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

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**FORM 10-K**

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- ☒ **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2006
- ☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 0-27428

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**OceanFirst Financial Corp.**  
(Exact name of registrant as specified in its charter)

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DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

22-3412577  
(I.R.S. Employer  
Identification No.)

975 Hooper Avenue, Toms River, New Jersey 08753  
(Address of principal executive offices)

Registrant's telephone number, including area code: (732) 240-4500

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**Securities registered pursuant to Section 12(b) of the Act:**

Common Stock, par value \$0.01 per share  
(Title of class)

The Nasdaq Stock Market LLC  
(Name of each exchange on which registered)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒ .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒ .

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K.  
☐

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, i.e., persons other than the directors and executive officers of the registrant, was \$254,256,750, based upon the closing price of such common equity as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares outstanding of the registrant's Common Stock as of March 27, 2007 was 12,318,370.

**DOCUMENTS INCORPORATED BY REFERENCE**

**Portions of the Annual Report to Stockholders for the year ended December 31, 2006, are incorporated by reference into Part II of this Form 10-K.**

**Portions of the Proxy Statement for the 2007 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.**



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**PART I**

**Item 1. Business**

**General**

OceanFirst Financial Corp. (the “Company”) was organized by the Board of Directors of OceanFirst Bank (the “Bank”) for the purpose of acquiring all of the capital stock of the Bank issued in connection with the Bank’s conversion from mutual to stock form, which was completed on July 2, 1996. On August 18, 2000 the Bank acquired Columbia Home Loans, LLC (“Columbia”), a mortgage banking company based in Westchester County, New York in a transaction accounted for as a purchase. At December 31, 2006, the Company had consolidated total assets of \$2.1 billion and total stockholders’ equity of \$132.3 million. The Company was incorporated under Delaware law and is a savings and loan holding company subject to regulation by the Office of Thrift Supervision (“OTS”), the Federal Deposit Insurance Corporation (“FDIC”) and the Securities and Exchange Commission (“SEC”). Currently, the Company does not transact any material business other than through its subsidiary, the Bank.

The Bank was originally founded as a state-chartered building and loan association in 1902, and converted to a federal savings and loan association in 1945. The Bank became a Federally-chartered mutual savings bank in 1989. The Bank’s principal business has been and continues to be attracting retail deposits from the general public in the communities surrounding its branch offices and investing those deposits, together with funds generated from operations and borrowings, primarily in single-family, owner-occupied residential mortgage loans. To a lesser extent, the Bank invests in other types of loans including commercial real estate, multi-family, construction, consumer and commercial loans. The Bank also invests in mortgage-backed securities, securities issued by the U.S. Government and agencies thereof, corporate securities and other investments permitted by applicable law and regulations. As a mortgage banking subsidiary of the Bank, Columbia originates, sells and services a full product line of residential mortgage loans. Columbia sells virtually all loan production into the secondary market, except that the Bank will often purchase adjustable-rate and fixed-rate mortgage loans originated by Columbia for inclusion in its loan portfolio. The Bank also periodically sells part of its mortgage loan production in order to manage interest rate risk and liquidity. Presently, servicing rights are retained in connection with most loan sales. The Bank’s revenues are derived principally from interest on its loans, and to a lesser extent, interest on its investment and mortgage-backed securities. The Bank also receives income from fees and service charges on loan and deposit products, including reverse mortgage loans, and from the sale of trust and asset management services and alternative investment products, e.g., mutual funds, annuities and life insurance. The Bank’s primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities (“MBS”), proceeds from the sale of loans, Federal Home Loan Bank (“FHLB”) advances and other borrowings and to a lesser extent, investment maturities.

The Company’s Internet website address is [www.oceanfirst.com](http://www.oceanfirst.com). The Company’s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available free of charge through its website, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The Company’s Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

In addition to historical information, this Form 10-K contains certain forward-looking statements which are based on certain assumptions and describes 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,” or similar expressions. 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, 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

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Company's market area and accounting principles and guidelines. These risks and uncertainties 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.

### Market Area and Competition

The Bank is a community-oriented financial institution, offering a wide variety of financial services to meet the needs of the communities it serves. The Bank conducts its business through an administrative and branch office located in Toms River, New Jersey, and twenty additional branch offices. Seventeen of the twenty-one branch offices are located in Ocean County with three located in Monmouth County and one located in Middlesex County, New Jersey. One of the branches opened in 2006 was to relocate an existing facility to a preferred location. To complete the relocation, the older branch is expected to close in 2007. The Bank's deposit gathering base is concentrated in the communities surrounding its offices. While the Bank's lending activities are concentrated in the sub markets served by its branch office network, lending activities extend throughout New Jersey, and to a lesser extent, adjacent markets served by Columbia. Lending activities are supported by loan production offices in Red Bank and Kenilworth, New Jersey. Columbia's loan volume is primarily derived from the tri-state area around New York City. Columbia conducts business through an administrative and production office in Valhalla, New York and satellite production offices in adjacent markets.

The Bank is the oldest and largest community-based financial institution headquartered in Ocean County, New Jersey, which is located along the central New Jersey shore. Ocean County is among the fastest growing population areas in New Jersey and has a significant number of retired residents who have traditionally provided the Bank with a stable source of deposit funds. The economy in the Bank's primary market area is based upon a mixture of service and retail trade. Other employment is provided by a variety of wholesale trade, manufacturing, Federal, state and local government, hospitals and utilities. The area is also home to commuters working in New Jersey suburban areas around New York and Philadelphia.

The Bank faces significant competition both in making loans and in attracting deposits. The State of New Jersey has a high density of financial institutions, many of which are branches of significantly larger institutions headquartered out-of-market which have greater financial resources than the Bank, all of which are competitors of the Bank to varying degrees. The Bank's competition for loans comes principally from commercial banks, savings banks, savings and loan associations, credit unions, mortgage banking companies and insurance companies. Its most direct competition for deposits has historically come from commercial banks, savings banks, savings and loan associations and credit unions although the Bank also faces increasing competition for deposits from short-term money market funds, other corporate and government securities funds, Internet only providers and from other financial service institutions such as brokerage firms and insurance companies.

### Lending Activities

Loan Portfolio Composition. The Bank's loan portfolio consists primarily of conventional first mortgage loans secured by one-to-four family residences. At December 31, 2006, the Bank had total loans outstanding of \$1.791 billion, of which \$1.232 billion or 68.8% of total loans were one-to-four family, residential mortgage loans. The remainder of the portfolio consisted of \$306.3 million of commercial real estate, multi-family and land loans, or 17.1% of total loans; \$13.5 million of real estate construction loans, or 0.7% of total loans; \$190.0 million of consumer loans, primarily home equity loans and lines of credit, or 10.6% of total loans; and \$49.7 million of commercial loans, or 2.8% of total loans. Included in total loans are \$82.9 million in loans held for sale at December 31, 2006. At that same date, 49.4% of the Bank's total loans had adjustable interest rates.

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The types of loans that the Bank may originate are subject to federal and state law and regulations. Interest rates charged by the Bank on loans are affected by the demand for such loans and the supply of money available for lending purposes and the rates offered by competitors. These factors are, in turn, affected by, among other things, economic conditions, monetary policies of the Federal government, including the Federal Reserve Board, and legislative tax policies.

The following table sets forth the composition of the Bank's loan portfolio in dollar amounts and as a percentage of the portfolio at the dates indicated.

|                                               | 2006               |                  | 2005               |                  | At December 31,<br>2004          |                  | 2003               |                  | 2002               |                  |
|-----------------------------------------------|--------------------|------------------|--------------------|------------------|----------------------------------|------------------|--------------------|------------------|--------------------|------------------|
|                                               | Amount             | Percent of Total | Amount             | Percent of Total | Amount<br>(Dollars in thousands) | Percent of Total | Amount             | Percent of Total | Amount             | Percent of Total |
| Real estate:                                  |                    |                  |                    |                  |                                  |                  |                    |                  |                    |                  |
| One-to-four family                            | \$1,231,716        | 68.77%           | \$1,187,226        | 69.83%           | \$1,126,585                      | 72.70%           | \$1,081,901        | 75.50%           | \$1,101,904        | 77.94%           |
| Commercial real estate, multi-family and land | 306,288            | 17.10            | 281,585            | 16.56            | 243,299                          | 15.70            | 205,066            | 14.31            | 146,149            | 10.34            |
| Construction                                  | 13,475             | .75              | 22,739             | 1.34             | 19,189                           | 1.23             | 11,274             | .79              | 11,079             | .78              |
| Consumer (1)                                  | 190,029            | 10.61            | 146,911            | 8.64             | 99,279                           | 6.41             | 81,455             | 5.68             | 80,218             | 5.67             |
| Commercial                                    | 49,693             | 2.77             | 61,637             | 3.63             | 61,290                           | 3.96             | 53,231             | 3.72             | 74,545             | 5.27             |
| Total loans                                   | 1,791,201          | 100.00%          | 1,700,098          | 100.00%          | 1,549,642                        | 100.00%          | 1,432,927          | 100.00%          | 1,413,895          | 100.00%          |
| Loans in process                              | (2,318)            |                  | (7,646)            |                  | (5,970)                          |                  | (3,829)            |                  | (3,531)            |                  |
| Deferred origination costs, net               | 5,723              |                  | 4,596              |                  | 3,888                            |                  | 4,136              |                  | 2,239              |                  |
| Unamortized discount, net                     | —                  |                  | —                  |                  | (4)                              |                  | (5)                |                  | (5)                |                  |
| Allowance for loan losses                     | (10,238)           |                  | (10,460)           |                  | (10,688)                         |                  | (10,802)           |                  | (10,074)           |                  |
| Total loans, net                              | 1,784,368          |                  | 1,686,588          |                  | 1,536,868                        |                  | 1,422,427          |                  | 1,402,524          |                  |
| Less:                                         |                    |                  |                    |                  |                                  |                  |                    |                  |                    |                  |
| Mortgage loans held for sale                  | 82,943             |                  | 32,044             |                  | 63,961                           |                  | 33,207             |                  | 66,626             |                  |
| Loans receivable, net                         | <u>\$1,701,425</u> |                  | <u>\$1,654,544</u> |                  | <u>\$1,472,907</u>               |                  | <u>\$1,389,220</u> |                  | <u>\$1,335,898</u> |                  |
| Total loans:                                  |                    |                  |                    |                  |                                  |                  |                    |                  |                    |                  |
| Adjustable rate                               | \$ 885,342         | 49.43%           | \$ 975,672         | 57.39%           | \$ 849,034                       | 54.79%           | \$ 670,398         | 46.79%           | \$ 622,348         | 44.02%           |
| Fixed rate                                    | 905,859            | 50.57            | 724,426            | 42.61            | 700,608                          | 45.21            | 762,529            | 53.21            | 791,547            | 55.98            |
|                                               | <u>\$1,791,201</u> | <u>100.00%</u>   | <u>\$1,700,098</u> | <u>100.00%</u>   | <u>\$1,549,642</u>               | <u>100.00%</u>   | <u>\$1,432,927</u> | <u>100.00%</u>   | <u>\$1,413,895</u> | <u>100.00%</u>   |

(1) Consists primarily of home equity loans and lines of credit, and to a lesser extent, loans on savings accounts and automobile loans.

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Loan Maturity. The following table shows the contractual maturity of the Bank's total loans at December 31, 2006. The table does not include principal repayments. Principal repayments, including prepayments on total loans was \$563.7 million, \$444.0 million, and \$443.6 million for the years ended December 31, 2006, 2005 and 2004, respectively.

|                                     | At December 31, 2006 |                                               |                  |                  |                  |                        |
|-------------------------------------|----------------------|-----------------------------------------------|------------------|------------------|------------------|------------------------|
|                                     | One-to-Four Family   | Commercial real estate, multi-family and land | Construction     | Consumer         | Commercial       | Total Loans Receivable |
|                                     | (In thousands)       |                                               |                  |                  |                  |                        |
| One year or less                    | \$ 12,208            | \$ 53,610                                     | \$ 13,475        | \$ 545           | \$ 27,164        | \$ 107,002             |
| After one year:                     |                      |                                               |                  |                  |                  |                        |
| More than one year to three years   | 3,092                | 71,309                                        | —                | 1,681            | 9,843            | 85,925                 |
| More than three years to five years | 5,092                | 52,575                                        | —                | 6,093            | 6,159            | 69,919                 |
| More than five years to ten years   | 65,128               | 81,861                                        | —                | 26,585           | 6,527            | 180,101                |
| More than ten years to twenty years | 245,116              | 37,224                                        | —                | 155,125          | —                | 437,465                |
| More than twenty years              | 901,080              | 9,709                                         | —                | —                | —                | 910,789                |
| Total due after December 31, 2007   | 1,219,508            | 252,678                                       | —                | 189,484          | 22,529           | 1,684,199              |
| Total amount due                    | <u>\$1,231,716</u>   | <u>\$ 306,288</u>                             | <u>\$ 13,475</u> | <u>\$190,029</u> | <u>\$ 49,693</u> | 1,791,201              |
| Loans in process                    |                      |                                               |                  |                  |                  | (2,318)                |
| Deferred origination costs, net     |                      |                                               |                  |                  |                  | 5,723                  |
| Allowance for loan losses           |                      |                                               |                  |                  |                  | (10,238)               |
| Total loans, net                    |                      |                                               |                  |                  |                  | 1,784,368              |
| Less: Mortgage loans held for sale  |                      |                                               |                  |                  |                  | 82,943                 |
| Loans receivable, net               |                      |                                               |                  |                  |                  | <u>\$1,701,425</u>     |

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The following table sets forth at December 31, 2006, the dollar amount of total loans receivable contractually due after December 31, 2007, and whether such loans have fixed interest rates or adjustable interest rates.

|                                               | Due After December 31, 2007 |                              |                     |
|-----------------------------------------------|-----------------------------|------------------------------|---------------------|
|                                               | Fixed                       | Adjustable<br>(In thousands) | Total               |
| Real estate loans:                            |                             |                              |                     |
| One-to-four family                            | \$ 485,421                  | \$ 734,087                   | \$ 1,219,508        |
| Commercial real estate, multi-family and land | 199,527                     | 53,151                       | 252,678             |
| Consumer                                      | 113,503                     | 75,981                       | 189,484             |
| Commercial                                    | 14,819                      | 7,710                        | 22,529              |
| Total loans receivable                        | <u>\$ 813,270</u>           | <u>\$ 870,929</u>            | <u>\$ 1,684,199</u> |

**Origination, Sale, Servicing and Purchase of Loans.** The Bank's residential mortgage lending activities are conducted primarily by commissioned loan representatives in the exclusive employment of the Bank. The Bank originates both adjustable-rate and fixed-rate loans. The type of loan originated is dependent upon the relative customer demand for fixed-rate or adjustable-rate mortgage ("ARM") loans, which is affected by the current and expected future level of interest rates. Columbia, as a mortgage banker, sells virtually all loan production except that the Bank may purchase adjustable-rate and fixed-rate mortgage loans originated by Columbia for inclusion in its loan portfolio. Based upon availability and best execution Columbia sells its loan production on both a servicing released and servicing retained basis.

Columbia has entered into loan sale agreements with investors in the normal course of business. The loan sale agreements may require Columbia to repurchase certain loans previously sold in the event of an Early Payment Default, generally defined as the failure by the borrower to make a payment within a designated period early in the loan term. Columbia may also be required to repurchase loans in the event of a breach of a representation or warranty or a misrepresentation during the loan origination process. A portion of Columbia's loan production consists of subprime mortgage loans which are made to individuals whose borrowing needs are generally not fulfilled by traditional financial institutions because they do not satisfy the credit documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers. These mortgage loans are generally underwritten to investor specifications, subjected to investor due diligence and subsequently sold to investors. Despite these procedures, the risk of an Early Payment Default and subsequent repurchase of these loans is significantly greater than conventional mortgage loans. For the year ended December 31, 2006, Columbia originated \$728.3 million in total loans, of which \$299.8 million was in subprime loans, representing 41.2% of the total loans it originated. Included in this amount is \$148.2 million of a new subprime loan product which Columbia began offering in 2006. This product provided the borrower with 100% financing relative to the value of the underlying property. During the first quarter of 2007, Columbia discontinued the origination of subprime loans.

For the year ended December 31, 2006 the Company established a reserve for repurchased loans of \$9.6 million related to potential losses on loans sold which may have to be repurchased due to an Early Payment Default or a violation of a misrepresentation or warranty. Provisions for losses are charged to gain on sale of loans and credited to the reserve while actual losses are charged to the reserve. In order to estimate an appropriate reserve for repurchased loans, the Company considers recent and historical experience, product type and volume of recent whole loan sales and the general economic environment. Management believes that the Company has established and maintained the reserve for repurchased loans at adequate levels, however, future adjustments to the reserve may be necessary due to economic, operating or other conditions beyond the Company's control.

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The Bank also periodically sells part of its mortgage production in order to manage interest rate risk and liquidity. See “Loan Servicing.” At December 31, 2006 there were \$82.9 million in loans categorized as held for sale.

The following table sets forth the Bank’s loan originations, purchases, sales, principal repayments and loan activity, including loans held for sale, for the periods indicated.

|                                               | For the Year December 31, |                        |                     |
|-----------------------------------------------|---------------------------|------------------------|---------------------|
|                                               | 2006                      | 2005<br>(In thousands) | 2004                |
| Total loans:                                  |                           |                        |                     |
| Beginning balance                             | \$ 1,700,098              | \$ 1,549,642           | \$ 1,432,927        |
| Loans originated:                             |                           |                        |                     |
| One-to-four family                            | 900,595                   | 1,008,342              | 817,198             |
| Commercial real estate, multi-family and land | 93,555                    | 83,511                 | 88,758              |
| Construction                                  | 8,814                     | 9,617                  | 17,320              |
| Consumer                                      | 225,663                   | 172,146                | 76,844              |
| Commercial                                    | 115,814                   | 32,820                 | 59,909              |
| Total loans originated                        | <u>1,344,441</u>          | <u>1,306,436</u>       | <u>1,060,029</u>    |
| Total                                         | 3,044,539                 | 2,856,078              | 2,492,956           |
| Less:                                         |                           |                        |                     |
| Principal repayments                          | 563,707                   | 444,028                | 443,631             |
| Sales of loans                                | 689,561                   | 711,952                | 499,395             |
| Transfer to REO                               | 70                        | —                      | 288                 |
| Total loans                                   | <u>\$ 1,791,201</u>       | <u>\$ 1,700,098</u>    | <u>\$ 1,549,642</u> |

**One-to-Four Family Mortgage Lending.** The Bank offers both fixed-rate, regular amortizing adjustable-rate and interest-only mortgage loans secured by one-to-four family residences with maturities up to 30 years. The majority of such loans are secured by property located in the Bank’s primary market area. Loan originations are typically generated by commissioned loan representatives and their contacts within the local real estate industry, members of the local communities and the Bank’s existing or past customers.

At December 31, 2006, the Bank’s total loans outstanding were \$1.791 billion, of which \$1.232 billion, or 68.8%, were one-to-four family residential mortgage loans, primarily single-family and owner-occupied. To a lesser extent and included in this activity are residential mortgage loans secured by seasonal second homes and non-owner occupied investment properties. The average size of the Bank’s one-to-four family mortgage loan was approximately \$184,000 at December 31, 2006. The Bank currently offers a number of ARM loan programs with interest rates which adjust every one-, three-, five- or ten-years. The Bank’s ARM loans generally provide for periodic (not less than 2%) and overall (not more than 6%) caps on the increase or decrease in the interest rate at any adjustment date and over the life of the loan. The interest rate on these loans is indexed to the applicable one-, three-, five- or ten-year U.S. Treasury constant maturity yield, with a repricing margin which ranges generally from 2.50% to 3.25% above the index. The Bank also offers three-, five-, seven- and ten-year ARM loans which operate as fixed-rate loans for three, five, seven or ten years and then convert to one-year ARM loans for the remainder of the term. The ARM loans are then indexed to a margin of generally 2.50% to 3.25% above the one-year U.S. Treasury constant maturity yield.

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Generally, ARM loans pose credit risks different than risks inherent in fixed-rate loans, primarily because as interest rates rise, the payments of the borrower rise, thereby increasing the potential for delinquency and default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. In order to minimize risks, borrowers of one-year ARM loans with a loan-to-value ratio of 75% or less are qualified at the fully-indexed rate (the applicable U.S. Treasury index plus the margin, rounded to the nearest one-eighth of one percent), and borrowers of one-year ARM loans with a loan-to-value ratio over 75% are qualified at the higher of the fully indexed rate or the initial rate plus the 2% annual interest rate cap. The Bank does not originate ARM loans which provide for negative amortization. The Bank does offer interest-only ARM loans in which the borrower makes only interest payments for the first five, seven or ten years of the mortgage loan term and then convert to a fully amortizing loan until maturity. Borrowers for interest-only ARM loans originated for portfolio are qualified at the fully indexed rate when the loan reprices in less than five years and are qualified at the fully amortized payment when the loan reprices in more than five years. The interest-only feature will result in future increases in the borrower's loan repayment when the contractually required payments increase due to the required amortization of the principal amount. These payment increases could affect a borrower's ability to repay the loan. The amount of interest-only one-to-four family mortgage loans at December 31, 2006 was \$227.0 million.

The Bank's fixed-rate mortgage loans currently are made for terms from 10 to 30 years. The normal terms for fixed-rate loan commitments provide for a maximum of 60 days rate lock upon receipt of a 0.5% to 1.0% fee charged on the mortgage amount which typically becomes non-refundable in the event the loan does not close prior to expiration of the rate lock. The Bank may periodically sell part of the fixed-rate residential mortgage loans that it originates. The Bank retains the servicing on all loans sold. The Bank generally retains for its portfolio shorter term, fixed-rate loans and certain longer term fixed-rate loans, generally consisting of loans to facilitate the sale of Real Estate Owned ("REO") and loans to officers, directors or employees of the Bank. The Bank may retain a portion of its longer term fixed-rate loans after considering volume and yield and after evaluating interest rate risk and capital management considerations. The retention of fixed-rate mortgage loans may increase the level of interest rate risk exposure of the Bank, as the rates on these loans will not adjust during periods of rising interest rates and the loans can be subject to substantial increases in prepayments during periods of falling interest rates.

The Bank's policy is to originate one-to-four family residential mortgage loans in amounts up to 80% of the lower of the appraised value or the selling price of the property securing the loan and up to 97% of the appraised value or selling price if private mortgage insurance is obtained (up to 100% for certain Community Reinvestment Act related programs covered by private mortgage insurance). Generally, independent appraisals are obtained for loans secured by real property, however, as allowed by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), under certain defined circumstances, a real estate collateral analysis is obtained instead. The average loan-to-value ratio of the Bank's one-to-four family mortgage loans was 62% at December 31, 2006. Title insurance is required for all first mortgage loans. Mortgage loans originated by the Bank include due-on-sale clauses which provide the Bank with the contractual right to declare the loan immediately due and payable in the event the borrower transfers ownership of the property without the Bank's consent. Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio and the Bank has generally exercised its rights under these clauses.

Commercial Real Estate, Multi-Family and Land Lending. The Bank originates commercial real estate loans that are secured by properties, or properties under construction, generally used for business purposes such as small office buildings or retail facilities, the majority of which are located in the Bank's primary market area. The Bank's underwriting procedures provide that commercial real estate loans may

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be made in amounts up to 80% of the appraised value of the property. The Bank currently originates commercial real estate loans with terms of up to twenty five years with fixed or adjustable rates which are indexed to a margin above the corresponding U.S. Treasury constant maturity yield. The loans typically contain prepayment penalties over the initial three to five years. In reaching its decision on whether to make a commercial real estate loan, the Bank considers the net operating income of the property and the borrower's expertise, credit history, profitability and the term and quantity of leases. The Bank has generally required that the properties securing commercial real estate loans have debt service coverage ratios of at least 130%. The Bank typically requires the personal guarantee of the principal borrowers for all commercial real estate loans. The Bank's commercial real estate loan portfolio at December 31, 2006 was \$306.3 million, or 17.1% of total loans. The largest commercial real estate loan in the Bank's portfolio at December 31, 2006 was a performing loan for which the Bank had an outstanding carrying balance of \$8.6 million, secured by a first mortgage on commercial real estate used as a health care facility. The average size of the Bank's commercial real estate loans at December 31, 2006 was approximately \$522,000.

The commercial real estate portfolio includes loans for the construction of commercial properties. Typically, these loans are underwritten based upon commercial leases in place prior to funding. In many cases, commercial construction loans are extended to owners that intend to occupy the property for business operations, in which case the loan is based upon the financial capacity of the related business and the owner of the business. At December 31, 2006, the Bank had an outstanding balance in commercial construction loans of \$20.8 million.

The Bank also originates multi-family mortgage loans and land loans on a limited and highly selective basis. The Bank's multi-family loans and land loans at December 31, 2006, totaled \$3.0 million and \$4.4 million, respectively.

Loans secured by multi-family residential properties are generally larger and involve a greater degree of risk than one-to-four family residential mortgage loans. Because payments on loans secured by multi-family properties are often dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through its underwriting policies, which require such loans to be qualified at origination on the basis of the property's income and debt coverage ratio.

Residential Construction Lending. At December 31, 2006, residential construction loans totaled \$13.5 million, or 0.7%, of the Bank's total loans outstanding. The Bank originates residential construction loans primarily on a construction/permanent basis with such loans converting to an amortizing loan following the completion of the construction phase. Most of the Bank's construction loans are made to individuals building their primary residence, while, to a lesser extent, loans are made to finance a second home or to developers known to the Bank in order to build single-family houses for sale, which loans become due and payable over terms generally not exceeding 18 months. The current policy of the Bank is to charge interest rates on its construction loans which float at margins which are generally 0.5% to 2.0% above the prime rate (as published in the *Wall Street Journal*). The Bank's construction loans increase the interest rate sensitivity of its earning assets. At December 31, 2006, the Bank had 21 residential construction loans, with the largest exposure relating to a \$3.5 million performing loan. The Bank may originate construction loans to individuals and contractors on approved building lots in amounts typically no greater than 75% of the appraised value of the land and the building. Once construction is complete, the loans are either paid in full or converted to permanent amortizing loans with maturities similar to the Bank's other one-to-four family mortgage products. The Bank requires an appraisal of the property, credit reports, and financial statements on all principals and guarantors, among other items, for all construction loans.

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Construction lending, by its nature, entails additional risks compared to one-to-four family mortgage lending, attributable primarily to the fact that funds are advanced based upon a security interest in a project which is not yet complete. As a result, construction lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower or guarantor to repay the loan. Because of these factors, the analysis of prospective construction loan projects requires an expertise that is different in significant respects from that which is required for residential mortgage lending. The Bank seeks to address these risks through its underwriting procedures.

Consumer Loans. The Bank also offers consumer loans. At December 31, 2006, the Bank's consumer loans totaled \$190.0 million, or 10.6% of the Bank's total loan portfolio. Of that amount, home equity loans comprised \$116.4 million, or 61.3%; home equity lines of credit comprised \$73.1 million, or 38.5%; loans on savings accounts totaled \$201,000, or 0.1%; and automobile and overdraft line of credit loans totaled \$240,000 or 0.1%.

The Bank originates home equity loans typically secured by second liens on one-to-four family residences. These loans are originated as either adjustable-rate or fixed-rate loans with terms ranging from 5 to 20 years. Home equity loans are typically made on owner-occupied, one-to-four family residences and generally to Bank customers. Generally, these loans are subject to a 80% loan-to-value limitation, including any other outstanding mortgages or liens, although the Bank will also originate loans with loan-to-value limitations of up to 90%, subject to more restrictive underwriting requirements.

The Bank also offers a variable-rate home equity line of credit which extends a credit line based on the applicant's income and equity in the home. Generally, the credit line, when combined with the balance of the first mortgage lien, may not exceed 80% of the appraised value of the property at the time of the loan commitment, although the Bank will also originate loans with loan-to-value limitations of up to 90%, subject to more restrictive underwriting requirements. Home equity lines of credit are secured by a mortgage on the underlying real estate. The Bank presently charges no origination fees for these loans, but may in the future charge origination fees for its home equity lines of credit. The Bank does, however, charge early termination fees should a line of credit be closed within three years of origination. A borrower is required to make monthly payments of principal and interest, at a minimum of \$50, based upon a 10, 15 or 20 year amortization period. The Bank also offers home equity lines of credit which require the payment of interest only during the first five years with fully amortizing payments thereafter. Generally, the adjustable rate of interest charged is based upon the prime rate of interest (as published in the *Wall Street Journal* ), although the range of interest rates charged may vary from 1.0% below prime to 1.5% over prime. The loans have an 18% lifetime cap on interest rate adjustments.

Commercial Lending. At December 31, 2006, commercial loans totaled \$49.7 million, or 2.8% of the Bank's total loans outstanding. The Commercial Lending group's primary function is to service the business communities' banking and financing needs in the Bank's primary market area. The Commercial Lending group originates both commercial real estate loans and commercial loans (including loans for working capital; fixed asset purchases; and acquisition, receivable and inventory financing). Credit facilities such as lines of credit and term loans will be used to facilitate these requests. In all cases, the Bank will review and analyze financial history and capacity, collateral value, strength and character of the principals, and general payment history of the borrower and principals in coming to a credit decision. The Bank typically requires the personal guarantee of the principal borrowers for all commercial loans.

A well-defined credit policy has been approved by the Bank's Board of Directors. This policy discourages high risk credits, while focusing on quality underwriting, sound financial strength and close

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monitoring. Commercial business lending, both secured and unsecured, is generally considered to involve a higher degree of risk than secured residential real estate lending. Risk of loss on a commercial business loan is dependent largely on the borrower's ability to remain financially able to repay the loan from ongoing operations. If the Bank's estimate of the borrower's financial ability is inaccurate, the Bank may be confronted with a loss of principal on the loan. The Bank's largest commercial loan at December 31, 2006 was a performing loan with an outstanding balance of \$2.6 million which was secured by a first lien on all corporate assets. The average size of the Bank's commercial loans at December 31, 2006 was approximately \$140,000.

Loan Approval Procedures and Authority. The Board of Directors establishes the loan approval policies of the Bank based on total exposure to the individual borrower. The Board of Directors has authorized the approval of loans with a total exposure of up to \$7.0 million by various officers of the Bank or a management credit committee, on a scale which requires approval by personnel with progressively higher levels of responsibility as the loan amount increases. A minimum of two employees' signatures are required to approve residential loans over conforming loan limits. Loans with a total exposure in excess of \$3.0 million require approval by the Management Credit Committee. Loans with a total exposure in excess of \$7.0 million require approval by the Board of Directors. The Bank's loan approval policies also apply to loans originated by Columbia except as may be otherwise specified by individual investor guidelines with respect to loans originated for sale. The Bank's loan approval policies also delegate approval authority to specified employees at Columbia within assigned exposure limits for loans originated for the Bank's portfolio. Columbia maintains a Credit Policy that establishes the delegated authority levels for loans originated for sale. Pursuant to OTS regulations, loans to one borrower generally cannot exceed 15% of the Bank's unimpaired capital, which at December 31, 2006 amounted to \$19.7 million. At December 31, 2006, the Bank's maximum loan exposure to a single borrower was \$10.7 million, net of participations sold. This relationship consists of nine separate credit facilities and several of the notes have separate and distinct guarantors.

Loan Servicing. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, making inspections as required of mortgaged premises, contacting delinquent borrowers, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. The Bank also services mortgage loans for others. All of the loans currently being serviced for others are loans which have been sold by the Bank. At December 31, 2006, the Bank was servicing \$992.7 million of loans for others. For the years ended December 31, 2006, 2005 and 2004, loan servicing income, net of related amortization and write down of the loan servicing asset, totaled \$515,000, \$280,000 and \$328,000, respectively. The Bank evaluates mortgage servicing rights for impairment on a quarterly basis. The valuation of mortgage servicing rights is determined through a discounted analysis of future cash flows, incorporating numerous assumptions which are subject to significant change in the near term. Generally, a decline in market interest rates will cause expected repayment speeds to increase resulting in a lower valuation for mortgage servicing rights and ultimately lower future servicing fee income.

Delinquencies and Classified Assets. The Board of Directors performs a monthly review of all delinquent loan totals which includes loans sixty days or more past due, and the detail of each loan thirty days or more past due that was originated within the past year. In addition, the Chief Risk Officer compiles a quarterly list of all classified loans and a narrative report of classified commercial, commercial real estate, multi-family, land and construction loans. The steps taken by the Bank with respect to delinquencies vary depending on the nature of the loan and period of delinquency. When a borrower fails to make a required payment on a loan, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. The Bank generally sends the borrower a written notice of non-payment after the loan is first past due. In the event payment is not then

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received, additional letters and phone calls generally are made. If the loan is still not brought current and it becomes necessary for the Bank to take legal action, which typically occurs after a loan is delinquent at least 90 days or more, the Bank will commence foreclosure proceedings against any real property that secures the loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or an acceptable workout accommodation is not agreed upon before the foreclosure sale, the real property securing the loan generally is sold at foreclosure.

The Bank's Internal Asset Classification Committee, which is chaired by the Chief Risk Officer who reports directly to the Audit Committee of the Board of Directors, reviews and classifies the Bank's assets quarterly and reports the results of its review to the Board of Directors. The Bank classifies assets in accordance with certain regulatory guidelines established by the OTS which are applicable to all savings institutions. At December 31, 2006, the Bank had \$8.2 million of assets, including all REO, classified as Substandard, \$185,000 of assets classified as Doubtful and no assets classified as Loss. Loans and other assets may also be placed on a watch list as "Special Mention" assets. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated "Special Mention." Special Mention assets totaled \$18.2 million at December 31, 2006. Loans are classified as Special Mention due to past delinquencies or other identifiable weaknesses. The Substandard classification includes \$4.6 million of commercial loans, the largest being a \$2.6 million relationship for the construction of townhouses. The loans in the relationship are delinquent from 60 to 90 days and the project has experienced construction delays. The loans are secured by residential real estate. The Special Mention classification includes one relationship for \$7.8 million which was fully repaid in January 2007. The second largest Special Mention relationship was a \$4.5 million credit to a real estate agency which was current as to payments, but classified due to declining revenue and net income of the borrower. The loan is secured by commercial real estate, corporate assets and the personal guarantees of the principals.

### Non-Accrual Loans and REO

The following table sets forth information regarding non-accrual loans and REO. The Bank had no troubled-debt restructured loans and one REO property at December 31, 2006. It is the policy of the Bank to cease accruing interest on loans 90 days or more past due or in the process of foreclosure. For the years ended December 31, 2006, 2005, 2004, 2003 and 2002, respectively, the amount of interest income that would have been recognized on non-accrual loans if such loans had continued to perform in accordance with their contractual terms was \$189,000, \$115,000, \$128,000, \$96,000, and \$87,000.

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|                                                                          | 2006            | 2005            | December 31,<br>2004<br>(Dollars in thousands) | 2003            | 2002            |
|--------------------------------------------------------------------------|-----------------|-----------------|------------------------------------------------|-----------------|-----------------|
| Non-accrual loans:                                                       |                 |                 |                                                |                 |                 |
| Real estate:                                                             |                 |                 |                                                |                 |                 |
| One-to-four family                                                       | \$ 2,703        | \$ 1,084        | \$ 1,337                                       | \$ 1,712        | \$ 2,222        |
| Commercial real estate, multi-family and land                            | 286             | —               | 744                                            | 242             | 74              |
| Consumer                                                                 | 281             | 299             | 784                                            | 90              | 95              |
| Commercial                                                               | 1,255           | 212             | 623                                            | 118             | 297             |
| Total                                                                    | 4,525           | 1,595           | 3,488                                          | 2,162           | 2,688           |
| REO, net(1)                                                              | 288             | 278             | 288                                            | 252             | 141             |
| Total non-performing assets                                              | <u>\$ 4,813</u> | <u>\$ 1,873</u> | <u>\$ 3,776</u>                                | <u>\$ 2,414</u> | <u>\$ 2,829</u> |
| Allowance for loan losses as a percent of total loans receivable (2)     | .57%            | .62%            | .69%                                           | .75%            | .71%            |
| Allowance for loan losses as a percent of total non-performing loans (3) | 226.25          | 655.80          | 306.42                                         | 499.63          | 374.78          |
| Non-performing loans as a percent of total loans receivable (2)(3)       | .25             | .09             | .23                                            | .15             | .19             |
| Non-performing assets as a percent of total assets (3)                   | .23             | .09             | .20                                            | .14             | .16             |

(1) REO balances are shown net of related loss allowances.

(2) Total loans includes loans receivable and mortgage loans held for sale.

(3) Non-performing assets consist of non-performing loans and REO. Non-performing loans consist of all loans 90 days or more past due and other loans in the process of foreclosure.

Allowance for Loan Losses. The allowance for loan losses is a valuation account that reflects probable incurred losses in the loan portfolio based on management's evaluation of the risks inherent in its loan portfolio and the general economy. The Bank maintains the allowance for loan losses through provisions for loan losses that are charged to income. Charge-offs against the allowance for loan losses are taken on loans where management determines that the collection of loan principal is unlikely. Recoveries made on loans that have been charged-off are credited to the allowance for loan losses.

The allowance for loan losses is maintained at an amount management considers sufficient to provide for probable losses based on evaluating known and inherent risks in the loan portfolio resulting from management's continuing analysis of the factors underlying the quality of the loan portfolio. These factors include changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, detailed analysis of individual loans for which full collectibility may not be assured, and the determination of the existence and realizable value of the collateral and guarantees securing the loan.

The Bank's allowance for loan losses consists of a specific allowance and a general allowance, each updated on a quarterly basis. A specific allowance is determined for all assets classified as Substandard,

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Doubtful or Loss where the value of the underlying collateral can reasonably be evaluated; generally those loans secured by real estate. The Bank obtains an updated appraisal whenever a loan secured by real estate becomes 90 days delinquent. The specific allowance represents the difference between the Bank's recorded investment in the loan and the fair value of the collateral, less estimated disposal costs. A general allowance is determined for all other classified and non-classified loans. In determining the level of the general allowance, the Bank segments the loan portfolio into various risk tranches based on type of loan (mortgage, consumer and commercial); and certain underwriting characteristics. An estimated loss factor is then applied to each risk tranche. The loss factors are determined based upon historical loan loss experience, current economic conditions, underwriting standards, internal loan review results and other factors.

An overwhelming percentage of the Bank's loan portfolio, whether one-to-four family, consumer or commercial, is secured by real estate. Additionally, most of the Bank's borrowers are located in Ocean and Monmouth Counties, New Jersey and the surrounding area. These concentrations may adversely affect the Bank's loan loss experience should local real estate values decline or should the markets served experience an adverse economic shock.

Management believes the primary risks inherent in the portfolio are possible increases in interest rates, a decline in the economy, generally, and a decline in real estate market values. Any one or a combination of these events may adversely affect the borrowers' ability to repay the loans, resulting in increased delinquencies, loan losses and future levels of provisions. Accordingly, the Bank has provided for loan losses at the current level to address the current risk in the loan portfolio.

Although management believes that the Bank has established and maintained the allowance for loan losses at adequate levels to reserve for inherent losses probable in its loan portfolio, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to make additional provisions for loan losses based upon information available to them at the time of their examination. Although management uses the best information available, future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Bank's control.

As of December 31, 2006 and 2005, the Bank's allowance for loan losses was .57% and .62%, respectively, of total loans. The Bank had non-accrual loans of \$4.5 million and \$1.6 million at December 31, 2006 and 2005, respectively. The Bank will continue to monitor and modify its allowance for loan losses as conditions dictate.

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The following table sets forth activity in the Bank's allowance for loan losses for the periods set forth in the table.

|                                                                                           | At or for the Year Ended |                 |                 |                 |                 |
|-------------------------------------------------------------------------------------------|--------------------------|-----------------|-----------------|-----------------|-----------------|
|                                                                                           | 2006                     | 2005            | 2004            | 2003            | 2002            |
|                                                                                           | (Dollars in thousands)   |                 |                 |                 |                 |
| Balance at beginning of year                                                              | <u>\$10,460</u>          | <u>\$10,688</u> | <u>\$10,802</u> | <u>\$10,074</u> | <u>\$10,351</u> |
| Charge-offs:                                                                              |                          |                 |                 |                 |                 |
| Real Estate:                                                                              |                          |                 |                 |                 |                 |
| One-to-four family                                                                        | 113                      | 11              | 175             | 78              | 149             |
| Commercial real estate, multi-family and land                                             | —                        | —               | —               | —               | —               |
| Consumer                                                                                  | 6                        | —               | —               | —               | 2               |
| Commercial                                                                                | <u>450</u>               | <u>673</u>      | <u>312</u>      | <u>180</u>      | <u>2,368</u>    |
| Total                                                                                     | 569                      | 684             | 487             | 258             | 2,519           |
| Recoveries                                                                                | <u>197</u>               | <u>106</u>      | <u>73</u>       | <u>298</u>      | <u>592</u>      |
| Net charge-offs (recoveries)                                                              | <u>372</u>               | <u>578</u>      | <u>414</u>      | <u>(40)</u>     | <u>1,927</u>    |
| Provision for loan losses                                                                 | <u>150</u>               | <u>350</u>      | <u>300</u>      | <u>688</u>      | <u>1,650</u>    |
| Balance at end of year                                                                    | <u>\$10,238</u>          | <u>\$10,460</u> | <u>\$10,688</u> | <u>\$10,802</u> | <u>\$10,074</u> |
| Ratio of net charge-offs during the year to average net loans outstanding during the year | <u>.02%</u>              | <u>.04%</u>     | <u>.03%</u>     | <u>.00%</u>     | <u>.14%</u>     |

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The following table sets forth the Bank's percent of allowance for loan losses to total allowance and the percent of loans to total loans in each of the categories listed at the dates indicated (Dollars in thousands).

|                                                               | At December 31, |                                         |                                                  |                 |                                         |                                                  |                 |                                         |                                                  |                 |                                         |                                                  |                 |                                         |                                                  |
|---------------------------------------------------------------|-----------------|-----------------------------------------|--------------------------------------------------|-----------------|-----------------------------------------|--------------------------------------------------|-----------------|-----------------------------------------|--------------------------------------------------|-----------------|-----------------------------------------|--------------------------------------------------|-----------------|-----------------------------------------|--------------------------------------------------|
|                                                               | 2006            |                                         |                                                  | 2005            |                                         |                                                  | 2004            |                                         |                                                  | 2003            |                                         |                                                  | 2002            |                                         |                                                  |
|                                                               | Amount          | Percent of Allowance to Total Allowance | Percent of Loans in Each Category to Total Loans | Amount          | Percent of Allowance to Total Allowance | Percent of Loans in Each Category to Total Loans | Amount          | Percent of Allowance to Total Allowance | Percent of Loans in Each Category to Total Loans | Amount          | Percent of Allowance to Total Allowance | Percent of Loans in Each Category to Total Loans | Amount          | Percent of Allowance to Total Allowance | Percent of Loans in Each Category to Total Loans |
|                                                               |                 |                                         |                                                  |                 |                                         |                                                  |                 |                                         |                                                  |                 |                                         |                                                  |                 |                                         |                                                  |
| One- to-<br>Four<br>family                                    | \$ 2,828        | 27.62%                                  | 68.77%                                           | \$ 2,181        | 20.85%                                  | 69.83%                                           | \$ 1,940        | 18.15%                                  | 72.70%                                           | \$ 1,978        | 18.31%                                  | 75.50%                                           | \$ 2,417        | 23.99%                                  | 77.94%                                           |
| Commercial<br>real<br>estate,<br>multi-<br>family<br>and land | 3,034           | 29.64                                   | 17.10                                            | 3,080           | 29.44                                   | 16.41                                            | 3,895           | 36.44                                   | 15.70                                            | 4,347           | 40.24                                   | 14.31                                            | 3,341           | 33.17                                   | 10.34                                            |
| Construction                                                  | 84              | .82                                     | .75                                              | 113             | 1.08                                    | 1.34                                             | 144             | 1.35                                    | 1.23                                             | 81              | .75                                     | .79                                              | 83              | .82                                     | .78                                              |
| Consumer                                                      | 1,490           | 14.55                                   | 10.61                                            | 1,146           | 10.96                                   | 8.64                                             | 1,037           | 9.70                                    | 6.41                                             | 781             | 7.23                                    | 5.68                                             | 754             | 7.48                                    | 5.67                                             |
| Commercial                                                    | 1,324           | 12.93                                   | 2.77                                             | 1,909           | 18.25                                   | 3.78                                             | 1,970           | 18.43                                   | 3.96                                             | 1,415           | 13.10                                   | 3.72                                             | 1,423           | 14.13                                   | 5.27                                             |
| Unallocated                                                   | 1,478           | 14.44                                   | —                                                | 2,031           | 19.42                                   | —                                                | 1,702           | 15.93                                   | —                                                | 2,200           | 20.37                                   | —                                                | 2,056           | 20.41                                   | —                                                |
| Total                                                         | <u>\$10,238</u> | <u>100.00%</u>                          | <u>100.00%</u>                                   | <u>\$10,460</u> | <u>100.00%</u>                          | <u>100.00%</u>                                   | <u>\$10,688</u> | <u>100.00%</u>                          | <u>100.00%</u>                                   | <u>\$10,802</u> | <u>100.00%</u>                          | <u>100.00%</u>                                   | <u>\$10,074</u> | <u>100.00%</u>                          | <u>100.00%</u>                                   |

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### Investment Activities

Federally-chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various Federal agencies, certificates of deposit of insured banks and savings institutions, bankers' acceptances, repurchase agreements and Federal funds. Subject to various restrictions, Federally-chartered savings institutions may also invest in commercial paper, investment-grade corporate debt securities and mutual funds whose assets conform to the investments that a Federally-chartered savings institution is otherwise authorized to make directly.

The investment policy of the Bank as established by the Board of Directors attempts to provide and maintain liquidity, generate a favorable return on investments without incurring undue interest rate and credit risk, and complement the Bank's lending activities. Specifically, the Bank's policies generally limit investments to government and Federal agency-backed securities and other non-government guaranteed securities, including corporate debt obligations, that are investment grade. The Bank's policies provide that all investment purchases must be approved by two officers (either the Vice President/Treasurer, Executive Vice President/Chief Financial Officer or the President/Chief Executive Officer) and must be ratified by the Board of Directors.

Investment and mortgage-backed securities identified as held to maturity are carried at cost, adjusted for amortization of premium and accretion of discount, which are recognized as adjustments to interest income. Management determines the appropriate classification of securities at the time of purchase. If the Bank has the intent and the ability at the time of purchase to hold securities until maturity, they are classified as held to maturity. Securities to be held for indefinite periods of time, but not necessarily to maturity are classified as available for sale. Securities available for sale include securities that management intends to use as part of its asset/liability management strategy. Such securities are carried at fair value and unrealized gains and losses, net of related tax effect, are excluded from earnings, but are included as a separate component of stockholders' equity. At December 31, 2006, all of the Bank's investment and mortgage-backed securities were classified as available for sale.

Mortgage-backed Securities . Mortgage-backed securities represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which, in general, are passed from the mortgage originators, through intermediaries that pool and repackage the participation interests in the form of securities, to investors such as the Bank. Such intermediaries may be private issuers, or agencies including FHLMC, FNMA and the Government National Mortgage Association ("GNMA") that guarantee the payment of principal and interest to investors. Mortgage-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with interest rates that are within a certain range and with varying maturities. The underlying pool of mortgages can be composed of either fixed-rate or ARM loans.

The actual maturity of a mortgage-backed security varies, depending on when the mortgagors repay or prepay the underlying mortgages. Prepayments of the underlying mortgages may shorten the life of the security, thereby affecting its yield to maturity and the related market value of the mortgage-backed security. The prepayments of the underlying mortgages depend on many factors, including the type of mortgages, the coupon rates, the age of mortgages, the geographical location of the underlying real estate collateralizing the mortgages, the general levels of market interest rates, and general economic conditions. GNMA mortgage-backed securities that are backed by assumable Federal Housing Authority ("FHA") or Department of Veterans Affairs ("VA") loans generally have a longer life than conventional non-assumable loans underlying FHLMC and FNMA mortgage-backed securities. During periods of falling mortgage interest rates, prepayments generally increase, as opposed to periods of increasing

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interest rates when prepayments generally decrease. If the interest rate of underlying mortgages significantly exceeds the prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages. Prepayment experience is more difficult to estimate for adjustable-rate mortgage-backed securities.

The Bank has investments in mortgage-backed securities and has utilized such investments to complement its lending activities. The Bank invests in a large variety of mortgage-backed securities, including ARM, balloon and fixed-rate mortgage-backed securities, the majority of which are directly insured or guaranteed by FHLMC, FNMA and GNMA. At December 31, 2006, mortgage-backed securities totaled \$68.4 million, or 3.3% of total assets.

The following table sets forth the Bank's mortgage-backed securities activities for the periods indicated.

|                                                                                | For the Year Ended December 31, |                  |                  |
|--------------------------------------------------------------------------------|---------------------------------|------------------|------------------|
|                                                                                | 2006                            | 2005             | 2004             |
|                                                                                |                                 | (In thousands)   |                  |
| Beginning balance                                                              | \$ 85,025                       | \$124,478        | \$ 86,938        |
| Mortgage-backed securities purchased                                           | 6,439                           | 7,704            | 82,844           |
| Less: Principal repayments                                                     | (17,117)                        | (37,473)         | (43,478)         |
| Amortization of premium                                                        | (353)                           | (871)            | (1,353)          |
| Sales                                                                          | (6,389)                         | (7,745)          | —                |
| Change in net unrealized loss on mortgage-backed securities available for sale | 764                             | (1,068)          | (473)            |
| Ending balance                                                                 | <u>\$ 68,369</u>                | <u>\$ 85,025</u> | <u>\$124,478</u> |

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The following table sets forth certain information regarding the amortized cost and market value of the Bank's mortgage-backed securities at the dates indicated.

|                                  | At December 31,   |                              |                   |                              |                   |                              |
|----------------------------------|-------------------|------------------------------|-------------------|------------------------------|-------------------|------------------------------|
|                                  | 2006              |                              | 2005              |                              | 2004              |                              |
|                                  | Amortized<br>Cost | Estimated<br>Market<br>Value | Amortized<br>Cost | Estimated<br>Market<br>Value | Amortized<br>Cost | Estimated<br>Market<br>Value |
|                                  | (In thousands)    |                              |                   |                              |                   |                              |
| Mortgage-backed securities:      |                   |                              |                   |                              |                   |                              |
| FHLMC                            | \$ 14,726         | \$ 14,649                    | \$ 10,964         | \$ 10,809                    | \$ 17,729         | \$ 17,768                    |
| FNMA                             | 52,264            | 51,684                       | 72,861            | 71,531                       | 103,297           | 102,701                      |
| GNMA                             | 1,960             | 2,036                        | 2,545             | 2,685                        | 3,729             | 4,009                        |
| Total mortgage-backed securities | <u>\$ 68,950</u>  | <u>\$ 68,369</u>             | <u>\$ 86,370</u>  | <u>\$ 85,025</u>             | <u>\$ 124,755</u> | <u>\$ 124,478</u>            |

Investment Securities. The following table sets forth certain information regarding the amortized cost and market values of the Company's investment securities at the dates indicated.

|                                 | At December 31,   |                              |                   |                              |                   |                              |
|---------------------------------|-------------------|------------------------------|-------------------|------------------------------|-------------------|------------------------------|
|                                 | 2006              |                              | 2005              |                              | 2004              |                              |
|                                 | Amortized<br>Cost | Estimated<br>Market<br>Value | Amortized<br>Cost | Estimated<br>Market<br>Value | Amortized<br>Cost | Estimated<br>Market<br>Value |
|                                 | (In thousands)    |                              |                   |                              |                   |                              |
| Investment securities:          |                   |                              |                   |                              |                   |                              |
| U.S. Government obligations     | \$ —              | \$ —                         | \$ —              | \$ —                         | \$ 998            | \$ 992                       |
| U.S. Agency obligations         | 290               | 289                          | 201               | 200                          | 208               | 205                          |
| State and municipal obligations | 1,747             | 1,768                        | 4,131             | 4,157                        | 3,812             | 3,862                        |
| Corporate debt securities       | 75,655            | 74,060                       | 75,528            | 73,630                       | 75,449            | 73,175                       |
| Equity investments              | 4,905             | 6,267                        | 4,724             | 5,874                        | 4,344             | 5,726                        |
| Total investment securities     | <u>\$ 82,597</u>  | <u>\$ 82,384</u>             | <u>\$ 84,584</u>  | <u>\$ 83,861</u>             | <u>\$ 84,811</u>  | <u>\$ 83,960</u>             |

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The table below sets forth certain information regarding the amortized cost, weighted average yields and contractual maturities, excluding scheduled principal amortization, of the Bank's investment and mortgage-backed securities, excluding equity securities, as of December 31, 2006. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                         | At December 31, 2006               |                                                       |                                                                                  |                                          | Total            |                           |
|-----------------------------------------|------------------------------------|-------------------------------------------------------|----------------------------------------------------------------------------------|------------------------------------------|------------------|---------------------------|
|                                         | One Year or Less<br>Amortized Cost | More than One<br>Year to Five Years<br>Amortized Cost | More than Five<br>Years to Ten Years<br>Amortized Cost<br>(Dollars in thousands) | More than Ten<br>Years<br>Amortized Cost | Amortized Cost   | Estimated<br>Market Value |
| <b>Investment securities:</b>           |                                    |                                                       |                                                                                  |                                          |                  |                           |
| U.S. agency obligations                 | —                                  | \$ 290                                                | —                                                                                | \$ —                                     | \$ 290           | \$ 289                    |
| State and municipal<br>obligations (1)  | —                                  | —                                                     | —                                                                                | 1,747                                    | 1,747            | 1,768                     |
| Corporate debt securities<br>(2)        | —                                  | —                                                     | —                                                                                | 75,655                                   | 75,655           | 74,060                    |
| <b>Total investment securities</b>      | <b>—</b>                           | <b>\$ 290</b>                                         | <b>—</b>                                                                         | <b>\$ 77,402</b>                         | <b>\$ 77,692</b> | <b>\$ 76,117</b>          |
| Weighted average yield                  | —                                  | 4.91%                                                 | —                                                                                | 6.19%                                    | 6.19%            |                           |
| <b>Mortgage-backed securities:</b>      |                                    |                                                       |                                                                                  |                                          |                  |                           |
| FHLMC                                   | \$ —                               | \$ 13                                                 | \$ 13                                                                            | \$ 14,700                                | \$ 14,726        | \$ 14,649                 |
| FNMA                                    | 3                                  | —                                                     | 9                                                                                | 52,252                                   | 52,264           | 51,684                    |
| GNMA                                    | —                                  | 17                                                    | 28                                                                               | 1,915                                    | 1,960            | 2,036                     |
| <b>Total mortgage-backed securities</b> | <b>\$ 3</b>                        | <b>\$ 30</b>                                          | <b>\$ 50</b>                                                                     | <b>\$ 68,867</b>                         | <b>\$ 68,950</b> | <b>\$ 68,369</b>          |
| Weighted average yield                  | 7.00%                              | 11.39%                                                | 12.04%                                                                           | 4.80%                                    | 4.81%            |                           |

(1) State and municipal obligations are reported at tax equivalent yield.

(2) All of the Bank's corporate debt securities with maturities over one year carry interest rates which adjust to a spread over LIBOR on a quarterly basis.

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### Sources of Funds

General. Deposits, loan and mortgage-backed securities repayments and prepayments, proceeds from sales of loans, investment maturities, cash flows generated from operations and FHLB advances and other borrowings are the primary sources of the Bank's funds for use in lending, investing and for other general purposes.

Deposits. The Bank offers a variety of deposit accounts with a range of interest rates and terms. The Bank's deposits consist of money market accounts, savings accounts, interest-bearing checking accounts, non-interest bearing accounts and time deposits. For the year ended December 31, 2006, time deposits constituted 38.9% of total average deposits. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. The Bank's deposits are obtained predominantly from the areas in which its branch offices are located. The Bank relies on its community-banking focus stressing customer service and long-standing relationships with customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions significantly affect the Bank's ability to attract and retain deposits. The Bank does not currently use brokers to obtain deposits.

The following table presents the deposit activity of the Bank for the periods indicated:

|                                       | For the Year Ended December 31, |                 |                  |
|---------------------------------------|---------------------------------|-----------------|------------------|
|                                       | 2006                            | 2005            | 2004             |
|                                       | (In thousands)                  |                 |                  |
| Net (withdrawals) deposits            | \$(16,844)                      | \$63,919        | \$111,765        |
| Interest credited on deposit accounts | 32,604                          | 22,114          | 14,565           |
| Total increase in deposit accounts    | <u>\$ 15,760</u>                | <u>\$86,033</u> | <u>\$126,330</u> |

At December 31, 2006, the Bank had \$143.1 million in time deposits in amounts of \$100,000 or more maturing as follows:

| Maturity Period               | Amount                 | Weighted<br>Average<br>Rate |
|-------------------------------|------------------------|-----------------------------|
|                               | (Dollars in thousands) |                             |
| Three months or less          | \$ 78,085              | 4.92%                       |
| Over three through six months | 24,052                 | 4.67                        |
| Over six through 12 months    | 23,138                 | 4.85                        |
| Over 12 months                | 17,833                 | 4.12                        |
| Total                         | <u>\$143,108</u>       | <u>4.77</u>                 |

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The following table sets forth the distribution of the Bank's average deposit accounts and the average rate paid on those deposits for the periods indicated.

|                                    | For the Years Ended December 31, |                                            |                         |                    |                                            |                         |                    |                                            |                         |
|------------------------------------|----------------------------------|--------------------------------------------|-------------------------|--------------------|--------------------------------------------|-------------------------|--------------------|--------------------------------------------|-------------------------|
|                                    | 2006                             |                                            |                         | 2005               |                                            |                         | 2004               |                                            |                         |
|                                    | Average<br>Balance               | Percent<br>of Total<br>Average<br>Deposits | Average<br>Rate<br>Paid | Average<br>Balance | Percent<br>of Total<br>Average<br>Deposits | Average<br>Rate<br>Paid | Average<br>Balance | Percent<br>of Total<br>Average<br>Deposits | Average<br>Rate<br>Paid |
|                                    | (Dollars in thousands)           |                                            |                         |                    |                                            |                         |                    |                                            |                         |
| Money market deposit accounts      | \$ 117,935                       | 8.59%                                      | 1.69%                   | \$ 135,907         | 10.10%                                     | 1.18%                   | \$ 143,064         | 11.88%                                     | .94%                    |
| Savings accounts                   | 219,879                          | 16.02                                      | .79                     | 260,655            | 19.38                                      | .71                     | 263,133            | 21.86                                      | .50                     |
| Interest-bearing checking accounts | 379,997                          | 27.69                                      | 2.16                    | 350,839            | 26.09                                      | 1.33                    | 272,076            | 22.61                                      | .57                     |
| Non-interest-bearing accounts      | 120,482                          | 8.78                                       | —                       | 115,681            | 8.60                                       | —                       | 111,135            | 9.23                                       | —                       |
| Total time deposits                | 534,056                          | 38.92                                      | 4.02                    | 481,585            | 35.83                                      | 3.05                    | 414,393            | 34.42                                      | 2.65                    |
| Total average deposits             | <u>\$1,372,349</u>               | <u>100.00%</u>                             | <u>2.43%</u>            | <u>\$1,344,667</u> | <u>100.00%</u>                             | <u>1.70%</u>            | <u>\$1,203,801</u> | <u>100.00%</u>                             | <u>1.26%</u>            |

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**Borrowings.** From time-to-time the Bank has obtained term advances from the Federal Home Loan Bank of New York (“FHLB-NY”) as an alternative to retail deposit funds and may do so in the future as part of its operating strategy. FHLB-NY term advances may also be used to acquire certain other assets as may be deemed appropriate for investment purposes. These term advances are collateralized primarily by certain of the Bank’s mortgage loans and investment and mortgage-backed securities and secondarily by the Bank’s investment in capital stock of the FHLB-NY. In addition, the Bank has an available overnight line of credit with the FHLB-NY for \$100 million which expires July 31, 2007. The Bank also has available from the FHLB-NY a one-month, overnight repricing line of credit for \$100 million which also expires on July 31, 2007. The Bank expects both lines to be renewed upon expiration. When utilized, both lines carry a floating interest rate of 10-15 basis points over the current Federal funds rate and are secured by the Bank’s mortgage loans, mortgage-backed securities, U.S. Government and agency securities and FHLB-NY stock. The maximum amount that the FHLB-NY will advance to member institutions, including the Bank, fluctuates from time to time in accordance with the policies of the OTS and the FHLB-NY. At December 31, 2006, the Bank had \$42.5 million borrowed under the FHLB-NY lines of credit and \$388.0 million under various term advances.

The Bank also borrows funds using securities sold under agreements to repurchase. Under this form of borrowing specific U.S. Government agency, corporates and/or mortgage-backed securities are pledged as collateral to secure the borrowing. These pledged securities are held by a third party custodian. At December 31, 2006, the Bank had borrowed \$85.0 million through securities sold under agreements to repurchase.

### Subsidiary Activities

At December 31, 2006 the Bank owned three subsidiaries – Columbia Home Loans, LLC, OceanFirst Services, LLC and OceanFirst REIT Holdings, Inc.

Columbia Home Loans, LLC was acquired by the Bank on August 18, 2000 and operates as a mortgage banking subsidiary based in Westchester County, New York. Columbia originates, sells and services a full product line of residential mortgage loans primarily in New York and New Jersey. Loans are originated through retail branches and a network of independent mortgage brokers and, to a lesser extent direct Internet sales. Columbia sells virtually all loan production in the secondary market or, to a lesser extent, the Bank.

OceanFirst Services, LLC was originally organized in 1982 under the name Dome Financial Services, Inc., to engage in the sale of all-savers life insurance. Prior to 1998 the subsidiary was inactive, however, in 1998, the Bank began to sell non-deposit investment products (annuities, mutual funds and insurance) through a third-party marketing firm to Bank customers through this subsidiary, recognizing fee income from such sales. OFB Reinsurance, Ltd., was established in 2002 as a subsidiary of OceanFirst Services, LLC to reinsure a percentage of the private mortgage insurance risks on one-to-four family residential mortgages originated by the Bank and Columbia.

OceanFirst REIT Holdings, Inc., was established in 2001 and acts as the holding company for OceanFirst Realty Corp. OceanFirst Realty Corp. was established in 1997 and is intended to qualify as a real estate investment trust, which may, among other things, be utilized by the Company to raise capital in the future. Upon formation of OceanFirst Realty Corp., the Bank transferred \$668 million of mortgage loans to this subsidiary.

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### **Personnel**

As of December 31, 2006, the Bank had 445 full-time employees and 68 part-time employees. The employees are not represented by a collective bargaining unit and the Bank considers its relationship with its employees to be good.

## **REGULATION AND SUPERVISION**

### **General**

As a savings and loan holding company, the Company is required by Federal law to file reports with, and otherwise comply with, the rules and regulations of the OTS. The Bank is subject to extensive regulation, examination and supervision by the OTS, as its primary Federal regulator, and the FDIC, as the deposit insurer. The Bank is a member of the Federal Home Loan Bank System and, with respect to deposit insurance, of the Deposit Insurance Fund managed by the FDIC. The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other savings institutions. The OTS and/or the FDIC conduct periodic examinations to test the Bank's safety and soundness and compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the OTS, the FDIC or the Congress, could have a material adverse impact on the Company, the Bank and their operations. Certain of the regulatory requirements applicable to the Bank and to the Company are referred to below or elsewhere herein. The description of statutory provisions and regulations applicable to savings institutions and their holding companies set forth in this Form 10-K does not purport to be a complete description of such statutes and regulations and their effects on the Bank and the Company and is qualified in its entirety by reference to the actual laws and regulations involved.

### **Holding Company Regulation**

The Company is a nondiversified unitary savings and loan holding company within the meaning of Federal law. Under prior law, a unitary savings and loan holding company, such as the Company, was not generally restricted as to the types of business activities in which it may engage, provided that the Bank continued to be a qualified thrift lender ("QTL"). See "Federal Savings Institution Regulation - QTL Test." The Gramm-Leach-Bliley Act of 1999 provides that no company may acquire control of a savings association after May 4, 1999 unless it engages only in the financial activities permitted for financial holding companies under the law or for multiple savings and loan holding companies as described below. Further, the Gramm-Leach-Bliley Act specifies that existing savings and loan holding companies may only engage in such activities. The Gramm-Leach-Bliley Act, however, grandfathered the unrestricted authority for activities with respect to unitary savings and loan holding companies existing prior to May 4, 1999, such as the Company, so long as the Bank continues to comply with the QTL test. The Company qualifies for the grandfather provision. Upon any non-supervisory acquisition by the Company of another savings institution or savings bank that meets the QTL test and is deemed to be a savings institution by the OTS, the Company would become a multiple savings and loan holding company (if the acquired institution is held as a separate subsidiary) and would generally be limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the OTS, and certain activities authorized by OTS regulation. However, the OTS has issued an interpretation concluding that multiple savings and loan holding companies may also engage in activities permitted for financial holding companies.

A savings and loan holding company is prohibited from, directly or indirectly, acquiring more than 5% of

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the voting stock of another savings institution or savings and loan holding company without prior written approval of the OTS and from acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings institutions, the OTS considers the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the deposit insurance funds, the convenience and needs of the community and competitive factors.

The OTS may not approve any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Although savings and loan holding companies are not subject to specific capital requirements or specific restrictions on the payment of dividends or other capital distributions, Federal regulations do prescribe such restrictions on subsidiary savings institutions as described below. The Bank must notify the OTS 30 days before declaring any dividend to the Company. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the OTS which has the authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

Acquisition of the Company. Under the Federal Change in Bank Control Act (“CBCA”) and OTS regulations, a notice must be submitted to the OTS if any person (including a company), or group acting in concert, seeks to acquire 10% or more of the Company’s outstanding voting stock, unless the OTS has found that the acquisition will not result in a change of control of the Company. Under CBCA, the OTS has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

### Federal Savings Institution Regulation

Business Activities. The activities of Federal savings institutions are governed by Federal law and regulations. These laws and regulations delineate the nature and extent of the activities in which Federal savings banks may engage. In particular, many types of lending authority for Federal savings banks, e.g. , commercial, non-residential real property loans and consumer loans, are limited to a specified percentage of the institution’s capital or assets.

Capital Requirements. The OTS capital regulations require savings institutions to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for institutions receiving the highest rating on the CAMELS examination rating system) and an 8% risk-based capital ratio. In addition, the prompt corrective action standards discussed below also establish, in effect, a minimum 2% tangible capital standard, a 4% leverage ratio (3% for institutions receiving the highest rating on the CAMELS examination rating system), and, together with the risk-based capital standard itself, a 4% Tier 1 risk-based capital standard. The OTS regulations also require that, in meeting the tangible, leverage and risk-based capital standards, institutions must generally deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank.

The risk-based capital standard for savings institutions requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet activities, are multiplied by a risk-weight factor of 0% to 100%, assigned by the OTS capital regulation based on the risks believed inherent in the type of asset. Core (Tier 1) capital is defined as common stockholders’ equity (including retained earnings), certain noncumulative perpetual

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preferred stock and related surplus, and minority interests in equity accounts of consolidated subsidiaries less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. The OTS has authority to establish individual minimum capital requirements in cases where it is determined that a particular institution's capital level is, or may, become inadequate in light of the circumstances involved.

The following table presents the Bank's capital position at December 31, 2006. The Bank met each of its capital requirements at that date.

|                        | Actual<br>Capital | Required<br>Capital | Excess<br>Amount | Capital           |                     |
|------------------------|-------------------|---------------------|------------------|-------------------|---------------------|
|                        |                   |                     |                  | Actual<br>Percent | Required<br>Percent |
| (Dollars in thousands) |                   |                     |                  |                   |                     |
| Tangible               | \$131,643         | \$ 31,109           | \$100,534        | 6.35%             | 1.50%               |
| Core (Leverage)        | 131,643           | 62,218              | 69,425           | 6.35              | 3.00                |
| Risk-based             | 141,416           | 107,939             | 33,477           | 10.48             | 8.00                |

**Prompt Corrective Regulatory Action.** The OTS is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution's degree of undercapitalization. Generally, a savings institution that has a ratio of total capital to risk weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be "undercapitalized." A savings institution that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be "significantly undercapitalized" and a savings institution that has a tangible capital to assets ratio equal to or less than 2% is deemed to be "critically undercapitalized." Subject to a narrow exception, the OTS is required to appoint a receiver or conservator for an institution that is "critically undercapitalized." The regulation also provides that a capital restoration plan must be filed with the OTS within 45 days of the date a savings institution receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Compliance with the plan must be guaranteed by any parent holding company. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The OTS could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and critically undercapitalized institutions are subject to additional mandatory and discretionary measures.

**Insurance of Deposit Accounts.** The Bank is a member of the Deposit Insurance Fund. The FDIC maintains a risk-based assessment system by which institutions are assigned to one of three categories based on their capitalization and one of three subcategories based on examination ratings and other supervisory information. An institution's assessment rate depends upon the categories to which it is assigned. Assessment rates for member institutions are determined semiannually by the FDIC and currently range from zero basis points of assessable deposits for the healthiest institutions to 27 basis points for the riskiest.

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In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation (“FICO”) to recapitalize the predecessor to the Savings Association Insurance Fund. During 2006, FICO payments approximated 1.28 basis points.

The Bank’s assessment rate for fiscal 2006 was zero basis points and the total assessments paid for this period (including the FICO assessment) was \$177,000. The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OTS. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Federal Deposit Insurance Reform Act of 2005. As a result of the Federal Deposit Insurance Reform Act of 2005, the Bank Insurance Fund and Savings Association Insurance Fund have been merged into a new combined fund, called the Deposit Insurance Fund. The Federal Deposit Insurance Reform Act also (i) increases deposit insurance coverage for retirement accounts to \$250,000, (ii) indexes the current \$100,000 insurance coverage limit for standard accounts and the new \$250,000 limit for retirement accounts to reflect inflation (with adjustments for inflation every five years, commencing January 1, 2011, (iii) requires the Federal Deposit Insurance Corporation to assess annual deposit insurance premiums on all banks and savings institutions, (iv) gives a one-time insurance assessment credit totaling \$4.7 billion to banks and savings institutions in existence on December 31, 1996 that can be used to offset premiums otherwise due, (v) imposes a cap on the level of the Deposit Insurance Fund and provides for dividends or rebates when the fund grows beyond a specified threshold, (vi) adopts a historical basis concept for distributing the aforementioned one-time credit and dividends (with each institution’s historical basis to be determined by a formula that looks back to the institution’s assessment base in 1996 and adds premiums paid since that time) and (vii) authorizes revisions to the current risk-based system for assessing premiums, including replacing the current fixed reserve ratio requirement of 1.25% with a range of between 1.15% and 1.5% of insured deposits. Because of assessment credits the Federal Deposit Insurance Reform Act is not expected to have a significant impact on the Bank’s operations during 2007, although insurance premiums may increase in future periods.

Loans to One Borrower. Federal law provides that savings institutions are generally subject to the limits on loans to one borrower applicable to national banks. Subject to certain exceptions, a savings institution may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if secured by specified readily-marketable collateral. At December 31, 2006, the Bank’s limit on loans to one borrower was \$19.7 million, and the Bank’s largest aggregate outstanding balance of loans to one borrower was \$10.7 million.

QTL Test. The Home Owners Loan Act requires savings institutions to meet a qualified thrift lender test. Under the test, a savings association is required to either qualify as a “domestic building and loan association” under the Internal Revenue Code or maintain at least 65% of its “portfolio assets” (total assets less: (1) specified liquid assets up to 20% of total assets; (2) intangibles, including goodwill; and (3) the value of property used to conduct business) in certain “qualified thrift investments” (primarily residential mortgages and related investments, including certain mortgage-backed securities) in at least nine months out of each 12 month period. Additionally, education loans, credit card loans and small business loans may be considered “qualified thrift investments.”

A savings institution that fails the qualified thrift lender test is subject to certain operating restrictions and may be required to convert to a bank charter. As of December 31, 2006, the Bank met the qualified thrift lender test.

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Limitation on Capital Distributions . OTS regulations impose limitations upon all capital distributions by a savings institution, including cash dividends, payments to repurchase its shares and payments to shareholders of another institution in a cash-out merger. Under the regulations, an application to and the approval of the OTS is required prior to any capital distribution if the institution does not meet the criteria for “expedited treatment” of applications under OTS regulations ( *i.e.* , generally, examination ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OTS. If an application is not required, the institution must still provide prior notice to the OTS of the capital distribution if, like the Bank, it is a subsidiary of a holding company. In the event the Bank’s capital fell below its regulatory requirements or the OTS notified it that it was in need of more than normal supervision, the Bank’s ability to make capital distributions could be restricted. In addition, the OTS could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the OTS determines that such distribution would constitute an unsafe or unsound practice. The OTS has notified the Bank that it does not object to the payment of capital dividends, so long as the Bank remains well capitalized after each capital distribution, and also maintains a tier one core leverage ratio above 6.0% and a total risk-based capital ratio above 10.5% after each capital distribution.

Assessments . Savings institutions are required to pay assessments to the OTS to fund the agency’s operations. The assessments, paid on a semi-annual basis, are based upon the institution’s total assets, including consolidated subsidiaries as reported in the Bank’s latest quarterly thrift financial report. The assessments paid by the Bank for the fiscal year ended December 31, 2006 totaled \$364,000.

Transactions with Related Parties . The Bank’s authority to engage in transactions with “affiliates” ( *e.g.* , any company that controls or is under common control with an institution, including the Company and its non-savings institution subsidiaries) is limited by Federal law. The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution’s capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type described in Federal law. The purchase of low quality assets from affiliates is generally prohibited. The transactions with affiliates must be on terms and under circumstances, that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings institution may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002, generally prohibits loans by the Company to its executive officers and directors. However, the Act contains a specific exemption for loans from the Bank to its executive officers and directors in compliance with Federal banking laws. Under such laws, the Bank’s authority to extend credit to executive officers, directors and 10% shareholders (“insiders”), as well as entities such persons control, is limited. The law limits both the individual and aggregate amount of loans the Bank may make to insiders based, in part, on the Bank’s capital position and requires certain board approval procedures to be followed. Such loans must not involve more than the normal risk of repayment and are required to be made on terms substantially the same as those offered to unaffiliated individuals, except for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Loans to executive officers are subject to additional restrictions.

Enforcement . The OTS has primary enforcement responsibility over savings institutions and has the authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in

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wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors to the institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to \$25,000 per day, or even \$1 million per day in especially egregious cases. The FDIC has the authority to recommend to the Director of the OTS that enforcement action be taken with respect to a particular savings institution. If action is not taken by the Director, the FDIC has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations.

**Standards for Safety and Soundness.** The Federal banking agencies have adopted Interagency Guidelines prescribing Standards for Safety and Soundness. The guidelines set forth the safety and soundness standards that the Federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the OTS determines that a savings institution fails to meet any standard prescribed by the guidelines, the OTS may require the institution to submit an acceptable plan to achieve compliance with the standard.

### **Federal Home Loan Bank System**

The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional FHLBs. Each FHLB provides member institutions with a central credit facility. The Bank, as a member of the FHLB-NY is required to acquire and hold shares of capital stock in that FHLB in an amount at least equal to .20% of mortgage related assets and 4.5% of the specified value of certain transactions with the FHLB. The Bank was in compliance with this requirement with an investment in FHLB-NY stock at December 31, 2006 of \$25.3 million.

The FHLBs are required to provide funds for the previous resolution of insolvent thrifts and to contribute funds for affordable housing programs. These requirements could reduce the amount of dividends that the FHLBs pay to their members and could also result in the FHLB imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future FHLB advances increased, the Bank's net interest income would likely also be reduced.

### **Federal Reserve System**

The Federal Reserve Board regulations require savings institutions to maintain non-interest earning reserves against their transaction accounts (primarily interest-bearing checking and regular checking accounts). The regulations generally provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including \$45.8 million; a 10% reserve ratio is applied above \$45.8 million. The first \$8.5 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempt from the reserve requirements. The amounts are adjusted annually. The Bank complies with the foregoing requirements.

## **FEDERAL AND STATE TAXATION**

### **Federal Taxation**

General. The Company and the Bank report their income on a calendar year basis using the accrual method of accounting, and are subject to Federal income taxation in the same manner as other corporations with some exceptions, including particularly the Bank's reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company. The Bank has not been audited by the IRS in over 10 years. For its 2006 taxable year, the Bank is subject to a maximum Federal income tax rate of 35.0%.

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**Distributions.** Under the 1996 Act, if the Bank makes “non-dividend distributions” to the Company, such distributions will be considered to have been made from the Bank’s unrecaptured tax bad debt reserves (including the balance of its reserves as of December 31, 1987) to the extent thereof, and then from the Bank’s supplemental reserve for losses on loans, to the extent thereof, and an amount based on the amount distributed (but not in excess of the amount of such reserves) will be included in the Bank’s income. Non-dividend distributions include distributions in excess of the Bank’s current and accumulated earnings and profits, as calculated for Federal income tax purposes, distributions in redemption of stock, and distributions in partial or complete liquidation. Dividends paid out of the Bank’s current or accumulated earnings and profits will not be so included in the Bank’s income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Thus, if the Bank makes a non-dividend distribution to the Company, approximately one and one-half times the amount of such distribution (but not in excess of the amount of such reserves) would be includable in income for Federal income tax purposes, assuming a 35% Federal corporate income tax rate. The Bank does not intend to pay dividends that would result in a recapture of any portion of its bad debt reserves.

**Corporate Alternative Minimum Tax.** The Internal Revenue Code of 1986, as amended (the “Code”) imposes a tax on alternative minimum taxable income (“AMTI”) at a rate of 20%. The excess of the bad debt reserve deduction using the percentage of taxable income method over the deduction that would have been allowable under the experience method is treated as a preference item for purposes of computing the AMTI. Only 90% of AMTI can be offset by net operating loss carryovers of which the Bank currently has none. AMTI is increased by an amount equal to 75% of the amount by which the Bank’s adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses). The Bank does not expect to be subject to the AMTI.

**Dividends Received Deduction and Other Matters.** The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is generally 70% in the case of dividends received from unaffiliated corporations with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank own more than 20% of the stock of a corporation distributing a dividend then 80% of any dividends received may be deducted.

## State and Local Taxation

**New Jersey Taxation.** The Bank files New Jersey income tax returns. For New Jersey income tax purposes, savings institutions were previously taxed at a rate equal to 3% of taxable income. On July 2, 2002, the New Jersey legislature passed the New Jersey Business Tax Reform Act (the “Tax Reform Act”). The legislation increased the tax rate on savings institutions, such as the Bank, from 3% to 9% of taxable income. The legislation was retroactive to January 1, 2002. For this purpose, “taxable income” generally means Federal taxable income, subject to certain adjustments (including addition of interest income on State and municipal obligations).

The Tax Reform Act also provided for an Alternative Minimum Assessment (AMA) tax based on the larger of gross receipts or gross profits, as defined.

The Company is required to file a New Jersey income tax return because it does business in New Jersey. For New Jersey tax purposes, regular corporations are presently taxed at a rate equal to 9% of taxable income. However, if the Company meets certain requirements, it may be eligible to elect to be taxed as a New Jersey Investment Company at a tax rate presently equal to 3.60% (40% of 9%) of taxable income.

On February 6, 2006, the State of New Jersey published regulations to disallow the dividends received deduction for the direct receipt of a dividend from a Real Estate Investment Trust (“REIT”) to its corporate parent. The regulation will apply to dividends paid on and after February 6, 2006. The

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regulation may cause the Company's effective state tax rate to increase by approximately 3.6% (2.34% after federal benefit), however, the Company may be able to employ alternative tax planning strategies to mitigate this increase.

New York Taxation. The Bank is subject to New York State income tax. The tax is measured by "entire net income" which is Federal taxable income with adjustments.

Delaware Taxation. As a Delaware holding company not earning income in Delaware, the Company is exempted from Delaware corporate income tax but is required to file an annual report with and pay an annual franchise tax to the State of Delaware.

### Item 1A. Risk Factors

Rising interest rates may hurt profits. Interest rates were recently at historically low levels. However, from mid 2004 through mid 2006, the Federal Reserve has increased its target for the Federal funds rate seventeen times. If short-term interest rates continue to rise or if the yield curve remains flat or inverted, and if rates on deposits and borrowings reprice upwards faster than the rates on loans and investments, the Company would experience compression of its interest rate spread and net interest margin, which would have a negative effect on profitability.

Increased emphasis on commercial lending may expose the Bank to increased lending risks. At December 31, 2006, \$356.0 million, or 19.9%, of the Bank's total loans consisted of commercial, multi-family and land real estate loans, and commercial business loans. This portfolio has grown in recent years and the Bank intends to continue to emphasize these types of lending. These types of loans generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. Also, many of the Bank's commercial borrowers have more than one loan outstanding. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Bank to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four family residential mortgage loan.

A downturn in the local economy or a decline in real estate values could hurt profits. Most of the Bank's loans are secured by real estate or are made to businesses in Ocean and Monmouth Counties, New Jersey and the surrounding area. As a result of this concentration, a downturn in the local economy could cause significant increases in nonperforming loans, which would hurt profits. In recent years there has been a significant increase in real estate values in the Bank's market area. As a result of rising home prices, loans have been well collateralized. A decline in real estate values could cause some mortgage loans to become inadequately collateralized, which would expose the Bank to a greater risk of loss.

The Bank operates in a highly regulated environment and may be adversely affected by changes in laws and regulations. The Bank is subject to extensive regulation, supervision and examination by the Office of Thrift Supervision, the Bank's chartering authority, and by the Federal Deposit Insurance Corporation, as insurer of deposits. The Company and the Bank are subject to regulation and supervision by the Office of Thrift Supervision. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and depositors. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and determination of the level of the allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on operations.

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The Company's allowance for loan losses may be inadequate, which could hurt the Company's earnings. The Company's allowance for loan losses may prove to be inadequate to cover actual loan losses and if the Company is required to increase its allowance, current earnings may be reduced. When borrowers default and do not repay the loans that the Bank makes to them, the Company may lose money. The Company's experience shows that some borrowers either will not pay on time or will not pay at all, which will require the Company to cancel or "charge-off" the defaulted loan or loans. The Company provides for losses by reserving what it believes to be an adequate amount to absorb any probable inherent losses. A "charge-off" reduces the Company's reserve for possible loan losses. If the Company's reserves were insufficient, it would be required to record a larger reserve, which would reduce earnings for that period.

The Company's subsidiary may be required to repurchase mortgage loans for an Early Payment Default or a breach of representations and warranties, which could harm the Company's earnings. The Company's subsidiary, Columbia, has entered into loan sale agreements with investors in the normal course of business. The loan sale agreements generally require the repurchase of certain loans previously sold in the event of an Early Payment Default or a violation of various representations and warranties customary to the mortgage banking industry. The repurchased mortgage loans could typically only be resold at a significant discount to the unpaid principal balance. Columbia maintains a reserve for repurchased loans, however, if repurchase activity is significant, the reserve may prove to be inadequate to cover actual losses which could harm future earnings.

In addition, \$299.8 million or 41.2% of the total loans originated by Columbia in 2006 are considered "subprime" loans, which are loans made to individuals whose borrowing needs are generally not fulfilled by traditional loan products because they do not satisfy the credit documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers. In the event Columbia is required to repurchase a significant amount of subprime loans, Columbia may be required to hold such loans in portfolio for an extended period of time or to maturity, if such loans cannot be later resold. Subprime loans generally have a higher incidence of delinquency, foreclosure and bankruptcy, which may be substantially higher than that experienced by mortgage loans underwritten in a more traditional manner. Such risk associated with subprime loans may be increased during periods of economic slow-downs, increasing interest rates, and events that affect specifically the geographic areas in which the loans are made. Moreover, as most of the subprime loans made by Columbia have loan-to-value ratios of 100%, there would be little, if any, equity to fully recover the net carrying value of the loan in the event of default and foreclosure. In such event, the Company may be required to substantially increase its allowance for loan losses which would reduce earnings for that period.

The Company's mortgage servicing rights may become impaired which could hurt profits. Mortgage servicing rights are carried at the lower of cost or fair value. Any impairment is recognized as a reduction to servicing fee income. In the event that loan prepayments increase due to increased loan refinancing, the fair value of mortgage servicing rights would likely decline.

The Company's inability to achieve profitability on new branches may negatively affect earnings. The Bank continues to expand its presence within the market area through de novo branching. The profitability of this expansion strategy will depend on whether the income from the new branches will offset the increased expenses resulting from operating these branches. It is expected to take a period of time before these branches can become profitable. During this period, the expense of operating these branches may negatively affect net income.

### Item 1B. Unresolved Staff Comments

None

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### Item 2. Properties

The Bank conducts its business through its administrative office, which includes a branch office, and 20 other full service offices located in Ocean, Monmouth and Middlesex Counties, through loan production offices and through the administrative and loan production offices of Columbia.

### Item 3. Legal Proceedings

The Company and the Bank are not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such other routine legal proceedings in the aggregate are believed by management to be immaterial to the Company's financial condition or results of operations.

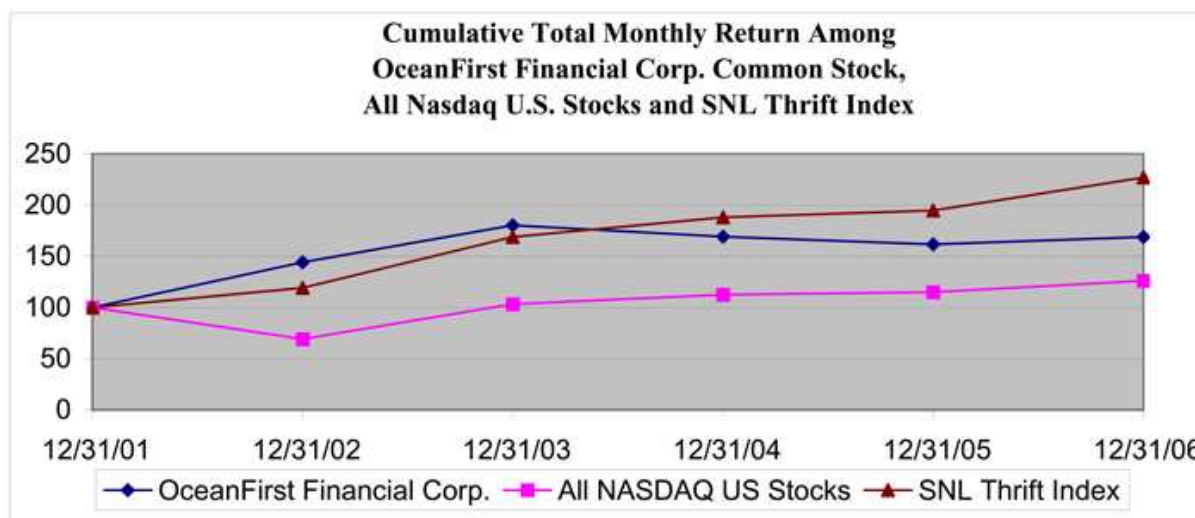
### Item 4. Submission of Matters to a Vote of Security Holders

None.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The following graph shows a comparison of total stockholder return on OceanFirst Financial Corp.'s common stock, based on the market price of the Company's common stock with the cumulative total return of companies in the Nasdaq Market Index and the SNL Thrift Index for the period December 31, 2001 through December 31, 2006. The graph may not be indicative of possible future performance of the Company's common stock.



OceanFirst Financial Corp.  
All Nasdaq US Stocks  
SNL Thrift Index

| 12/31/01 | 12/31/02 | 12/31/03 | 12/31/04 | 12/31/05 | 12/31/06 |
|----------|----------|----------|----------|----------|----------|
| 100.00   | 144.17   | 180.14   | 169.26   | 161.80   | 168.79   |
| 100.00   | 69.13    | 103.36   | 112.49   | 114.88   | 126.22   |
| 100.00   | 119.29   | 168.88   | 188.16   | 194.80   | 227.97   |

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### Notes:

- A. The lines represent annual index levels derived from compounded daily returns that include all dividends.
- B. The indexes are reweighted daily, using the market capitalization on the previous trading day.
- C. If the annual interval, based on the fiscal year end, is not a trading day, the preceding trading day is used.
- D. The index level for all series was set to \$100 on 12/31/01.

For the years ended December 31, 2006 and 2005, the Company paid a quarterly cash dividend of \$.20 per share.

Information relating to the market for Registrant's common equity and related stockholder matters appears under "Shareholder Information" on the Inside Back Cover in the Registrant's 2006 Annual Report to Stockholders and is incorporated herein by reference.

Information regarding the Company's common stock repurchases for the three month period ended December 31, 2006 is as follows:

| Period                                     | Total<br>Number of<br>Shares<br>Purchased | Average Price<br>Paid per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs | Maximum Number<br>of Shares that May<br>Yet Be Purchased<br>Under the Plans or<br>Programs |
|--------------------------------------------|-------------------------------------------|---------------------------------|----------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| October 1, 2006 through October 31, 2006   | -0-                                       | —                               | -0-                                                                                          | 641,963                                                                                    |
| November 1, 2006 through November 30, 2006 | 33,600                                    | \$ 22.56                        | 33,600                                                                                       | 608,363                                                                                    |
| December 1, 2006 through December 31, 2006 | 69,600                                    | \$ 22.60                        | 69,600                                                                                       | 538,763                                                                                    |

On July 19, 2006, the Company announced its intention to repurchase up to 615,883 shares or 5% of its outstanding common stock.

### Item 6. Selected Financial Data

The above-captioned information appears under "Selected Consolidated Financial and Other Data of the Company" in the Registrant's 2006 Annual Report to Stockholders on pages 5 and 6 is incorporated herein by reference.

### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The above-captioned information appears under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Registrant's 2006 Annual Report to Stockholders on pages 7 through 20 and is incorporated herein by reference.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The above captioned information appears under "Management's Discussion and Analysis of Financial Condition and Results of Operations - Management of Interest Rate Risk" in the Registrant's 2006 Annual Report to Stockholders on pages 17 through 20 and is incorporated herein by reference.

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### Item 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements of OceanFirst Financial Corp. and its subsidiary, together with the report thereon by KPMG LLP appears in the Registrant's 2006 Annual Report to Stockholders on pages 21 through 37 and are incorporated herein by reference.

### Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None.

### Item 9A. Controls and Procedures

#### (a) Evaluation of Disclosure 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) 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 not effective due to the material weakness discussed below. 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 (the "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.

#### (b) Management Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting, as such term is defined in Rule 13a-15 (f) of the Exchange Act. The Company's internal control over financial reporting was designed to provide reasonable assurance regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the Company's internal control over financial reporting as of December 31, 2006. This assessment was based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2006 due to the existence of the following material weakness identified by management: The Company's policies and procedures were not effective to provide for the proper evaluation and assessment of the adequacy of its reserve for repurchased loans at its mortgage banking subsidiary. Specifically, the Company lacked an effective process to ensure that the exercise of loan repurchase requests by purchasers of its loans were timely identified and incorporated properly in the analysis of its reserve for repurchased loans. This deficiency resulted in material misstatements in the Company's reserve for repurchased loans and amounts recorded as a gain on sales of loans, and resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim consolidated financial statements would not be prevented or detected. These misstatements have been corrected in the consolidated financial statements included elsewhere in this Form 10-K.

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The Company's independent registered public accounting firm has issued an audit report on management's assessment of the Company's internal control over financial reporting. This report is included in Item 9A(d) below.

### (c) Changes in Internal Control over Financial Reporting and Management's Remediation Initiatives

There were no changes in the Company's internal control over financial reporting during the quarter ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

To address the material weakness identified in Item 9A(b), during the first quarter of 2007, the Company enhanced its policies and procedures related to the quarterly evaluation of the adequacy of the reserve for repurchased loans. All repurchase requests received must be reported to the President of the mortgage banking subsidiary for evaluation and incorporation into the analysis of the reserve for repurchased loans. Additionally, the Company's mortgage banking subsidiary modified its mortgage loan product menu to eliminate the origination of subprime loans. Furthermore, the Company has taken disciplinary action against certain officers of the mortgage banking subsidiary responsible for not following established policies and procedures.

### (d) Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
OceanFirst Financial Corp.:

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting (Item 9A(b)), that OceanFirst Financial Corp. and subsidiary (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of the material weakness identified in management's assessment, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management of the Company is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment as of December 31, 2006: The Company's policies and procedures were not effective to provide for the proper evaluation and assessment of the adequacy of its reserve for repurchased loans at its mortgage banking subsidiary. Specifically, the Company lacked an effective process to ensure that the exercise of loan repurchase requests by purchasers of its loans were timely identified and incorporated properly in the analysis of its reserve for repurchased loans. This deficiency resulted in material misstatements in the Company's reserve for repurchased loans and amounts recorded as a gain on sales of loans, and resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim consolidated financial statements would not be prevented or detected.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of OceanFirst Financial Corp. and subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006. The aforementioned material weakness was considered in determining the nature, timing and extent of audit tests applied in our audit of the 2006 consolidated financial statements, and this report does not affect our report dated March 26, 2007, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, management's assessment that OceanFirst Financial Corp. and subsidiary did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ KPMG LLP  
Short Hills, New Jersey  
March 26, 2007

### Item 9B. Other Information

None

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

The information relating to directors, executive officers and corporate governance and the Registrant's compliance with Section 16(a) of the Exchange Act required by Part III is incorporated herein by reference from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 17, 2007 at pages 5, 6, 11 through 13, 38 and 39.

### Item 11. Executive Compensation

The information relating to executive compensation required by Part III is incorporated herein by reference from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 17, 2007 at pages 16 through 37.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information relating to security ownership of certain beneficial owners and management and related stockholder matters required by Part III is incorporated herein by reference from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 17, 2007 at pages 8 through 10.

Information regarding the Company's equity compensation plans existing as of December 31, 2006 is as follows:

| Plan category                                              | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|------------------------------------------------------------|-------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 1,495,859                                                                                       | \$ 20.24                                                                    | 1,260,002                                                                                                                                   |
| Equity compensation plans not approved by security holders | —                                                                                               | —                                                                           | —                                                                                                                                           |
| Total                                                      | 1,495,859                                                                                       | \$ 20.24                                                                    | 1,260,002                                                                                                                                   |

### Item 13. Certain Relationships and Related Transactions and Director Independence

The information relating to certain relationships and related transactions and director independence required by Part III is incorporated herein by reference from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 17, 2007 at pages 39 to 40.

### Item 14. Principal Accountant Fees and Services

The information relating to the principal accounting fees and services is incorporated by reference to the Registrant's Proxy Statement for the Annual Meeting to be held on May 17, 2007 at page 13.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as a part of this report:

(1) Consolidated Financial Statements of the Company are incorporated by reference to the following indicated pages of the 2006 Annual Report to Stockholders.

|                                                                                                                 | <u>PAGE</u> |
|-----------------------------------------------------------------------------------------------------------------|-------------|
| Report of Independent Registered Public Accounting Firm                                                         | 37          |
| Consolidated Statements of Financial Condition at December 31, 2006 and 2005                                    | 21          |
| Consolidated Statements of Income for the Years Ended December 31, 2006, 2005 and 2004                          | 22          |
| Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2006, 2005 and 2004 | 23          |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004                      | 24          |
| Notes to Consolidated Financial Statements for the Years Ended December 31, 2006, 2005 and 2004                 | 25-36       |

The remaining information appearing in the 2006 Annual Report to Stockholders is not deemed to be filed as part of this report, except as expressly provided herein.

(2) All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

|         |                                                                                                                                                                                                                                                                                        |
|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1     | Stock Purchase Agreement by and among Richard S. Pardes (the sole stockholder of Columbia Home Loans, LLC (formerly Columbia Equities, Ltd.)) and Columbia Home Loans, LLC (formerly Columbia Equities, Ltd.) and OceanFirst Bank as buyer, dated June 27, 2000 (without exhibits) (2) |
| 3.1     | Certificate of Incorporation of OceanFirst Financial Corp. (1)                                                                                                                                                                                                                         |
| 3.2     | Bylaws of OceanFirst Financial Corp. (6)                                                                                                                                                                                                                                               |
| 3.3     | Certificate of Ownership Merging Ocean Interim, Inc. into OceanFirst Financial Corp. (6)                                                                                                                                                                                               |
| 4.0     | Stock Certificate of OceanFirst Financial Corp.(1)                                                                                                                                                                                                                                     |
| 10.1    | Form of OceanFirst Bank Employee Stock Ownership Plan (1)                                                                                                                                                                                                                              |
| 10.1(a) | Amendment to OceanFirst Bank Employee Stock Ownership Plan (3)                                                                                                                                                                                                                         |
| 10.2    | OceanFirst Bank Employees' Savings and Profit Sharing Plan (1)                                                                                                                                                                                                                         |
| 10.3    | OceanFirst Bank 1995 Supplemental Executive Retirement Plan (1)                                                                                                                                                                                                                        |
| 10.4    | OceanFirst Bank Deferred Compensation Plan for Directors (1)                                                                                                                                                                                                                           |
| 10.5    | OceanFirst Bank Deferred Compensation Plan for Officers (1)                                                                                                                                                                                                                            |
| 10.8    | Amended and Restated OceanFirst Financial Corp. 1997 Incentive Plan (4)                                                                                                                                                                                                                |
| 10.9    | Form of Employment Agreement between OceanFirst Bank and certain executive officers, including Michael J. Fitzpatrick, John R. Garbarino and Robert M. Pardes (1)                                                                                                                      |
| 10.10   | Form of Employment Agreement between OceanFirst Financial Corp. and certain executive officers, including Michael J. Fitzpatrick, John R. Garbarino and Robert M. Pardes (1)                                                                                                           |
| 10.11   | Form of Change in Control Agreement between OceanFirst Bank and certain executive officers, including John K. Kelly and Vito R. Nardelli (9)                                                                                                                                           |
| 10.12   | Form of Change in Control Agreement between OceanFirst Financial Corp. and certain executive officers, including John K. Kelly and Vito R. Nardelli (9)                                                                                                                                |
| 10.13   | 2000 Stock Option Plan (5)                                                                                                                                                                                                                                                             |
| 10.14   | Form of Employment Agreement between Columbia Home Loans, LLC (formerly Columbia Equities, Ltd.) and Robert M. Pardes (6).                                                                                                                                                             |

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|-------|-------------------------------------------------------------------------------------------------------|
| 10.15 | Amendment of the OceanFirst Financial Corp. 2000 Stock Option Plan (7)                                |
| 10.16 | Form of OceanFirst Financial Corp. 2000 Stock Option Plan Non-Statutory Option Award Agreement (9)    |
| 10.17 | Form of Amended and Restated OceanFirst Financial Corp. 1997 Incentive Plan Stock Award Agreement (9) |
| 10.18 | Amendment and form of OceanFirst Bank Employee Severance Compensation Plan (10)                       |
| 10.19 | Form of OceanFirst Financial Corp. Deferred Incentive Compensation Award Program (11)                 |
| 10.20 | 2006 Stock Incentive Plan (12)                                                                        |
| 13.0  | Portions of 2006 Annual Report to Stockholders (filed herewith)                                       |
| 14.0  | OceanFirst Financial Corp. Code of Ethics and Standards of Personal Conduct (8)                       |
| 21.0  | Subsidiary information is incorporated herein by reference to “Part I - Subsidiaries”                 |
| 23.0  | Consent of KPMG LLP (filed herewith)                                                                  |
| 31.1  | Rule 13a-14(a)/15d-14(c) Certification of Chief Executive Officer (filed herewith)                    |
| 31.2  | Rule 13a-14(a)/15d-14(c) Certification of Chief Financial Officer (filed herewith)                    |
| 32.1  | Section 1350 Certifications (filed herewith)                                                          |

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- (1) Incorporated herein by reference from the Exhibits to Form S-1, Registration Statement, effective May 13, 1996 as amended, Registration No. 33-80123.
- (2) Incorporated herein by reference from the Exhibits to Form 8-K filed on June 28, 2000.
- (3) Incorporated herein by reference from the Exhibits to Form 10-K filed on March 25, 1997.
- (4) Incorporated herein by reference from Form 14-A Definitive Proxy Statement filed on March 19, 1998.
- (5) Incorporated herein by reference from Form 14-A Definitive Proxy Statement filed on March 17, 2000.
- (6) Incorporated herein by reference from the Exhibits to Form 10-K filed on March 23, 2003.
- (7) Incorporated herein by reference from the Form 14-A Definitive Proxy Statement filed on March 21, 2003.
- (8) Incorporated herein by reference from the Exhibits to Form 10-K filed on March 15, 2004.
- (9) Incorporated herein by reference from Exhibits to Form 10-K filed on March 15, 2005
- (10) Incorporated herein by reference from Exhibits to Form 10-Q filed on August 9, 2005
- (11) Incorporated herein by reference from Exhibits to Form 10-K filed on March 14, 2006
- (12) Incorporated herein by reference from Form 14-A Definitive Proxy Statement filed on March 14, 2006.

CONFORMED

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.  
  
By: /s/ John R. Garbarino  
John R. Garbarino  
Chairman of the Board, President  
and Chief Executive Officer and Director

Date: March 27, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

| <u>Name</u>                                                                                                                                                            | <u>Date</u>    |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| <u>/s/ John R. Garbarino</u><br>John R. Garbarino<br>Chairman of the Board, President and<br>Chief Executive Officer<br>(principal executive officer)                  | March 27, 2007 |
| <u>/s/ Michael J. Fitzpatrick</u><br>Michael J. Fitzpatrick<br>Executive Vice President and<br>Chief Financial Officer<br>(principal accounting and financial officer) | March 27, 2007 |
| <u>/s/ Joseph J. Burke</u><br>Joseph J. Burke<br>Director                                                                                                              | March 27, 2007 |
| <u>/s/ Angelo Catania</u><br>Angelo Catania<br>Director                                                                                                                | March 27, 2007 |
| <u>/s/ Carl Feltz, Jr.</u><br>Carl Feltz, Jr.<br>Director                                                                                                              | March 27, 2007 |

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|--------------------------------------------------------------|----------------|
| /s/ John W. Chadwick<br>John W. Chadwick<br>Director         | March 27, 2007 |
| /s/ Donald E. McLaughlin<br>Donald E. McLaughlin<br>Director | March 27, 2007 |
| /s/ Diane F. Rhine<br>Diane F. Rhine<br>Director             | March 27, 2007 |
| /s/ James T. Snyder<br>James T. Snyder<br>Director           | March 27, 2007 |
| /s/ John E. Walsh<br>John E. Walsh<br>Director               | March 27, 2007 |

## Selected Consolidated Financial and Other Data of the Company

The selected consolidated financial and other data of the Company set forth below is derived in part from, and should be read in conjunction with the Consolidated Financial Statements of the Company and Notes thereto presented elsewhere in this Annual Report.

| At December 31,<br>(dollars in thousands)                                                   | 2006             | 2005             | 2004             | 2003             | 2002             |
|---------------------------------------------------------------------------------------------|------------------|------------------|------------------|------------------|------------------|
| <b>Selected Financial Condition Data:</b>                                                   |                  |                  |                  |                  |                  |
| Total assets                                                                                | \$ 2,077,002     | \$ 1,985,357     | \$ 1,914,275     | \$ 1,717,409     | \$ 1,743,698     |
| Investment securities available for sale                                                    | 82,384           | 83,861           | 83,960           | 80,458           | 91,978           |
| Federal Home Loan Bank of New York stock                                                    | 25,346           | 21,792           | 21,250           | 19,220           | 18,700           |
| Mortgage-backed securities available for sale                                               | 68,369           | 85,025           | 124,478          | 86,938           | 138,657          |
| Loans receivable, net                                                                       | 1,701,425        | 1,654,544        | 1,472,907        | 1,389,220        | 1,335,898        |
| Mortgage loans held for sale                                                                | 82,943           | 32,044           | 63,961           | 33,207           | 66,626           |
| Deposits                                                                                    | 1,372,328        | 1,356,568        | 1,270,535        | 1,144,205        | 1,184,836        |
| Federal Home Loan Bank advances                                                             | 430,500          | 354,900          | 312,000          | 314,400          | 214,000          |
| Securities sold under agreements to repurchase and other borrowings                         | 102,482          | 118,289          | 151,072          | 106,723          | 184,584          |
| Stockholders' equity                                                                        | 132,320          | 138,784          | 137,956          | 134,662          | 135,305          |
| <b>For the Year Ended December 31,<br/>(dollars in thousands; except per share amounts)</b> |                  |                  |                  |                  |                  |
| <b>Selected Operating Data:</b>                                                             |                  |                  |                  |                  |                  |
| Interest income                                                                             | \$ 116,562       | \$ 102,799       | \$ 90,952        | \$ 94,537        | \$ 108,456       |
| Interest expense                                                                            | 58,443           | 41,873           | 34,931           | 36,894           | 47,624           |
| Net interest income                                                                         | 58,119           | 60,926           | 56,021           | 57,643           | 60,832           |
| Provision for loan losses                                                                   | 150              | 350              | 300              | 688              | 1,650            |
| Net interest income after provision for loan losses                                         | 57,969           | 60,576           | 55,721           | 56,955           | 59,182           |
| Other income                                                                                | 13,608           | 24,090           | 20,740           | 18,749           | 10,857           |
| Operating expenses                                                                          | 52,381           | 54,834           | 48,759           | 44,857           | 40,144           |
| Income before provision for income taxes                                                    | 19,196           | 29,832           | 27,702           | 30,847           | 29,895           |
| Provision for income taxes                                                                  | 6,563            | 10,335           | 9,757            | 10,974           | 9,752            |
| Net income                                                                                  | <u>\$ 12,633</u> | <u>\$ 19,497</u> | <u>\$ 17,945</u> | <u>\$ 19,873</u> | <u>\$ 20,143</u> |
| Basic earnings per share                                                                    | <u>\$ 1.09</u>   | <u>\$ 1.65</u>   | <u>\$ 1.48</u>   | <u>\$ 1.62</u>   | <u>\$ 1.57</u>   |
| Diluted earnings per share                                                                  | <u>\$ 1.07</u>   | <u>\$ 1.60</u>   | <u>\$ 1.42</u>   | <u>\$ 1.53</u>   | <u>\$ 1.47</u>   |

## Selected Consolidated Financial and Other Data (continued)

## Selected Consolidated Financial and Other Data of the Company (continued)

| At or For the Year Ended December 31,                                               | 2006   | 2005   | 2004   | 2003   | 2002   |
|-------------------------------------------------------------------------------------|--------|--------|--------|--------|--------|
| <b>Selected Financial Ratios and Other Data <sup>(1)</sup>:</b>                     |        |        |        |        |        |
| <b>Performance Ratios:</b>                                                          |        |        |        |        |        |
| Return on average assets                                                            | .62%   | 1.00%  | .98%   | 1.14%  | 1.16%  |
| Return on average stockholders' equity                                              | 9.40   | 14.43  | 13.34  | 14.84  | 14.31  |
| Stockholders' equity to total assets                                                | 6.37   | 6.99   | 7.21   | 7.84   | 7.76   |
| Tangible equity to tangible assets                                                  | 6.32   | 6.93   | 7.13   | 7.75   | 7.67   |
| Average interest rate spread <sup>(2)</sup>                                         | 2.69   | 3.07   | 3.03   | 3.24   | 3.41   |
| Net interest margin <sup>(3)</sup>                                                  | 2.98   | 3.30   | 3.23   | 3.48   | 3.70   |
| Average interest-earning assets to average interest-bearing liabilities             | 109.53 | 109.74 | 110.24 | 110.82 | 109.78 |
| Operating expenses to average assets                                                | 2.56   | 2.81   | 2.67   | 2.57   | 2.32   |
| Efficiency ratio <sup>(4)</sup>                                                     | 73.03  | 64.50  | 63.52  | 58.72  | 56.00  |
| <b>Asset Quality Ratios:</b>                                                        |        |        |        |        |        |
| Non-performing loans as a percent of total loans receivable <sup>(5)(6)</sup>       | .25    | .09    | .23    | .15    | .19    |
| Non-performing assets as a percent of total assets <sup>(6)</sup>                   | .23    | .09    | .20    | .14    | .16    |
| Allowance for loan losses as a percent of total loans receivable <sup>(5)</sup>     | .57    | .62    | .69    | .75    | .71    |
| Allowance for loan losses as a percent of total non-performing loans <sup>(6)</sup> | 226.25 | 655.80 | 306.42 | 499.63 | 374.78 |
| <b>Per Share Data:</b>                                                              |        |        |        |        |        |
| Cash dividends per common share                                                     | \$ .80 | \$ .80 | \$ .80 | \$ .78 | \$ .69 |
| Book value per common share at end of period                                        | 10.79  | 10.93  | 10.59  | 10.09  | 9.83   |
| Tangible book value per common share at end of period                               | 10.70  | 10.83  | 10.49  | 9.98   | 9.72   |
| <b>Number of full-service customer facilities:</b>                                  | 21     | 18     | 17     | 17     | 17     |

(1) With the exception of end of year ratios, all ratios are based on average daily balances.

(2) The average interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.

(3) The net interest margin represents net interest income as a percentage of average interest-earning assets.

(4) Efficiency ratio represents the ratio of operating expenses to the aggregate of other income and net interest income.

(5) Total loans receivable includes loans receivable and loans held for sale.

(6) Non-performing assets consist of non-performing loans and real estate acquired through foreclosure ("REO"). Non-performing loans consist of all loans 90 days or more past due and other loans in the process of foreclosure. It is the Company's policy to cease accruing interest on all such loans.

## Overview

OceanFirst Financial Corp. (the "Company" or "OCFC") is the holding company for OceanFirst Bank (the "Bank"). On August 17, 1995, the Board of Directors (the "Board") of the Bank adopted a Plan of Conversion, as amended, to convert from a Federally-chartered mutual savings bank to a Federally-chartered capital stock savings bank with the concurrent formation of a holding company (the "Conversion").

The Conversion was completed on July 2, 1996 with the issuance by the Company of 25,164,235 shares of its common stock in a public offering to the Bank's eligible depositors and the Bank's employee stock ownership plan (the "ESOP"). Concurrent with the close of the Conversion, an additional 2,013,137 shares of common stock (8% of the offering) were issued and donated by the Company to OceanFirst Foundation (the "Foundation"), a private foundation dedicated to charitable purposes within Ocean County, New Jersey and its neighboring communities.

On August 18, 2000 the Bank acquired Columbia Home Loans, LLC ("Columbia"), a mortgage banking company based in Westchester County, New York in a transaction accounted for as a purchase. Columbia offers a full product line of residential mortgage loans with operations primarily centered in New York and New Jersey. Loans are originated through loan production offices, a web site and a network of independent mortgage brokers.

The Company conducts business, primarily through its ownership of the Bank which operates its administrative/branch office located in Toms River and twenty other branch offices. Seventeen of the twenty-one branch offices are located in Ocean County, New Jersey, with three branches in Monmouth County and one in Middlesex County. One of the branches opened in 2006 was to relocate an existing facility to a preferred location. To complete the relocation, the older branch is expected to close in 2007. The Bank also operates two loan production offices.

The Company's results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on the Company's interest-earning assets, such as loans and investments, and the interest expense on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates non-interest income such as income from loan sales, loan servicing, loan originations, including reverse mortgage loan originations, merchant check card services, deposit accounts, the sale of alternative investments, trust and asset management services and other fees. The Company's operating expenses primarily consist of compensation and employee benefits, occupancy and equipment, marketing, and other general and administrative expenses. The Company's results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

## Strategy

The Company operates as a consumer-oriented bank, with a strong focus on its local community. The Bank is the oldest and largest community-based financial institution headquartered in Ocean County, New Jersey. The Company competes with generally larger and out-of-market financial service providers through its local focus and the delivery of superior service. Additionally, over the past few years, the Company has developed a more pro-active sales culture throughout the organization.

The Company's strategy has been to consistently grow profitability while limiting credit and interest rate risk exposure. To accomplish these objectives, the Company has sought to (1) grow loans receivable through the Bank's traditional mortgage portfolio emphasis supplemented by the offering of commercial lending services to local businesses; (2) grow core deposits (defined as all deposits other than time deposits) through de novo branch expansion and product offerings appealing to a broadened customer base; (3) increase non-interest income by expanding the menu of fee-based products and services; and (4) actively manage the Company's capital position.

With industry consolidation eliminating most locally-headquartered competitors, the Company saw an opportunity to fill a perceived void for locally delivered commercial loan and deposit services. As such, the Company assembled an experienced team of business banking professionals responsible for offering commercial loan and deposit services and merchant check card services to businesses in Ocean County and surrounding communities. As a result of this initiative, commercial loans represented 19.9% of the Bank's total loans receivable at December 31, 2006 as compared to only 3.6% at December 31, 1997. Commercial loan growth during 2006 of \$12.8 million, or 3.7%, was significantly less than the Company's expectations and less than the results experienced in prior years due to unfilled staff positions and heightened competition. For 2007, these factors may once again keep the Company from attaining its commercial loan growth targets. The diversification of the Company's loan products entails a higher degree of credit risk than is involved in one-to-four family residential mortgage lending activity. As a consequence, management continues to employ a well-defined credit policy focusing on quality underwriting and close management and Board monitoring.

The Company seeks to increase core deposit market share in its primary market area by expanding the Bank's branch network and improving market penetration. Over the past nine years, the Company has opened twelve branch offices, nine in Ocean County and three in Monmouth County. The Company has committed to the opening of new branches in Freehold and Bayville which are expected to open in late 2007. Additionally, a new branch in Wall is expected to open in 2008. The Company is continually evaluating additional office sites within its existing market area.

At December 31, 2006, the twelve most recently opened branches maintained an average core deposit ratio of 64.5%. Core account development has also benefited from the Company's efforts to attract business deposits in conjunction with its commercial lending operations and from an expanded mix of retail core account products. Additionally, marketing and incentive plans have focused on core account growth. As a result of these efforts the Company's core deposit ratio has grown to 60.5% at December 31, 2006 as compared to only 33.0% at December 31, 1997. Core deposits are generally considered a less expensive and more stable funding source than certificates of deposit.

Management continues to diversify the Company's product line in order to enhance non-interest income. The Company offers alternative investment products (annuities, mutual funds and life insurance) for sale through its retail branch network. The products are non-proprietary, sold through a third party vendor, and provide the Company with fee income opportunities. In early 2005, the alternative investment program was expanded to add Licensed Bank Employees which allows the Company to capture more of the revenue associated with the sale of investment products. The Company introduced trust and asset management

services in early 2000 and has also expanded the non-interest income received from small business relationships including merchant services. During 2002, the Company established a captive subsidiary to recognize fee income from private mortgage insurance. In early 2005, the Company entered into a joint venture agreement with a title insurance agency to capture part of the revenue associated with offering title insurance to the Company's mortgage loan customers. During 2003, the Company began offering reverse mortgage loans. For these loans, the Company typically acts as a broker and collects a fee when the loan is closed. Recently, the Company was approved by the Federal National Mortgage Association ("FNMA") and another institutional investor as a seller/servicer of reverse mortgage loans. As a result, in 2007 the Company expects to close reverse mortgage loans in its name and sell the loan either with or without the servicing rights. The seller/servicer designation is expected to improve the profit margin on reverse mortgage loan volume. As a result of these initiatives, income from fees and service charges has increased from \$1.4 million for the year ended December 31, 1997 to \$10.5 million for the year ended December 31, 2006, a 25.3% average annual increase.

With post conversion capital levels exceeding 20%, management recognized the need to address the Company's overcapitalized position in order to improve return on equity. The capital management plan implemented over the past few years includes share repurchases and cash dividends. During 2006 the Company repurchased 772,804 common shares. Under the 10% repurchase program authorized by the Board of Directors in July 2006, 538,763 shares remain to be purchased as of December 31, 2006. From conversion date through December 31, 2006, the Company has repurchased a total of 16.9 million common shares, 62.3% of the shares originally issued in the conversion. The Company has historically targeted a cash dividend payout of 40% to 50% of net income. The dividend has increased by 200% since the initial dividend in 1997. The capital management plan has successfully reduced the Company's capital ratio from 19.4% at December 31, 1996 to 6.4% at December 31, 2006.

### Summary

From mid 2004 through mid 2006, the Board of Governors of the Federal Reserve increased the federal funds borrowing rate 17 times for an aggregate total of 4.25%. These increases outpaced increases in longer-term rates resulting in a flattening of the interest rate yield curve. The pause in short-term rate increases by the Federal Reserve during the second half of 2006 brought about an inversion of the interest rate yield curve as longer-term rates began to decline.

The flat or inverted yield curve throughout 2006 had a negative impact on the Company's net interest margin and results of operations as interest-earning assets, both loans and securities, are priced against longer-term indices, while interest-bearing liabilities, primarily deposits and borrowings, are priced against shorter-term indices. Despite the contraction in the net interest margin the Company has generally not repriced all core deposits in line with the market increases in short-term interest rates. The likely upward pricing of core deposits into 2007 can be expected to have a continued negative impact on the Company's net interest margin and results of operations.

While the Bank continues to focus on growing core deposits, the rise in interest rates has made certificates of deposit relatively more attractive as an investment option to the Bank's depositors. The Bank has generally repriced certificates of deposit upwards in line with market rates while core deposit repricing has lagged the rise in short-term rates. As competition for core deposits has intensified, some of the Bank's competitors have aggressively raised their core deposit pricing. In light of these trends, the Bank recorded growth in certificates of deposit during 2006 while core deposit balances declined.

During 2006, Columbia offered a subprime mortgage loan product which provided the borrower with 100% financing relative to the value of the underlying property. These mortgage loans were underwritten to investor specifications, subjected to investor due diligence and subsequently sold to investors, however, the loan sale agreements may require Columbia to repurchase the loan in the event of an Early Payment Default, generally defined as the failure by the borrower to make a payment within a designated period early in the loan term following sale of the loan. Columbia may also repurchase a loan in the event of a breach to a representation or warranty or a misrepresentation during the loan origination process. For the year ended December 31, 2006 the Company established a reserve for repurchased loans of \$9.6 million with a corresponding provision which reduced the net gain on sale of loans. In the first quarter of 2007, Columbia discontinued the origination of subprime loans.

### Critical Accounting Policies

Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2006 contains a summary of significant accounting policies. Various elements of these accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Certain assets are carried in the consolidated statements of financial condition at fair value or the lower of cost or fair value. Policies with respect to the methodologies used to determine the allowance for loan losses, the reserve for repurchased loans, the valuation of Mortgage Servicing Rights and judgments regarding securities impairment are the most critical accounting policies because they are important to the presentation of the Company's financial condition and results of operations, 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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## Allowance for Loan Losses

The allowance for loan losses is a valuation account that reflects probable incurred losses in the loan portfolio based on management's evaluation of the risks inherent in its loan portfolio and the general economy. The Company maintains the allowance for loan losses through provisions for loan losses that are charged to income. Charge-offs against the allowance for loan losses are taken on loans where management determines that the collection of loan principal is unlikely. Recoveries made on loans that have been charged-off are credited to the allowance for loan losses when payment is received. The allowance for loan losses is maintained at an amount management considers sufficient to provide for probable losses based on evaluating known and inherent risks in the loan portfolio resulting from management's continuing analysis of the factors underlying the quality of the loan portfolio. These factors include changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, detailed analysis of individual loans for which full collectibility may not be assured, and the determination of the existence and realizable value of the collateral and guarantees securing the loan.

The Bank's allowance for loan losses consists of a specific allowance and a general allowance, each updated on a quarterly basis. A specific allowance is determined for all assets classified as substandard, doubtful or loss where the value of the underlying collateral can reasonably be evaluated; generally those loans secured by real estate. The Bank obtains an updated appraisal whenever a loan secured by real estate becomes 90 days delinquent. The specific allowance represents the difference between the Bank's recorded investment in the loan and the fair value of the collateral, less estimated disposal costs. A general allowance is determined for all other classified and non-classified loans. In determining the level of the general allowance, the Bank segments the loan portfolio into various risk tranches based on type of loan (mortgage, consumer and commercial); and certain underwriting characteristics. An estimated loss factor is then applied to each risk tranche. The loss factors are determined based upon historical loan loss experience, current economic conditions, underwriting standards, internal loan review results and other factors.

An overwhelming percentage of the Company's loan portfolio, whether one-to-four family, consumer or commercial, is secured by real estate. Additionally, most of the Company's borrowers are located in Ocean County, New Jersey and the surrounding area. These concentrations may adversely affect the Company's loan loss experience should real estate values decline or should the Ocean County area experience an adverse economic shock.

Management believes the primary risks inherent in the portfolio are possible increases in interest rates, a decline in the economy, generally, and a decline in real estate market values. Any one or a combination of these events may adversely affect the borrowers' ability to repay the loans, resulting in increased delinquencies, loan losses and future levels of provisions. Accordingly, the Company has provided for loan losses at the current level to address the current risk in the loan portfolio.

Although management believes that the Company has established and maintained the allowance for loan losses at adequate levels, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to make additional provisions for loan losses based upon information available to them at the time of their examination. Although management uses the best information available, future adjustments to the allowance may be necessary due to economic, operating, regulatory and other conditions beyond the Company's control.

## Reserve for Repurchased Loans

The reserve for repurchased loans relates to potential losses on loans sold which may have to be repurchased due to an Early Payment Default. Additionally, loans may be repurchased based on violation of representations and warranties. Provisions for losses are charged to gain on sale of loans and credited to the reserve, which is part of other liabilities while actual losses are charged to the reserve. In order to estimate an appropriate reserve for repurchased loans, the Company considers recent and historical experience, product type and volume of recent whole loan sales and the general economic environment. Management believes that the Company has established and maintained the reserve for repurchased loans at adequate levels, however, future adjustments to the reserve may be necessary due to economic, operating or other conditions beyond the Company's control.

## Valuation of Mortgage Servicing Rights ("MSR")

The estimated origination and servicing costs of mortgage loans sold in which servicing rights are retained is allocated between the loans and the servicing rights based on their estimated fair values at the time of the loan sale. Servicing assets are carried at the lower of cost or fair value and are amortized in proportion to, and over the period of, net servicing income. The estimated fair value of MSR is determined through a discounted analysis of future cash flows, incorporating numerous assumptions including servicing income, servicing costs, market discount rates, prepayment speeds and default rates. Impairment of the MSR is assessed on the fair value of those rights with any impairment recognized as a component of loan servicing fee income.

The fair value of MSR is sensitive to changes in assumptions. Fluctuations in prepayment speed assumptions have the most significant impact on the fair value of MSR. In the event that loan prepayment activities increase due to increased loan refinancing, the fair value of MSR would likely decline. In the event that loan prepayment activities decrease due to a decline in loan refinancing, the fair value of MSR would likely increase. Any measurement of MSR is limited by the existing conditions and assumptions utilized at a particular point in time, and would not necessarily be appropriate if applied at a different point in time.

## Impairment of Securities

On a quarterly basis the Company evaluates whether any securities are other-than-temporarily impaired. In making this determination, the Company considers the extent and duration of the impairment, the nature and financial health of the issuer, the ability and intent to hold the securities for a period of time sufficient to allow for any anticipated recovery in market value and other factors relevant to specific securities, such as the credit risk of the issuer and whether a guarantee or insurance applies to the security. If a security is determined to be other-than-temporarily impaired, an impairment loss is charged to income during the period the impairment loss is found to exist, resulting in a reduction to earnings for that period.

Management's Discussion and Analysis  
of Financial Condition and Results of Operations *(continued)*

As of December 31, 2006, the Company concluded that any unrealized losses in the securities available for sale portfolios were temporary in nature because they were primarily related to market interest rates and not related to the underlying credit quality of the issuers of the securities. Additionally, the Company has the intent and ability to hold these investments for the time necessary to recover the amortized cost. Future events that would materially change this conclusion and require an impairment loss to be charged to operations include a change in the credit quality of the issuers.

### Analysis of Net Interest Income

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

The following table sets forth certain information relating to the Company for each of the years ended December 31, 2006, 2005, and 2004. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown except where noted otherwise. Average balances are derived from average daily balances. The yields and costs include fees which are considered adjustments to yields.

|                                                                  | Year Ended December 31, |                  |                    |                    |                  |                    |                    |                 |                    |
|------------------------------------------------------------------|-------------------------|------------------|--------------------|--------------------|------------------|--------------------|--------------------|-----------------|--------------------|
|                                                                  | 2006                    |                  |                    | 2005               |                  |                    | 2004               |                 |                    |
|                                                                  | Average Balance         | Interest         | Average Yield/Cost | Average Balance    | Interest         | Average Yield/Cost | Average Balance    | Interest        | Average Yield/Cost |
| <i>(dollars in thousands)</i>                                    |                         |                  |                    |                    |                  |                    |                    |                 |                    |
| <b>Assets:</b>                                                   |                         |                  |                    |                    |                  |                    |                    |                 |                    |
| Interest-earning assets:                                         |                         |                  |                    |                    |                  |                    |                    |                 |                    |
| Interest-earning deposits and short-term investments             | \$ 8,885                | \$ 437           | 4.92%              | \$ 10,796          | \$ 344           | 3.19%              | \$ 14,527          | \$ 190          | 1.31%              |
| Investment securities <sup>(1)</sup>                             | 83,999                  | 5,122            | 6.10               | 85,942             | 3,871            | 4.50               | 85,258             | 2,400           | 2.81               |
| FHLB stock                                                       | 24,575                  | 1,315            | 5.35               | 20,105             | 907              | 4.51               | 22,357             | 405             | 1.81               |
| Mortgage-backed securities <sup>(1)</sup>                        | 77,416                  | 3,304            | 4.27               | 106,148            | 3,813            | 3.59               | 130,749            | 4,363           | 3.34               |
| Loans receivable, net <sup>(2)</sup>                             | 1,758,230               | 106,384          | 6.05               | 1,624,761          | 93,864           | 5.78               | 1,479,504          | 83,594          | 5.65               |
| Total interest-earning assets                                    | 1,953,105               | 116,562          | 5.97               | 1,847,752          | 102,799          | 5.56               | 1,732,395          | 90,952          | 5.25               |
| Non-interest-earning assets                                      | 96,752                  |                  |                    | 101,357            |                  |                    | 97,072             |                 |                    |
| Total assets                                                     | <u>\$2,049,857</u>      |                  |                    | <u>\$1,949,109</u> |                  |                    | <u>\$1,829,467</u> |                 |                    |
| <b>Liabilities and Equity:</b>                                   |                         |                  |                    |                    |                  |                    |                    |                 |                    |
| Interest-bearing liabilities:                                    |                         |                  |                    |                    |                  |                    |                    |                 |                    |
| Money market deposit accounts                                    | \$ 117,935              | \$ 1,994         | 1.69%              | \$ 135,907         | \$ 1,604         | 1.18%              | \$ 143,064         | \$ 1,350        | .94%               |
| Savings accounts                                                 | 219,879                 | 1,730            | .79                | 260,655            | 1,858            | .71                | 263,133            | 1,310           | .50                |
| Interest-bearing checking accounts                               | 379,997                 | 8,216            | 2.16               | 350,839            | 4,674            | 1.33               | 272,076            | 1,556           | .57                |
| Time deposits                                                    | 534,056                 | 21,461           | 4.02               | 481,585            | 14,671           | 3.05               | 414,393            | 10,978          | 2.65               |
| Total                                                            | 1,251,867               | 33,401           | 2.67               | 1,228,986          | 22,807           | 1.86               | 1,092,666          | 15,194          | 1.39               |
| FHLB advances                                                    | 426,792                 | 20,184           | 4.73               | 320,231            | 13,698           | 4.28               | 335,916            | 14,815          | 4.41               |
| Securities sold under agreements to repurchase                   | 92,930                  | 4,068            | 4.38               | 132,520            | 5,237            | 3.95               | 142,824            | 4,922           | 3.45               |
| Other borrowings                                                 | 11,543                  | 790              | 6.84               | 2,055              | 131              | 6.37               | —                  | —               | —                  |
| Total interest-bearing liabilities                               | 1,783,132               | 58,443           | 3.28               | 1,683,792          | 41,873           | 2.49               | 1,571,406          | 34,931          | 2.22               |
| Non-interest-bearing deposits                                    | 120,482                 |                  |                    | 115,681            |                  |                    | 111,135            |                 |                    |
| Non-interest-bearing liabilities                                 | 11,875                  |                  |                    | 14,499             |                  |                    | 12,378             |                 |                    |
| Total liabilities                                                | 1,915,489               |                  |                    | 1,813,972          |                  |                    | 1,694,919          |                 |                    |
| Stockholders' equity                                             | 134,368                 |                  |                    | 135,137            |                  |                    | 134,548            |                 |                    |
| Total liabilities and equity                                     | <u>\$2,049,857</u>      |                  |                    | <u>\$1,949,109</u> |                  |                    | <u>\$1,829,467</u> |                 |                    |
| Net interest income                                              |                         | <u>\$ 58,119</u> |                    |                    | <u>\$ 60,926</u> |                    |                    | <u>\$56,021</u> |                    |
| Net interest rate spread <sup>(3)</sup>                          |                         |                  | <u>2.69%</u>       |                    |                  | <u>3.07%</u>       |                    |                 | <u>3.03%</u>       |
| Net interest margin <sup>(4)</sup>                               |                         |                  | <u>2.98%</u>       |                    |                  | <u>3.30%</u>       |                    |                 | <u>3.23%</u>       |
| Ratio of interest-earning assets to interest-bearing liabilities |                         | <u>109.53%</u>   |                    |                    | <u>109.74%</u>   |                    |                    | <u>110.24%</u>  |                    |

(1) Amounts are recorded at average amortized cost.

(2) Amount is net of deferred loan fees, undisbursed loan funds, discounts and premiums and estimated loan 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.

Rate Volume Analysis. The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

| (in thousands)                                       | Year Ended December 31, 2006<br>Compared to<br>Year Ended December 31, 2005 |            |            | Year Ended December 31, 2005<br>Compared to<br>Year Ended December 31, 2004 |            |          |
|------------------------------------------------------|-----------------------------------------------------------------------------|------------|------------|-----------------------------------------------------------------------------|------------|----------|
|                                                      | Increase (Decrease) Due to                                                  |            |            | Increase (Decrease) Due to                                                  |            |          |
|                                                      | Volume                                                                      | Rate       | Net        | Volume                                                                      | Rate       | Net      |
| <b>Interest-earning assets:</b>                      |                                                                             |            |            |                                                                             |            |          |
| Interest-earning deposits and short-term investments | \$ (69)                                                                     | \$ 162     | \$ 93      | \$ (60)                                                                     | \$ 214     | \$ 154   |
| Investment securities                                | (90)                                                                        | 1,341      | 1,251      | 19                                                                          | 1,452      | 1,471    |
| FHLB stock                                           | 222                                                                         | 186        | 408        | (45)                                                                        | 547        | 502      |
| Mortgage-backed securities                           | (1,149)                                                                     | 640        | (509)      | (861)                                                                       | 311        | (550)    |
| Loans receivable, net                                | 7,981                                                                       | 4,539      | 12,520     | 8,320                                                                       | 1,950      | 10,270   |
| Total interest-earning assets                        | 6,895                                                                       | 6,868      | 13,763     | 7,373                                                                       | 4,474      | 11,847   |
| <b>Interest-bearing liabilities:</b>                 |                                                                             |            |            |                                                                             |            |          |
| Money market deposit accounts                        | (233)                                                                       | 623        | 390        | (71)                                                                        | 325        | 254      |
| Savings accounts                                     | (317)                                                                       | 189        | (128)      | (12)                                                                        | 560        | 548      |
| Interest-bearing checking accounts                   | 416                                                                         | 3,126      | 3,542      | 556                                                                         | 2,562      | 3,118    |
| Time deposits                                        | 1,733                                                                       | 5,057      | 6,790      | 1,913                                                                       | 1,780      | 3,693    |
| Total                                                | 1,599                                                                       | 8,995      | 10,594     | 2,386                                                                       | 5,227      | 7,613    |
| FHLB advances                                        | 4,929                                                                       | 1,557      | 6,486      | (685)                                                                       | (432)      | (1,117)  |
| Securities sold under agreements to repurchase       | (1,692)                                                                     | 523        | (1,169)    | (370)                                                                       | 685        | 315      |
| Other borrowings                                     | 649                                                                         | 10         | 659        | 131                                                                         | —          | 131      |
| Total interest-bearing liabilities                   | 5,485                                                                       | 11,085     | 16,570     | 1,462                                                                       | 5,480      | 6,942    |
| Net change in net interest income                    | \$ 1,410                                                                    | \$ (4,217) | \$ (2,807) | \$ 5,911                                                                    | \$ (1,006) | \$ 4,905 |

#### Comparison of Financial Condition at December 31, 2006 and December 31, 2005

Total assets at December 31, 2006 were \$2.077 billion, an increase of \$91.6 million, compared to \$1.985 billion at December 31, 2005.

Mortgage-backed securities decreased \$16.7 million as cash flow from these securities was used to fund loan growth. Loans receivable, net increased by \$46.9 million to a balance of \$1.701 billion at December 31, 2006, compared to a balance of \$1.655 billion at December 31, 2005. Consumer loans grew \$43.1 million, or 29.3%, as the Bank maintained an emphasis on this lending product. Commercial and commercial real estate loans outstanding increased \$12.8 million, or 3.7%, which was less than the Company's expectations and less than the results experienced in prior years due to unfilled staff positions and heightened competition. Mortgage loans held for sale increased \$50.9 million to a balance of \$82.9 million at December 31, 2006 compared to a balance of \$32.0 million at December 31, 2005. The increase occurred primarily at Columbia.

Deposit balances increased \$15.8 million to \$1.372 billion at December 31, 2006 from \$1.357 billion at December 31, 2005. Core deposits decreased by \$40.1 million, while time deposits increased by \$55.9 million.

Total Federal Home Loan Bank ("FHLB") borrowings, consisting of securities sold under agreements to repurchase and advances, increased \$50.6 million to \$464.5 million at December 31, 2006, compared to a balance of \$413.9 million at December 31, 2005. The increase was used to fund loan growth. Other borrowings increased \$12.5 million to \$17.5 million at December 31, 2006 compared to a balance of \$5.0 million at December 31, 2005. These borrowings were issued by the Company to primarily fund the repurchase of common stock.

Stockholders' equity at December 31, 2006 decreased to \$132.3 million, compared to \$138.8 million at December 31, 2005. For the year ended December 31, 2006, the Company repurchased 772,804 shares of common stock at a total cost of \$17.6 million. The reduction in stockholders' equity due to common stock repurchases was partly offset by net income, proceeds from stock option exercises and the related tax benefit, and Employee Stock Ownership Plan amortization.

## **Comparison of Operating Results for the Years Ended December 31, 2006 and December 31, 2005**

### **General**

Net income decreased to \$12.6 million for the year ended December 31, 2006, as compared to net income of \$19.5 million for the year ended December 31, 2005. Diluted earnings per share decreased to \$1.07 for the year ended December 31, 2006, as compared to \$1.60 for the same prior year period. Earnings per share was favorably affected by the Company's repurchase program, which reduced the average diluted shares outstanding.

### **Interest Income**

Interest income for the year ended December 31, 2006 was \$116.6 million, compared to \$102.8 million for the year ended December 31, 2005. The yield on interest-earning assets increased to 5.97% for the year ended December 31, 2006, as compared to 5.56% for the same prior year period. Average interest-earning assets increased by \$105.4 million for the year ended December 31, 2006, as compared to the same prior year period. The growth was concentrated in average loans receivable which grew \$133.5 million, or 8.2%, for the year ended December 31, 2006, as compared to the same prior year period.

### **Interest Expense**

Interest expense for the year ended December 31, 2006 was \$58.4 million, compared to \$41.9 million for the year ended December 31, 2005. The cost of interest-bearing liabilities increased to 3.28% for the year ended December 31, 2006, as compared to 2.49%, in the same prior year period. Average interest-bearing liabilities increased by \$99.3 million for the year ended December 31, 2006 as compared to the same prior year period. The growth was concentrated in borrowed funds which grew \$76.5 million, or 16.8% for the year ended December 31, 2006 as compared to the same prior year period.

### **Net Interest Income**

Net interest income for the year ended December 31, 2006 decreased to \$58.1 million, as compared to \$60.9 million in the same prior year period. The net interest margin decreased to 2.98% for the year ended December 31, 2006 from 3.30% in the same prior year period. Net interest income did benefit from the increase in average interest-earning assets as noted above, but not enough to offset the decline in the net interest margin.

### **Provision for Loan Losses**

For the year ended December 31, 2006, the Company's provision for loan losses was \$150,000, as compared to \$350,000 for the the same prior year period. Net charge-offs decreased to \$372,000 for the year ended December 31, 2006, as compared to \$578,000 for the same prior year period. Total loans receivable increased \$91.1 million, or 5.4%, at December 31, 2006, as compared to December 31, 2005, although almost all of this growth was in one-to-four family and consumer loans which generally carry a lower risk as compared to other types of loans. Non-performing loans increased by \$2.9 million, however, most of the increase also related to lower risk one-to-four family mortgage loans. Additionally, all non-performing loans were well secured.

### **Other Income**

Other income was \$13.6 million for the year ended December 31, 2006, compared to \$24.1 million for the same prior year period. For the year ended December 31, 2006, the Bank recorded gains of \$1.4 million on the sale of loans and securities available for sale, as compared to gains of \$13.2 million in the same prior year period. Loans sold for the year ended December 31, 2006 decreased to \$689.6 million from \$712.0 million in the same prior year period. Most of the decline in sales volume for year ended December 31, 2006 occurred at Columbia Home Loans during the first quarter of 2006. The decline experienced at Columbia was partly reflective of declines experienced industry-wide. In light of continuing pressure on volume and margins, Columbia implemented plans to consolidate lending channels to a more centralized platform designed to improve efficiency and reduce operating costs. As expected, the consolidation temporarily reduced lending capacity and adversely impacted the volume of loan sales. Additionally, staff turnover in the wholesale alternative credit channel adversely affected sales volume. During the second quarter of 2006 Columbia re-established the wholesale alternative credit channel and sales volume was restored. The gain on sale margin from sold loans, however, decreased for the year ended December 31, 2006 as compared to the same prior year period due to competitive pressures and a change in the mix to a greater proportion of wholesale loans. The wholesale loan production was generally subprime in nature and included a mortgage loan product which provided the borrower with 100% financing relative to the value of the underlying property. These mortgage loans were sold to investors, however, the loan sale agreements may have required Columbia to repurchase the loan in the event of an Early Payment Default or a breach to a representation or warranty. For the year ended December 31, 2006 the Company established a reserve for repurchased loans of \$9.6 million with a corresponding provision which reduced the net gain on sale of loans.

Fees and service charges increased \$1.1 million for the year ended December 31, 2006, as compared to the same prior year period primarily related to increases in fees generated from reverse mortgage loans, a new emphasis for the Bank, as well as fees from title insurance and trust services.

### **Operating Expenses**

Operating expenses were \$52.4 million for the year ended December 31, 2006, as compared to \$54.8 million in the same prior year period. The decrease was primarily due to reduced incentive plan accruals and planned reductions to loan related marketing expense.

### **Provision for Income Taxes**

Income tax expense was \$6.6 million for the year ended December 31, 2006, as compared to \$10.3 million for the same prior year period. The effective tax rate decreased slightly to 34.2% for the year ended December 31, 2006 as compared to 34.6% for the same prior year period.

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## **Comparison of Operating Results for the Years Ended December 31, 2005 and December 31, 2004**

### **General**

Net income increased to \$19.5 million for the year ended December 31, 2005, as compared to net income of \$17.9 million for the year ended December 31, 2004. Diluted earnings per share increased to \$1.60 for the year ended December 31, 2005, as compared to \$1.42 for the same prior year period. Earnings per share was favorably affected by the Company's repurchase program, which reduced the average diluted shares outstanding.

### **Interest Income**

Interest income for the year ended December 31, 2005 was \$102.8 million, compared to \$91.0 million for the year ended December 31, 2004. The yield on interest-earning assets increased to 5.56% for the year ended December 31, 2005, as compared to 5.25% for the same prior year period. Average interest-earning assets increased by \$115.4 million for the year ended December 31, 2005, as compared to the same prior year period. The growth was concentrated in average loans receivable which grew \$145.3 million, or 9.8%, for the year ended December 31, 2005, as compared to the same prior year period.

### **Interest Expense**

Interest expense for the year ended December 31, 2005 was \$41.9 million, compared to \$34.9 million for the year ended December 31, 2004. The cost of interest-bearing liabilities increased to 2.49% for the year ended December 31, 2005, as compared to 2.22%, in the same prior year period. Average interest-bearing liabilities increased by \$112.4 million for the year ended December 31, 2005, as compared to the same prior year period. The growth was concentrated in interest-bearing deposits which grew \$136.3 million, or 12.5% for the year ended December 31, 2005 as compared to the same prior year period.

### **Net Interest Income**

Net interest income for the year ended December 31, 2005 increased to \$60.9 million, as compared to \$56.0 million in the same prior year period. The net interest margin increased to 3.30% for the year ended December 31, 2005 from 3.23% in the same prior year period. Net interest income benefited from the wider net interest margin and the increase in average interest-earning assets as noted above.

### **Provision for Loan Losses**

For the year ended December 31, 2005, the Company's provision for loan losses was \$350,000, as compared to \$300,000 for the the same prior year period. Total loans receivable increased and net charge-offs for the year ended December 31, 2005 increased to \$578,000 from \$414,000 for the same prior year period, however, non-performing loans decreased to \$1.6 million at December 31, 2005 from \$3.5 million at December 31, 2004.

### **Other Income**

Other income was \$24.1 million for the year ended December 31, 2005, compared to \$20.7 million for the same prior year period. For the year ended December 31, 2005, the Company recorded gains of \$13.2 million on the sale of loans and securities available for sale, as compared to gains of \$10.8 million in the same prior year period. For the year ended December 31, 2004, the gain on sale of loans and securities includes a gain of \$186,000 on the sale of equity securities. For the year ended December 31, 2005, the Company received proceeds from the sale of mortgage loans of \$726.0 million as compared to \$510.0 million for the year ended December 31, 2004. Loan sales benefited from the full year impact of the third quarter 2004 acquisition of a consumer direct lending operation by Columbia.

Fees and service charges increased \$1.1 million, or 13.8%, for the year ended December 31, 2005, as compared to the same prior year period primarily related to increases in investment services and trust fees. In early 2005 the investment services program was expanded to add Licensed Bank Employees which allowed the Company to capture more of the revenue associated with the sale of investment products. Partly as a result of this initiative fee income from investment sales increased to \$1.2 million for the year ended December 31, 2005, a 60.8% increase over the comparable 2004 amount.

### **Operating Expenses**

Operating expenses were \$54.8 million for the year ended December 31, 2005, as compared to \$48.8 million in the same prior year period. The increase was primarily due to the full year effect in 2005 of the costs related to the third quarter 2004 acquisition of the consumer direct lending operation, as well as increased incentive plan costs.

### **Provision for Income Taxes**

Income tax expense was \$10.3 million for the year ended December 31, 2005, as compared to \$9.8 million for the same prior year period. The effective tax rate decreased slightly to 34.6% for the year ended December 31, 2005 as compared to 35.2% for the same prior year period. The Company's lower average stock price in 2005 as compared to 2004 decreased that portion of the ESOP expense which is not deductible for tax purposes.

### Cash Earnings

Stockholders' equity is a critical measure of a company's ability to repurchase shares, pay dividends and continue to grow. Although reported earnings and return on stockholders' equity are traditional measures of performance, the Company believes that the change in stockholders' equity, or "cash earnings," and related return measures are also a significant measure of a company's performance. Cash earnings exclude the effects of various non-cash expenses, such as the employee stock plans amortization expense and related tax benefit, as well as the amortization of intangible assets. In the case of tangible stockholders' equity (stockholders' equity less intangible assets) these items have either been previously charged to stockholders' equity, as in the case of employee stock plans amortization expense, through contra-equity accounts, or do not affect tangible stockholders' equity, such as the market appreciation of allocated ESOP shares for which the operating charge is offset by a credit to additional paid-in capital and intangible asset amortization for which the related intangible asset has already been deducted in the calculation of tangible stockholders' equity.

The following table reconciles the Company's net income with cash earnings. The table is a pro forma calculation which is not in accordance with Generally Accepted Accounting Principles.

| Year Ended December 31,<br>(in thousands, except share data) | 2006            | 2005            | 2004            |
|--------------------------------------------------------------|-----------------|-----------------|-----------------|
| Net income                                                   | \$12,633        | \$19,497        | \$17,945        |
| Add: Employee stock plans amortization expense               | 3,290           | 3,374           | 3,792           |
| Amortization of intangible assets                            | 158             | 104             | 105             |
| Less: Tax benefit <sup>(1)</sup>                             | 560             | 496             | 548             |
| Cash earnings                                                | <u>\$15,521</u> | <u>\$22,479</u> | <u>\$21,294</u> |
| Basic cash earnings per share                                | <u>\$ 1.34</u>  | <u>\$ 1.91</u>  | <u>\$ 1.76</u>  |
| Diluted cash earnings per share                              | <u>\$ 1.32</u>  | <u>\$ 1.84</u>  | <u>\$ 1.68</u>  |

(1) The Company does not receive any tax benefit for that portion of employee stock plan amortization expense relating to the ESOP fair market value adjustment.

### Liquidity and Capital Resources

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

At December 31, 2006, the Company had outstanding overnight borrowings from the FHLB of \$42.5 million, a decrease from \$51.9 million in overnight borrowings at December 31, 2005. The Company utilizes the overnight line from time-to-time to fund short-term liquidity needs. Securities sold under agreements to repurchase with retail customers decreased to \$51.0 million at December 31, 2006 from \$54.3 million at December 31, 2005. Like deposit flows, this funding source is dependent upon demand from the Bank's customer base. The Company also had other borrowings with the FHLB of \$422.0 million at December 31, 2006, an increase from \$362.0 million at December 31, 2005. These borrowings were used to fund loan growth.

The Company's cash needs for the years ended December 31, 2006 and 2005 were primarily provided by principal payments on loans and mortgage-backed securities, increased deposits and total borrowings and proceeds from the sale of mortgage loans held-for-sale. The cash was principally utilized for loan originations and the purchase of treasury stock.

In the normal course of business, the Company routinely enters into various commitments, primarily relating to the origination and sale of loans. At December 31, 2006, outstanding commitments to originate loans totaled \$227.6 million; outstanding unused lines of credit totaled \$175.5 million; and outstanding commitments to sell loans totaled \$94.6 million. The Company expects to have sufficient funds available to meet current commitments in the normal course of business.

Time deposits scheduled to mature in one year or less totaled \$444.2 million at December 31, 2006. Based upon historical experience, management estimates that a significant portion of such deposits will remain with the Company.

Under the Company's stock repurchase programs, shares of OceanFirst Financial Corp. common stock may be purchased in the open market and through other privately negotiated transactions, from time-to-time, depending on market conditions. The repurchased shares are held as treasury stock for general corporate use. For the year ended December 31, 2006, the Company purchased 772,804 shares of common stock at a total cost of \$17.6 million compared with purchases of 690,407 shares for the year ended December 31, 2005 at an aggregate cost of \$16.0 million. At December 31, 2006, there were 538,763 shares remaining to be repurchased under the existing stock repurchase program. Cash dividends declared and paid during the year ended December 31, 2006 were \$9.3 million, a decrease from \$9.5 million from the same prior year period due to the reduction in common shares outstanding. On January 18, 2007, the Board of Directors declared a quarterly cash dividend of twenty cents (\$0.20) per common share. The dividend is payable on February 9, 2007 to stockholders of record at the close of business on January 26, 2007.

The primary source of liquidity for OceanFirst Financial Corp., the holding company of OceanFirst Bank, is capital distributions from the banking subsidiary. For the year ended December 31, 2006, OceanFirst Financial Corp. received \$15.0 million in dividend payments from OceanFirst Bank. The Company also received \$12.5 million from the issuance of Trust Preferred Securities. The primary use of these funds is the payment of

dividends to shareholders and the repurchase of common stock. OceanFirst Financial Corp.'s ability to continue these activities is partly dependent upon capital distributions from OceanFirst Bank. Applicable Federal law or the Bank's regulator, may limit the amount of capital distributions OceanFirst Bank may make.

At December 31, 2006, the Bank exceeded all of its regulatory capital requirements with tangible capital of \$131.6 million, or 6.4%, of the Bank's total adjusted assets, which is above the required level of \$31.1 million or 1.5%; core capital of \$131.6 million or 6.4% of the Bank's total adjusted assets, which is above the required level of \$62.2 million, or 3.0%; and risk-based capital of \$141.4 million, or 10.5% of the Bank's risk-weighted assets, which is above the required level of \$107.9 million or 8.0%. The Bank is considered a "well-capitalized" institution under the Office of Thrift Supervision's prompt corrective action regulations.

#### 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, or are recorded in amounts that differ from the notional amounts. 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 unused consumer lines of credit and commitments to extend credit and are discussed in Note 13 to the Consolidated Financial Statements. The Company also has outstanding commitments to sell loans amounting to \$94.6 million.

The Company has entered 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 an Early Payment Default or a violation of various representations and warranties customary to the mortgage banking industry. In the opinion of management, the potential exposure related to the Company's loan sale agreements is adequately provided for in the reserve for repurchased loans included in other liabilities. At December 31, 2006 and 2005 the reserve for repurchased loans amounted to \$9,600,000 and zero, respectively.

The following table shows the contractual obligations of the Company by expected payment period as of December 31, 2006 (in thousands). Further discussion of these commitments is included in Notes 9 and 13 to the Consolidated Financial Statements.

| Contractual Obligation      | Total             | Less than one year | 1-3 years         | 3-5 years         | More than 5 years |
|-----------------------------|-------------------|--------------------|-------------------|-------------------|-------------------|
| Long-Term Debt Obligations  | \$ 439,500        | \$ 95,000          | \$ 219,000        | \$ 108,000        | \$ 17,500         |
| Operating Lease Obligations | 24,425            | 2,166              | 4,230             | 2,900             | 15,129            |
| Purchase Obligations        | 5,050             | 3,350              | 1,700             | —                 | —                 |
|                             | <u>\$ 468,975</u> | <u>\$ 100,516</u>  | <u>\$ 224,930</u> | <u>\$ 110,900</u> | <u>\$ 32,629</u>  |

Long-term debt obligations includes borrowings from the Federal Home Loan Bank and other borrowings. The borrowings have defined terms and under certain circumstances are callable at the option of the lender.

Operating leases represent obligations entered into by the Company for the use of land and premises. The leases generally have escalation terms based upon certain defined indexes.

Purchase obligations represent legally binding and enforceable agreements to purchase goods and services from third parties and consist primarily of contractual obligations under data processing servicing agreements. Actual amounts expended vary based on transaction volumes, number of users and other factors.

#### Impact of New Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, allows an entity to re-measure and fair value a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation from the host, if the holder irrevocably elects to account for the whole instrument on a fair value basis. Subsequent changes in the fair value would be recognized in earnings. Statement 155 is effective for financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, with earlier adoption permitted. The Company does not expect the adoption of Statement No. 155 to have a material impact on its financial statements.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets." SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends Statement 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. By electing that option, an entity may simplify its accounting because this Statement permits income statement recognition of the potential offsetting changes in fair value of those servicing assets and servicing liabilities and derivative instruments in the same accounting period. The Statement is effective in the first fiscal year beginning after September 15, 2006 with earlier adoption permitted. The Company does not expect the adoption of Statement No. 156 to have a material impact on its financial statements.

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In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." The Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109 - "Accounting for Income Taxes." This Interpretation presents a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of Interpretation No. 48 to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. The Statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of Statement No. 157 to have a material impact on its financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires that the Company quantify misstatements based on their impact on each of its financial statements and related disclosures. SAB 108 was effective as of the end of the Company's 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. The adoption of SAB 108 did not have an impact on the Company's financial statements.

### Asset Quality

The following table sets forth information regarding non-performing assets consisting of non-accrual loans and Real Estate Owned ("REO") and activity in the allowance for loan losses. The Bank had no troubled-debt restructured loans and one REO property at December 31, 2006. It is the policy of the Bank to cease accruing interest on loans 90 days or more past due or in the process of foreclosure. For the years ended December 31, 2006, 2005, 2004, 2003 and 2002, respectively, the amount of interest income that would have been recognized on non-accrual loans if such loans had continued to perform in accordance with their contractual terms was \$189,000, \$115,000, \$128,000, \$96,000 and \$87,000.

| <u>At or For The Year Ended December 31,</u>                                                           | <u>2006</u>     | <u>2005</u>     | <u>2004</u>     | <u>2003</u>     | <u>2002</u>     |
|--------------------------------------------------------------------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| <i>(dollars in thousands)</i>                                                                          |                 |                 |                 |                 |                 |
| Non-accrual loans:                                                                                     |                 |                 |                 |                 |                 |
| Real estate:                                                                                           |                 |                 |                 |                 |                 |
| One- to-four family                                                                                    | \$ 2,703        | \$ 1,084        | \$ 1,337        | \$ 1,712        | \$ 2,222        |
| Commercial real estate, multi-family and land                                                          | 286             | —               | 744             | 242             | 74              |
| Consumer                                                                                               | 281             | 299             | 784             | 90              | 95              |
| Commercial                                                                                             | 1,255           | 212             | 623             | 118             | 297             |
| Total                                                                                                  | 4,525           | 1,595           | 3,488           | 2,162           | 2,688           |
| REO, net                                                                                               | 288             | 278             | 288             | 252             | 141             |
| Total non-performing assets                                                                            | <u>\$ 4,813</u> | <u>\$ 1,873</u> | <u>\$ 3,776</u> | <u>\$ 2,414</u> | <u>\$ 2,829</u> |
| Allowance for loan losses:                                                                             |                 |                 |                 |                 |                 |
| Balance at beginning of year                                                                           | \$10,460        | \$10,688        | \$10,802        | \$10,074        | \$10,351        |
| Less: Net charge-offs (recoveries)                                                                     | 372             | 578             | 414             | (40)            | 1,927           |
| Add: Provision for loan losses                                                                         | 150             | 350             | 300             | 688             | 1,650           |
| Balance at end of year                                                                                 | <u>\$10,238</u> | <u>\$10,460</u> | <u>\$10,688</u> | <u>\$10,802</u> | <u>\$10,074</u> |
| Ratio of net charge-offs (recoveries) during the year to average net loans outstanding during the year | .02%            | .04%            | .03%            | .00%            | .14%            |
| Allowance for loan losses as percent of total loans receivable <sup>(1)</sup>                          | .57             | .62             | .69             | .75             | .71             |
| Allowance for loan losses as a percent of total non-performing loans <sup>(2)</sup>                    | 226.25          | 655.80          | 306.42          | 499.63          | 374.78          |
| Non-performing loans as a percent of total loans receivable <sup>(1)(2)</sup>                          | .25             | .09             | .23             | .15             | .19             |
| Non-performing assets as a percent of total assets <sup>(2)</sup>                                      | .23             | .09             | .20             | .14             | .16             |

(1) Total loans receivable includes loans receivable and loans held for sale.

(2) Non-performing assets consist of non-performing loans and real estate acquired through foreclosure. Non-performing loans consist of all loans 90 days or more past due and other loans in the process of foreclosure. It is the Company's policy to cease accruing interest on all such loans.

The Company has developed an internal asset classification system which classifies assets depending on risk of loss characteristics. The asset classifications comply with certain regulatory guidelines. At December 31, 2006, the Bank had \$8.2 million of assets, including all REO, classified as "Substandard," \$185,000 of assets classified as "Doubtful" and no assets classified as "Loss." Additionally, "Special Mention" assets totaled \$18.2 million at December 31, 2006. These loans are classified as Special Mention due to past delinquencies or other identifiable weaknesses.

The Substandard classification includes \$4.6 million of commercial loans, the largest being a \$2.6 million relationship for the construction of townhouses. The loans in the relationship are delinquent from 60 to 90 days and the projects have experienced construction delays. The Special Mention classification includes one relationship for \$7.8 million which was fully repaid in January 2007. The second largest Special Mention relationship was a \$4.5 million credit to a large, multi-state, real estate agency which was current as to payments, but classified due to declining revenue and net income of the borrower. The loan is secured by commercial real estate and corporate assets and the personal guarantees of the principals.

The provision for loan losses decreased by \$200,000 for the year ended December 31, 2006, as compared to the prior year. Net charge-offs decreased to \$372,000 for the year ended December 31, 2006, as compared to \$578,000 for the same prior year period. Total loans receivable increased \$91.1 million, or 5.4%, at December 31, 2006, as compared to December 31, 2005, although almost all of this growth was in one-to-four family and consumer loans which generally carry a lower risk as compared to other types of loans. Non-performing loans increased by \$2.9 million, however, most of the increase also related to lower risk one-to-four family mortgage loans. Additionally, all non-performing loans were well secured.

### Management of Interest Rate Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its lending, investment and deposit-taking activities. The Company's profitability is affected by fluctuations in interest rates. A sudden and substantial change in interest rates may adversely impact the Company's earnings to the extent that the interest rates borne by assets and liabilities do not change at the same speed, to the same extent or on the same basis. To that end, management actively monitors and manages interest rate risk exposure.

The principal objectives of the Company's interest rate risk management function are to evaluate the interest rate risk inherent in certain balance sheet accounts; determine the level of risk appropriate given the Company's business focus, operating environment, capital and liquidity requirements and performance objectives; and manage the risk consistent with Board approved guidelines. Through such management, the Company seeks to reduce the exposure of its operations to changes in interest rates. The Company monitors its interest rate risk as such risk relates to its operating strategies. The Company's Board of Directors has established an Asset Liability Committee ("ALCO") consisting of members of the Company's management, responsible for reviewing the Company's asset liability policies and interest rate risk position. ALCO meets monthly and reports trends and the Company's interest rate risk position to the Board of Directors on a quarterly basis. The extent of the movement of interest rates, higher or lower, is an uncertainty that could have an impact on the earnings of the Company.

The Company utilizes the following strategies to manage interest rate risk: (1) emphasizing the origination for portfolio of fixed-rate mortgage loans generally having terms to maturity of not more than fifteen years, adjustable-rate loans, floating-rate and balloon maturity commercial loans, and consumer loans consisting primarily of home equity loans and lines of credit; (2) holding primarily short-term and/or adjustable- or floating-rate mortgage-backed and investment securities; (3) attempting to reduce the overall interest rate sensitivity of liabilities by emphasizing core and longer-term deposits; and (4) extending the maturities on wholesale borrowings. The Company may also sell fixed-rate mortgage loans into the secondary market. In determining whether to retain fixed-rate mortgages, management considers the Company's overall interest rate risk position, the volume of such loans, the loan yield and the types and amount of funding sources. The Company periodically retains fixed-rate mortgage loan production in order to improve yields and increase balance sheet leverage. During periods when fixed-rate mortgage loan production is retained, the Company generally attempts to extend the maturity on part of its wholesale borrowings. For the past few years, the Company has sold most 30-year fixed-rate mortgage loan originations in the secondary market. In addition, during 2006 the Company sold a significant volume of 15-year fixed-rate mortgage loan originations. The Company currently does not participate in financial futures contracts, interest rate swaps or other activities involving the use of off-balance sheet derivative financial instruments, but may do so in the future to manage interest rate risk.

The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring an institution's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. Accordingly, during a period of rising interest rates, an institution with a negative gap position theoretically would not be in as favorable a position, compared to an institution with a positive gap, to invest in higher-yielding assets. This may result in the yield on the institution's assets increasing at a slower rate than the increase in its cost of interest-bearing liabilities. Conversely, during a period of falling interest rates, an institution with a negative gap might experience a repricing of its assets at a slower rate than its interest-bearing liabilities, which, consequently, may result in its net interest income growing at a faster rate than an institution with a positive gap position.

The Company's interest rate sensitivity is monitored through the use of an interest rate risk ("IRR") model. As of March 31, 2006 the Company adopted a new interest rate risk model which was expected to provide improved modeling capabilities. The new model allows for greater disaggregation of data elements, enhanced loan prepayment modeling and greater flexibility. The following tables set forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2006 and 2005, which were anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown. The Company's results for December 31, 2005 have been restated for comparative purposes using the new IRR model. At December 31, 2006 the Company's one-year gap was negative 0.80% as compared to positive 4.19% at December 31, 2005. Except as stated below, the amount of assets and liabilities which reprice or mature during a particular period were determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The tables are intended to provide an approximation of the projected repricing of assets and liabilities at December 31, 2006 and 2005, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments

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within a three month period and subsequent selected time intervals. Loans receivable reflect principal balances expected to be redeployed and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable-rate loans and fixed-rate loans, and as a result of contractual rate adjustments on adjustable-rate loans. Loans were projected to prepay at rates between 3.0% and 30.0% annually at December 31, 2006 and at rates between 3.0% and 35.0% annually at December 31, 2005. Mortgage-backed securities were projected to prepay at rates between 13.0% and 32.0% annually at December 31, 2006 and at rates between 26.0% and 28.0% annually at December 31, 2005. Savings accounts, interest-bearing checking accounts and money market deposit accounts were assumed to decay, or run-off, at 1.50% per month. Prepayment and decay rates can have a significant impact on the Company's estimated gap.

There can be no assurance that projected prepayment rates for loans and mortgage-backed securities will be achieved or that projected decay rates for deposits will be realized.

| At December 31, 2006<br><i>(dollars in thousands)</i>                             | 3 Months<br>or Less | More than<br>3 Months<br>to 1 Year | More than<br>1 Year to<br>3 Years | More than<br>3 Years to 5<br>Years | More than<br>5 Years | Total             |
|-----------------------------------------------------------------------------------|---------------------|------------------------------------|-----------------------------------|------------------------------------|----------------------|-------------------|
| <b>Interest-earning assets <sup>(1)</sup>:</b>                                    |                     |                                    |                                   |                                    |                      |                   |
| Interest-earning deposits and short-term investments                              | \$ 6,619            | \$ —                               | \$ —                              | \$ —                               | \$ —                 | \$ 6,619          |
| Investment securities                                                             | 75,655              | —                                  | 290                               | —                                  | 6,652                | 82,597            |
| FHLB stock                                                                        | —                   | —                                  | —                                 | —                                  | 25,346               | 25,346            |
| Mortgage-backed securities                                                        | 8,344               | 17,675                             | 28,068                            | 9,568                              | 5,295                | 68,950            |
| Loans receivable <sup>(2)</sup>                                                   | 334,999             | 316,547                            | 583,167                           | 288,150                            | 266,020              | 1,788,883         |
| Total interest-earning assets                                                     | <u>425,617</u>      | <u>334,222</u>                     | <u>611,525</u>                    | <u>297,718</u>                     | <u>303,313</u>       | <u>1,972,395</u>  |
| <b>Interest-bearing liabilities:</b>                                              |                     |                                    |                                   |                                    |                      |                   |
| Money market deposit accounts                                                     | 4,799               | 14,396                             | 38,390                            | 47,986                             | —                    | 105,571           |
| Savings accounts                                                                  | 9,623               | 27,274                             | 72,732                            | 90,915                             | —                    | 200,544           |
| Interest-bearing checking accounts                                                | 18,574              | 55,723                             | 148,594                           | 185,775                            | —                    | 408,666           |
| Time deposits                                                                     | 213,078             | 231,155                            | 82,541                            | 14,469                             | 1,354                | 542,597           |
| FHLB advances                                                                     | 64,500              | 58,000                             | 200,000                           | 108,000                            | —                    | 430,500           |
| Securities sold under agreements to repurchase and other borrowings               | 63,482              | 15,000                             | 19,000                            | —                                  | 5,000                | 102,482           |
| Total interest-bearing liabilities                                                | <u>374,056</u>      | <u>401,548</u>                     | <u>561,257</u>                    | <u>447,145</u>                     | <u>6,354</u>         | <u>1,790,360</u>  |
| Interest sensitivity gap <sup>(3)</sup>                                           | <u>\$ 51,561</u>    | <u>\$ (67,326)</u>                 | <u>\$ 50,268</u>                  | <u>\$ (149,427)</u>                | <u>\$ 296,959</u>    | <u>\$ 182,035</u> |
| Cumulative interest sensitivity gap                                               | <u>\$ 51,561</u>    | <u>\$ (15,765)</u>                 | <u>\$ 34,503</u>                  | <u>\$ (114,924)</u>                | <u>\$ 182,035</u>    | <u>\$ 182,035</u> |
| Cumulative interest sensitivity gap as a percent of total interest-earning assets | <u>2.61%</u>        | <u>(0.80)%</u>                     | <u>1.75%</u>                      | <u>(5.83)%</u>                     | <u>9.23%</u>         | <u>9.23%</u>      |

At December 31, 2005  
(dollars in thousands)

|                                                                                   | 3 Months<br>or Less | More than<br>3 Months<br>to 1 Year | More than<br>1 Year to<br>3 Years | More than<br>3 Years to 5<br>Years | More than<br>5 Years | Total      |
|-----------------------------------------------------------------------------------|---------------------|------------------------------------|-----------------------------------|------------------------------------|----------------------|------------|
| <b>Interest-earning assets <sup>(1)</sup> :</b>                                   |                     |                                    |                                   |                                    |                      |            |
| Interest-earning deposits and short-term investments                              | \$ 5,144            | \$ —                               | \$ —                              | \$ —                               | \$ —                 | \$ 5,144   |
| Investment securities                                                             | 75,729              | 2,384                              | —                                 | —                                  | 6,471                | 84,584     |
| FHLB stock                                                                        | —                   | —                                  | —                                 | —                                  | 21,792               | 21,792     |
| Mortgage-backed securities                                                        | 18,289              | 16,314                             | 24,841                            | 22,435                             | 4,491                | 86,370     |
| Loans receivable <sup>(2)</sup>                                                   | 274,230             | 357,158                            | 559,501                           | 275,400                            | 226,163              | 1,692,452  |
| Total interest-earning assets                                                     | 373,392             | 375,856                            | 584,342                           | 297,835                            | 258,917              | 1,890,342  |
| <b>Interest-bearing liabilities:</b>                                              |                     |                                    |                                   |                                    |                      |            |
| Money market deposit accounts                                                     | 5,690               | 17,069                             | 45,516                            | 56,894                             | —                    | 125,169    |
| Savings accounts                                                                  | 11,005              | 33,592                             | 88,041                            | 110,051                            | —                    | 242,689    |
| Interest-bearing checking accounts                                                | 17,408              | 52,225                             | 139,268                           | 172,886                            | —                    | 381,787    |
| Time deposits                                                                     | 93,846              | 230,103                            | 134,031                           | 21,784                             | 6,971                | 486,735    |
| FHLB advances                                                                     | 80,900              | 74,000                             | 115,000                           | 70,000                             | 15,000               | 354,900    |
| Securities sold under agreement to repurchase and other borrowings                | 54,289              | —                                  | 56,000                            | 3,000                              | 5,000                | 118,289    |
| Total interest-bearing liabilities                                                | 263,138             | 406,989                            | 577,856                           | 434,615                            | 26,971               | 1,709,569  |
| Interest sensitivity gap <sup>(3)</sup>                                           | \$110,254           | \$ (31,133)                        | \$ 6,486                          | \$ (136,780)                       | \$231,946            | \$ 180,773 |
| Cumulative interest sensitivity gap                                               | \$110,254           | \$ 79,121                          | \$ 85,607                         | \$ (51,173)                        | \$180,773            | \$ 180,773 |
| Cumulative interest sensitivity gap as a percent of total interest-earning assets | 5.83%               | 4.19%                              | 4.53%                             | (2.71)%                            | 9.56%                | 9.56%      |

- (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.

Certain shortcomings are inherent in gap analysis. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market interest rates. Additionally, certain assets, such as adjustable-rate loans, have features which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and decay rates would likely deviate significantly from those assumed in the calculation. Finally, the ability of many borrowers to service their adjustable-rate loans may be impaired in the event of an interest rate increase.

Another method of analyzing an institution's exposure to interest rate risk is by measuring the change in the institution's net portfolio value ("NPV") and net interest income under various interest rate scenarios. NPV is the difference between the net present value of assets, liabilities and off-balance sheet contracts. The NPV ratio, in any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The Company's interest rate sensitivity is monitored by management through the use of an interest rate risk model which measures IRR by modeling the change in NPV and net interest income over a range of interest rate scenarios. The Office of Thrift Supervision ("OTS") also produces an NPV only analysis using its own model, based upon data submitted on the Bank's quarterly Thrift Financial Reports. The results produced by the OTS may vary from the results produced by the Company's model, primarily due to differences in the assumptions utilized including estimated loan prepayment rates, reinvestment rates and deposit decay rates. The following table sets forth the Company's NPV and net interest income projections as of December 31, 2006 and 2005, as calculated by the Company (in thousands). For purposes of this table, the Company used prepayment speeds and deposit decay rates similar to those used in calculating the Company's gap.

At December 31, 2006, the Company's NPV in a static rate environment is less than the NPV at December 31, 2005 primarily reflecting the decline of core deposits and the value of those deposits.

| December 31, 2006                                        |                     |          |              |                     |          |
|----------------------------------------------------------|---------------------|----------|--------------|---------------------|----------|
| Change in Interest Rates in Basis Points<br>(Rate Shock) | Net Portfolio Value |          | NPV<br>Ratio | Net Interest Income |          |
|                                                          | Amount              | % Change |              | Amount              | % Change |
| 200                                                      | \$172,422           | (16.0)%  | 8.7%         | \$53,028            | (4.9)%   |
| 100                                                      | 192,040             | (6.5)    | 9.5          | 54,748              | (1.9)    |
| Static                                                   | 205,312             | —        | 9.9          | 55,788              | —        |
| (100)                                                    | 206,157             | 0.4      | 9.8          | 55,431              | (0.6)    |
| (200)                                                    | 191,711             | (6.6)    | 9.1          | 52,490              | (5.9)    |

| December 31, 2005                                        |                     |          |              |                     |          |
|----------------------------------------------------------|---------------------|----------|--------------|---------------------|----------|
| Change in Interest Rates in Basis Points<br>(Rate Shock) | Net Portfolio Value |          | NPV<br>Ratio | Net Interest Income |          |
|                                                          | Amount              | % Change |              | Amount              | % Change |
| 200                                                      | \$191,412           | (13.4)%  | 10.2%        | \$58,488            | (1.3)%   |
| 100                                                      | 211,514             | (4.3)    | 11.0         | 59,147              | (0.2)    |
| Static                                                   | 221,078             | —        | 11.2         | 59,283              | —        |
| (100)                                                    | 220,257             | (0.4)    | 11.0         | 58,652              | (1.1)    |
| (200)                                                    | 208,516             | (5.7)    | 10.4         | 56,769              | (4.2)    |

As is the case with the gap calculation, certain shortcomings are inherent in the methodology used in the NPV and net interest income IRR measurements. The model requires the making of certain assumptions which may tend to oversimplify the manner in which actual yields and costs respond to changes in market interest rates. First, the model assumes that the composition of the Company's interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured. Second, the model assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Third, the model does not take into account the Company's business or strategic plans. Accordingly, although the above measurements do provide an indication of the Company's IRR exposure at a particular point in time, such measurements are not intended to provide a precise forecast of the effect of changes in market interest rates on the Company's NPV and net interest income and can be expected to differ from actual results.

### Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollar amounts without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Company's operations. Unlike industrial companies, nearly all of the assets and liabilities of the Company are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

### Private Securities Litigation Reform Act Safe Harbor Statement

In addition to historical information, this annual report contains certain forward-looking statements which are based on certain assumptions and describes 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," or similar expressions. 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 the subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. These risks and uncertainties 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 of the Company's 2006 Form 10-K.

Consolidated Statements of Financial Condition

(dollars in thousands, except per share amounts)

| December 31, 2006 and 2005                                                                                                                                                         | 2006               | 2005               |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|--------------------|
| <b>Assets</b>                                                                                                                                                                      |                    |                    |
| Cash and due from banks                                                                                                                                                            | \$ 32,204          | \$ 31,108          |
| Investment securities available for sale (notes 3, 9 and 10)                                                                                                                       | 82,384             | 83,861             |
| Federal Home Loan Bank of New York stock, at cost (note 9)                                                                                                                         | 25,346             | 21,792             |
| Mortgage-backed securities available for sale (notes 4, 9 and 10)                                                                                                                  | 68,369             | 85,025             |
| Loans receivable, net (notes 5 and 9)                                                                                                                                              | 1,701,425          | 1,654,544          |
| Mortgage loans held for sale                                                                                                                                                       | 82,943             | 32,044             |
| Interest and dividends receivable (note 6)                                                                                                                                         | 8,083              | 7,089              |
| Real estate owned, net                                                                                                                                                             | 288                | 278                |
| Premises and equipment, net (note 7)                                                                                                                                               | 18,196             | 16,118             |
| Servicing asset (note 5)                                                                                                                                                           | 9,787              | 9,730              |
| Bank Owned Life Insurance (BOLI)                                                                                                                                                   | 37,145             | 36,002             |
| Intangible assets                                                                                                                                                                  | 1,114              | 1,272              |
| Other assets (note 10)                                                                                                                                                             | 9,718              | 6,494              |
| Total assets                                                                                                                                                                       | <u>\$2,077,002</u> | <u>\$1,985,357</u> |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                                        |                    |                    |
| Deposits (note 8)                                                                                                                                                                  | \$1,372,328        | \$1,356,568        |
| Securities sold under agreements to repurchase with retail customers (note 9)                                                                                                      | 50,982             | 54,289             |
| Securities sold under agreements to repurchase with the Federal Home Loan Bank (note 9)                                                                                            | 34,000             | 59,000             |
| Federal Home Loan Bank advances (note 9)                                                                                                                                           | 430,500            | 354,900            |
| Other borrowings (note 9)                                                                                                                                                          | 17,500             | 5,000              |
| Advances by borrowers for taxes and insurance                                                                                                                                      | 7,743              | 7,699              |
| Other liabilities (notes 10 and 13)                                                                                                                                                | 31,629             | 9,117              |
| Total liabilities                                                                                                                                                                  | <u>1,944,682</u>   | <u>1,846,573</u>   |
| Commitments and contingencies (note 13)                                                                                                                                            |                    |                    |
| Stockholders' equity (notes 2, 10, 11 and 12):                                                                                                                                     |                    |                    |
| Preferred stock, \$.01 par value, 5,000,000 shares authorized, no shares issued                                                                                                    | —                  | —                  |
| Common stock, \$.01 par value, 55,000,000 shares authorized, 27,177,372 shares issued and 12,262,307 and 12,698,505 shares outstanding at December 31, 2006 and 2005, respectively | 272                | 272                |
| Additional paid-in capital                                                                                                                                                         | 201,936            | 197,621            |
| Retained earnings                                                                                                                                                                  | 164,121            | 164,613            |
| Accumulated other comprehensive loss                                                                                                                                               | (470)              | (1,223)            |
| Less: Unallocated common stock held by Employee Stock Ownership Plan                                                                                                               | (6,369)            | (7,472)            |
| Treasury stock, 14,915,065 and 14,478,867 shares at December 31, 2006 and 2005, respectively                                                                                       | (227,170)          | (215,027)          |
| Common stock acquired by Deferred Compensation Plan                                                                                                                                | 1,457              | 1,383              |
| Deferred Compensation Plan liability                                                                                                                                               | (1,457)            | (1,383)            |
| Total stockholders' equity                                                                                                                                                         | <u>132,320</u>     | <u>138,784</u>     |
| Total liabilities and stockholders' equity                                                                                                                                         | <u>\$2,077,002</u> | <u>\$1,985,357</u> |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Income

(in thousands, except per share amounts)

Years Ended December 31, 2006, 2005 and 2004

|                                                                                  | 2006             | 2005             | 2004            |
|----------------------------------------------------------------------------------|------------------|------------------|-----------------|
| <b>Interest income:</b>                                                          |                  |                  |                 |
| Loans                                                                            | \$106,384        | \$ 93,864        | \$83,594        |
| Mortgage-backed securities                                                       | 3,304            | 3,813            | 4,363           |
| Investment securities and other                                                  | 6,874            | 5,122            | 2,995           |
| Total interest income                                                            | <u>116,562</u>   | <u>102,799</u>   | <u>90,952</u>   |
| <b>Interest expense:</b>                                                         |                  |                  |                 |
| Deposits (note 8)                                                                | 33,401           | 22,807           | 15,194          |
| Borrowed funds (note 9)                                                          | 25,042           | 19,066           | 19,737          |
| Total interest expense                                                           | <u>58,443</u>    | <u>41,873</u>    | <u>34,931</u>   |
| Net interest income                                                              | 58,119           | 60,926           | 56,021          |
| Provision for loan losses (note 5)                                               | 150              | 350              | 300             |
| Net interest income after provision for loan losses                              | <u>57,969</u>    | <u>60,576</u>    | <u>55,721</u>   |
| <b>Other income:</b>                                                             |                  |                  |                 |
| Loan servicing income (note 5)                                                   | 515              | 280              | 328             |
| Fees and service charges                                                         | 10,488           | 9,434            | 8,289           |
| Net gain on sales of loans and securities available for sale (notes 3, 4 and 13) | 1,358            | 13,183           | 10,832          |
| Income on Bank Owned Life Insurance                                              | 1,143            | 1,122            | 1,256           |
| Other                                                                            | 104              | 71               | 35              |
| Total other income                                                               | <u>13,608</u>    | <u>24,090</u>    | <u>20,740</u>   |
| <b>Operating expenses:</b>                                                       |                  |                  |                 |
| Compensation and employee benefits (notes 11 and 12)                             | 29,317           | 31,184           | 27,242          |
| Occupancy (note 13)                                                              | 4,850            | 4,539            | 3,840           |
| Equipment                                                                        | 2,533            | 2,531            | 2,341           |
| Marketing                                                                        | 1,517            | 2,914            | 2,020           |
| Federal deposit insurance                                                        | 533              | 507              | 478             |
| Data processing                                                                  | 3,416            | 3,243            | 2,959           |
| General and administrative                                                       | 10,215           | 9,916            | 9,879           |
| Total operating expenses                                                         | <u>52,381</u>    | <u>54,834</u>    | <u>48,759</u>   |
| Income before provision for income taxes                                         | 19,196           | 29,832           | 27,702          |
| Provision for income taxes (note 10)                                             | 6,563            | 10,335           | 9,757           |
| Net Income                                                                       | <u>\$ 12,633</u> | <u>\$ 19,497</u> | <u>\$17,945</u> |
| Basic earnings per share (note 1)                                                | <u>\$ 1.09</u>   | <u>\$ 1.65</u>   | <u>\$ 1.48</u>  |
| Diluted earnings per share (note 1)                                              | <u>\$ 1.07</u>   | <u>\$ 1.60</u>   | <u>\$ 1.42</u>  |
| Average basic shares outstanding (note 1)                                        | <u>11,547</u>    | <u>11,786</u>    | <u>12,108</u>   |
| Average diluted shares outstanding (note 1)                                      | <u>11,765</u>    | <u>12,219</u>    | <u>12,666</u>   |

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Changes in Stockholders' Equity**  
*(dollars in thousands, except per share amounts)*

| Years Ended December 31,<br>2006, 2005 and 2004                                           | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Employee<br>Stock<br>Ownership<br>Plan | Treasury<br>Stock | Common<br>Stock<br>Acquired by<br>Deferred<br>Compensation<br>Plan | Deferred<br>Compensation<br>Plan<br>Liability | Total     |
|-------------------------------------------------------------------------------------------|-----------------|----------------------------------|----------------------|-----------------------------------------------|----------------------------------------|-------------------|--------------------------------------------------------------------|-----------------------------------------------|-----------|
| Balance at December 31, 2003                                                              | \$ 272          | \$189,615                        | \$150,804            | \$ (3,400)                                    | \$ (9,911)                             | \$ (192,718)      | \$ 563                                                             | \$ (563)                                      | \$134,662 |
| Comprehensive income:                                                                     |                 |                                  |                      |                                               |                                        |                   |                                                                    |                                               |           |
| Net income                                                                                | —               | —                                | 17,945               | —                                             | —                                      | —                 | —                                                                  | —                                             | 17,945    |
| Other comprehensive income:                                                               |                 |                                  |                      |                                               |                                        |                   |                                                                    |                                               |           |
| Unrealized holding gain on securities (net of tax expense \$1,953)                        | —               | —                                | —                    | 2,854                                         | —                                      | —                 | —                                                                  | —                                             | 2,854     |
| Reclassification adjustment for gains included in net income (net of tax expense of \$65) | —               | —                                | —                    | (121)                                         | —                                      | —                 | —                                                                  | —                                             | (121)     |
| Total comprehensive income                                                                | —               | —                                | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 20,678    |
| Stock award                                                                               | —               | 202                              | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 202       |
| Tax benefit of stock plans                                                                | —               | 1,575                            | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 1,575     |
| Purchase 674,339 shares of common stock                                                   | —               | —                                | —                    | —                                             | —                                      | (16,247)          | —                                                                  | —                                             | (16,247)  |
| Allocation of ESOP stock                                                                  | —               | —                                | —                    | —                                             | 1,259                                  | —                 | —                                                                  | —                                             | 1,259     |
| ESOP adjustment                                                                           | —               | 2,331                            | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 2,331     |
| Cash dividend – \$.80 per share                                                           | —               | —                                | (9,686)              | —                                             | —                                      | —                 | —                                                                  | —                                             | (9,686)   |
| Exercise of stock options                                                                 | —               | —                                | (1,488)              | —                                             | —                                      | 4,670             | —                                                                  | —                                             | 3,182     |
| Purchase of stock for the deferred compensation plan, net                                 | —               | —                                | —                    | —                                             | —                                      | —                 | 423                                                                | (423)                                         | —         |
| Balance at December 31, 2004                                                              | 272             | 193,723                          | 157,575              | (667)                                         | (8,652)                                | (204,295)         | 986                                                                | (986)                                         | 137,956   |
| Comprehensive income:                                                                     |                 |                                  |                      |                                               |                                        |                   |                                                                    |                                               |           |
| Net income                                                                                | —               | —                                | 19,497               | —                                             | —                                      | —                 | —                                                                  | —                                             | 19,497    |
| Other comprehensive income:                                                               |                 |                                  |                      |                                               |                                        |                   |                                                                    |                                               |           |
| Unrealized holding loss on securities (net of tax benefit \$377)                          | —               | —                                | —                    | (544)                                         | —                                      | —                 | —                                                                  | —                                             | (544)     |
| Reclassification adjustment for gains included in net income (net of tax expense \$7)     | —               | —                                | —                    | (12)                                          | —                                      | —                 | —                                                                  | —                                             | (12)      |
| Total comprehensive income                                                                | —               | —                                | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 18,941    |
| Stock Award                                                                               | —               | 130                              | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 130       |
| Tax benefit of stock plans                                                                | —               | 1,704                            | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 1,704     |
| Purchase 690,407 shares of common stock                                                   | —               | —                                | —                    | —                                             | —                                      | (15,962)          | —                                                                  | —                                             | (15,962)  |
| Allocation of ESOP stock                                                                  | —               | —                                | —                    | —                                             | 1,180                                  | —                 | —                                                                  | —                                             | 1,180     |
| ESOP adjustment                                                                           | —               | 2,064                            | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 2,064     |
| Cash dividend – \$.80 per share                                                           | —               | —                                | (9,469)              | —                                             | —                                      | —                 | —                                                                  | —                                             | (9,469)   |
| Exercise of stock options                                                                 | —               | —                                | (2,990)              | —                                             | —                                      | 5,230             | —                                                                  | —                                             | 2,240     |
| Purchase of stock for the deferred compensation plan, net                                 | —               | —                                | —                    | —                                             | —                                      | —                 | 397                                                                | (397)                                         | —         |
| Balance at December 31, 2005                                                              | 272             | 197,621                          | 164,613              | (1,223)                                       | (7,472)                                | (215,027)         | 1,383                                                              | (1,383)                                       | 138,784   |
| Comprehensive income:                                                                     |                 |                                  |                      |                                               |                                        |                   |                                                                    |                                               |           |
| Net income                                                                                | —               | —                                | 12,633               | —                                             | —                                      | —                 | —                                                                  | —                                             | 12,633    |
| Other comprehensive income:                                                               |                 |                                  |                      |                                               |                                        |                   |                                                                    |                                               |           |
| Unrealized holding gain on securities (net of tax expense \$523)                          | —               | —                                | —                    | 757                                           | —                                      | —                 | —                                                                  | —                                             | 757       |
| Reclassification adjustment for gains included in net income (net of tax expense \$3)     | —               | —                                | —                    | (4)                                           | —                                      | —                 | —                                                                  | —                                             | (4)       |
| Total comprehensive income                                                                | —               | —                                | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 13,386    |
| Stock Award                                                                               | —               | 337                              | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 337       |
| Tax benefit of stock plans                                                                | —               | 2,129                            | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 2,129     |
| Purchase 772,804 shares of common stock                                                   | —               | —                                | —                    | —                                             | —                                      | (17,618)          | —                                                                  | —                                             | (17,618)  |
| Allocation of ESOP stock                                                                  | —               | —                                | —                    | —                                             | 1,103                                  | —                 | —                                                                  | —                                             | 1,103     |
| ESOP adjustment                                                                           | —               | 1,849                            | —                    | —                                             | —                                      | —                 | —                                                                  | —                                             | 1,849     |
| Cash dividend – \$.80 per share                                                           | —               | —                                | (9,277)              | —                                             | —                                      | —                 | —                                                                  | —                                             | (9,277)   |
| Exercise of stock options                                                                 | —               | —                                | (3,848)              | —                                             | —                                      | 5,475             | —                                                                  | —                                             | 1,627     |
| Purchase of stock for the deferred compensation plan, net                                 | —               | —                                | —                    | —                                             | —                                      | —                 | 74                                                                 | (74)                                          | —         |
| Balance at December 31, 2006                                                              | \$ 272          | \$201,936                        | \$164,121            | \$ (470)                                      | \$ (6,369)                             | \$ (227,170)      | \$ 1,457                                                           | \$ (1,457)                                    | \$132,320 |

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

(in thousands)

Years Ended December 31, 2006, 2005 and 2004

|                                                                                             | 2006      | 2005      | 2004      |
|---------------------------------------------------------------------------------------------|-----------|-----------|-----------|
| <b>Cash flows from operating activities:</b>                                                |           |           |           |
| Net income                                                                                  | \$ 12,633 | \$ 19,497 | \$ 17,945 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |           |           |           |
| Depreciation and amortization of premises and equipment                                     | 2,068     | 2,030     | 2,053     |
| Amortization of ESOP                                                                        | 1,103     | 1,180     | 1,259     |
| ESOP adjustment                                                                             | 1,849     | 2,064     | 2,331     |
| Stock awards                                                                                | 337       | 130       | 202       |
| Amortization and impairment of servicing asset                                              | 2,048     | 2,252     | 1,905     |
| Amortization of intangible assets                                                           | 158       | 104       | 105       |
| Net premium amortization in excess of discount accretion on securities                      | 221       | 793       | 1,270     |
| Net premium (accretion) of deferred fees and discounts on loans                             | 714       | 178       | (177)     |
| Provision for loan losses                                                                   | 150       | 350       | 300       |
| Provision for repurchased loans                                                             | 9,600     | —         | —         |
| Deferred taxes                                                                              | (2,950)   | 334       | (886)     |
| Net gain on sale of premises and equipment                                                  | —         | (28)      | —         |
| Net loss (gain) on sales of real estate owned                                               | 99        | —         | (5)       |
| Net gain on sales of loans and securities available for sale                                | (10,958)  | (13,183)  | (10,832)  |
| Proceeds from sales of mortgage loans held for sale                                         | 701,112   | 726,041   | 510,041   |
| Mortgage loans originated for sale                                                          | (743,165) | (684,153) | (533,371) |
| Increase in value of Bank Owned Life Insurance                                              | (1,143)   | (1,122)   | (1,256)   |
| Proceeds from Bank Owned Life Insurance                                                     | —         | 110       | 214       |
| Increase in interest and dividends receivable                                               | (994)     | (1,056)   | (556)     |
| Increase in other assets                                                                    | (793)     | (261)     | (94)      |
| Increase (decrease) in other liabilities                                                    | 12,911    | (27,306)  | 25,156    |
| Total adjustments                                                                           | (27,633)  | 8,457     | (2,341)   |
| Net cash (used in) provided by operating activities                                         | (15,000)  | 27,954    | 15,604    |
| <b>Cash flows from investing activities:</b>                                                |           |           |           |
| Net increase in loans receivable                                                            | (47,815)  | (182,165) | (84,098)  |
| Proceeds from sales of investment securities available for sale                             | 437       | 199       | 545       |
| Proceeds from sales of mortgage-backed securities available for sale                        | 6,241     | 7,629     | —         |
| Purchase of investment securities available for sale                                        | (748)     | (4,427)   | (802)     |
| Purchase of mortgage-backed securities available for sale                                   | (6,439)   | (7,704)   | (82,844)  |
| Proceeds from maturities of investment securities available for sale                        | 2,584     | 4,670     | 2,116     |
| Principal payments on mortgage-backed securities available for sale                         | 17,117    | 37,473    | 43,478    |
| Purchases of Federal Home Loan Bank of New York stock                                       | (3,554)   | (542)     | (2,030)   |
| Net (disbursements) proceeds from sales of real estate owned                                | (39)      | 10        | 257       |
| Proceeds from sale of premises and equipment                                                | —         | 49        | —         |
| Purchases of premises and equipment                                                         | (4,146)   | (2,132)   | (1,617)   |
| Net cash used in investing activities                                                       | (36,362)  | (146,940) | (124,995) |
| <b>Cash flows from financing activities:</b>                                                |           |           |           |
| Increase in deposits                                                                        | 15,760    | 86,033    | 126,330   |
| (Decrease) increase in short-term borrowings                                                | (12,707)  | 61,117    | (16,051)  |
| Proceeds from Federal Home Loan Bank advances                                               | 205,000   | 54,000    | 121,000   |
| Repayments of Federal Home Loan Bank advances                                               | (135,000) | (99,000)  | (89,000)  |
| Proceeds from securities sold under agreements to repurchase                                | —         | —         | 44,000    |
| Repayments of securities sold under agreements to repurchase                                | (10,000)  | (11,000)  | (18,000)  |
| Proceeds from subordinated debenture                                                        | 12,500    | 5,000     | —         |
| Increase in advances by borrowers for taxes and insurance                                   | 44        | 1,410     | 137       |
| Tax benefit of stock plans                                                                  | 2,129     | 1,704     | 1,575     |
| Exercise of stock options                                                                   | 1,627     | 2,240     | 3,182     |
| Dividends paid                                                                              | (9,277)   | (9,469)   | (9,686)   |
| Purchase of treasury stock                                                                  | (17,618)  | (15,962)  | (16,247)  |
| Net cash provided by financing activities                                                   | 52,458    | 76,073    | 147,240   |
| Net increase (decrease) in cash and due from banks                                          | 1,096     | (42,913)  | 37,849    |
| Cash and due from banks at beginning of year                                                | 31,108    | 74,021    | 36,172    |
| Cash and due from banks at end of year                                                      | \$ 32,204 | \$ 31,108 | \$ 74,021 |
| <b>Supplemental Disclosure of Cash Flow Information:</b>                                    |           |           |           |
| Cash paid during the year for:                                                              |           |           |           |
| Interest                                                                                    | \$ 57,538 | \$ 42,159 | \$ 34,630 |
| Income taxes                                                                                | 5,374     | 19,151    | 7,387     |
| Noncash investing activities:                                                               |           |           |           |
| Transfer of securities sold under agreements to repurchase to advances                      | 15,000    | 36,000    | 10,000    |
| Transfer of loans receivable to real estate owned                                           | 70        | —         | 288       |

See accompanying notes to consolidated financial statements.

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## Notes to Consolidated Financial Statements

### (1) Summary of Significant Accounting Policies

#### Principles of Consolidation

The consolidated financial statements include the accounts of OceanFirst Financial Corp. (the “Company”) and its wholly-owned subsidiary, OceanFirst Bank (the “Bank”) and its wholly-owned subsidiaries, Columbia Home Loans, LLC (“Columbia”), OceanFirst REIT Holdings, Inc., and its wholly-owned subsidiary OceanFirst Realty Corp. and OceanFirst Services, LLC, and its wholly-owned subsidiary OFB Reinsurance, Ltd. 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.

#### Business

The Bank provides a range of community banking services to customers through a network of branches in Ocean, Monmouth and Middlesex counties in New Jersey. The Bank is subject to competition from other financial institutions; it is also subject to the regulations of certain regulatory agencies and undergoes periodic examinations by those regulatory authorities.

#### Basis of Financial Statement Presentation

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles. 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 consolidated statement of financial condition and revenues and expenses for the period then ended. Actual results could differ significantly from those estimates and assumptions.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of real estate acquired in connection with foreclosures or in settlement of loans and the valuation of mortgage servicing rights. In connection with the determination of the allowances for loan losses and Real Estate Owned (“REO”), management obtains independent appraisals for significant properties.

#### Cash Equivalents

Cash equivalents consist of interest-bearing deposits in other financial institutions and loans of Federal funds. For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

#### Investment and Mortgage-Backed Securities

The Company classifies all investment and mortgage-backed securities as available-for-sale. Securities available-for-sale include securities that management intends to use as part of its asset/liability management strategy. Such securities are carried at fair value and unrealized gains and losses, net of related tax effect, are excluded from earnings, but are included as a separate component of stockholders’ equity. Gains or losses on the sale of such securities are included in other income using the specific identification method. Securities are evaluated for other-than-temporary impairment on a quarterly basis.

#### Loans Receivable

Loans receivable, other than loans held-for-sale, are stated at unpaid principal balance, plus unamortized premiums less unearned discounts, net of deferred loan origination and commitment fees and costs, and the allowance for loan losses.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net fee or cost is recognized in interest income using the level-yield method over the contractual life of the specifically identified loans, adjusted for actual prepayments.

Loans on which interest is more than 90 days past due, including impaired loans, and other loans in the process of foreclosure are placed on non-accrual status. Interest income previously accrued on these loans, but not yet received, is reversed in the current period. Any interest subsequently collected is credited to income in the period of recovery only after the full principal balance has been brought current. A loan is returned to accrual status when all amounts due have been received and the remaining principal balance is deemed collectible.

A loan is considered impaired when it is deemed probable that the Company will not collect all amounts due according to the contractual terms of the loan agreement. The Company has defined the population of impaired loans to be all non-accrual commercial real estate, multi-family, land, construction and commercial loans in excess of \$250,000. Impaired loans are individually assessed to determine that the loan’s carrying value is not in excess of the fair value of the collateral or the present value of the loan’s expected future cash flows. Smaller balance homogeneous loans that are collectively evaluated for impairment, such as residential mortgage loans and installment loans, are specifically excluded from the impaired loan portfolio.

#### Mortgage Loans Held-for-Sale

The Company regularly sells part of its mortgage loan originations. Mortgage loans held-for-sale are carried at the lower of unpaid principal balance, net, or market value on an aggregate basis.

#### Allowance for Loan Losses

The adequacy of the allowance for loan losses is based on management’s evaluation of the Company’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and current economic conditions. Additions to the allowance arise from charges to operations through the provision for loan losses or from the recovery of amounts previously charged off. The allowance is reduced by loan charge-offs. Loans are charged-off when management believes such loans are uncollectible.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions in the Company’s market area. In addition, various regulatory agencies, as an integral part of their routine examination process, periodically review the Bank’s allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

#### Reserve for Repurchased Loans

The reserve for repurchased loans relates to potential losses on loans sold which may have to be repurchased due to an Early Payment Default, generally defined as the failure by the borrower to make a payment within a designated period early in the loan term. Additionally, loans may be repurchased based on violation of representations and warranties. Provisions for losses are charged to gain on sale of loans and credited to the reserve while actual losses are charged to the reserve. The reserve represents the Company’s estimate of the total losses expected to occur and is considered to be adequate by management based upon the Company’s evaluation of the potential exposure related to the loan sale agreements over the period of repurchase risk. The reserve for repurchased loans is included in other

liabilities on the Company’s consolidated statement of financial condition.

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## Notes to Consolidated Financial Statements (continued)

### Mortgage Servicing Rights, or MSR

The Company recognizes as a separate asset the rights to service mortgage loans, whether those rights are acquired through purchase or loan origination activities. MSR are amortized in proportion to and over the estimated period of net servicing income. The estimated fair value of MSR is determined through a discounted analysis of future cash flows, incorporating numerous assumptions including servicing income, servicing costs, market discount rates, prepayment speeds and default rates. Impairment of the MSR is assessed on the fair value of those rights with any impairment recognized as a component of loan servicing fee income.

### Real Estate Owned

Real estate owned is carried at the lower of cost or fair value, less estimated costs to sell. When a property is acquired, the excess of the loan balance over fair value is charged to the allowance for loan losses. A reserve for real estate owned may be established to provide for subsequent declines in the fair values of properties. Real estate owned is carried net of any related reserve. Operating results from real estate owned, including rental income, operating expenses, and gains and losses realized from the sales of real estate owned are recorded as incurred.

### Premises and Equipment

Land is carried at cost and premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets or leases. Depreciable lives are as follows: computer equipment: 3 years; furniture, fixtures and other electronic equipment: 5 years; building improvements: 10 years; and buildings: 30 years. Repair and maintenance items are expensed and improvements are capitalized. Gains and losses on dispositions are reflected in current operations.

### Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### Impact of New Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 155, “Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140.” SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, allows an entity to re-measure and fair value a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation from the host, if the holder irrevocably elects to account for the whole instrument on a fair value basis. Subsequent changes in the fair value would be recognized in earnings. Statement 155 is effective for financial instruments acquired or issued after the beginning of an entity’s first fiscal year that begins after September 15, 2006, with earlier adoption permitted. The Company does not expect the adoption of Statement No. 155 to have a material impact on its financial statements.

In March 2006, the FASB issued SFAS No. 156, “Accounting for Servicing of Financial Assets.” SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends Statement 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. By electing that option, an entity may simplify its accounting because this Statement permits income statement recognition of the potential offsetting changes in fair value of those servicing assets and servicing liabilities and derivative instruments in the same accounting period. The Statement is effective in the first fiscal year beginning after September 15, 2006 with earlier adoption permitted. The Company does not expect the adoption of Statement No. 156 to have a material impact on its financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes.” The Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement 109 “Accounting for Income Taxes.” This Interpretation presents a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of Interpretation No. 48 to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements.” This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. The Statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of Statement No. 157 to have a material impact on its financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires that the Company quantify misstatements based on their impact on each of its financial statements and related disclosures. SAB 108 was effective as of the end of the Company’s 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. The adoption of SAB 108 did not have an impact on the Company’s financial statements.

## Stock-based Compensation

Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method under Accounting Principles Board Opinion No. 25 and accordingly recognized no compensation expense for stock option grants under this method. Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement No. 123 (revised 2004) which requires an entity to recognize the grant-date fair value of stock options and other stock-based compensation issued to employees in the income statement. The modified prospective transition method was adopted and, as a result, the income statement includes \$206,000 of expense for stock option grants for the year ended December 31, 2006. Prior periods have not been restated. At December 31, 2006 the Company had \$1.0 million in compensation cost related to non-vested awards not yet recognized. This cost will be recognized over the remaining vesting period of 4.1 years.

As a result of adopting Statement 123 (R) on January 1, 2006, the Company's income before income taxes and net income for the year ended December 31, 2006 are \$206,000 and \$134,000 lower, respectively, than if it had continued to account for stock-based compensation under Opinion No. 25. Basic and diluted earnings per share for the year ended December 31, 2006 would have increased to \$1.11 and \$1.09, respectively, if the Company had not adopted Statement 123(R).

On December 22, 2005, the Company accelerated the vesting of 645,535 outstanding unvested stock options awarded to directors and officers of the Bank. Of the 645,535 stock options for which vesting was accelerated 464,516, or 72% were "in the money" options having exercise prices from \$14.33 to \$23.23. The remaining 181,019, or 28%, were "out of the money" options having exercise prices from \$23.44 to \$27.11. The acceleration was undertaken in an attempt to eliminate compensation expense that the Company would otherwise be required to recognize with respect to these unvested stock options upon adopting Statement 123 (R). The Company recognized a pre-tax charge of \$27,000 in the fourth quarter of 2005 while eliminating potential pre-tax compensation expense in future periods of approximately \$2.3 million, of which \$1.0 million would have been incurred during the year ended December 31, 2006. Had the compensation costs for the Company's stock option plan for the years ended December 31, 2005 and 2004 been determined based on the fair value method, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands except per share data).

|                                                                                                                                                                           | 2005     | 2004     |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| <b>Net income:</b>                                                                                                                                                        |          |          |
| As reported                                                                                                                                                               | \$19,497 | \$17,945 |
| Stock-based compensation expense included in reported net income, net of related tax effects                                                                              | 85       | 131      |
| Total stock-based compensation expense determined under the fair value based method including earned incentive awards and stock option grants, net of related tax effects | (2,450)  | (711)    |
| Net stock-based compensation expense not included in reported net income, all relating to stock option grants, net of related tax effects                                 | (2,365)  | (580)    |
| Pro forma                                                                                                                                                                 | \$17,132 | \$17,365 |
| <b>Basic earnings per share:</b>                                                                                                                                          |          |          |
| As reported                                                                                                                                                               | \$ 1.65  | \$ 1.48  |
| Pro forma                                                                                                                                                                 | 1.45     | 1.43     |
| <b>Diluted earnings per share:</b>                                                                                                                                        |          |          |
| As reported                                                                                                                                                               | \$ 1.60  | \$ 1.42  |
| Pro forma                                                                                                                                                                 | 1.40     | 1.37     |

The fair value of stock options granted by the Company was estimated through the use of the Black-Scholes option pricing model applying the following assumptions:

|                                                                        | 2006    | 2005    | 2004    |
|------------------------------------------------------------------------|---------|---------|---------|
| Risk-free interest rate                                                | 4.71%   | 3.95%   | 4.21%   |
| Expected option life                                                   | 7 years | 6 years | 6 years |
| Expected volatility                                                    | 22%     | 22%     | 23%     |
| Expected dividend yield                                                | 3.49%   | 3.41%   | 3.36%   |
| Weighted average fair value of an option share granted during the year | \$ 4.81 | \$ 4.05 | \$ 4.66 |
| Intrinsic value of options exercised during the year (in thousands)    | 5,866   | 6,128   | 5,258   |

The risk-free interest rate is based on the U.S. Treasury rate with a term equal to the expected option life. The expected option life was updated in 2006 to conform to the Company's actual experience. Expected volatility is based on actual historical results.

## Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income (loss). Other comprehensive income (loss) includes items recorded directly in equity, such as unrealized gains or losses on securities available for sale.

## Intangible Assets

The Company accounts for intangible assets under SFAS 142, "Goodwill and Other Intangible Assets." SFAS 142 eliminated amortization of goodwill and requires that an annual impairment test be performed. The Company has determined that there is no impairment to goodwill based on the criteria of SFAS 142. The Company's intangible assets, primarily core deposit intangibles, are being amortized on a straight line basis over a period of ten years.

## Bank-Owned Life Insurance

Bank-owned life insurance (BOLI) is accounted for using the cash surrender value method and is recorded at its realizable value. The change in the net asset value is included in other non-interest income.

## Segment Reporting

As a community-oriented financial institution, substantially all of the Bank's operations involve the delivery of loan and deposit products to customers. The Bank makes operating decisions and assesses performance based on an ongoing review of these community banking operations, which constitute the only operating segment for financial reporting purposes.

## Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding plus potential common stock, utilizing the treasury stock method. All share amounts exclude unallocated shares of stock held by the Employee Stock Ownership Plan ("ESOP") and the Incentive Plan.

## Notes to Consolidated Financial Statements (continued)

The following reconciles shares outstanding for basic and diluted earnings per share for the years ended December 31, 2006, 2005 and 2004 (in thousands):

| Year ended December 31,                                                          | 2006   | 2005   | 2004    |
|----------------------------------------------------------------------------------|--------|--------|---------|
| Weighted average shares outstanding                                              | 12,444 | 12,817 | 13,241  |
| Less: Unallocated ESOP shares                                                    | (821)  | (956)  | (1,101) |
| Unallocated Incentive award shares and shares held by deferred compensation plan | (76)   | (75)   | (32)    |
| Average basic shares outstanding                                                 | 11,547 | 11,786 | 12,108  |
| Add: Effect of dilutive securities:                                              |        |        |         |
| Stock options                                                                    | 143    | 362    | 533     |
| Incentive Awards and shares held by deferred compensation plan                   | 75     | 71     | 25      |
| Average diluted shares outstanding                                               | 11,765 | 12,219 | 12,666  |

## (2) Regulatory Matters

Office of Thrift Supervision (“OTS”) regulations require savings institutions to maintain minimum levels of regulatory capital. Under the regulations in effect at December 31, 2006, the Bank was required to maintain a minimum ratio of tangible capital to total adjusted assets of 1.5%; a minimum ratio of Tier 1 (core) capital to total adjusted assets of 3.0%; and a minimum ratio of total (core and supplementary) capital to risk-weighted assets of 8.0%.

Under its prompt corrective action regulations, the OTS is required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized institution. Such actions could have a direct material effect on the institution’s financial statements. The regulations establish a framework for the classification of savings institutions into five categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Generally an institution is considered well capitalized if it has a Tier 1 ratio of at least 6.0%; and a total risk-based capital ratio of at least 10.0%. At December 31, 2006 and 2005 the Bank was considered well capitalized.

The following is a summary of the Bank’s actual capital amounts and ratios as of December 31, 2006 and 2005, compared to the OTS minimum capital adequacy requirements and the OTS requirements for classification as a well capitalized institution (in thousands).

| As of December 31, 2006:  | Actual    |       | For capital adequacy purposes |       | To be well capitalized under prompt corrective action |       |
|---------------------------|-----------|-------|-------------------------------|-------|-------------------------------------------------------|-------|
|                           | Amount    | Ratio | Amount                        | Ratio | Amount                                                | Ratio |
| Tangible capital          | \$131,643 | 6.4%  | \$ 31,109                     | 1.5%  | \$ —                                                  | — %   |
| Core capital              | 131,643   | 6.4   | 62,218                        | 3.0   | 103,697                                               | 5.0   |
| Tier 1 risk-based capital | 131,643   | 9.8   | 53,969                        | 4.0   | 80,954                                                | 6.0   |
| Risk-based capital        | 141,416   | 10.5  | 107,939                       | 8.0   | 134,923                                               | 10.0  |
| As of December 31, 2005:  | Amount    | Ratio | Amount                        | Ratio | Amount                                                | Ratio |
| Tangible capital          | \$127,731 | 6.4%  | \$ 29,787                     | 1.5%  | \$ —                                                  | — %   |
| Core capital              | 127,731   | 6.4   | 59,575                        | 3.0   | 99,291                                                | 5.0   |
| Tier 1 risk-based capital | 127,731   | 10.2  | 49,960                        | 4.0   | 74,941                                                | 6.0   |
| Risk-based capital        | 138,152   | 11.1  | 99,921                        | 8.0   | 124,901                                               | 10.0  |

OTS regulations impose limitations upon all capital distributions by savings institutions, like the Bank, such as dividends and payments to repurchase or otherwise acquire shares. The Company may not declare or pay cash dividends on or repurchase any of its shares of common stock if the effect thereof would cause stockholders’ equity to be reduced below applicable regulatory capital maintenance requirements or if such declaration and payment would otherwise violate regulatory requirements.

## (3) Investment Securities Available for Sale

The amortized cost and estimated market value of investment securities available for sale at December 31, 2006 and 2005 are as follows (in thousands):

| December 31, 2006               | Amortized Cost   | Gross Unrealized | Gross Unrealized  | Estimated Market Value |
|---------------------------------|------------------|------------------|-------------------|------------------------|
|                                 |                  | Gains            | Losses            |                        |
| U. S. agency obligations        | \$ 290           | \$ —             | \$ (1)            | \$ 289                 |
| State and municipal obligations | 1,747            | 21               | —                 | 1,768                  |
| Corporate debt securities       | 75,655           | —                | (1,595)           | 74,060                 |
| Equity investments              | 4,905            | 1,362            | —                 | 6,267                  |
|                                 | <u>\$ 82,597</u> | <u>\$ 1,383</u>  | <u>\$ (1,596)</u> | <u>\$82,384</u>        |
| December 31, 2005               | Amortized Cost   | Gross Unrealized | Gross Unrealized  | Estimated Market Value |
|                                 |                  | Gains            | Losses            |                        |
| U. S. agency obligations        | \$ 201           | \$ —             | \$ (1)            | \$ 200                 |
| State and municipal obligations | 4,131            | 26               | —                 | 4,157                  |
| Corporate debt securities       | 75,528           | —                | (1,898)           | 73,630                 |
| Equity investments              | 4,724            | 1,150            | —                 | 5,874                  |
|                                 | <u>\$84,584</u>  | <u>\$ 1,176</u>  | <u>\$ (1,899)</u> | <u>\$83,861</u>        |

Gains realized during 2006, 2005 and 2004 on the sale of investment securities available for sale totaled \$155,000, \$136,000 and \$186,000, respectively. There were no losses realized during 2006, 2005 or 2004 on the sale of investment securities available for sale.

The amortized cost and estimated market value of investment securities available for sale, excluding equity investments, at December 31, 2006 by contractual maturity, are shown below (in thousands). Actual maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. At December 31, 2006, investment securities available for sale with an amortized cost and estimated market value of \$77,402,000 and \$75,828,000, respectively, were callable prior to the maturity date.

|                                        | Amortized        | Estimated       |
|----------------------------------------|------------------|-----------------|
| December 31, 2006                      | Cost             | Market Value    |
| Less than one year                     | \$ —             | \$ —            |
| Due after one year through five years  | 290              | 289             |
| Due after five years through ten years | —                | —               |
| Due after ten years                    | 77,402           | 75,828          |
|                                        | <u>\$ 77,692</u> | <u>\$76,117</u> |

The estimated market value (carrying amount) of investment securities pledged as required security for deposits and for other purposes required by law amounted to \$2,058,000 and \$1,948,000 at December 31, 2006 and 2005, respectively. Additionally, the estimated market value (carrying amount) of investment securities pledged as collateral for reverse repurchase agreements amounted to \$74,059,000 and \$75,603,000 at December 31, 2006 and 2005, respectively.

The estimated market value and unrealized loss for investment securities available for sale at December 31, 2006 and 2005, segregated by the duration of the unrealized loss are as follows (in thousands):

#### December 31, 2006

|                           | Less than 12 months |             | 12 months or longer |                   | Total           |                   |
|---------------------------|---------------------|-------------|---------------------|-------------------|-----------------|-------------------|
|                           | Estimated           | Unrealized  | Estimated           | Unrealized        | Estimated       | Unrealized        |
|                           | Market Value        | Losses      | Market Value        | Losses            | Market Value    | Losses            |
| U.S. agency obligations   | \$ —                | \$ —        | \$ 289              | \$ (1)            | \$ 289          | \$ (1)            |
| Corporate debt securities | —                   | —           | 69,059              | (1,595)           | 69,059          | (1,595)           |
|                           | <u>\$ —</u>         | <u>\$ —</u> | <u>\$69,348</u>     | <u>\$ (1,596)</u> | <u>\$69,348</u> | <u>\$ (1,596)</u> |

#### December 31, 2005

|                           | Less than 12 months |               | 12 months or longer |                   | Total           |                   |
|---------------------------|---------------------|---------------|---------------------|-------------------|-----------------|-------------------|
|                           | Estimated           | Unrealized    | Estimated           | Unrealized        | Estimated       | Unrealized        |
|                           | Market Value        | Losses        | Market Value        | Losses            | Market Value    | Losses            |
| U.S. agency obligations   | \$ 200              | \$ (1)        | \$ —                | \$ —              | \$ 200          | \$ (1)            |
| Corporate debt securities | —                   | —             | 73,630              | (1,898)           | 73,630          | (1,898)           |
|                           | <u>\$200</u>        | <u>\$ (1)</u> | <u>\$73,630</u>     | <u>\$ (1,898)</u> | <u>\$73,830</u> | <u>\$ (1,899)</u> |

The United States Government and agency obligations in the tables above are either direct obligations of the United States Government or are issued by one of the stockholder-owned corporations chartered by the United States Government, whose debt obligations are rated AA or better 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 market value of the securities.

The corporate debt securities are issued by other financial institutions each with an investment grade credit rating of BBB or better as rated by one of the internationally-recognized credit rating services. These floating rate securities were purchased during the period May 1998 to September 1998 and have paid coupon interest continuously since issuance. Floating rate debt securities such as these pay a fixed interest rate spread over LIBOR. Following the purchase of these securities, the required spread increased for these types of securities causing a decline in the market price. Although these investment securities are available for sale, the Company has the ability to hold these securities until maturity or market recovery at which time the Company expects to receive the fully amortized cost.

#### (4) Mortgage-Backed Securities Available for Sale

The amortized cost and estimated market value of mortgage-backed securities available for sale at December 31, 2006 and 2005 are as follows (in thousands):

|                          | Amortized       | Gross Unrealized | Gross Unrealized  | Estimated       |
|--------------------------|-----------------|------------------|-------------------|-----------------|
|                          | Cost            | Gains            | Losses            | Market Value    |
| <b>December 31, 2006</b> |                 |                  |                   |                 |
| FHLMC                    | \$ 14,726       | \$ 55            | \$ (132)          | \$14,649        |
| FNMA                     | 52,264          | 51               | (631)             | 51,684          |
| GNMA                     | 1,960           | 76               | —                 | 2,036           |
|                          | <u>\$68,950</u> | <u>\$ 182</u>    | <u>\$ (763)</u>   | <u>\$68,369</u> |
|                          |                 |                  |                   |                 |
|                          | Amortized       | Gross Unrealized | Gross Unrealized  | Estimated       |
|                          | Cost            | Gains            | Losses            | Market Value    |
| <b>December 31, 2005</b> |                 |                  |                   |                 |
| FHLMC                    | \$ 10,964       | \$ 61            | \$ (216)          | \$10,809        |
| FNMA                     | 72,861          | 23               | (1,353)           | 71,531          |
| GNMA                     | 2,545           | 140              | —                 | 2,685           |
|                          | <u>\$86,370</u> | <u>\$ 224</u>    | <u>\$ (1,569)</u> | <u>\$85,025</u> |

There were no gains realized on the sale of mortgage-backed securities available for sale during 2006, 2005 or 2004. Losses realized during 2006 and 2005 on the sale of mortgage-backed securities available for sale totaled \$148,000 and \$117,000, respectively. There were no losses realized during 2004 on the sale of mortgage-backed securities available for sale.

The contractual maturities of mortgage-backed securities available for sale generally exceed 20 years; however, the effective lives are expected to be shorter due to principal prepayments.

The estimated market value (carrying amount) of mortgage-backed securities pledged as required security for deposits and for other purposes required by law amounted to \$25,328,000 and \$6,013,000 at December 31, 2006 and 2005, respectively. The estimated market value (carrying amount) of mortgage-backed securities pledged as collateral for reverse repurchase agreements amounted to \$42,529,000 and \$76,274,000 at December 31, 2006 and 2005, respectively.

The estimated market value and unrealized loss for mortgage-backed securities available for sale at December 31, 2006 and 2005 segregated by the duration of the unrealized loss are as follows (in thousands):

#### December 31, 2006

|  | Less than 12 months |            | 12 months or longer |            | Total        |            |
|--|---------------------|------------|---------------------|------------|--------------|------------|
|  | Estimated           | Unrealized | Estimated           | Unrealized | Estimated    | Unrealized |
|  | Market Value        | Losses     | Market Value        | Losses     | Market Value | Losses     |

|       |                   |                    |                        |                        |                        |                        |
|-------|-------------------|--------------------|------------------------|------------------------|------------------------|------------------------|
| FHLMC | \$ —              | \$ —               | \$ 6,130               | \$ (132)               | \$ 6,130               | \$ (132)               |
| FNMA  | <u>—</u>          | <u>—</u>           | <u>45,222</u>          | <u>(631)</u>           | <u>45,222</u>          | <u>(631)</u>           |
|       | <u><u>\$—</u></u> | <u><u>\$ —</u></u> | <u><u>\$51,352</u></u> | <u><u>\$ (763)</u></u> | <u><u>\$51,352</u></u> | <u><u>\$ (763)</u></u> |

**Notes to Consolidated Financial Statements (continued)**
**December 31, 2005**

|       | Less than 12 months |             | 12 months or longer |                   | Total           |                   |
|-------|---------------------|-------------|---------------------|-------------------|-----------------|-------------------|
|       | Estimated           | Unrealized  | Estimated           | Unrealized        | Estimated       | Unrealized        |
|       | Market Value        | Losses      | Market Value        | Losses            | Market Value    | Losses            |
| FHLMC | \$ —                | \$ —        | \$ 7,302            | \$ (216)          | \$ 7,302        | \$ (216)          |
| FNMA  | —                   | —           | 62,349              | (1,353)           | 62,349          | (1,353)           |
|       | <u>\$ —</u>         | <u>\$ —</u> | <u>\$69,651</u>     | <u>\$ (1,569)</u> | <u>\$69,651</u> | <u>\$ (1,569)</u> |

The mortgage-backed securities are issued and guaranteed by either FHLMC or FNMA, stockholder-owned corporations chartered by the United States Government, whose debt obligations are rated AA or better 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 market value of the mortgage-backed securities. Although these mortgage-backed securities are available for sale, the Company has the ability to hold these securities until maturity or market recovery at which time the Company expects to receive the fully amortized cost.

**(5) Loans Receivable, Net**

A summary of loans receivable at December 31, 2006 and 2005 follows (in thousands):

| December 31,                                  | 2006               | 2005               |
|-----------------------------------------------|--------------------|--------------------|
| Real estate mortgage:                         |                    |                    |
| One-to-four family                            | \$1,142,897        | \$1,150,447        |
| Commercial real estate, multi-family and land | 306,288            | 281,585            |
| FHA insured & VA guaranteed                   | 5,876              | 4,735              |
|                                               | <u>1,455,061</u>   | <u>1,436,767</u>   |
| Real estate construction                      | 13,475             | 22,739             |
| Consumer                                      | 190,029            | 146,911            |
| Commercial                                    | 49,693             | 61,637             |
| Total loans                                   | <u>1,708,258</u>   | <u>1,668,054</u>   |
| Loans in process                              | (2,318)            | (7,646)            |
| Deferred origination costs, net               | 5,723              | 4,596              |
| Allowance for loan losses                     | <u>(10,238)</u>    | <u>(10,460)</u>    |
|                                               | <u>\$1,701,425</u> | <u>\$1,654,544</u> |

At December 31, 2006, 2005 and 2004 loans in the amount of \$4,525,000, \$1,595,000 and \$3,488,000, respectively, were three or more months delinquent or in the process of foreclosure and the Company was not accruing interest income. At December 31, 2006, the impaired loan portfolio consisted of one commercial loan for \$962,000 for which there was no specific or general allocations in the allowance for loan losses due to collateral adequacy. At December 31, 2005 there were no impaired loans. The average balance of impaired loans for the years ended December 31, 2006, 2005 and 2004 was \$347,000, \$389,000 and \$1,010,000, respectively. If interest income on nonaccrual loans and impaired loans had been current in accordance with their original terms, approximately \$189,000, \$115,000 and \$128,000 of interest income for the years ended December 31, 2006, 2005 and 2004, respectively, would have been recorded. At December 31, 2006, there were no commitments to lend additional funds to borrowers whose loans are classified as nonperforming.

An analysis of the allowance for loan losses for the years ended December 31, 2006, 2005 and 2004 is as follows (in thousands):

| Year Ended December 31,         | 2006            | 2005            | 2004            |
|---------------------------------|-----------------|-----------------|-----------------|
| Balance at beginning of year    | \$10,460        | \$10,688        | \$10,802        |
| Provision charged to operations | 150             | 350             | 300             |
| Charge-offs                     | (569)           | (684)           | (487)           |
| Recoveries                      | 197             | 106             | 73              |
| Balance at end of year          | <u>\$10,238</u> | <u>\$10,460</u> | <u>\$10,688</u> |

An analysis of the servicing asset for the years ended December 31, 2006, 2005 and 2004 is as follows (in thousands):

| Year Ended December 31,               | 2006            | 2005            | 2004            |
|---------------------------------------|-----------------|-----------------|-----------------|
| Balance at beginning of year          | \$ 9,730        | \$ 8,790        | \$ 7,473        |
| Capitalized mortgage servicing rights | 2,105           | 3,192           | 3,222           |
| Amortization and impairment charges   | (2,048)         | (2,252)         | (1,905)         |
| Balance at end of year                | <u>\$ 9,787</u> | <u>\$ 9,730</u> | <u>\$ 8,790</u> |

Loans serviced for others amounted to \$992.7 million at December 31, 2006, all of which relate to residential loans. The estimated fair value of the servicing asset at December 31, 2006 was \$15,036,000.

**(6) Interest and Dividends Receivable**

A summary of interest and dividends receivable at December 31, 2006 and 2005 follows (in thousands):

| December 31,               | 2006           | 2005           |
|----------------------------|----------------|----------------|
| Loans                      | \$ 7,035       | \$6,080        |
| Investment securities      | 737            | 660            |
| Mortgage-backed securities | 311            | 349            |
|                            | <u>\$8,083</u> | <u>\$7,089</u> |

**(7) Premises and Equipment, Net**

Premises and equipment at December 31, 2006 and 2005 are summarized as follows (in thousands):

| December 31,                              | 2006             | 2005             |
|-------------------------------------------|------------------|------------------|
| Land                                      | \$ 3,195         | \$ 3,195         |
| Buildings and improvements                | 18,647           | 15,506           |
| Leasehold improvements                    | 2,199            | 2,187            |
| Furniture and equipment                   | 14,056           | 12,708           |
| Automobiles                               | 330              | 277              |
| Construction in progress                  | 70               | 533              |
| Total                                     | 38,497           | 34,406           |
| Accumulated depreciation and amortization | (20,301)         | (18,288)         |
|                                           | <u>\$ 18,196</u> | <u>\$ 16,118</u> |

#### (8) Deposits

Deposits, including accrued interest payable of \$548,000 and \$239,000 at December 31, 2006 and 2005, respectively, are summarized as follows (in thousands):

| December 31,                       | 2006               |                             | 2005               |                             |
|------------------------------------|--------------------|-----------------------------|--------------------|-----------------------------|
|                                    | Amount             | Weighted<br>Average<br>Cost | Amount             | Weighted<br>Average<br>Cost |
| Non-interest bearing accounts      | \$ 114,950         | — %                         | \$ 120,188         | — %                         |
| Interest-bearing checking accounts | 408,666            | 2.55                        | 381,787            | 1.78                        |
| Money market deposit accounts      | 105,571            | 1.77                        | 125,169            | 1.34                        |
| Savings accounts                   | 200,544            | .80                         | 242,689            | .73                         |
| Time deposits                      | 542,597            | 4.48                        | 486,735            | 3.49                        |
|                                    | <u>\$1,372,328</u> | <u>2.78%</u>                | <u>\$1,356,568</u> | <u>2.01%</u>                |

Included in time deposits at December 31, 2006 and 2005, respectively, is \$143,108,000 and \$110,488,000 in deposits of \$100,000 and over.

Time deposits at December 31, 2006 mature as follows (in thousands):

| Year Ended December 31, |                   |
|-------------------------|-------------------|
| 2007                    | \$ 444,233        |
| 2008                    | 67,018            |
| 2009                    | 15,523            |
| 2010                    | 8,436             |
| 2011                    | 6,033             |
| Thereafter              | 1,354             |
|                         | <u>\$ 542,597</u> |

Interest expense on deposits for the years ended December 31, 2006, 2005 and 2004 is as follows (in thousands):

| Year Ended December 31,            | 2006            | 2005            | 2004            |
|------------------------------------|-----------------|-----------------|-----------------|
| Interest-bearing checking accounts | \$ 8,216        | \$ 4,674        | \$ 1,556        |
| Money market deposit accounts      | 1,994           | 1,604           | 1,350           |
| Savings accounts                   | 1,730           | 1,858           | 1,310           |
| Time deposits                      | 21,461          | 14,671          | 10,978          |
|                                    | <u>\$33,401</u> | <u>\$22,807</u> | <u>\$15,194</u> |

### (9) Borrowed Funds

Borrowed funds are summarized as follows (in thousands):

| December 31,                                   | 2006             |                       | 2005             |                       |
|------------------------------------------------|------------------|-----------------------|------------------|-----------------------|
|                                                | Amount           | Weighted Average Rate | Amount           | Weighted Average Rate |
| Federal Home Loan Bank advances                | \$430,500        | 4.84%                 | \$354,900        | 4.27%                 |
| Securities sold under agreements to repurchase | 84,982           | 4.34                  | 113,289          | 4.27                  |
| Other borrowings                               | 17,500           | 6.90                  | 5,000            | 6.35                  |
|                                                | <u>\$532,982</u> | <u>4.83%</u>          | <u>\$473,189</u> | <u>4.29%</u>          |

Information concerning Federal Home Loan Bank ("FHLB") advances and securities sold under agreements to repurchase ("reverse repurchase agreements") is summarized as follows (in thousands):

|                                             | FHLB Advances |           | Reverse Repurchase Agreements |           |
|---------------------------------------------|---------------|-----------|-------------------------------|-----------|
|                                             | 2006          | 2005      | 2006                          | 2005      |
| Average balance                             | \$426,792     | \$320,231 | \$ 92,930                     | \$132,520 |
| Maximum amount outstanding at any month end | 504,200       | 363,000   | 103,529                       | 152,445   |
| Average interest rate for the year          | 4.73%         | 4.28%     | 4.38%                         | 3.95%     |
| Amortized cost of collateral:               |               |           |                               |           |
| Corporate securities                        | —             | —         | \$ 75,655                     | \$ 75,528 |
| Mortgage-backed securities                  | —             | —         | 42,792                        | 77,641    |
| Other securities                            | —             | —         | —                             | 1,948     |
| Estimated market value of collateral:       |               |           |                               |           |
| Corporate securities                        | —             | —         | 74,059                        | 73,630    |
| Mortgage-backed securities                  | —             | —         | 42,529                        | 76,274    |
| Other securities                            | —             | —         | —                             | 1,973     |

The securities collateralizing the reverse repurchase agreements are delivered to the lender with whom each transaction is executed or to a third party custodian. The lender, who may sell, loan or otherwise dispose of such securities to other parties in the normal course of their operations, agrees to resell to the Company substantially the same securities at the maturity of the reverse repurchase agreements. (See notes 3 and 4.)

FHLB advances and reverse repurchase agreements have contractual maturities at December 31, 2006 as follows (in thousands):

| Year Ended December 31,                              | FHLB Advances    | Reverse Repurchase Agreements |
|------------------------------------------------------|------------------|-------------------------------|
| 2007                                                 | \$122,500        | \$ 65,982                     |
| 2008                                                 | 100,000          | 16,000                        |
| 2009                                                 | 100,000          | 3,000                         |
| 2010                                                 | 80,000           | —                             |
| 2011                                                 | 28,000           | —                             |
| Thereafter                                           | —                | —                             |
|                                                      | <u>\$430,500</u> | <u>\$ 84,982</u>              |
| Amount callable by lender prior to the maturity date | <u>\$ 40,000</u> | <u>\$ 15,000</u>              |

During 2006, the Company issued \$12,500,000 of trust preferred securities. The trust preferred securities carry a floating rate of 166 basis points over 3 month LIBOR adjusted quarterly. Accrued interest is due quarterly with principal due at the maturity date in 2036. On August 4, 2005, the Company issued \$5,000,000 of subordinated debt at a fixed interest rate of 6.35%. Accrued interest is due quarterly with principal due at the maturity date of November 23, 2015.

Interest expense on borrowings for the years ended December 31, 2006, 2005 and 2004 is as follows (in thousands):

| Year Ended December 31,         | 2006     | 2005     | 2004     |
|---------------------------------|----------|----------|----------|
| Federal Home Loan Bank advances | \$20,184 | \$13,698 | \$14,815 |

|                                                |                 |                 |                 |
|------------------------------------------------|-----------------|-----------------|-----------------|
| Securities sold under agreements to repurchase | 4,068           | 5,237           | 4,922           |
| Other borrowings                               | 790             | 131             | —               |
|                                                | <u>\$25,042</u> | <u>\$19,066</u> | <u>\$19,737</u> |

The Bank has an available overnight line of credit with the FHLB for \$100,000,000 which expires July 31, 2007. The Bank also has available from the FHLB, a one-month overnight repricing line of credit for \$100,000,000 which expires July 31, 2007. The Bank expects both lines to be renewed upon expiration. When utilized, both lines carry a floating interest rate of 10-15 basis points over the current Federal funds rate. All FHLB advances, including the lines of credit, are secured by the Bank's mortgage loans, mortgage-backed securities and FHLB stock. As a member of the FHLB of New York, the Company is required to maintain a minimum investment in the capital stock of the FHLB, at cost, in an amount equal to 0.20% of the Bank's mortgage-related assets, plus 4.5% of the specified value of certain transactions between the Bank and the FHLB.

## Notes to Consolidated Financial Statements (continued)

### (10) Income Taxes

The provision for income taxes for the years ended December 31, 2006, 2005 and 2004 consists of the following (in thousands):

| Year Ended December 31, | 2006            | 2005            | 2004            |
|-------------------------|-----------------|-----------------|-----------------|
| <b>Current:</b>         |                 |                 |                 |
| Federal                 | \$ 8,932        | \$ 9,500        | \$10,179        |
| State                   | 581             | 501             | 464             |
| Total Current           | 9,513           | 10,001          | 10,643          |
| <b>Deferred:</b>        |                 |                 |                 |
| Federal                 | (2,499)         | 710             | (626)           |
| State                   | (451)           | (376)           | (260)           |
| Total deferred          | (2,950)         | 334             | (886)           |
|                         | <u>\$ 6,563</u> | <u>\$10,335</u> | <u>\$ 9,757</u> |

Included in other comprehensive income (loss) is income tax expense (benefit) attributable to net unrealized gains (losses) on securities available for sale in the amount of \$520,000, \$(384,000) and \$1,888,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Included in stockholders' equity is income tax benefit attributable to stock plans in the amount of \$2,129,000, \$1,704,000 and \$1,575,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

A reconciliation between the provision for income taxes and the expected amount computed by multiplying income before the provision for income taxes times the applicable statutory Federal income tax rate for the years ended December 31, 2006, 2005 and 2004 is as follows (in thousands):

| Year Ended December 31,                                          | 2006            | 2005            | 2004            |
|------------------------------------------------------------------|-----------------|-----------------|-----------------|
| Income before provision for income taxes                         | \$19,196        | \$29,832        | \$27,702        |
| Applicable statutory Federal income tax rate                     | 35.0%           | 35.0%           | 35.0%           |
| Computed "expected" Federal income tax expense                   | \$ 6,719        | \$10,441        | \$ 9,696        |
| Increase(decrease) in Federal income tax expense resulting from: |                 |                 |                 |
| ESOP adjustment                                                  | 647             | 722             | 816             |
| ESOP dividends                                                   | (397)           | (368)           | (317)           |
| Earnings on life insurance                                       | (400)           | (393)           | (440)           |
| State income taxes net of Federal benefit                        | 85              | 82              | 132             |
| Other items, net                                                 | (91)            | (149)           | (130)           |
|                                                                  | <u>\$ 6,563</u> | <u>\$10,335</u> | <u>\$ 9,757</u> |

Included in other assets at December 31, 2006 and 2005 is a net deferred tax asset of \$6,819,000 and \$4,389,000, respectively. In addition, at December 31, 2006 and 2005 the Company recorded a current tax payable (receivable) of \$284,000 and \$(1,754,000), respectively.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are presented in the following table (in thousands):

| December 31,                                              | 2006            | 2005            |
|-----------------------------------------------------------|-----------------|-----------------|
| <b>Deferred tax assets:</b>                               |                 |                 |
| Allowance for loan and real estate owned losses per books | \$ 4,182        | \$ 4,273        |
| Reserve for repurchased loans                             | 3,359           | —               |
| Reserve for uncollected interest                          | 84              | 33              |
| Deferred compensation                                     | 1,174           | 1,202           |
| Premises and equipment, differences in depreciation       | 543             | 310             |
| Other reserves                                            | 115             | 162             |
| Stock plans                                               | 137             | 72              |
| Unrealized loss on securities available for sale          | 325             | 845             |
| Intangible assets                                         | 49              | 51              |
| Lease termination costs                                   | —               | 32              |
| Penalty on early extinguishment of debt                   | —               | 11              |
| Partnership investment income                             | —               | 189             |
| State alternative minimum tax                             | 1,164           | 871             |
| State net operating loss carry forward                    | 927             | 523             |
| Total gross deferred tax assets                           | 12,059          | 8,574           |
| Less valuation allowance                                  | 927             | 523             |
| Deferred tax assets, net                                  | <u>11,132</u>   | <u>8,051</u>    |
| <b>Deferred tax liabilities:</b>                          |                 |                 |
| Excess servicing on sale of mortgage loans                | (1,395)         | (1,331)         |
| Investments, discount accretion                           | (377)           | (280)           |
| Deferred loan and commitment costs, net                   | (2,397)         | (2,000)         |
| Loans held for sale                                       | —               | (19)            |
| ESOP                                                      | (144)           | (32)            |
| Total deferred tax liabilities                            | <u>(4,313)</u>  | <u>(3,662)</u>  |
| Net deferred tax assets                                   | <u>\$ 6,819</u> | <u>\$ 4,389</u> |

The Company has determined that a valuation allowance should be established for the state net operating loss carryforward as it was considered unlikely that the Bank, due to its REIT subsidiary, would have sufficient earnings to realize the benefit. The Company has determined that it is not required to establish a valuation reserve for the remaining net deferred tax asset account since it is "more likely than not" that the net deferred tax assets will be realized through future reversals of existing taxable temporary differences, future taxable income and tax planning strategies. The conclusion that it is "more likely than not" that the remaining net deferred tax assets will be realized is based on the history of earnings and the prospects for continued growth. Management will continue to review the tax criteria related to the recognition of deferred tax assets.

Retained earnings at December 31, 2006 includes approximately \$10,750,000 for which no provision for income tax has been made. This amount represents an

allocation of income to bad debt deductions for tax purposes only. Events that would result in taxation of these reserves include failure to qualify as a bank for tax purposes, distributions in complete or partial liquidation, stock redemptions and excess distributions to shareholders. At December 31, 2006 the Company had an unrecognized deferred tax liability of \$4,391,000 with respect to this reserve.

#### **(11) Employee Stock Ownership Plan**

As part of the Conversion, the Bank established an Employee Stock Ownership Plan and in 2006 the Bank established a Matching Contribution Employee Stock Ownership Plan (collectively the “ESOP”) to provide retirement benefits for eligible employees. All full-time employees are eligible to participate in the ESOP after they attain age

21 and complete one year of service during which they work at least 1,000 hours. ESOP shares are first allocated to employees who also participate in the Bank's Incentive Savings (401K) Plan in an amount equal to 50% of the first 6% of the employees contribution. During 2006, 2005 and 2004, 19,339, 18,646 and 14,409 shares, respectively, were either released or committed to be released under this formula. The remaining ESOP shares are allocated among participants on the basis of compensation earned during the year. Employees are fully vested in their ESOP account after the completion of five years of credited service or completely if service was terminated due to death, retirement, disability, or change in control of the Company except that shares allocated based on participation in the 401K Plan vest on a graduated basis over years two through six. ESOP participants are entitled to receive distributions from the ESOP account only upon termination of service, which includes retirement and death.

The ESOP originally borrowed \$13,421,000 from the Company to purchase 2,013,137 shares of common stock issued in the conversion. On May 12, 1998, the initial loan agreement was amended to allow the ESOP to borrow an additional \$8,200,000 in order to fund the purchase of 633,750 shares of common stock. At the same time the term of the loan was extended from the initial twelve years to thirty years. As part of the establishment of the Matching Contribution Employee Stock Ownership Plan the term of the loan was reduced by one year and now expires in 2026. The amended loan is to be repaid from contributions by the Bank to the ESOP trust. The Bank is required to make contributions to the ESOP in amounts at least equal to the principal and interest requirement of the debt, assuming a fixed interest rate of 8.25%.

The Bank's obligation to make such contributions is reduced to the extent of any dividends paid by the Company on unallocated shares and any investment earnings realized on such dividends. As of December 31, 2006 and 2005 contributions to the ESOP, which were used to fund principal and interest payments on the ESOP debt, totaled \$1,986,000 and \$2,127,000, respectively. During 2006 and 2005, \$701,000 and \$813,000, respectively, of dividends paid on unallocated ESOP shares were used for debt service. At December 31, 2006 and 2005, the loan had an outstanding balance of \$5,991,000 and \$7,369,000, respectively, and the ESOP had unallocated shares of 755,259 and 886,029, respectively. At December 31, 2006, the unallocated shares had a fair value of \$17,318,000. The unamortized balance of the ESOP is shown as unallocated common stock held by the ESOP and is reflected as a reduction of stockholders' equity.

For the years ended December 31, 2006, 2005 and 2004, the Bank recorded compensation expense related to the ESOP of \$2,952,000, \$3,244,000 and \$3,590,000, respectively, including \$1,849,000, \$2,064,000 and \$2,331,000, respectively, representing additional compensation expense to reflect the increase in the average fair value of committed to be released and allocated shares in excess of the Bank's cost. As of December 31, 2006, 1,775,818 shares had been allocated to participants and 115,811 shares were committed to be released.

## (12) Incentive Plan

The Company has established the Amended and Restated OceanFirst Financial Corp. 1997 Incentive Plan (the "Incentive Plan") which authorizes the granting of stock options and awards of Common Stock and the OceanFirst Financial Corp. 2000 Stock Option Plan which authorizes the granting of stock options. On April 24, 2003 the Company's shareholders ratified an amendment of the OceanFirst Financial Corp. 2000 Stock Option Plan which increased the number of shares available under option. On April 20, 2006, the OceanFirst Financial Corp. 2006 Stock Incentive Plan was approved which authorizes the granting of stock options or awards of common stock. The purpose of these plans is to attract and retain qualified personnel in key positions, provide officers, employees and non-employee directors ("Outside Directors") with a proprietary interest in the Company as an incentive to contribute to the success of the Company, align the interests of management with those of other stockholders' and reward employees for outstanding performance. All officers, other employees and Outside Directors of the Company and its affiliates are eligible to receive awards under the plans.

Under the Incentive Plan and the Amended 2000 Stock Option Plan, the Company is authorized to issue up to 4,153,564 shares subject to option of which 260,767 shares remain to be issued at December 31, 2006. Under the 2006 Stock Incentive Plan, the Company is authorized to issue up to an additional 1,000,000 shares subject to option of which 999,235 shares remain to be issued at December 31, 2006. In lieu of options, up to 333,333 shares in the form of stock awards may be issued. All options expire 10 years from the date of grant and generally vest at the rate of 20% per year. The exercise price of each option equals the closing market price of the Company's stock on the date of grant. The Company typically issues Treasury shares to satisfy stock option exercises.

A summary of option activity for the years ended December 31, 2006, 2005 and 2004 follows:

|                                  | 2006             |                        | 2005             |                        | 2004             |                        |
|----------------------------------|------------------|------------------------|------------------|------------------------|------------------|------------------------|
|                                  | Weighted         |                        | Weighted         |                        | Weighted         |                        |
|                                  | Number of Shares | Average Exercise Price | Number of Shares | Average Exercise Price | Number of Shares | Average Exercise Price |
| Outstanding at beginning of year | 1,732,410        | \$ 16.90               | 2,215,514        | \$ 15.47               | 2,291,337        | \$ 13.71               |
| Granted                          | 258,800          | 23.43                  | 18,850           | 22.06                  | 395,276          | 22.57                  |
| Exercised                        | (480,500)        | 9.94                   | (483,414)        | 10.23                  | (388,708)        | 10.86                  |
| Forfeited                        | (14,851)         | 22.62                  | (18,540)         | 22.33                  | (82,391)         | 22.34                  |
| Outstanding at end of year       | 1,495,859        | \$ 20.24               | 1,732,410        | \$ 16.90               | 2,215,514        | \$ 15.47               |
| Options exercisable              | 1,235,769        |                        | 1,723,426        |                        | 1,337,326        |                        |

The following table summarizes information about stock options outstanding at December 31, 2006:

| Exercise Prices | Options Outstanding |                                             |                                 |                   | Options Exercisable                         |                                 |
|-----------------|---------------------|---------------------------------------------|---------------------------------|-------------------|---------------------------------------------|---------------------------------|
|                 | Number of Options   | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number of Options | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |
| \$ 9.60 to 9.87 | 76,269              | 0.13 years                                  | \$ 9.61                         | 76,269            | 0.13 years                                  | \$ 9.61                         |
| 10.00 to 12.87  | 103,190             | 2.49                                        | 11.87                           | 103,190           | 2.49                                        | 11.87                           |
| 13.06 to 16.91  | 16,080              | 3.76                                        | 14.25                           | 16,080            | 3.76                                        | 14.25                           |
| 17.14 to 17.88  | 363,724             | 5.16                                        | 17.88                           | 363,724           | 5.16                                        | 17.88                           |
| 18.64 to 23.23  | 394,391             | 7.49                                        | 22.46                           | 379,447           | 7.42                                        | 22.45                           |
| 23.44 to 27.11  | 542,205             | 7.68                                        | 23.49                           | 297,059           | 6.53                                        | 23.49                           |
|                 | 1,495,859           | 6.23 years                                  | \$ 20.24                        | 1,235,769         | 5.63 years                                  | \$ 19.57                        |

The aggregate intrinsic value for stock options outstanding and stock options exercisable at December 31, 2006 is \$4,323,000 and \$4,318,000, respectively.

## (13) Commitments, Contingencies and Concentrations of Credit Risk

The Company, in the normal course of business, is party to financial instruments and commitments which involve, to varying degrees, elements of risk in excess of the amounts recognized in the consolidated financial statements. These financial instruments and commitments include unused consumer lines of credit and commitments

to extend credit.

## Notes to Consolidated Financial Statements (continued)

At December 31, 2006, the following commitments and contingent liabilities existed which are not reflected in the accompanying consolidated financial statements (in thousands):

| December 31,                                                                    | 2006       |
|---------------------------------------------------------------------------------|------------|
| Unused consumer and construction loan lines of credit (primarily floating-rate) | \$ 115,402 |
| Unused commercial loan lines of credit (primarily floating-rate)                | 60,076     |
| Other commitments to extend credit:                                             |            |
| Fixed-Rate                                                                      | 113,284    |
| Adjustable-Rate                                                                 | 94,116     |
| Floating-Rate                                                                   | 20,226     |

The Company's fixed-rate loan commitments expire within 90 days of issuance and carried interest rates ranging from 5.50% to 10.63% at December 31, 2006.

The Company's maximum exposure to credit losses in the event of nonperformance by the other party to these financial instruments and commitments is represented by the contractual amounts. The Company uses the same credit policies in granting commitments and conditional obligations as it does for financial instruments recorded in the consolidated statements of financial condition.

These commitments and obligations do not necessarily represent future cash flow requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's assessment of risk. Substantially all of the unused consumer and construction loan lines of credit are collateralized by mortgages on real estate.

The Company has entered 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 an Early Payment Default or a violation of various representations and warranties customary to the mortgage banking industry. In the opinion of management, the potential exposure related to the Company's loan sale agreements is adequately provided for in the reserve for repurchased loans which is included in other liabilities with a corresponding provision which reduced the net gain on sale of loans. At December 31, 2006 and 2005 the reserve for repurchased loans amounted to \$9,600,000 and zero, respectively.

At December 31, 2006, the Company is obligated under noncancelable operating leases for premises and equipment.

Rental expense under these leases aggregated approximately \$2,159,000, \$2,030,000 and \$1,655,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

The projected minimum rental commitments as of December 31, 2006 are as follows (in thousands):

| Year ended December 31, |                 |
|-------------------------|-----------------|
| 2007                    | \$ 2,166        |
| 2008                    | 2,285           |
| 2009                    | 1,945           |
| 2010                    | 1,459           |
| 2011                    | 1,441           |
| Thereafter              | 15,129          |
|                         | <u>\$24,425</u> |

The Company grants one-to-four family and commercial first mortgage real estate loans to borrowers primarily located in Ocean, Middlesex and Monmouth Counties, New Jersey and other surrounding areas of New York City. The Company also originates interest-only one-to-four family mortgage loans in which the borrower makes only interest payments for the first five, seven or ten years of the mortgage loan term. This feature will result in future increases in the borrower's loan repayment when the contractually required repayments increase due to the required amortization of the principal amount. These payment increases could affect a borrower's ability to repay the loan. The amount of interest-only one-to-four family mortgage loans at December 31, 2006 was \$227.0 million. The ability of borrowers to repay their obligations are dependent upon various factors including the borrowers' income and net worth, cash flows generated by the underlying collateral, value of the underlying collateral and priority of the Company's lien on the property. Such factors are dependent upon various economic conditions and individual circumstances beyond the Company's control; the Company is, therefore, subject to risk of loss.

The Company believes its lending policies and procedures adequately minimize the potential exposure to such risks and that adequate provisions for loan losses are provided for all known and inherent risks. Collateral and/or guarantees are required for all loans.

### Contingencies

The Company is a defendant in certain claims and legal actions arising in the ordinary course of business. Management and its legal counsel are of the opinion that the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial condition, results of operations or liquidity.

## (14) Fair Value of Financial Instruments

Fair value estimates, methods and assumptions are set forth below for the Company's financial instruments.

### Cash and Due from Banks

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

### Investments and Mortgage-Backed Securities

The fair value of investment and mortgage-backed securities is estimated based on bid quotations received from securities dealers, if available. If a quoted market price was not available, fair value was estimated using quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

### Federal Home Loan Bank of New York Stock

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

## Loans

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

Fair value of performing and non-performing loans was estimated by discounting the future cash flows, net of estimated prepayments, at a rate for which similar loans would be originated to new borrowers with similar terms.

## Deposits

The fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, savings, and interest-bearing checking accounts and money market accounts are, by definition, equal to the

amount payable on demand. The related insensitivity of the majority of these deposits to interest rate changes creates a significant inherent value which is not reflected in the fair value reported. The fair value of certificates of deposit 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.

#### 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.

#### Commitments to Extend Credit and Sell Loans

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The estimated fair values of the Bank's financial instruments as of December 31, 2006 and 2005 are presented in the following tables (in thousands). Since the fair value of off-balance sheet commitments approximate book value and are not significant, these disclosures are not included.

| December 31, 2006                                 | Book Value | Fair Value |
|---------------------------------------------------|------------|------------|
| <b>Financial Assets:</b>                          |            |            |
| Cash and due from banks                           | \$ 32,204  | \$ 32,204  |
| Investment securities available for sale          | 82,384     | 82,384     |
| Mortgage-backed securities available for sale     | 68,369     | 68,369     |
| Federal Home Loan Bank of New York stock          | 25,346     | 25,346     |
| Loans receivable and mortgage loans held for sale | 1,784,368  | 1,781,154  |
| <b>Financial Liabilities:</b>                     |            |            |
| Deposits                                          | 1,372,328  | 1,368,677  |
| Borrowed funds                                    | 532,982    | 530,709    |

| December 31, 2005                                 | Book Value | Fair Value |
|---------------------------------------------------|------------|------------|
| <b>Financial Assets:</b>                          |            |            |
| Cash and due from banks                           | \$ 31,108  | \$ 31,108  |
| Investment securities available for sale          | 83,861     | 83,861     |
| Mortgage-backed securities available for sale     | 85,025     | 85,025     |
| Federal Home Loan Bank of New York stock          | 21,792     | 21,792     |
| Loans receivable and mortgage loans held for sale | 1,686,588  | 1,673,670  |
| <b>Financial Liabilities:</b>                     |            |            |
| Deposits                                          | 1,356,568  | 1,350,337  |
| Borrowed funds                                    | 473,189    | 470,001    |

#### 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 no 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 factors. 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 the mortgage banking operation, deferred tax assets, and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

#### (15) Parent-Only Financial Information

The following condensed statements of financial condition at December 31, 2006 and 2005 and condensed statements of operations and cash flows for the years ended December 31, 2006, 2005 and 2004 for OceanFirst Financial Corp. (parent company only) reflects the Company's investment in its wholly-owned subsidiary, the Bank, using the equity method of accounting.

#### CONDENSED STATEMENTS OF FINANCIAL CONDITION (in thousands)

| December 31,                                | 2006              | 2005              |
|---------------------------------------------|-------------------|-------------------|
| <b>Assets</b>                               |                   |                   |
| Cash and due from banks                     | \$ 7              | \$ 7              |
| Advances to subsidiary Bank                 | 5,683             | 2,894             |
| Investment securities                       | 6,268             | 5,874             |
| ESOP loan receivable                        | 5,991             | 7,369             |
| Investment in subsidiary Bank               | 132,208           | 128,073           |
| Total assets                                | <u>\$ 150,157</u> | <u>\$ 144,217</u> |
| <b>Liabilities and Stockholders' Equity</b> |                   |                   |
| Borrowings                                  | \$ 17,500         | \$ 5,000          |
| Other liabilities                           | 337               | 433               |
| Stockholders' equity                        | 132,320           | 138,784           |
| Total liabilities and stockholders' equity  | <u>\$ 150,157</u> | <u>\$ 144,217</u> |

#### CONDENSED STATEMENTS OF OPERATIONS (in thousands)

| Year ended December 31,                                                                                        | 2006            | 2005            | 2004            |
|----------------------------------------------------------------------------------------------------------------|-----------------|-----------------|-----------------|
| Dividend income - Subsidiary Bank                                                                              | \$15,000        | \$15,000        | \$20,000        |
| Dividend income - Investment securities                                                                        | 485             | 477             | 484             |
| Gain on sale- Investment securities                                                                            | 155             | 136             | 186             |
| Interest income - Advances to subsidiary Bank                                                                  | 106             | 46              | 47              |
| Interest income - ESOP loan receivable                                                                         | 608             | 724             | 841             |
| Total dividend and interest income                                                                             | 16,354          | 16,383          | 21,558          |
| Interest expense - borrowings                                                                                  | 790             | 131             | —               |
| Operating expenses                                                                                             | 1,273           | 1,167           | 1,212           |
| Income before income taxes and undistributed earnings/ (distribution in excess of earnings) of subsidiary Bank | 14,291          | 15,085          | 20,346          |
| Benefit (provision) for income taxes                                                                           | 253             | (31)            | (119)           |
| Income before undistributed earnings/ (distributions in excess of earnings) of subsidiary Bank                 | 14,544          | 15,054          | 20,227          |
| (Distributions in excess of earnings) undistributed earnings of subsidiary Bank                                | (1,911)         | 4,443           | (2,282)         |
| Net income                                                                                                     | <u>\$12,633</u> | <u>\$19,497</u> | <u>\$17,945</u> |

**Notes to Consolidated Financial Statements (continued)**
**CONDENSED STATEMENTS OF CASH FLOWS**  
*(in thousands)*

| <b>Year ended December 31,</b>                                                  | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|---------------------------------------------------------------------------------|-------------|-------------|-------------|
| <b>Cash flows from operating activities:</b>                                    |             |             |             |
| Net income                                                                      | \$ 12,633   | \$ 19,497   | \$ 17,945   |
| (Increase) decrease in advances to subsidiary Bank                              | (2,789)     | 2,076       | 1,513       |
| Distributions in excess of earnings (undistributed earnings) of subsidiary Bank | 1,911       | (4,443)     | 2,282       |
| Gain on sale of investment securities                                           | (155)       | (136)       | (186)       |
| (Decrease) increase in other liabilities                                        | (183)       | 38          | (332)       |
| Net cash provided by operating activities                                       | 11,417      | 17,032      | 21,222      |
| <b>Cash flows from investing activities:</b>                                    |             |             |             |
| Proceeds from sale of investment securities                                     | 436         | 199         | 545         |
| Purchase of investment securities                                               | (463)       | (443)       | (441)       |
| Repayments on ESOP loan receivable                                              | 1,378       | 1,403       | 1,425       |
| Net cash provided by investing activities                                       | 1,351       | 1,159       | 1,529       |
| <b>Cash flows from financing activities:</b>                                    |             |             |             |
| Proceeds from borrowings                                                        | 12,500      | 5,000       | —           |
| Dividends paid                                                                  | (9,277)     | (9,469)     | (9,686)     |
| Purchase of treasury stock                                                      | (17,618)    | (15,962)    | (16,247)    |
| Exercise of stock options                                                       | 1,627       | 2,240       | 3,182       |
| Net cash used in financing activities                                           | (12,768)    | (18,191)    | (22,751)    |
| Net increase in cash and due from banks                                         | —           | —           | —           |
| Cash and due from banks at beginning of year                                    | 7           | 7           | 7           |
| Cash and due from banks at end of year                                          | <u>\$ 7</u> | <u>\$ 7</u> | <u>\$ 7</u> |

**SELECTED CONSOLIDATED QUARTERLY FINANCIAL DATA**  
*(Unaudited)*

| <b>Quarter ended</b>                                      | <b>Dec. 31</b>    | <b>Sept. 30</b> | <b>June 30</b>  | <b>March 31</b> |
|-----------------------------------------------------------|-------------------|-----------------|-----------------|-----------------|
| <i>(dollars in thousands, except per share data)</i>      |                   |                 |                 |                 |
| <b>2006</b>                                               |                   |                 |                 |                 |
| Interest income                                           | \$29,892          | \$30,316        | \$28,568        | \$27,786        |
| Interest expense                                          | 16,060            | 15,857          | 14,157          | 12,369          |
| Net interest income                                       | 13,832            | 14,459          | 14,411          | 15,417          |
| Provision for loan losses                                 | 50                | 50              | —               | 50              |
| Net interest income after provision for loan losses       | 13,782            | 14,409          | 14,411          | 15,367          |
| Other (loss) income                                       | (3,963)           | 6,603           | 6,541           | 4,427           |
| Operating expenses                                        | 12,156            | 13,514          | 13,535          | 13,176          |
| (Loss) income before (benefit) provision for income taxes | (2,337)           | 7,498           | 7,417           | 6,618           |
| (Benefit) provision for income taxes                      | (898)             | 2,592           | 2,565           | 2,304           |
| Net (loss) income                                         | <u>\$ (1,439)</u> | <u>\$ 4,906</u> | <u>\$ 4,852</u> | <u>\$ 4,314</u> |
| Basic (loss) earnings per share                           | <u>\$ (.13)</u>   | <u>\$ .43</u>   | <u>\$ .42</u>   | <u>\$ .37</u>   |
| Diluted (loss) earnings per share                         | <u>\$ (.13)</u>   | <u>\$ .42</u>   | <u>\$ .41</u>   | <u>\$ .36</u>   |
| <b>2005</b>                                               |                   |                 |                 |                 |
| Interest income                                           | \$27,290          | \$26,328        | \$24,860        | \$24,321        |
| Interest expense                                          | 11,880            | 10,918          | 9,931           | 9,144           |
| Net interest income                                       | 15,410            | 15,410          | 14,929          | 15,177          |
| Provision for loan losses                                 | —                 | 100             | 200             | 50              |
| Net interest income after provision for loan losses       | 15,410            | 15,310          | 14,729          | 15,127          |
| Other income                                              | 5,984             | 6,314           | 5,918           | 5,874           |
| Operating expenses                                        | 14,116            | 14,192          | 13,157          | 13,369          |
| Income before provision for income taxes                  | 7,278             | 7,432           | 7,490           | 7,632           |
| Provision for income taxes                                | 2,432             | 2,602           | 2,615           | 2,686           |
| Net Income                                                | <u>\$ 4,846</u>   | <u>\$ 4,830</u> | <u>\$ 4,875</u> | <u>\$ 4,946</u> |
| Basic earnings per share                                  | <u>\$ .41</u>     | <u>\$ .41</u>   | <u>\$ .41</u>   | <u>\$ .42</u>   |
| Diluted earnings per share                                | <u>\$ .40</u>     | <u>\$ .40</u>   | <u>\$ .40</u>   | <u>\$ .40</u>   |

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Report of Independent  
Registered Public Accounting Firm

The Board of Directors and Stockholders  
OceanFirst Financial Corp.:

We have audited the accompanying consolidated statements of financial condition of OceanFirst Financial Corp. and subsidiary (the “Company”) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OceanFirst Financial Corp. and subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), and our report dated March 26, 2007 expressed an unqualified opinion on management’s assessment of, and an adverse opinion on the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Short Hills, New Jersey  
March 26, 2007

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Management Report on Internal Control  
Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting, as such term is defined in Rule 13a-15 (f) of the Exchange Act. The Company's internal control over financial reporting was designed to provide reasonable assurance regarding the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the Company's internal control over financial reporting as of December 31, 2006. This assessment was based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2006 due to the existence of the following material weakness identified by management: The Company's policies and procedures were not effective to provide for the proper evaluation and assessment of the adequacy of its reserve for repurchased loans at its mortgage banking subsidiary. Specifically, the Company lacked an effective process to ensure that the exercise of loan repurchase requests by purchasers of its loans were timely identified and incorporated properly in the analysis of its reserve for repurchased loans. This deficiency resulted in material misstatements in the Company's reserve for repurchased loans and amounts recorded as a gain on sales of loans, and resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim consolidated financial statements would not be prevented or detected. These misstatements have been corrected in the consolidated financial statements included elsewhere in this Form 10-K.

The Company's independent registered public accounting firm has issued an audit report on management's assessment of the Company's internal control over financial reporting. This report appears on page 39.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
OceanFirst Financial Corp.:

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting that OceanFirst Financial Corp. and subsidiary (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of the material weakness identified in management's assessment, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management of the Company is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment as of December 31, 2006: The Company's policies and procedures were not effective to provide for the proper evaluation and assessment of the adequacy of its reserve for repurchased loans at its mortgage banking subsidiary. Specifically, the Company lacked an effective process to ensure that the exercise of loan repurchase requests by purchasers of its loans were timely identified and incorporated properly in the analysis of its reserve for repurchased loans. This deficiency resulted in material misstatements in the Company's reserve for repurchased loans and amounts recorded as a gain on sales of loans, and resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim consolidated financial statements would not be prevented or detected.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of OceanFirst Financial Corp. and subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006. The aforementioned material weakness was considered in determining the nature, timing and extent of audit tests applied in our audit of the 2006 consolidated financial statements, and this report does not affect our report dated March 26, 2007, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, management's assessment that OceanFirst Financial Corp. and subsidiary did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**KPMG LLP**

Short Hills, New Jersey  
March 26, 2007

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
OceanFirst Financial Corp.:

We consent to incorporation by reference in the registration statement (No. 333-42088) on Form S-8, pertaining to the OceanFirst Financial Corp. 2000 Stock Option Plan, in the registration statement (No. 333-34143) on Form S-8, pertaining to the OceanFirst Financial Corp. 1997 Incentive Plan, and in the registration statement (No. 333-34145), on Form S-8, pertaining to the Retirement Plan for OceanFirst Bank, of OceanFirst Financial Corp., of our reports dated March 26, 2007, with respect to the consolidated statements of financial condition of OceanFirst Financial Corp. and subsidiary as of December 31, 2006 and 2005 and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, and the effectiveness of internal control over financial reporting as of December 31, 2006, which reports are incorporated by reference in the December 31, 2006 Annual Report on Form 10-K of OceanFirst Financial Corp.

Our report dated March 26, 2007, on management's assessment of the effectiveness of internal control over financial reporting and effectiveness of internal control over financial reporting as of December 31, 2006, expresses our opinion that OceanFirst Financial Corp. and subsidiary did not maintain effective internal control over financial reporting as of December 31, 2006 because the effect of a material weakness on the achievement of the objectives of the control criteria and contains an explanatory paragraph that states that the Company's policies and procedures were not effective to provide for the proper evaluation and assessment of the adequacy of its reserve for repurchased loans at its mortgage banking subsidiary. Specifically, the Company lacked an effective process to ensure that the exercise of loan repurchase requests by purchasers of its loans were timely identified and incorporated properly in the analysis of its reserve for repurchased loans. This deficiency resulted in material misstatements in the Company's reserve for repurchased loans and amounts recorded as a gain on sales of loans, and resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim consolidated financial statements would not be prevented or detected.

**KPMG LLP**

Short Hills, New Jersey  
March 26, 2007

**CERTIFICATION PURSUANT TO  
RULE 13a-14(a)/15d-14(a)**

I, John R. Garbarino, certify that:

1. I have reviewed this annual report on Form 10-K of OceanFirst Financial Corp. and subsidiary;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures or caused such disclosure controls to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
  - b. Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 27, 2007

/s/ John R. Garbarino  
John R. Garbarino  
Chief Executive Officer  
(principal executive officer)

**CERTIFICATION PURSUANT TO  
RULE 13a-14(a)/15d-14(a)**

I, Michael J. Fitzpatrick certify that:

1. I have reviewed this annual report on Form 10-K of OceanFirst Financial Corp. and subsidiary;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures or caused such disclosure controls to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
  - b. Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 27, 2007

/s/ Michael J. Fitzpatrick  
Michael J. Fitzpatrick  
Chief Financial Officer  
(principal financial officer)

**CERTIFICATION PURSUANT TO  
SECTION 1350**

In connection with the Annual Report of OceanFirst Financial Corp. and subsidiary (the "Company") on Form 10-K for the period ending December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned certify, pursuant to 18 U.S.C. §1350, as added by §906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

/s/ John R. Garbarino

John R. Garbarino  
Chief Executive Officer  
March 27, 2007

/s/ Michael J. Fitzpatrick

Michael J. Fitzpatrick  
Chief Financial Officer  
March 27, 2007