,346
Accrued interest receivable	5,621
Bank Owned Life Insurance	85,238
Deferred tax asset	57,943
Other assets	42,121
Core deposit intangible	11,897
Total assets acquired	2,043,320
Liabilities assumed:	
Deposits	(1,616,073)
Borrowings	(127,747)
Other liabilities	(13,042)
Total liabilities assumed	(1,756,862)
Net assets acquired	$286,458
Goodwill recorded in the merger	$188,472

The calculation of goodwill is subject to change for up to one year after the date of acquisition as additional information relative to the closing date estimates and uncertainties become available. As the Company finalizes its review of the acquired assets and liabilities, certain adjustments to the recorded carrying values may be required.

Supplemental Pro Forma Financial Information

The following table presents financial information regarding the former Sun operations included in the Consolidated Statements of Income from the date of the acquisition (January 31, 2018) through June 30, 2018. In addition, the table provides unaudited condensed pro forma financial information assuming the Sun acquisition had been completed as of January 1, 2018 for the six months ended June 30, 2018 and as of January 1, 2017 for the six months ended June 30, 2017. The table below has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma information does not reflect management's estimate of any revenue-enhancing opportunities nor anticipated cost savings or the impact of conforming certain accounting policies of the acquired company to the Company's policies that may have occurred as a result of the integration and consolidation of Sun's operations. The pro forma information shown reflects adjustments related to certain purchase accounting fair value adjustments; amortization of core deposit and other intangibles; and related income tax effects.

(in thousands)	Pro forma Six Months Ended	Pro forma Six Months Ended

	June 30, 2018	June 30, 2017
Net interest income	$123,538	$119,805
Provision for loan losses	2,077	1,034
Non-interest income	18,609	19,400
Non-interest expense	125,005	100,758
Net income	$11,627	$27,481
Fully diluted earnings per share	$0.24	$0.57

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Fair Value Measurement of Assets Assumed and Liabilities Assumed

The methods used to determine the fair value of the assets acquired and liabilities assumed in the Sun acquisition were as follows. Refer to Note 8, Fair Value Measurements, for a discussion of the fair value hierarchy.

Securities

The estimated fair values of the securities were calculated utilizing Level 2 inputs. The securities acquired are bought and sold in active markets. Prices for these instruments were obtained through security industry sources that actively participate in the buying and selling of securities.

Loans

The acquired loan portfolio was valued utilizing Level 3 inputs and included the use of present value techniques employing cash flow estimates and incorporated assumptions that marketplace participants would use in estimating fair values. In instances where reliable market information was not available, the Company used its own assumptions in an effort to determine reasonable fair value. Specifically, the Company utilized three separate fair value analyses which a market participant would employ in estimating the total fair value adjustment. The three separate fair valuation methodologies used were: 1) interest rate loan fair value analysis; 2) general credit fair value adjustment; and 3) specific credit fair value adjustment.

To prepare the interest rate fair value analysis, loans were grouped by characteristics such as loan type, term, collateral and rate. Market rates for similar loans were obtained from various external data sources and reviewed by Company management for reasonableness. The average of these rates was used as the fair value interest rate a market participant would utilize. A present value approach was utilized to calculate the interest rate fair value adjustment.

The general credit fair value adjustment was calculated using a two part general credit fair value analysis: 1) expected lifetime losses and 2) estimated fair value adjustment for qualitative factors. The expected lifetime losses were calculated using an average of historical losses of the acquired bank. The adjustment related to qualitative factors was impacted by general economic conditions and the risk related to lack of experience with the originator’s underwriting process.

To calculate the specific credit fair value adjustment, the Company reviewed the acquired loan portfolio for loans meeting the definition of an impaired loan with deteriorated credit quality. Loans meeting these criteria were reviewed by comparing the contractual cash flows to expected collectible cash flows. The aggregate expected cash flows less the acquisition date fair value resulted in an accretable yield amount which will be recognized over the life of the loans on a level yield basis as an adjustment to yield.

Premises and Equipment

Fair values are based upon appraisals from independent third parties. In addition to owned properties, Sun operated twenty-one properties subject to lease agreements.

Deposits and Core Deposit Premium

Core deposit premium represents the value assigned to non-interest-bearing demand deposits, interest-bearing checking, money market and saving accounts acquired as part of the acquisition. The core deposit premium value represents the future economic benefit, including the present value of future tax benefits, of the potential cost saving from acquiring the core deposits as part of an acquisition compared to the cost of alternative funding sources and is valued utilizing Level 2 inputs. The core deposit premium totaled $11.9 million for the acquisition of Sun, and is being amortized over its estimated useful life of approximately 10 years using an accelerated method.

Time deposits are not considered to be core deposits as they are assumed to have a low expected average life upon acquisition. The fair value of time deposits represents the present value of the expected contractual payments discounted by market rates for similar time deposits and is valued utilizing Level 2 inputs.

Borrowings

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

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OceanFirst Financial Corp.

Notes to Unaudited Consolidated Financial Statements

Note 3. Earnings per Share

The following reconciles shares outstanding for basic and diluted earnings per share for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Weighted average shares outstanding	48,156	32,500	46,189	32,410
Less: Unallocated ESOP shares	(378)	(315)	(334)	(319)
Unallocated incentive award shares and shares held by deferred compensation plan	(60)	(63)	(50)	(77)
Average basic shares outstanding	47,718	32,122	45,805	32,014
Add: Effect of dilutive securities:				
Incentive awards and shares held by deferred compensation plan	986	1,016	981	1,097
Average diluted shares outstanding	48,704	33,138	46,786	33,111

For the three months ended June 30, 2018 and 2017, antidilutive stock options of 464,000 and 480,000, respectively, were excluded from earnings per share calculations. For the six months ended June 30, 2018 and 2017, antidilutive stock options of 464,000 and 200,000, respectively, were excluded from earnings per share calculations.

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OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements

Note 4. Securities
The amortized cost and estimated fair value of debt securities available-for-sale and held-to-maturity at June 30, 2018, and December 31, 2017, are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At June 30, 2018				
Debt securities available-for-sale:				
Investment securities - U.S. agency obligations	$100,407	$ 6	$(1,361)	$99,052
Mortgage-backed securities - FNMA	1,325	—	(8)	1,317
Total debt securities available-for-sale	$101,732	$ 6	$(1,369)	$100,369
Debt securities held-to-maturity:				
Investment securities:				
U.S. agency obligations	$14,972	$ —	$(182)	$14,790
State and municipal obligations	140,037	12	(2,278)	137,771
Corporate debt securities	66,805	641	(3,090)	64,356
Total investment securities	221,814	653	(5,550)	216,917
Mortgage-backed securities:				
FHLMC	263,312	59	(7,074)	256,297
FNMA	303,598	939	(8,085)	296,452
GNMA	134,838	189	(2,345)	132,682
SBA	4,728	—	(87)	4,641
Total mortgage-backed securities	706,476	1,187	(17,591)	690,072
Total debt securities held-to-maturity	$928,290	$ 1,840	$(23,141)	$906,989
Total debt securities	$1,030,022	$ 1,846	$(24,510)	$1,007,358
At December 31, 2017				
Debt securities available-for-sale:				
Investment securities - U.S. agency obligations	$82,378	$ —	$(797)	$81,581
Debt securities held-to-maturity:				
Investment securities:				
U.S. agency obligations	$14,968	$ —	$(65)	$14,903
State and municipal obligations	149,958	219	(1,475)	148,702
Corporate debt securities	76,024	312	(3,962)	72,374
Total investment securities	240,950	531	(5,502)	235,979
Mortgage-backed securities:				
FHLMC	186,921	151	(2,937)	184,135
FNMA	263,103	1,193	(3,000)	261,296
GNMA	75,243	64	(928)	74,379
SBA	5,843	28	—	5,871
Total mortgage-backed securities	531,110	1,436	(6,865)	525,681
Total debt securities held-to-maturity	$772,060	$ 1,967	$(12,367)	$761,660
Total debt securities	$854,438	$ 1,967	$(13,164)	$843,241

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OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements

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 debt securities held-to-maturity at June 30, 2018, and December 31, 2017, is as follows (in thousands):

	June 30, 2018	December 31, 2017
Amortized cost	$928,290	$772,060
Net loss on date of transfer from available-for-sale	(13,347)	(13,347)
Accretion of net unrealized loss on securities reclassified as held-to-maturity	7,813	5,349
Carrying value	$922,756	$764,062

Realized gains were $246,000 and $248,000 for the three and six months ended June 30, 2018, respectively, and there were no realized gains or losses on the sale of securities for the three and six months ended June 30, 2017.

The amortized cost and estimated fair value of investment securities at June 30, 2018 by contractual maturity are shown below (in thousands). Actual maturities may differ from contractual maturities in instances where issuers have the right to call or prepay obligations with or without call or prepayment penalties. At June 30, 2018, corporate debt with an amortized cost of $53.7 million and estimated fair value of $51.4 million were callable prior to the maturity date.

June 30, 2018	Amortized Cost	Estimated Fair Value
Less than one year	$50,536	$50,361
Due after one year through five years	165,817	163,396
Due after five years through ten years	90,095	86,235
Due after ten years	15,773	15,977
	$322,221	$315,969

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 of securities pledged as required security for deposits and for other purposes required by law amounted to $552.9 million and $466.4 million, at June 30, 2018 and December 31, 2017, respectively, including $77.3 million and $58.0 million at June 30, 2018 and December 31, 2017, respectively, pledged as collateral for reverse repurchase agreements.

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OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements

The estimated fair value and unrealized losses of debt securities available-for-sale and held-to-maturity at June 30, 2018 and December 31, 2017, segregated by the duration of the unrealized losses, are as follows (in thousands):

	At June 30, 2018					
	Less than 12 months		12 months or longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Debt securities available-for-sale:						
Investment securities - U.S. agency obligations	$65,034	$(765)	$21,953	$(596)	$86,987	$(1,361)
Mortgage-backed securities - FNMA	1,317	(8)	—	—	1,317	(8)
Total debt securities available-for-sale	66,351	(773)	21,953	(596)	88,304	(1,369)
Debt securities held-to-maturity:						
Investment securities:						
U.S. agency obligations	14,790	(182)	—	—	14,790	(182)
State and municipal obligations	103,443	(1,679)	16,255	(599)	119,698	(2,278)
Corporate debt securities	6,384	(114)	40,055	(2,976)	46,439	(3,090)
Total investment securities	124,617	(1,975)	56,310	(3,575)	180,927	(5,550)
Mortgage-backed securities:						
FHLMC	190,811	(3,936)	61,563	(3,138)	252,374	(7,074)
FNMA	183,931	(5,039)	58,634	(3,046)	242,565	(8,085)
GNMA	69,051	(1,154)	39,052	(1,191)	108,103	(2,345)
SBA	4,641	(87)	—	—	4,641	(87)
Total mortgage-backed securities	448,434	(10,216)	159,249	(7,375)	607,683	(17,591)
Total debt securities held-to-maturity	573,051	(12,191)	215,559	(10,950)	788,610	(23,141)
Total debt securities	$639,402	$(12,964)	$237,512	$(11,546)	$876,914	$(24,510)

	At December 31, 2017					
	Less than 12 months		12 months or longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Debt securities available-for-sale:						
Investment securities - U.S. agency obligations	$69,375	$(496)	$12,206	$(301)	$81,581	$(797)
Debt securities held-to-maturity:						
Investment securities:						
U.S. agency obligations	14,903	(65)	—	—	14,903	(65)
State and municipal obligations	104,883	(1,153)	14,363	(322)	119,246	(1,475)
Corporate debt securities	4,035	(30)	56,106	(3,932)	60,141	(3,962)
Total investment securities	123,821	(1,248)	70,469	(4,254)	194,290	(5,502)
Mortgage-backed securities:						
FHLMC	98,138	(781)	68,238	(2,156)	166,376	(2,937)
FNMA	132,982	(1,058)	65,060	(1,942)	198,042	(3,000)
GNMA	26,105	(223)	45,281	(705)	71,386	(928)
Total mortgage-backed securities	257,225	(2,062)	178,579	(4,803)	435,804	(6,865)
Total debt securities held-to-maturity	381,046	(3,310)	249,048	(9,057)	630,094	(12,367)

Total debt securities	$450,421	$(3,806)	$261,254	$(9,358)	$711,675	$(13,164)

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OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements

At June 30, 2018, 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 Cost	Estimated Fair Value	Credit Rating Moody's/ S&P
Chase Capital	$ 10,000	$ 9,275	Baa2/BBB-
Wells Fargo Capital	5,000	4,700	A1/BBB
Huntington Capital	5,000	4,525	Baa2/BB+
Keycorp Capital	5,000	4,625	Baa2/BB+
PNC Capital	5,000	4,666	Baa1/BBB-
State Street Capital	5,000	4,675	A3/BBB
SunTrust Capital	5,000	4,625	Not Rated/BB+
Southern Company	1,519	1,487	Baa2/BBB+
AT&T Inc.	1,512	1,477	Baa2/BBB
	$ 43,031	$ 40,055	

At June 30, 2018, the estimated fair value of each of the above corporate debt securities was below cost. The Company concluded that these corporate debt securities were only temporarily impaired at June 30, 2018. 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. 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 corporate debt securities and it is more likely than not that the Company will not be required to sell the securities. Historically, the Company has not utilized securities sales 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"), the Federal National Mortgage Association ("FNMA"), the Government National Mortgage Association ("GNMA"), or the Small Business Administration ("SBA"), 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, 2018.

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Note 5. Loans Receivable, Net
Loans receivable, net at June 30, 2018 and December 31, 2017 consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Commercial:		
Commercial and industrial	$337,699	$187,645
Commercial real estate – owner occupied	716,441	569,497
Commercial real estate – investor	2,068,782	1,186,302
Total commercial	3,122,922	1,943,444
Consumer:		
Residential real estate	2,010,648	1,748,590
Home equity loans and lines	364,699	281,143
Other consumer	50,952	1,225
Total consumer	2,426,299	2,030,958
	5,549,221	3,974,402
Purchased credit impaired (“PCI”) loans	12,995	1,712
Total Loans	5,562,216	3,976,114
Deferred origination costs, net	7,510	5,380
Allowance for loan losses	(16,691)	(15,721)
Total loans, net	$5,553,035	$3,965,773

At June 30, 2018 and December 31, 2017, loans in the amount of $18.1 million and $20.9 million, respectively, were three or more months delinquent or in the process of foreclosure and the Company was not accruing interest income on these loans. At June 30, 2018, there were no loans that were 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 recorded investment in mortgage and consumer loans collateralized by residential real estate, which are in the process of foreclosure, amounted to $2.3 million at June 30, 2018. The amount of foreclosed residential real estate property held by the Company was $1.0 million at June 30, 2018.
The Company defines an impaired loan as 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, 2018, the impaired loan portfolio totaled $32.7 million for which there was a specific allocation in the allowance for loan losses of $675,000. At December 31, 2017, the impaired loan portfolio totaled $47.0 million for which there was no specific allocation in the allowance for loan losses. The average balance of impaired loans for the three and six months ended June 30, 2018 was $38.4 million and $41.3 million, respectively, and for the three and six months ended June 30, 2017 was $37.9 million and $35.6 million, respectively.
An analysis of the allowance for loan losses for the three and six months ended June 30, 2018 and 2017 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	$16,817	$16,151	$15,721	$15,183
Provision charged to operations	706	1,165	2,077	1,865
Charge-offs	(1,284)	(1,299)	(1,817)	(1,504)
Recoveries	452	540	710	1,013

Balance at end of period	$16,691	$16,557	$16,691	$16,557

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Notes to Unaudited Consolidated Financial Statements (Continued)

The following table presents an analysis of the allowance for loan losses for the three and six months ended June 30, 2018 and 2017 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, 2018 and December 31, 2017, excluding PCI loans (in thousands):

	Commercial and Industrial	Commercial Real Estate – Owner Occupied	Commercial Real Estate – Investor	Residential Real Estate	Consumer	Unallocated	Total
For the three months ended June 30, 2018							
Allowance for loan losses:							
Balance at beginning of period	$2,251	$2,871	$8,838	$2,138	$507	$ 212	$16,817
Provision (benefit) charged to operations	(186)	(616)	1,166	8	(15)	349	706
Charge-offs	(13)	(90)	(978)	(157)	(46)	—	(1,284)
Recoveries	28	175	32	137	80	—	452
Balance at end of period	$2,080	$2,340	$9,058	$2,126	$526	$ 561	$16,691
For the three months ended June 30, 2017							
Allowance for loan losses:							
Balance at beginning of period	$2,080	$3,449	$7,361	$1,569	$1,136	$ 556	$16,151
Provision (benefit) charged to operations	160	(342)	1,090	639	(244)	(138)	1,165
Charge-offs	—	(23)	(84)	(1,152)	(40)	—	(1,299)
Recoveries	13	13	—	436	78	—	540
Balance at end of period	$2,253	$3,097	$8,367	$1,492	$930	$ 418	$16,557
For the six months ended June 30, 2018							
Allowance for loan losses:							
Balance at beginning of period	$1,801	$3,175	$7,952	$1,804	$614	$ 375	$15,721
Provision (benefit) charged to operations	283	(923)	2,045	501	(15)	186	2,077
Charge-offs	(56)	(90)	(1,101)	(401)	(169)	—	(1,817)
Recoveries	52	178	162	222	96	—	710
Balance at end of period	$2,080	$2,340	$9,058	$2,126	$526	$ 561	$16,691
For the six months ended June 30, 2017							
Allowance for loan losses:							
Balance at beginning of period	$2,037	$2,999	$6,361	$2,245	$1,110	$ 431	$15,183
Provision (benefit) charged to operations	(41)	48	2,083	12	(224)	(13)	1,865

Charge-offs	(88)	(73)	(84)	(1,201)	(58)	—	(1,504)
Recoveries	345	123	7	436	102	—	1,013
Balance at end of period	$2,253	$3,097	$8,367	$1,492	$930	$ 418	$16,557
June 30, 2018							
Allowance for loan losses:							
Ending allowance balance attributed to loans:							
Individually evaluated for impairment	$675	$—	$—	$—	$—	$ —	$675
Collectively evaluated for impairment	1,405	2,340	9,058	2,126	526	561	16,016
Total ending allowance balance	$2,080	$2,340	$9,058	$2,126	$526	$ 561	$16,691
Loans:							
Loans individually evaluated for impairment	$1,698	$5,521	$11,622	$11,028	$2,874	$ —	$32,743
Loans collectively evaluated for impairment	336,001	710,920	2,057,160	1,999,620	412,777	—	5,516,478
Total ending loan balance	$337,699	$716,441	$2,068,782	$2,010,648	$415,651	$ —	$5,549,221

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	Commercial and Industrial	Commercial Real Estate – Owner Occupied	Commercial Real Estate – Investor	Residential Real Estate	Consumer	Unallocated	Total
December 31, 2017							
Allowance for loan losses:							
Ending allowance balance attributed to loans:							
Individually evaluated for impairment	$ —	$ —	$—	$—	$—	$ —	$—
Collectively evaluated for impairment	1,801	3,175	7,952	1,804	614	375	15,721
Total ending allowance balance	$ 1,801	$ 3,175	$ 7,952	$ 1,804	$ 614	$ 375	$ 15,721
Loans:							
Loans individually evaluated for impairment	$ 864	$ 15,132	$ 17,923	$ 10,605	$ 2,464	$ —	$ 46,988
Loans collectively evaluated for impairment	186,781	554,365	1,168,379	1,737,985	279,904	—	3,927,414
Total ending loan balance	$ 187,645	$ 569,497	$ 1,186,302	$ 1,748,590	$ 282,368	$ —	$ 3,974,402

A summary of impaired loans at June 30, 2018, and December 31, 2017, is as follows, excluding PCI loans (in thousands):

	June 30, 2018	December 31, 2017
Impaired loans with no allocated allowance for loan losses	$ 31,271	$ 46,988
Impaired loans with allocated allowance for loan losses	1,472	—
	$ 32,743	$ 46,988
Amount of the allowance for loan losses allocated	$ 675	$ —

At June 30, 2018, impaired loans included troubled debt restructured ("TDR") loans of $28.5 million, of which $24.3 million were performing in accordance with their restructured terms for a minimum of six months and were accruing interest. At December 31, 2017, impaired loans included TDR loans of $42.1 million, of which $33.3 million were performing in accordance with their restructured terms for a minimum of six months and were accruing interest.

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The summary of loans individually evaluated for impairment by loan portfolio segment as of June 30, 2018, and December 31, 2017 and for the three and six months ended June 30, 2018 and 2017, is as follows, excluding PCI loans (in thousands):

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
As of June 30, 2018			
With no related allowance recorded:			
Commercial and industrial	$ 239	$ 226	$ —
Commercial real estate – owner occupied	5,532	5,521	—
Commercial real estate – investor	14,024	11,622	—
Residential real estate	11,418	11,028	—
Consumer	3,241	2,874	—
	$ 34,454	$ 31,271	$ —
With an allowance recorded:			
Commercial and industrial	$ 1,472	$ 1,472	$ 675
Commercial real estate – owner occupied	—	—	—
Commercial real estate – investor	—	—	—
Residential real estate	—	—	—
Consumer	—	—	—
	$ 1,472	$ 1,472	$ 675
As of December 31, 2017			
With no related allowance recorded:			
Commercial and industrial	$ 895	$ 864	$ —
Commercial real estate – owner occupied	15,832	15,132	—
Commercial real estate – investor	19,457	17,923	—
Residential real estate	10,951	10,605	—
Consumer	2,941	2,464	—
	$ 50,076	$ 46,988	$ —
With an allowance recorded:			
Commercial and industrial	$ —	$ —	$ —
Commercial real estate – owner occupied	—	—	—
Commercial real estate – investor	—	—	—
Residential real estate	—	—	—
Consumer	—	—	—
	$ —	$ —	$ —

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Notes to Unaudited Consolidated Financial Statements (Continued)

	Three Months Ended June 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial and industrial	$512	$ —	$596	$ 19
Commercial real estate – owner occupied	7,666	36	10,830	24
Commercial real estate – investor	13,177	48	5,655	221
Residential real estate	11,217	112	10,929	187
Consumer	2,682	46	2,375	42
	$35,254	$ 242	$30,385	$ 493
With an allowance recorded:				
Commercial and industrial	$1,472	$ —	$—	$ —
Commercial real estate – owner occupied	—	—	—	—
Commercial real estate – investor	1,677	—	5,249	13
Residential real estate	—	—	2,156	—
Consumer	—	—	142	—
	$3,149	$ —	$7,547	$ 13

	Six Months Ended June 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial and industrial	$629	$ 16	$486	$ 24
Commercial real estate – owner occupied	10,155	151	10,927	185
Commercial real estate – investor	14,759	202	4,402	247
Residential real estate	11,013	237	10,517	273
Consumer	2,609	83	2,332	70
	$39,165	$ 689	$28,664	$ 799
With an allowance recorded:				
Commercial and industrial	$981	$ —	$—	$ —
Commercial real estate – owner occupied	—	—	—	—
Commercial real estate – investor	1,118	—	4,130	68
Residential real estate	—	—	2,641	62
Consumer	—	—	198	6
	$2,099	$ —	$6,969	$ 136

The following table presents the recorded investment in non-accrual loans by loan portfolio segment as of June 30, 2018 and December 31, 2017, excluding PCI loans (in thousands):

	June 30, 2018	December 31, 2017
Commercial and industrial	$1,947	$ 503
Commercial real estate – owner occupied	522	5,962
Commercial real estate – investor	6,364	8,281
Residential real estate	6,858	4,190

Consumer	2,415	1,929
	$18,106	$ 20,865

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OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements (Continued)

The following table presents the aging of the recorded investment in past due loans as of June 30, 2018 and December 31, 2017 by loan portfolio segment, excluding PCI loans (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
June 30, 2018						
Commercial and industrial	$651	$ 40	$1,674	$2,365	$335,334	$337,699
Commercial real estate – owner occupied	3,125	—	197	3,322	713,119	716,441
Commercial real estate – investor	12,074	728	3,503	16,305	2,052,477	2,068,782
Residential real estate	15,253	3,673	3,077	22,003	1,988,645	2,010,648
Consumer	1,714	905	1,940	4,559	411,092	415,651
	$32,817	$ 5,346	$10,391	$48,554	$5,500,667	$5,549,221
December 31, 2017						
Commercial and industrial	$2,694	$ 36	$503	$3,233	$184,412	$187,645
Commercial real estate – owner occupied	222	—	5,402	5,624	563,873	569,497
Commercial real estate – investor	135	1,426	4,507	6,068	1,180,234	1,186,302
Residential real estate	13,197	2,351	3,372	18,920	1,729,670	1,748,590
Consumer	1,067	310	1,687	3,064	279,304	282,368
	$17,315	$ 4,123	$15,471	$36,909	$3,937,493	$3,974,402

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. The Company uses the following definitions for risk ratings:
Pass: Loans classified as Pass are well protected by the paying capacity and net worth of the borrower.
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.
As of June 30, 2018 and December 31, 2017, and based on the most recent analysis performed, the risk category of loans by loan portfolio segment follows, excluding PCI loans (in thousands) is as follows:

	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2018					
Commercial and industrial	$331,369	$2,520	$ 3,135	$ 675	$337,699
Commercial real estate – owner occupied	697,195	3,651	15,595	—	716,441
Commercial real estate – investor	2,025,639	22,949	20,194	—	2,068,782
	$3,054,203	$29,120	$ 38,924	$ 675	$3,122,922
December 31, 2017					

Commercial and industrial	$181,438	$3,153	$ 3,054	$ —	$187,645
Commercial real estate – owner occupied	546,569	4,337	18,591	—	569,497
Commercial real estate – investor	1,146,630	14,644	25,028	—	1,186,302
	$1,874,637	$22,134	$ 46,673	$ —	$1,943,444

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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, 2018 and December 31, 2017, excluding PCI loans (in thousands):

	Residential	Consumer
June 30, 2018		
Performing	$2,003,790	$413,236
Non-performing	6,858	2,415
	$2,010,648	$415,651
December 31, 2017		
Performing	$1,744,400	$280,439
Non-performing	4,190	1,929
	$1,748,590	$282,368

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, the capitalization of past due amounts and/or the restructuring of scheduled principal payments. One-to-four family and consumer loans where the borrower's debt is discharged in a bankruptcy filing are also considered troubled debt restructurings. For these loans, the Bank retains its security interest in the real estate collateral. Included in the non-accrual loan total at June 30, 2018, and December 31, 2017, were $4.2 million and $8.8 million, respectively, of troubled debt restructurings. At June 30, 2018 and December 31, 2017, the Company had no specific reserves allocated to loans that 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 accruing troubled debt restructurings at June 30, 2018, and December 31, 2017, which totaled $24.3 million and $33.3 million, respectively. Troubled debt restructurings are considered in the allowance for loan losses similar to other impaired loans.

The following table presents information about troubled debt restructurings which occurred during the three and six months ended June 30, 2018 and 2017, and troubled debt restructurings modified within the previous year and which defaulted during the three and six months ended June 30, 2018 and 2017 (dollars in thousands):

	Number of Loans	Pre-modification Recorded Investment	Post-modification Recorded Investment
Three months ended June 30, 2018			
Troubled Debt Restructurings:			
Commercial and industrial	1	$ 259	$ 259
Commercial real estate – investor	1	1,045	1,045

	Number of Loans	Recorded Investment
Troubled Debt Restructurings Which Subsequently Defaulted:	None	None

	Number of Loans	Pre-modification Recorded Investment	Post-modification Recorded Investment
Six months ended June 30, 2018			
Troubled Debt Restructurings:			
Commercial and industrial	2	$ 496	$ 502
Commercial real estate – investor	2	1,224	1,225
Residential real estate	2	257	270

	Number of Loans	Recorded Investment

Troubled Debt Restructurings Which Subsequently Defaulted: None	None

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	Number of Loans	Pre-modification Recorded Investment	Post-modification Recorded Investment
Three Months Ended June 30, 2017			
Troubled Debt Restructurings:			
Commercial and industrial	1	$ 665	$ 665
Commercial real estate - owner occupied	1	966	966
Commercial real estate – investor	2	5,036	5,011
Residential real estate	2	658	658

	Number of Loans	Recorded Investment
Troubled Debt Restructurings Which Subsequently Defaulted:	None	None

	Number of Loans	Pre-modification Recorded Investment	Post-modification Recorded Investment
Six months ended June 30, 2017			
Troubled Debt Restructurings:			
Commercial and industrial	1	$ 665	$ 665
Commercial real estate - owner occupied	3	2,609	2,609
Commercial real estate – investor	3	5,662	5,784
Residential real estate	4	1,026	999

	Number of Loans	Recorded Investment
Troubled Debt Restructurings Which Subsequently Defaulted:	None	None

As part of the Sun acquisition, PCI loans were acquired at a discount primarily due to deteriorated credit quality. PCI loans are accounted for at fair value, based upon the present value of expected future cash flows, with no related allowance for loan losses.

The following table presents information regarding the estimates of the contractually required payments, the cash flows expected to be collected and the estimated fair value of the PCI loans acquired from Sun at January 31, 2018 (in thousands):

	Sun January 31, 2018
Contractually required principal and interest	$ 22,556
Contractual cash flows not expected to be collected (non-accretable discount)	(6,115)
Expected cash flows to be collected at acquisition	16,441
Interest component of expected cash flows (accretable yield)	(3,535)
Fair value of acquired loans	$ 12,906

The following table summarizes the changes in accretable yield for PCI loans during the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Beginning balance	$3,492	$161	$693	$749
Acquisition	—	3,535	—	—
Accretion	(869)	(1,091)	(152)	(314)
Reclassification from non-accretable difference	566	584	924	1,030
Ending balance	$3,189	$3,189	$1,465	$1,465

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Note 6. Deposits
The major types of deposits at June 30, 2018 and December 31, 2017 were as follows (in thousands):

Type of Account	June 30, 2018	December 31, 2017
Non-interest-bearing	$1,195,980	$756,513
Interest-bearing checking	2,265,971	1,954,358
Money market deposit	574,269	363,656
Savings	903,777	661,167
Time deposits	879,409	607,104
Total deposits	$5,819,406	$4,342,798

Included in time deposits at June 30, 2018 and December 31, 2017, is $117.0 million and $84.9 million, respectively, in deposits of $250,000 and over.

OceanFirst Financial Corp.
Notes to Unaudited Consolidated Financial Statements (Continued)

Note 7. Recent Accounting Pronouncements
In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU" or "Update") 2014-09, "Revenue from Contracts with Customers (Topic 606)" and subsequent related Updates modifies the guidance used to recognize revenue from contracts with customers for transfers of goods or services and transfers of nonfinancial assets, unless those contracts are within the scope of other guidance. The Updates also require new qualitative and quantitative disclosures, including disaggregation of revenues and descriptions of performance obligations. The amendments in this update were effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. On January 1, 2018, the Company adopted ASU 2014-09 and all subsequent amendments to the ASU (collectively, "ASC 606").
The majority of the Company's revenues are not subject to ASC 606, including revenue generated from financial instruments, such as interest and dividend income, including loans and securities, as these activities are subject to other U.S. Generally Accepted Accounting Principles ("GAAP"). Revenue generating activities that are within the scope of ASC 606 are presented within non-interest income and are recognized as revenue as the Company satisfies its obligation to the customer. Descriptions of revenue generating activities that are within the scope of ASC 606, which are presented in the Consolidated Statements of Income as components of other income are as follows:

- Bankcard services revenue - The Company generates other non-interest income from Bankcard services, which includes interchange revenue and merchant services revenue. The calculation of the revenue collected is based on customer transactions, which do not have a fixed duration. When there is a transaction, the performance obligation is fulfilled. The Company recognizes revenue per underlying transaction and recognizes the revenue when the performance obligation is satisfied at a point in time.

- Wealth management revenue - The Company provides customers with sound financial solutions and comprehensive wealth management products. Wealth management accounts earn minimum annual fees and may earn additional fees and service charges. Fees and service charges from wealth management accounts may include numerous fees such as Bill Pay fees, extraordinary service fees, unique asset fees, and transaction fees. The Company will recognize the fee when received because the Company provided the service to its customer at that time, and has no future performance obligation. Therefore, each month the Company will accrue and recognize the monthly portion of the minimum annual fee as a result of providing advisory services. If a customer utilizes additional services such as a wire transfer or bill pay, or any other advisory service outlined in their respective agreements, the Company will recognize revenue at that time, since there are no future performance obligations during the existing contract.

- Fees and service charges - The Company has multiple types of deposit accounts that may earn fees and service charges. Fees and service charges from deposit accounts represent general service fees for monthly account maintenance and activity-or-transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when the performance obligation is satisfied, which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are typically received at the time the performance obligations are satisfied.

The Company adopted the ASU using the modified retrospective method as of January 1, 2018. The adoption of this ASU did not result in a change to the accounting for any of the in-scope revenue streams; as such no cumulative effect adjustment was recorded on the Company's consolidated financial statements.
In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities." The main objective in developing this new ASU is to enhance the reporting model for financial instruments to provide users of financial statements with more useful information. The update requires equity investments to be measured at fair value with changes in fair value recognized

in net income. It simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a quantitative assessment to identify impairment. The amendment eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. It requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Financial assets and financial liabilities are to be presented separately by measurement category and the need for a valuation allowance on a deferred tax asset related to available-for-sale securities should be evaluated with other deferred tax assets. The amendments in this update were effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this ASU in its entirety on January 1, 2018, and has appropriately reflected the changes throughout the Company's consolidated financial statements. The adoption of this ASU resulted in an impact to retained earnings and other comprehensive income of $147,000.

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In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” This ASU requires all lessees to recognize a lease liability and a right-of-use asset, measured at the present value of the future minimum lease payments, at the lease commencement date. Lessor accounting remains largely unchanged under the new guidance. The guidance is effective for fiscal years beginning after December 15, 2018, including interim reporting periods within that reporting period, with early adoption permitted. A modified retrospective approach must be applied for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently assessing the impact that the guidance will have on the Company’s consolidated financial statements. The Company has begun its evaluation of the amended guidance including the potential impact on its consolidated financial statements. To date, the Company has identified its leased real estate as within the scope of the guidance and continues to evaluate the impact of the guidance, including determining whether other contracts exist that are deemed to be in scope. The Company expects total assets and total liabilities will increase by similar amounts. Further, to date, no guidance has been issued by either the Company’s or the Bank’s primary regulator with respect to how the impact of the amended standard is to be treated for regulatory capital purposes.

In June 2016, the FASB issued ASU 2016-13, “Measurement of Credit Losses on Financial Instruments.” This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren’t measured at fair value through net income. The standard will replace today’s “incurred loss” approach with an “expected loss” model. The new model, referred to as the current expected credit loss (“CECL”) model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale (“AFS”) debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity’s assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company has begun its evaluation of the amended guidance including the potential impact on its consolidated financial statements. As a result of the required change in approach toward determining estimated credit losses from the current “incurred loss” model to one based on estimated cash flows over a loan’s contractual life, adjusted for prepayments (a “life of loan” model), the Company expects that the new guidance will result in an increase in the allowance for loan losses, particularly for longer duration loan portfolios. The Company also expects that the new guidance may result in an allowance for debt securities. In both cases, the extent of the change is indeterminable at this time as it will be dependent upon portfolio composition and credit quality at the adoption date, as well as economic conditions and forecasts at that time.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805) - Clarifying the Definition of a Business.” This ASU narrows the definition of a business and clarifies that, to be considered a business, the fair value of the gross assets acquired (or disposed of) may not be substantially all concentrated in a single identifiable asset or group of similar assets. In addition, in order to be considered a business, a set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. This ASU was effective for fiscal years beginning after December 15, 2017; early adoption was permitted on a limited basis. The Company adopted this guidance on January 1, 2018 and it did not have a material impact on the Company’s

consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment.” This ASU intends to simplify the subsequent measurement of goodwill, eliminating Step 2 from the goodwill impairment test. Instead, an entity should perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge by which the carrying amount exceeds the reporting unit’s fair value; however the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The ASU also eliminates the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. ASU No. 2017-04 is effective for fiscal years beginning after December 15, 2019; early adoption is permitted for annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this update will not have a material impact on the Company’s consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities.” This ASU requires the amortization of premiums to the earliest call date on debt securities with call features that are explicit, noncontingent and callable at fixed prices and on preset dates. This ASU does not impact securities held as a discount, as the discount continues to be amortized to the contractual maturity. The guidance is

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effective for fiscal years beginning after December 15, 2018, with early adoption permitted, including adoption in an interim period. The amendments in this ASU should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The adoption of this update is not expected to have a material impact on the Company’s consolidated financial statements.
In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities.” The amendments in this ASU was issued to better align an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. As a result, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. Current GAAP contains limitations on how an entity can designate the hedged risk in certain cash flow and fair value hedging relationships. To address those current limitations, the amendments in this ASU permit hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk. In addition, the amendments in this ASU change the guidance for designating fair value hedges of interest rate risk and for measuring the change in fair value of the hedged item in fair value hedges of interest rate risk. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company does not enter into derivatives that are designated as hedging instruments and as such, the adoption of this ASU is not expected to have an impact on the Company’s consolidated financial statements.
In February 2018, the FASB issued ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This ASU was issued to address a narrow-scope financial reporting issue that arose as a result of the enactment of the Tax Cuts and Jobs Act (“Tax Reform”) on December 22, 2017. The objective of ASU 2018-02 is to address the tax effects of items within accumulated other comprehensive income (referred to as “stranded tax effects”) that do not reflect the appropriate tax rate enacted in the Tax Reform. As a result, the ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate of 35 percent and the newly enacted corporate income tax rate of 21 percent. ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted, including adoption in an interim period. The amendments in this ASU may be applied retrospectively to each period in which the effect of the change in the U.S. Federal corporate income tax rate in the Tax Reform is recognized. The Company has early adopted ASU 2018-02 for the year ended December 31, 2017, and has elected not to reclassify the income tax effects of the Tax Reform from accumulated other comprehensive loss to retained earnings.

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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 value 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, 2018. 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).
Debt Securities Available-For-Sale
Debt securities classified as available-for-sale are reported at fair value. Fair value for these debt securities is determined using inputs other than quoted prices that are based on market observable information (Level 2). Level 2 debt securities are priced through third-party pricing services 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 debt securities without relying exclusively on quoted prices for the specific securities, but comparing the debt securities to benchmark or comparable debt securities.

Equity Investments

Equity investments are reported at fair value. Fair value for these investments is determined using a quoted price in an active market or exchange (Level 1).

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Interest Rate Swaps
The Company's interest rate swaps, acquired from Sun, are reported at fair value utilizing models provided by an independent, third-party and observable market data. When entering into an interest rate swap agreement, the Company is exposed to fair value changes due to interest rate movements, and also the potential nonperformance of our contract counterparty.
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. Fair value is based on independent appraisals.
The following table summarizes financial assets and financial liabilities measured at fair value as of June 30, 2018 and December 31, 2017, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

	Total Fair Value	Fair Value Measurements at Reporting Date Using		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
June 30, 2018				
Items measured on a recurring basis:				
Debt securities available-for-sale	$100,369	$ —	$ 100,369	$ —
Equity investments	9,539	9,539	—	—
Interest rate swap asset	369	—	369	—
Interest rate swap liability	(369)	—	(369)	—
Items measured on a non-recurring basis:				
Other real estate owned	7,854	—	—	7,854
Loans measured for impairment based on the fair value of the underlying collateral	11,832	—	—	11,832
December 31, 2017				
Items measured on a recurring basis:				
Debt securities available-for-sale	$81,581	$ —	$ 81,581	$ —
Equity investments	8,700	8,700	—	—
Items measured on a non-recurring basis:				
Other real estate owned	8,186	—	—	8,186
Loans measured for impairment based on the fair value of the underlying collateral	16,496	—	—	16,496

Assets and Liabilities Disclosed at Fair Value
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.
Debt Securities Held-to-Maturity
Debt securities classified as held-to-maturity are carried at amortized cost, as the Company has the positive intent and ability to hold these debt securities to maturity. The Company determines the fair value of the debt 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 vendors or security industry sources that actively participate in the buying and

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

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Management's policy is to obtain and review all available documentation from the third party pricing service relating to their fair 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.

Restricted Equity Investments

The fair value for Federal Home Loan Bank of New York and Federal Reserve Bank 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 as stipulated by the respective agencies.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as residential mortgage, 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.

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 is, 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.

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Notes to Unaudited Consolidated Financial Statements (Continued)

The book value and estimated fair value of the Bank’s significant financial instruments not recorded at fair value as of June 30, 2018 and December 31, 2017 are presented in the following tables (in thousands):

June 30, 2018	Book Value	Fair Value Measurements at Reporting Date Using: Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Financial Assets:				
Cash and due from banks	$254,469	$ 254,469	$ —	$ —
Debt securities held-to-maturity	922,756	—	893,814	13,175
Restricted equity investments	66,981	—	—	66,981
Loans receivable, net and loans held-for-sale (1)	5,553,954	—	—	5,459,399
Financial Liabilities:				
Deposits other than time deposits	4,939,997	—	4,939,997	—
Time deposits	879,409	—	863,981	—
Federal Home Loan Bank advances and other borrowings	773,655	—	779,701	—
Securities sold under agreements to repurchase with retail customers	62,176	62,176	—	—

December 31, 2017	Book Value	Fair Value Measurements at Reporting Date Using: Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Financial Assets:				
Cash and due from banks	$109,613	$ 109,613	$ —	$ —
Debt securities held-to-maturity	764,062	—	751,182	10,478
Restricted equity investments	19,724	—	—	19,724
Loans receivable, net and loans held-for-sale (1)	3,966,014	—	—	3,962,689
Financial Liabilities:				
Deposits other than time deposits	3,735,694	—	3,735,694	—
Time deposits	607,104	—	599,677	—
Federal Home Loan Bank advances and other borrowings	345,210	—	341,820	—
Securities sold under agreements to repurchase with retail customers	79,668	79,668	—	—

(1) In accordance with the prospective adoption of ASU 2016-01, the fair value of loans was measured using the exit price notion as of June 30, 2018. The fair value of loans was measured using the entry price notion as of December 31, 2017.

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 premises and equipment,

Bank Owned Life Insurance, deferred tax assets and goodwill. 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.

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OceanFirst Financial Corp.
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Note 9. Derivatives, Hedging Activities and Other Financial Instruments
As a result of the Sun acquisition, the Company acquired derivative financial instruments which involve, to varying degrees, interest rate, market and credit risk. The Company manages these risks as part of its asset and liability management process and through credit policies and procedures, seeking to minimize counterparty credit risk by establishing credit limits and collateral agreements. The Company utilizes certain derivative financial instruments to enhance its ability to manage interest rate risk that exists as part of its ongoing business operations. The derivative financial instruments acquired by the Company are an economic hedge of a derivative offering to Bank customers. The Company does not use derivative financial instruments for trading purposes.
Customer Derivatives – Interest Rate Swaps
As a result of the Sun acquisition, the Company acquired interest rate swaps that allow commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to an interest rate swap agreement, which serves to effectively swap the customer’s variable-rate loan into a fixed-rate loan. The Company then enters into a corresponding swap agreement with a third party in order to economically hedge its exposure through the customer agreement. The interest rate swaps with both the customers and third parties are not designated as hedges under FASB Accounting Standards Codification (“ASC”) Topic 815, Derivatives and Hedging, and are marked to market through earnings. As the interest rate swaps are structured to offset each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC Topic 820, Fair Value Measurements. The Company recognized $0 and $2,000 in other income resulting from fair value adjustments during the three and six months ended June 30, 2018, respectively.

The table below presents the notional and fair value of derivatives not designated as hedging instruments as well as their location on the consolidated statements of financial condition as of June 30, 2018 (in thousands):

	June 30, 2018	
Balance Sheet Location	Notional	Fair Value
Other assets	$12,530	$ 369
Other liabilities	12,530	369

Credit risk-related Contingent Features
As a result of the Sun acquisition, the Company is a party to an International Swaps and Derivatives Association agreement with a third party broker-dealer that requires a minimum dollar transfer amount upon a margin call. This requirement is dependent on certain specified credit measures. The amount of collateral posted with the third party at June 30, 2018 was $1.8 million. The amount of collateral posted with the third party is deemed to be sufficient to collateralize both the fair market value change as well as any additional amounts that may be required as a result of a change in the specified credit measures. The aggregate fair value of all derivative financial instruments in a liability position with credit measure contingencies and entered into with the third party was $369,000 at June 30, 2018.

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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.
Item 1A. Risk Factors
In addition to the risk factors relevant to the Company set forth in Part I, Item 1A, "Risk Factors," in the 2017 Form 10-K, stockholders and investors of the Company should consider the following risk factor. There were no other material changes to risk factors relevant to the Company's operations since December 31, 2017.
Recent New Jersey legislative changes may increase tax expense. In connection with adopting the 2019 fiscal year budget, the New Jersey legislature adopted, and the Governor signed, legislation that will increase the Company's state income tax liability and could increase the overall tax expense. The legislation imposes a temporary surtax on corporations earning New Jersey allocated income in excess of $1 million of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey's current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. Regulations implementing the legislative changes have not yet been issued, and the Company cannot yet fully evaluate the impact of the legislation on overall tax expense or the valuation of the deferred tax asset. It is likely that the Company will lose the benefit of various tax management strategies, and as a result, the total tax expense will increase, although the deferred tax asset valuation may also increase.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
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 of which 154,804 shares remain available for repurchase. On April 27, 2017, the Company announced the authorization of the Board of Directors to repurchase up to an additional 5% of the Company's outstanding common stock, or 1.6 million shares of which all shares authorized for repurchase remain available at June 30, 2018. There were 1,754,804 shares available for repurchase at June 30, 2018 under these two stock repurchase programs. The Company did not repurchase shares of its common stock during the three month period ended June 30, 2018.
Item 3. Defaults Upon Senior Securities
Not Applicable.
Item 4. Mine Safety Disclosures
Not Applicable.
Item 5. Other Information
Not Applicable.

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Item 6. Exhibits

Exhibit No:	Exhibit Description	Reference
3.1	Certificate of Amendment to the Certificate of Incorporation of OceanFirst Financial Corp., effective June 1, 2018	Incorporated by reference to Exhibit 3.1A of the Registrant's Current Report on Form 8-K filed June 4, 2018
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed here within this document
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed here within this document
32.0	Certification pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002	Filed here within this document
101.0	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, 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	

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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, 2018	/s/ Christopher D. Maher
		Christopher D. Maher
		Chairman, President and Chief Executive Officer
DATE:	August 8, 2018	/s/ Michael J. Fitzpatrick
		Michael J. Fitzpatrick
		Executive Vice President and Chief Financial Officer

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