

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

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

For the transition period from to .

Commission file number: 001-11713

OceanFirst Financial Corp.

(Exact name of registrant as specified in its charter)

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

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)

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, a non-accelerated filer or a smaller reporting company. (Check one):

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐

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 \$205,356,402, 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 9, 2009 was 12,364,573.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Annual Report to Stockholders for the year ended December 31, 2008, are incorporated by reference into Part II of this Form 10-

K.

Portions of the Proxy Statement for the 2009 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

Table of Contents

INDEX		
PART I		<u>PAGE</u>
Item 1.	Business	1
Item 1A.	Risk Factors	33
Item 1B.	Unresolved Staff Comments	39
Item 2.	Properties	39
Item 3.	Legal Proceedings	39
Item 4.	Submission of Matters to a Vote of Security Holders	39
PART II		
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	39
Item 6.	Selected Financial Data	41
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	41
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	41
Item 8.	Financial Statements and Supplementary Data	41
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	41
Item 9A.	Controls and Procedures	41
Item 9B.	Other Information	42
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	42
Item 11.	Executive Compensation	42
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	42
Item 13.	Certain Relationships and Related Transactions and Director Independence	42
Item 14.	Principal Accountant Fees and Services	42
PART IV		
Item 15.	Exhibits and Financial Statement Schedules	43
Signatures		46

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. At December 31, 2008, the Company had consolidated total assets of \$1.9 billion and total stockholders’ equity of \$119.8 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 (“MBS”), securities issued by the U.S. Government and agencies thereof, corporate securities and other investments permitted by applicable law and regulations. On August 18, 2000 the Bank acquired Columbia Home Loans, LLC (“Columbia”), a mortgage banking company based in Westchester County, New York. As a mortgage banking subsidiary of the Bank, Columbia originated, sold and serviced a full product line of residential mortgage loans. Columbia sold virtually all loan production into the secondary market, except that the Bank often purchased adjustable-rate and fixed-rate mortgage loans originated by Columbia for inclusion in its loan portfolio. In September 2007, the Bank discontinued all of the loan origination activity of Columbia. The Bank retained Columbia’s loan servicing portfolio. The Bank 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, 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, 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 website address is 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 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

Table of Contents

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-two additional branch offices. Eighteen of the offices are located in Ocean County with four located in Monmouth County and one located in Middlesex County, New Jersey. 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. Lending activities are also supported by a loan production office in Kenilworth, New Jersey. The Bank also maintains a trust and wealth management office in Manchester, New Jersey.

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, 2008, the Bank had total loans outstanding of \$1.662 billion, of which \$1.039 billion or 62.5% of total loans were one-to-four family, residential mortgage loans. The remainder of the portfolio consisted of \$329.8 million of commercial real estate, multi-family and land loans, or 19.8% of total loans; \$10.6 million of real estate construction loans, or 0.7% of total loans; \$222.8 million of consumer loans, primarily home equity loans and lines of credit, or 13.4% of total loans; and \$59.8 million of commercial loans, or 3.6% of total loans. Included in total loans are \$3.9 million in loans held for sale at December 31, 2008. At that same date, 54.5% of the Bank's total loans had adjustable interest rates.

Table of Contents

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.

	At December 31,									
	2008		2007		2006		2005		2004	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
(Dollars in thousands)										
Real estate:										
One-to-four family	\$1,039,375	62.52%	\$1,084,687	64.20%	\$1,231,716	68.77%	\$1,187,226	69.83%	\$1,126,585	72.70%
Commercial real estate, multi-family and land	329,844	19.84	326,707	19.33	306,288	17.10	281,585	16.56	243,299	15.70
Construction	10,561	.65	10,816	.64	13,475	.75	22,739	1.34	19,189	1.23
Consumer (1)	222,797	13.40	213,282	12.62	190,029	10.61	146,911	8.64	99,279	6.41
Commercial	59,760	3.59	54,279	3.21	49,693	2.77	61,637	3.63	61,290	3.96
Total loans	<u>1,662,337</u>	<u>100.00%</u>	<u>1,689,771</u>	<u>100.00%</u>	<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>
Loans in process	(3,586)		(2,452)		(2,318)		(7,646)		(5,970)	
Deferred origination costs, net	5,195		5,140		5,723		4,596		3,888	
Unamortized discount, net	—		—		—		—		(4)	
Allowance for loan losses	<u>(11,665)</u>		<u>(10,468)</u>		<u>(10,238)</u>		<u>(10,460)</u>		<u>(10,688)</u>	
Total loans, net	<u>1,652,281</u>		<u>1,681,991</u>		<u>1,784,368</u>		<u>1,686,588</u>		<u>1,536,868</u>	
Less:										
Mortgage loans held for sale	<u>3,903</u>		<u>6,072</u>		<u>82,943</u>		<u>32,044</u>		<u>63,961</u>	
Loans receivable, net	<u>\$1,648,378</u>		<u>\$1,675,919</u>		<u>\$1,701,425</u>		<u>\$1,654,544</u>		<u>\$1,472,907</u>	
Total loans:										
Adjustable rate	\$ 906,674	54.54%	\$ 924,117	54.69%	\$ 885,342	49.43%	\$ 975,672	57.39%	\$ 849,034	54.79%
Fixed rate	<u>755,663</u>	<u>45.46</u>	<u>765,654</u>	<u>45.31</u>	<u>905,859</u>	<u>50.57</u>	<u>724,426</u>	<u>42.61</u>	<u>700,608</u>	<u>45.21</u>
	<u>\$1,662,337</u>	<u>100.00%</u>	<u>\$1,689,771</u>	<u>100.00%</u>	<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>

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

Table of Contents

Loan Maturity . The following table shows the contractual maturity of the Bank's total loans at December 31, 2008. The table does not include principal repayments. Principal repayments, including prepayments on total loans was \$410.8 million, \$561.6 million, and \$563.7 million for the years ended December 31, 2008, 2007 and 2006, respectively.

	At December 31, 2008					
	Commercial					
	One-to-four family	real estate, multi- family and land	Construction (In thousands)	Consumer	Commercial	Total Loans Receivable
One year or less	\$ 7,120	\$ 61,460	\$ 10,561	\$ 299	\$ 24,822	\$ 104,262
After one year:						
More than one year to three years	1,608	50,131	—	2,417	17,263	71,419
More than three years to five years	15,098	87,738	—	5,542	8,661	117,039
More than five years to ten years	127,389	88,451	—	29,751	5,514	251,105
More than ten years to twenty years	103,149	35,098	—	184,788	3,500	326,535
More than twenty years	785,011	6,966	—	—	—	791,977
Total due after December 31, 2009	1,032,255	268,384	—	222,498	34,938	1,558,075
Total amount due	<u>\$1,039,375</u>	<u>\$ 329,844</u>	<u>\$ 10,561</u>	<u>\$222,797</u>	<u>\$ 59,760</u>	1,662,337
Loans in process						(3,586)
Deferred origination costs, net						5,195
Allowance for loan losses						(11,665)
Total loans, net						1,652,281
Less: Mortgage loans held for sale						3,903
Loans receivable, net						\$1,648,378

Table of Contents

The following table sets forth at December 31, 2008, the dollar amount of total loans receivable contractually due after December 31, 2009, and whether such loans have fixed interest rates or adjustable interest rates.

	Due After December 31, 2009		
	Fixed	Adjustable (In thousands)	Total
Real estate loans:			
One-to-four family	\$374,004	\$658,251	\$1,032,255
Commercial real estate, multi-family and land	196,023	72,361	268,384
Consumer	132,010	90,488	222,498
Commercial	16,305	18,633	34,938
Total loans receivable	<u>\$718,342</u>	<u>\$839,733</u>	<u>\$1,558,075</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, sold virtually all loan production except that the Bank may have purchased adjustable-rate and fixed-rate mortgage loans originated by Columbia for inclusion in its loan portfolio. Based upon availability and best execution Columbia sold its loan production on both a servicing released and servicing retained basis.

In September 2007, the Bank discontinued all loan origination activity at Columbia. Columbia entered into loan sale agreements with investors in the normal course of business. The loan sale agreements may have required 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 have been 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 consisted of subprime and Alt-A mortgage loans which were made to individuals whose borrowing needs were generally not fulfilled by traditional loan products because they did not satisfy the credit documentation or other underwriting standards prescribed by conventional mortgage lenders and loan buyers. These mortgage loans were 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, 2007, Columbia originated \$241.0 million in total loans, of which \$38.6 million was in subprime loans, representing 16.0% of the total loans it originated. 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 these amounts were \$8.7 million and \$148.2 million for the years ended December 31, 2007 and 2006, respectively, 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. In March of 2007, Columbia discontinued the origination of subprime loans. For the year ended December 31, 2007, the Bank utilized \$15.5 million to repurchase loans from investors of which \$12.2 million were subsequently resold. At December 31, 2008, the Bank was holding subprime loans with a gross principal balance of \$5.3 million and a carrying value, net of reserves and lower of cost or market adjustment, of \$3.3 million. Also, at December 31, 2008, the Bank was holding Alt-A loans, originally originated by Columbia, with a gross principal balance of \$5.7 million and a carrying value, net of reserves and lower of cost or market adjustment, of \$4.9 million.

Table of Contents

At December 31, 2008 the Bank maintained a reserve for repurchased loans of \$1.1 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 representation 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 Bank considers recent and historical experience, product type and volume of recent whole loan sales and the general economic environment. Management believes that the Bank 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 Bank's control.

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, 2008 there were \$3.9 million in loans categorized as held for sale which are recorded at the lower of cost or fair market value.

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,		
	2008	2007 (In thousands)	2006
Total loans:			
Beginning balance	\$1,689,771	\$1,791,201	\$1,700,098
Loans originated:			
One-to-four family	252,899	487,289	900,595
Commercial real estate, multi-family and land	64,922	94,981	93,555
Construction	3,021	4,175	8,814
Consumer	79,236	166,158	225,663
Commercial	85,796	78,896	115,814
Total loans originated	485,874	831,499	1,344,441
Total	2,175,645	2,622,700	3,044,539
Loans repurchased from investors	968	15,495	—
Less:			
Principal repayments	410,783	561,621	563,707
Sales of loans	102,022	385,962	689,561
Transfer to REO	1,471	841	70
Total loans	<u>\$1,662,337</u>	<u>\$1,689,771</u>	<u>\$1,791,201</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, 2008, the Bank's total loans outstanding were \$1.662 billion, of which \$1.039 billion, or 62.5%, 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 \$188,000 at December 31, 2008. 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

Table of Contents

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 the first 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.

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, 2008 was \$172.9 million, or 16.7% of total one-to-four family mortgages.

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 some 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 weighted average loan-to-value ratio of the Bank's one-to-four family mortgage loans was 63% at December 31, 2008. 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.

Table of Contents

While the Bank obtains full verification of income on the majority of residential borrowers, it also originates stated income (no income verified) loans on a limited basis. The Bank currently offers stated income loans only to self-employed borrowers for purposes of financing primary residences and second home properties. In approving stated income loans, the Bank assesses the reasonableness of the stated income as compared with the borrower's profession. Borrowers for stated income loans generally require good to excellent credit profiles, lower loan-to-value ratios and a higher level of verified liquidity. The Bank currently offers stated income loans up to a maximum 75% loan to value for loan amounts up to \$500,000. To qualify under this product, the borrower must have a minimum FICO credit score of 680 and have liquid reserves equal to or greater than 20% of the loan amount. The Bank also offers stated income loans up to a maximum of 70% loan to value for loan amounts up to \$650,000. To qualify under this product, the borrower must show a minimum FICO credit score of 700 and have liquid reserves equal to or greater than 20% of the loan amount. The amount of stated income loans at December 31, 2008 was \$60.0 million, or 5.8% of total one-to-four family mortgages.

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 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. These margins have widened considerably during 2008, as Treasury rates declined to historical lows. 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 generally requires the personal guarantee of the principal for all commercial real estate loans. The Bank's commercial real estate loan portfolio at December 31, 2008 was \$329.8 million, or 19.8% of total loans. The largest commercial real estate loan in the Bank's portfolio at December 31, 2008 was a performing loan for which the Bank had an outstanding carrying balance of \$8.3 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, 2008 was approximately \$445,000.

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, 2008 the Bank had an outstanding balance in commercial construction loans of \$19.4 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, 2008 and 2007, totaled \$7.9 million and \$6.4 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,

Table of Contents

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, 2008, residential construction loans totaled \$10.6 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, 2008, the Bank had 22 residential construction loans, with the largest exposure relating to a \$1.5 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.

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, 2008, the Bank's consumer loans totaled \$222.8 million, or 13.4% of the Bank's total loan portfolio. Of that amount, home equity loans comprised \$132.2 million, or 59.3%; home equity lines of credit comprised \$90.0 million, or 40.4%; loans on savings accounts totaled \$191,000, or 0.1%; and automobile and overdraft line of credit loans totaled \$419,000 or 0.2%.

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 an 80% loan-to-value limitation, including any other outstanding mortgages or liens. 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. 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

Table of Contents

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 Bank currently maintains a 4.0% floor rate on new originations. The loans have an 18% lifetime cap on interest rate adjustments.

Commercial Lending . At December 31, 2008, commercial loans totaled \$59.8 million, or 3.6% 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 generally 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 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, 2008 was a performing loan with an outstanding balance of \$5.9 million which was secured by a first lien on all corporate assets. The average size of the Bank's commercial loans at December 31, 2008 was approximately \$129,000.

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 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. New borrowers with a total exposure in excess of \$3.0 million require approval by the Management Credit Committee. All borrowers with a total exposure in excess of \$7.0 million require approval by the Board of Directors. A minimum of two employees' signatures are required to approve residential loans over conforming loan limits. Pursuant to OTS regulations, loans to one borrower generally cannot exceed 15% of the Bank's unimpaired capital, which at December 31, 2008 amounted to \$22.9 million. At December 31, 2008, the Bank's maximum loan exposure to a single borrower was \$11.5 million, although the amount outstanding at December 31, 2008 was \$8.8 million. This relationship consists of five separate credit facilities secured by corporate assets, commercial real estate and equipment. All loans in this relationship are performing. The largest outstanding balance to a single borrower was \$10.8 million. This relationship consists of eight separate credit facilities all secured by commercial or residential real estate. All loans in this relationship are performing.

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 or Columbia. At December 31, 2008, the Bank was servicing \$977.4 million of loans for others. At December 31, 2008, 2007 and 2006 the balance of mortgage servicing rights totaled \$7.2 million, \$8.9 million and \$9.8 million, respectively. For the years ended December 31, 2008, 2007 and 2006, loan servicing income, net of related amortization totaled \$385,000, \$468,000

Table of Contents

and \$515,000, respectively. The Bank evaluates mortgage servicing rights for impairment on a quarterly basis. No impairment was recognized for the years ended December 31, 2008, 2007, and 2006. 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 received, additional letters and phone calls generally are made. In the case of residential mortgage loans, the Bank may offer to modify the terms or take other forbearance actions which afford the borrower an opportunity to remain in their home and satisfy the loan terms. The Bank plans to utilize the HOPE NOW loan modification reporting standards as well as the President's Homeowner Affordability and Stability Plan to mitigate foreclosure actions. HOPE NOW is an alliance between counselors, mortgage market participants and mortgage servicers to create a unified, coordinated plan to reach and help as many homeowners as possible. 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 litigation to realize on the collateral, including 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 Homeowner Affordability and Stability Plan's goal is to incent lenders to engage in sustainable mortgage modifications. The plan provides lenders with incentives to reduce rates on mortgages to a specified affordability level. The plan also provides access to low cost refinancing for responsible homeowners affected by falling home prices.

The Bank's internal Asset Classification Committee, which is chaired by the Chief Risk Officer, 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, 2008, the Bank had \$17.2 million of assets, including all REO, classified as "Substandard", \$14,300 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 \$9.0 million at December 31, 2008. Loans are classified as Special Mention due to past delinquencies or other identifiable weaknesses. The Substandard category includes two commercial loan relationships totaling \$4.0 million which became non-performing during 2008. The first loan relationship totals \$2.1 million and is adequately secured by commercial real estate collateral and personal guarantees. The second loan relationship totals \$1.9 million and is well-secured by commercial real estate collateral. The largest Special Mention relationship comprised several credit facilities to a large, real estate agency with an aggregate balance of \$3.3 million which was current as to payments, but criticized due to declining revenue and operating losses of the borrower. The loans are secured by commercial real estate and the personal guarantee of the principals. A second Special Mention relationship of \$3.2 million is outstanding to a leasing company. The loan is secured by commercial real estate, auto titles, other business assets and personal guarantees.

Table of Contents

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 five REO properties at December 31, 2008. 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, 2008, 2007, 2006, 2005 and 2004, 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 \$913,000, \$210,000, \$189,000, \$115,000 and \$128,000.

	2008	2007	December 31, 2006	2005	2004
	(Dollars in thousands)				
Non-accrual loans:					
Real estate:					
One-to-four family	\$ 8,696	\$ 6,620	\$ 2,703	\$ 1,084	\$ 1,337
Commercial real estate, multi-family and land	5,527	1,040	286	—	744
Consumer	1,435	586	281	299	784
Commercial	385	495	1,255	212	623
Total	16,043	8,741	4,525	1,595	3,488
REO, net(1)	1,141	438	288	278	288
Total non-performing assets	<u>\$17,184</u>	<u>\$ 9,179</u>	<u>\$ 4,813</u>	<u>\$ 1,873</u>	<u>\$ 3,776</u>
Allowance for loan losses as a percent of total loans receivable (2)	.70%	.62%	.57%	.62%	.69%
Allowance for loan losses as a percent of total non-performing loans (3)	72.71	119.76	226.25	655.80	306.42
Non-performing loans as a percent of total loans receivable (2)(3)	.97	.52	.25	.09	.23
Non-performing assets as a percent of total assets (3)	.92	.48	.23	.09	.20

(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.

The non-performing loan total includes \$1.4 million of repurchased one-to-four family and consumer loans and \$3.2 million of one-to-four family and consumer loans previously held for sale, which were written down to their fair market value. Of the \$4.6 million in loans written down to fair market value, \$4.0 million was subprime or Alt-A loans.

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.

Table of Contents

The allowance for loan losses is maintained at an amount management considers sufficient to provide for probable losses. The analysis considers known and inherent risks in the loan portfolio resulting from management's continuing review 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 loans which meet the definition of an impaired loan where the value of the underlying collateral can reasonably be evaluated. These are generally loans which are 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, 2008 and 2007, the Bank's allowance for loan losses was .70% and .62%, respectively, of total loans. The Bank had non-accrual loans of \$16.0 million and \$8.7 million at December 31, 2008 and 2007, respectively. The Bank will continue to monitor and modify its allowance for loan losses as conditions dictate.

Table of Contents

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				
	2008	2007	2006	2005	2004
			(Dollars in thousands)		
Balance at beginning of year	\$10,468	\$10,238	\$10,460	\$10,688	\$10,802
Charge-offs:					
Real Estate:					
One-to-four family	884	107	113	11	175
Commercial real estate, multi-family and land	—	—	—	—	—
Consumer	—	—	6	—	—
Commercial	—	370	450	673	312
Total	884	477	569	684	487
Recoveries	306	7	197	106	73
Net charge-offs	578	470	372	578	414
Provision for loan losses	1,775	700	150	350	300
Balance at end of year	\$11,665	\$10,468	\$10,238	\$10,460	\$10,688
Ratio of net charge-offs during the year to average net loans outstanding during the year	.03%	.03%	.02%	.04%	.03%

Table of Contents

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,														
	2008			2007			2006			2005			2004		
			Percent of Loans			Percent of Loans			Percent of Loans			Percent of Loans			Percent of Loans
	Percent of Allowance	in Each Category		Percent of Allowance	in Each Category		Percent of Allowance	in Each Category		Percent of Allowance	in Each Category		Percent of Allowance	in Each Category	
	Amount	to Total Allowance	to Total Loans	Amount	to Total Allowance	to Total Loans	Amount	to Total Allowance	to Total Loans	Amount	to Total Allowance	to Total Loans	Amount	to Total Allowance	to Total Loans
One- to- Four family	\$ 3,193	27.37%	62.52%	\$ 2,238	21.38%	64.20%	\$ 2,828	27.62%	68.77%	\$ 2,181	20.85%	69.83%	\$ 1,940	18.15%	72.70%
Commercial real estate, multi-family and land	3,580	30.69	19.84	3,547	33.88	19.33	3,034	29.64	17.10	3,080	29.44	16.56	3,895	36.44	15.70
Construction	52	0.45	0.65	63	.60	.64	84	.82	.75	113	1.08	1.34	144	1.35	1.23
Consumer	1,924	16.49	13.40	1,587	15.16	12.62	1,490	14.55	10.61	1,146	10.96	8.64	1,037	9.70	6.41
Commercial	1,442	12.36	3.59	1,329	12.70	3.21	1,324	12.93	2.77	1,909	18.25	3.63	1,970	18.43	3.96
Unallocated	1,474	12.64	—	1,704	16.28	—	1,478	14.44	—	2,031	19.42	—	1,702	15.93	—
Total	<u>\$11,665</u>	<u>100.00%</u>	<u>100.00%</u>	<u>\$10,468</u>	<u>100.00%</u>	<u>100.00%</u>	<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>

Table of Contents

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, the 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, 2008, all of the Bank's investment and mortgage-backed securities were classified as available for sale.

Investment Securities. As of December 31, 2008 investment securities primarily consisted of corporate debt securities which were issued by national and regional banks. The portfolio consisted of eleven \$5.0 million issues spread among eight issuers. Each security maintains an investment grade credit rating of BBB or better as rated by one of the internationally-recognized credit rating services. All of the financial institutions were considered well-capitalized and continue to make interest payments under the terms of the debt securities. No interest payments have been deferred. Based upon management's analysis, the financial institutions have the ability to meet debt service requirements for the foreseeable future. These floating rate securities were purchased during the period of 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 over LIBOR increased for new issuances of these types of securities causing a decline in the market price on the older issuances. In addition, the market for these types of securities has become increasingly illiquid and volatile in the current economic environment. Although these investment securities are available for sale, the Company has the intent and the ability to hold these securities until maturity or market recovery at which time the Company expects to receive the fully amortized cost.

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 the Federal Home Loan Mortgage Corporation ("FHLMC"), the Federal

Table of Contents

National Mortgage Association (“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 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 securities. At December 31, 2008, mortgage-backed securities totaled \$40.8 million, or 2.2% of total assets, and all were directly insured or guaranteed by FHLMC, FNMA and GNMA.

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

	For the Year Ended December 31,		
	2008	2007 (In thousands)	2006
Beginning balance	\$ 54,137	\$ 68,369	\$ 85,025
Mortgage-backed securities purchased	—	—	6,439
Less: Principal repayments	(13,431)	(14,653)	(17,117)
Amortization of premium	(72)	(197)	(353)
Sales	—	—	(6,389)
Change in net unrealized gain on mortgage-backed securities available for sale	167	618	764
Ending balance	<u>\$ 40,801</u>	<u>\$ 54,137</u>	<u>\$ 68,369</u>

Table of Contents

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,					
	2008		2007		2006	
	Amortized	Estimated	Amortized	Estimated	Amortized	Estimated
	Cost	Market Value	Cost	Market Value	Cost	Market Value
(In thousands)						
Mortgage-backed securities:						
FHLMC	\$ 9,593	\$ 9,687	\$ 11,845	\$ 11,862	\$ 14,726	\$ 14,649
FNMA	29,597	29,629	40,559	40,482	52,264	51,684
GNMA	1,407	1,485	1,696	1,793	1,960	2,036
Total mortgage-backed securities	<u>\$ 40,597</u>	<u>\$ 40,801</u>	<u>\$ 54,100</u>	<u>\$ 54,137</u>	<u>\$ 68,950</u>	<u>\$ 68,369</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,					
	2008		2007		2006	
	Amortized	Estimated	Amortized	Estimated	Amortized	Estimated
	Cost	Market Value	Cost	Market Value	Cost	Market Value
(In thousands)						
Investment securities:						
U.S. agency obligations	\$ 302	\$ 314	\$ 297	\$ 298	\$ 290	\$ 289
State and municipal obligations	150	150	1,747	1,756	1,747	1,768
Corporate debt securities	55,000	31,686	54,973	49,674	75,655	74,060
Equity investments	2,196	2,214	5,586	5,897	4,905	6,267
Total investment securities	<u>\$ 57,648</u>	<u>\$ 34,364</u>	<u>\$ 62,603</u>	<u>\$ 57,625</u>	<u>\$ 82,597</u>	<u>\$ 82,384</u>

Table of Contents

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, 2008. 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, 2008					Total	
	One Year or Less	More than One Year to Five Years	More than Five Years to Ten Years	More than Ten Years	Amortized	Estimated	
	Amortized Cost	Amortized Cost	Amortized Cost	Amortized Cost	Cost	Market Value	
(Dollars in thousands)							
Investment securities:							
U.S. agency obligations	\$ —	\$ 302	—	\$ —	\$ 302	\$ 314	
State and municipal obligations							
(1)	150	—	—	—	150	150	
Corporate debt securities (2)	—	—	—	55,000	55,000	31,686	
Total investment securities	<u>\$ 150</u>	<u>\$ 302</u>	<u>—</u>	<u>\$ 55,000</u>	<u>\$ 55,452</u>	<u>\$ 32,150</u>	
Weighted average yield	<u>2.83%</u>	<u>3.65%</u>	<u>—</u>	<u>3.78%</u>	<u>3.78%</u>		
Mortgage-backed securities:							
FHLMC	\$ 1	\$ 4	\$ 16	\$ 9,572	\$ 9,593	\$ 9,687	
FNMA	—	4	—	29,593	29,597	29,629	
GNMA	—	7	16	1,384	1,407	1,485	
Total mortgage-backed securities	<u>\$ 1</u>	<u>\$ 15</u>	<u>\$ 32</u>	<u>\$ 40,549</u>	<u>\$ 40,597</u>	<u>\$ 40,801</u>	
Weighted average yield	12.34%	12.14%	8.81%	4.89%	4.89%		

(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.

Table of Contents

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, 2008, time deposits constituted 31.4% 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,		
	2008	2007 (In thousands)	2006
Net (withdrawals) deposits	\$(36,030)	\$(124,410)	\$(16,844)
Interest credited on deposit accounts	26,372	35,872	32,604
Total (decrease) increase in deposit accounts	<u>\$ (9,658)</u>	<u>\$ (88,538)</u>	<u>\$ 15,760</u>

At December 31, 2008 the Bank had \$75.6 million in time deposits in amounts of \$100,000 or more maturing as follows:

<u>Maturity Period</u>	<u>Amount</u> (Dollars in thousands)	<u>Weighted Average Rate</u>
Three months or less	\$ 27,192	2.61%
Over three through six months	17,708	2.63
Over six through 12 months	17,733	3.11
Over 12 months	12,975	3.61
Total	<u>\$ 75,608</u>	<u>2.90</u>

Table of Contents

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,								
	2008			2007			2006		
	Average Balance	Percent of Total Average Deposits	Average Rate Paid	Average Balance	Percent of Total Average Deposits	Average Rate Paid	Average Balance	Percent of Total Average Deposits	Average Rate Paid
	(Dollars in thousands)								
Money market deposit accounts	\$ 84,605	6.49%	1.29%	\$ 94,374	7.10%	1.67%	\$ 117,935	8.59%	1.69%
Savings accounts	200,761	15.41	1.00	195,948	14.73	.99	219,879	16.02	.79
Interest-bearing checking accounts	500,540	38.42	1.94	435,433	32.74	2.60	379,997	27.69	2.16
Non-interest-bearing accounts	107,976	8.29	—	112,649	8.47	—	120,482	8.78	—
Total time deposits	408,870	31.39	3.42	491,465	36.96	4.42	534,056	38.92	4.02
Total average deposits	<u>\$1,302,752</u>	<u>100.00%</u>	<u>2.06</u>	<u>\$1,329,869</u>	<u>100.00%</u>	<u>2.75</u>	<u>\$1,372,349</u>	<u>100.00%</u>	<u>2.43</u>

Table of Contents

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 \$99.4 million which expires July 31, 2009. The Bank also has available from the FHLB-NY a one-month, overnight repricing line of credit for \$99.4 million which also expires on July 31, 2009. 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, 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, 2008, the Bank had \$83.9 million borrowed under the FHLB-NY lines of credit and \$276.0 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, 2008, the Bank had borrowed \$62.4 million through securities sold under agreements to repurchase.

The Bank can also borrow from the Federal Reserve Bank of Philadelphia (“Reserve Bank”) under the primary credit program. Primary credit is available on a short-term basis, typically overnight, at a rate above the Federal Open Market Committee’s Federal funds target rate. All extensions of credit by the Reserve Bank must be secured. At December 31, 2008, the Bank had no borrowings outstanding with the Reserve Bank.

Subsidiary Activities

At December 31, 2008 the Bank owned three subsidiaries – Columbia Home Loans, LLC (inactive), OceanFirst Services, LLC and OceanFirst REIT Holdings, LLC.

Columbia Home Loans, LLC was acquired by the Bank on August 18, 2000 and operated as a mortgage banking subsidiary based in Westchester County, New York. Columbia originated, sold and serviced a full product line of residential mortgage loans primarily in New York and New Jersey. Loans were originated through retail branches and a network of independent mortgage brokers and, to a lesser extent direct Internet sales. Columbia sold virtually all loan production in the secondary market or, to a lesser extent, to the Bank. In September 2007, the Bank discontinued all of the loan origination activity of Columbia, the offices were closed and all employees were either discharged or reassigned. The Bank retained Columbia’s loan servicing portfolio.

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, LLC. was established in 2007 and acts as the holding company for OceanFirst Realty Corp. OceanFirst REIT Holdings, LLC was converted to the corporate form of organization on January 1, 2009 and renamed OceanFirst REIT Holdings, Inc. 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.

[Table of Contents](#)

Personnel

As of December 31, 2008, the Bank had 361 full-time employees and 69 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 insured depository 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 and to ensure the safe and sound operation of the Bank. 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.

Table of Contents

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

Capital Purchase Program

On January 16, 2009, (the “Closing Date”), as part of the U.S. Department of the Treasury (the “Treasury”) Troubled Asset Relief Program (“TARP”) Capital Purchase Program, the Company entered into a Letter Agreement (“Letter Agreement”) and a Securities Purchase Agreement – Standard Terms attached thereto (“Securities Purchase Agreement”) with the Treasury, pursuant to which the Company agreed to issue and sell, and the Treasury agreed to purchase, (i) 38,263 shares (the “Preferred Shares”) of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of \$1,000 per share, and (ii) a ten-year warrant (the “Warrant”) to purchase up to 380,853 shares of the Company’s common stock, \$0.01 par value (“Common Stock”), at an exercise price of \$15.07 per share, for an aggregate purchase price of \$38,263,000 in cash. The issuance and sale of these securities was a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

Cumulative dividends on the Preferred Shares will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter, but will be paid only if, as and when declared by the Company’s Board of Directors. The Preferred Shares have no maturity date and rank senior to the Common Stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. Notwithstanding any provision in the Securities Purchase Agreement, the recently enacted American Recovery and Reinvestment Act of 2009 permits the Company, with the approval of the Secretary of the Treasury after consultation with the OTS, to redeem the preferred shares without regard to whether the Company has raised gross proceeds from a Qualified Equity Offering or any other source and without regard to any waiting period. In the event the Company would redeem the preferred shares, the Treasury must liquidate warrants at the current market price.

Table of Contents

The Treasury may not transfer a portion or portions of the Warrant with respect to, and/or exercise the Warrant for more than one-half of, the 380,853 shares of Common Stock issuable upon exercise of the Warrant, in the aggregate, prior to December 31, 2009. In the event the Company elects to redeem the Preferred Shares prior to December 31, 2009, the number of the shares of Common Stock underlying the portion of the Warrant then held by the Treasury will be reduced by one-half of the shares of Common Stock originally covered by the Warrant. Unless both the holder and the Company agree otherwise, the exercise of the Warrant will be a net exercise (i.e., the holder does not pay cash but gives up shares with a market value at the time of exercise equal to the exercise price, resulting in a net settlement with significantly fewer than the 380,853 shares of Common Stock being issued).

The Securities Purchase Agreement, pursuant to which the Preferred Shares and the Warrant were sold, contains limitations on the payment of dividends on the Common Stock (including with respect to the payment of cash dividends in excess of \$0.20 per share, which was the amount of the last regular dividend declared by the Company prior to October 14, 2008) and on the Company's ability to repurchase its Common Stock and repurchase or redeem its trust preferred securities, and subjects the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 ("EESA"). As a condition to the closing of the transaction, each of Messrs. John R. Garbarino, Vito R. Nardelli, Michael J. Fitzpatrick, Joseph R. Iantosca, Joseph J. Lebel III and John K. Kelly, the Company's Senior Executive Officers (as defined in the Securities Purchase Agreement) (the "Senior Executive Officers"), (i) executed a waiver (the "Waiver") voluntarily waiving any claim against the Treasury or the Company for any changes to such Senior Executive Officer's compensation or benefits that are required to comply with the regulation issued by the Treasury under the TARP Capital Purchase Program and acknowledging that the regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements and policies and agreements (including so-called "golden parachute" agreements) (collectively, "Benefit Plans") as they relate to the period the Treasury holds any equity or debt securities of the Company acquired through the TARP Capital Purchase Program; and (ii) entered into a senior executive officer agreement ("Senior Executive Officer Agreement") with the Company amending the Benefit Plans with respect to such Senior Executive Officer as may be necessary, during the period that the Treasury owns any debt or equity securities of the Company acquired pursuant to the Securities Purchase Agreement or the Warrant, to comply with Section 111(b) of the EESA.

The Securities Purchase Agreement and all related documents may be amended unilaterally by the Treasury to the extent required to comply with any changes in applicable federal statutes after the execution thereof.

On October 20, 2008, the U.S. Department of the Treasury issued an interim final rule (the "Initial Rule") which requires that the compensation committee of every TARP participant must promptly after, and in no event more than 90 days after, completion of the CPP investment, and annually thereafter, review with senior risk officers the compensation arrangements of senior executive officers ("SEO") to ensure that such arrangements do not encourage SEOs to take unnecessary and excessive risks and to discuss and review the relationship between risk management policies and SEO incentive compensation. The compensation committee must certify that it has completed the reviews of the SEO compensation set forth above and provide such certification in the proxy statement of the company. In addition, a TARP participant must: require that SEO bonus and incentive compensation paid during the period that the Treasury holds an equity or debt position acquired under the CPP be subject to recovery or "clawback" by the financial institution if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria; prohibit any "golden parachute payments" within the meaning of section 111(b) of EESA; and forgo income tax deductions for compensation deductions for payments to SEOs that would be prohibited by section 162(m)(5) of the Internal Revenue Code if that section applied to the TARP participant. Code section 162(m)(5) generally limits to \$500,000 the deduction for compensation paid to certain executives.

On January 16, 2009, the U.S. Department of the Treasury released an interim final rule (the "Proposed

Table of Contents

Rule”) to provide additional requirements and guidance for all institutions receiving TARP funds under the CPP. The Proposed Rule amends and supplements the Initial Rule, which remains in effect. The Proposed Rule requires new CEO certifications as to compliance with the executive compensation limitations and provides a few clarifications to the Initial Rule. The Proposed Rule will be effective upon publication in the Federal Register. However, it is not known at this point when the Proposed Rule will be effective because of the Obama administration directive on January 20, 2009, suspending Federal Register publication of all rulemaking until review and approval by President Obama’s designees. The final form of the Proposed Rule will probably be revised to reflect the legislation described in the following paragraph.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (“ARRA”), which amended the executive compensation provisions found in section 111 of EESA. Under ARRA, each TARP recipient will be subject to standards established by the Secretary of the Treasury and the provisions of section 162(m)(5) of the Internal Revenue code, which generally limit deductions for senior executive compensation to \$500,000. The standards established by the Secretary must include the following restrictions that apply during the period in which any obligation arising from financial assistance provided under TARP remains outstanding: (i) limits on compensation that exclude incentives for senior executive officers of TARP recipients to take unnecessary and excessive risks that threaten the value of such recipient; (ii) a provision for recovery of any bonus, retention award or incentive compensation paid to a senior executive officer and any of the next 20 most highly-compensated employees of the TARP recipient based on statements of earnings, revenues, gains or other criteria later found to be materially inaccurate; (iii) a prohibition on such TARP recipient from paying any golden parachute payment to a senior executive officer and any of the next 5 most highly-compensated employees of the TARP recipient; (iv) a prohibition on such TARP recipient paying or accruing any bonus, retention award or incentive compensation, except for the payment of long-term restricted stock that does not fully vest during the period in which any financial assistance provided to the TARP recipient remains outstanding, has a value that is not greater than $\frac{1}{3}$ the total annual compensation of the employee receiving the stock, and is subject to such other terms as determined by the Secretary; (v) a prohibition on any compensation that would encourage the manipulation of the reported earnings of the TARP recipient to enhance compensation of any employee and (vi) a requirement for the establishment of a Board Compensation Committee that meets the requirements set forth below. The restrictions in (iv) above apply to such numbers of officers and employees of the TARP recipient depending on the amount of financial assistance received. In the case of the Company, the restriction would apply to the 5 most highly-compensated employees of the Company. This restriction does not apply to any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009. The chief executive officer and chief financial officer of the Company must provide a written certification of compliance by the TARP recipient with the requirements described above, which must be filed with the SEC.

Under ARRA, the Company must establish a Board Compensation Committee comprised entirely of independent directors. The Company’s Human Resources/Compensation Committee complies with this requirement. Such Committee must meet at least semi-annually to discuss and evaluate employee compensation plans in light of any proposed risk to the TARP recipient from such plans. The Board must develop a company-wide policy regarding excessive or luxury expenditures, including expenditures on entertainment or events, office and facility renovations, aviation and other transportation services or other defined activities or events.

Any proxy statement distributed during the period in which any obligations arising from financial assistance provided to the TARP recipient remains outstanding shall permit a separate shareholder vote to approve the compensation of executives, as disclosed pursuant to the rules of the SEC. The shareholder vote shall not be binding on the Board and may not be construed as overruling a decision by the Board, nor create or imply any additional fiduciary duty on the Board, nor shall such vote be construed to restrict or limit the ability of shareholders to make proposals for inclusion in the proxy materials related to executive compensation.

The Secretary shall review the bonus, retention awards and other compensation paid to the senior executive officers and the next 20 most highly compensated employees of each entity receiving TARP assistance before the date of the ARRA to determine if such payments were inconsistent with the purposes of the TARP or otherwise contrary to the public interest. If the Secretary determines that

Table of Contents

payments are inconsistent with the purposes of TARP or are contrary to the public interest, the Secretary shall negotiate with the TARP recipient and the employee for reimbursement to the Federal government with respect to compensation and bonuses.

On February 25, 2009 the Treasury announced terms of its Capital Assistance Program (“CAP”) under which the Treasury will make additional capital available to the banking system in the form of cumulative mandatorily convertible preferred stock. The preferred shares would pay a cumulative dividend at the rate of 9% per year and would be convertible into common stock at a price equal to 90% of the average closing price for the 20 trading day period ending February 9, 2009. The preferred shares would mandatorily convert to common stock after seven years. The Treasury would also receive a warrant to purchase common stock with an aggregate market price equal to 20 percent of the preferred stock investment. The Company has the option to exchange its existing Preferred Shares for the new convertible preferred security.

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 Core (Tier 1) 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 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.

Table of Contents

The following table presents the Bank's capital position at December 31, 2008. The Bank met each of its capital requirements at that date.

	Actual Capital	Required Capital	Excess Amount	Capital	
				Actual Percent	Required Percent
(Dollars in thousands)					
Tangible	\$152,445	\$ 28,219	\$124,226	8.10%	1.50%
Core (Leverage)	152,445	75,251	77,194	8.10	4.00
Risk-based	162,868	103,058	59,810	12.64	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. Deposit accounts at the Bank are insured by the Deposit Insurance Fund (DIF) of the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits, therefore, are subject to FDIC deposit insurance assessments and the FDIC has adopted a risk-based system for determining deposit insurance assessments.

This assessment is based on the risk category of the institution and currently ranges from 5 to 43 basis points of the institution's deposits. Federal law requires that the designated reserve ratio for the deposit insurance fund be established by the FDIC at 1.15% to 1.50% of estimated insured deposits. If this reserve ratio drops below 1.15% or the FDIC expects that it will do so within six months, the FDIC must, within 90 days, establish and implement a plan to restore the designated reserve ratio to 1.15% of estimated insured deposits within five years (absent extraordinary circumstances).

Recent bank failures coupled with deteriorating economic conditions have significantly reduced the deposit insurance fund's reserve ratio. As of June 30, 2008, the designated reserve ratio was 1.01% of estimated insured deposits at March 31, 2008. As a result of this reduced reserve ratio, on October 16, 2008, the FDIC published a proposed rule that would restore the reserve ratio to its required level of 1.15 percent within five years. On February 27, 2009, the FDIC took action to extend the restoration plan horizon to seven years.

The amended restoration plan was accompanied by a final rule that sets assessment rates and makes

Table of Contents

adjustments that improve how the assessment system differentiates for risk. Currently, most banks are in the best risk category and pay anywhere from 12 to 14 cents per \$100 of deposits for insurance. Under the final rule, banks in this category will pay initial base rates ranging from 12 to 16 cents per \$100 on an annual basis, beginning on April 1, 2009.

The FDIC also adopted an interim rule imposing a 20 basis point emergency special assessment on the industry on June 30, 2009. The assessment is to be collected on September 30, 2009. The interim rule would also permit the FDIC to impose an emergency special assessment after June 30, 2009, of up to 10 basis point if necessary to maintain public confidence in federal deposit insurance.

On October 3, 2008, Congress temporarily increased deposit insurance from \$100,000 to \$250,000 per insured depositor. On October 14, 2008, the FDIC provided for unlimited coverage for non-interest bearing transaction accounts at participating banks. The Bank has elected to participate in this program. The increased deposit coverage is currently scheduled to expire on December 31, 2009 and will return to \$100,000 for all deposit categories, except for IRAs and certain retirement accounts that will continue to be insured up to \$250,000 as described above.

The FDIC may terminate the insurance of an institution's deposits 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. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Under the Deposit Insurance Funds Act of 1996 ("Funds Act"), the assessment base for the payments on bonds issued in the late 1980's by the Financing Corporation ("FICO") to recapitalize the now defunct Federal Savings and Loan Insurance Corporation was expanded to include, beginning January 1, 1997, the deposits of certain insured institutions, including the Bank. The bonds issued by FICO are due to mature in 2017 through 2019. The FICO payments are in addition to the deposit insurance assessment.

The total expense incurred in 2008 for the deposit insurance assessment and the FICO payments was \$644,000. The FDIC has approved a One-Time Assessment Credit to institutions that were in existence on December 31, 1996 and paid deposit insurance assessments prior to that date, or are a successor to such an institution. The Bank was entitled to a One-Time Assessment Credit of \$1.3 million which was used to offset part of the 2007 and 2008 calendar year deposit insurance assessment, excluding the FICO payments with \$687,000 of the credit applied to the 2008 calendar year deposit insurance assessment.

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, 2008, the Bank's limit on loans to one borrower was \$22.9 million. At December 31, 2008, the Bank's maximum loan exposure to a single borrower was \$11.5 million, although the amount outstanding at December 31, 2008 was \$8.8 million. The largest outstanding balance to a single borrower was \$10.8 million.

Qualified Thrift Lender 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, 2008, the Bank met the qualified thrift lender test.

Table of Contents

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. If the OTS objects to the Bank’s notice to pay a dividend to the Company, the Company may not have the liquidity necessary to pay a dividend in the future, pay a dividend at the same rate as historically paid, be able to repurchase stock, or to meet current debt obligations.

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, as well as the institution’s regulatory rating and complexity component. The assessments paid by the Bank for the fiscal year ended December 31, 2008 totaled \$460,000.

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.

Table of Contents

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 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 0.20% 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, 2008 of \$20.9 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 depository institutions to maintain 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 \$34.1 million; a 10% reserve ratio is applied above \$51.9 million. The first \$9.3 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 2008 taxable year, the Bank is subject to a maximum Federal income tax rate of 35%.

Table of Contents

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 distribution 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, the Bank is subject to a tax rate of 9% of taxable income. 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 Bank was also subject to an Alternative Minimum Assessment (AMA) tax based on the larger of gross receipts or gross profits, as defined, from 2002 through 2006. This tax expired in 2007.

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.

New York Taxation. The Bank, through Columbia, 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.

Table of Contents

Item 1A. Risk Factors

Difficult market conditions have adversely affected the industry. The Bank is exposed to downturns in the U.S. housing market. Dramatic declines in the national housing market over the past year, with falling home prices and increasing foreclosures, unemployment and under-employment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities, major commercial and investment banks, and regional and community financial institutions such as the Company. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. The continuing economic pressure on consumers and lack of confidence in the financial markets may adversely affect the Company's business, financial condition and results of operations. The difficult conditions in the financial markets are not likely to improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on the Company and others in the financial institutions industry. In particular, the Company may face the following risks in connection with these events:

- The Company's stock price could be negatively impacted by these events and could remain under pressure until a market recovery is under way.
- Increased regulation of the industry. Compliance with such regulation may increase costs and limit the Company's ability to pursue business opportunities.
- The process used to estimate losses inherent in the Company's credit exposure requires subjective and complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of borrowers to repay their loans. The level of uncertainty concerning economic conditions may adversely affect the accuracy of estimates which may, in turn, impact the reliability of the financial statements.
- Increased levels of nonperforming loans and loan losses may negatively impact earnings.
- The Company may be required to pay significantly higher FDIC deposit premiums because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.
- Consumer confidence in financial institutions is deteriorating, which could lead to declines in deposit totals and impact liquidity.

A continued downturn in the local economy or 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. Prior to 2008 there was a significant increase in real estate values in the Bank's market area. During 2008, there has been a weakening in the local economy coupled with declining real estate values. A further decline in real estate values could cause some residential and commercial mortgage loans to become inadequately collateralized, which would expose the Bank to a greater risk of loss.

Changes in interest rates could adversely affect results of operations and financial condition. The Bank's ability to make a profit largely depends on net interest income, which could be negatively affected by changes in interest rates. The interest income earned on interest-earning assets and the interest expense paid on interest-bearing liabilities are generally fixed for a contractual period of time. Interest-bearing liabilities generally have shorter contractual maturities than interest-earning assets. This imbalance can create significant earnings volatility, because market interest rates change over time. In a period of rising interest rates, the interest income earned on interest-earning assets may not increase as rapidly as the interest paid on interest-bearing liabilities.

Table of Contents

In addition, changes in interest rates can affect the average life of loans and mortgage-backed and related securities. A reduction in interest rates causes increased prepayments of loans and mortgage-backed and related securities as borrowers refinance their debt to reduce their borrowing costs. This creates reinvestment risk, which is the risk that the Bank may not be able to reinvest the funds from faster prepayments at rates that are comparable to the rates earned on the prepaid loans or securities. Conversely, an increase in interest rates generally reduces prepayments. Additionally, increases in interest rates may decrease loan demand and/or make it more difficult for borrowers to repay adjustable-rate loans.

Changes in interest rates also affect the current market value of the interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. Unrealized net losses on securities available for sale are reported as a separate component of equity. To the extent interest rates increase and the value of the available-for-sale portfolio decreases, stockholders' equity will be adversely affected.

Continued capital and credit market volatility may adversely affect the Company's ability to access capital and may have a material adverse effect on the Company's business, financial condition and results of operations. The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. The markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers' underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that the Company will not experience an adverse effect, which may be material, on the Company's ability to access capital. Additionally, the Company's business, financial condition and results of operations may be adversely affected.

Changes in the fair value of securities may reduce stockholder's equity and net income. At December 31, 2008, the Company maintained a securities portfolio of \$75.2 million all of which was classified as available for sale. The estimated fair value of the available for sale securities portfolio may increase or decrease depending on the credit quality of the underlying issuer, market liquidity, changes in interest rates and other factors. Stockholder's equity is increased or decreased by the amount of the change in the unrealized gain or loss (difference between the estimated fair value and the amortized cost) of the available for sale securities portfolio, net of the related tax benefit, under the category of accumulated other comprehensive income/loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholder's equity, as well as book value per common share. The decrease will occur even though the securities are not sold.

The Company conducts a periodic review and evaluation of the securities portfolio to determine if the decline in the fair value of any security below its cost basis is other-than-temporary. Factors which are considered in the analysis include, but are not limited to, the severity and duration of the decline in fair value of the security, the financial condition and near-term prospects of the issuer, whether the decline appears to be related to issuer conditions or general market or industry conditions, the intent and ability to retain the security for a period of time sufficient to allow for any anticipated recovery in fair value and the likelihood of any near-term fair value recovery. If such decline is deemed to be other-than-temporary, the security is written down to a new cost basis and the resulting loss is charged to earnings as a component of non-interest income.

At December 31, 2008, the securities available for sale portfolio included corporate debt securities issued by national and regional banks. The portfolio consisted of eleven \$5,000,000 issues spread among eight issuers. At December 31, 2008, the securities had a book value of \$55.0 million and an estimated fair value of \$31.7 million. The Company may be required to recognize an other-than-temporary impairment charge related to these securities if the fair values do not recover in the near future.

The Company owns stock of the Federal Home Loan Bank of New York (FHLB-NY). The aggregate cost and fair value of the FHLB-NY common stock as of December 31, 2008 was \$20.9 million based on

Table of Contents

its par value. There is no market for the FHLB-NY common stock. The banks within the Federal Home Bank System may be subject to accounting rules and asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the FHLB-NY, could be substantially diminished or reduced to zero. Consequently, there is a risk that the Company's investment in FHLB-NY common stock could be deemed other-than-temporarily impaired at some time in the future, and if this occurs, it would cause earnings and stockholders' equity to decrease by the after-tax amount of the impairment charge.

Increased emphasis on commercial lending may expose the Bank to increased lending risks. At December 31, 2008, \$389.6 million, or 23.4%, 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.

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 Bank 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 Bank's subsidiary, Columbia, entered into loan sale agreements with investors in the normal course of business through 2007. The loan sale agreements generally required 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. The Bank 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 September 2007, all loan origination activity at Columbia was discontinued. A portion of Columbia's loan production consisted of "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 March 2007, Columbia discontinued the origination of subprime loans. In the event the Bank is required to repurchase a significant amount of subprime loans, the Bank 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 many 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

Table of Contents

its allowance for loan losses which would reduce earnings for that period. The Bank has entered into settlements with some investors which may limit the Bank's obligation to repurchase mortgage loans for an early payment default or a breach of a representation or warranty.

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 has continued to expand its presence within the market area through de novo branching, although no new branches are planned in 2009. 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.

Deposit insurance assessments will increase substantially, which will adversely affect profits. Federal Deposit Insurance Corporation deposit insurance expense for the year ended December 31, 2008 was \$644,000. This assessment is based on the risk category of the institution and currently ranges from 5 to 43 basis points of the institution's deposits. Federal law requires that the designated reserve ratio for the deposit insurance fund be established by the FDIC at 1.15% to 1.50% of estimated insured deposits. If this reserve ratio drops below 1.15% or the FDIC expects that it will do so within six months, the FDIC must, within 90 days, establish and implement a plan to restore the designated reserve ratio to 1.15% of estimated insured deposits within five years (absent extraordinary circumstances).

Recent bank failures coupled with deteriorating economic conditions have significantly reduced the deposit insurance fund's reserve ratio. As of June 30, 2008, the designated reserve ratio was 1.01% of estimated insured deposits as March 31, 2008. As a result of this reduced reserve ratio, on December 22, 2008, the FDIC published a final rule raising the current deposit insurance assessment rates uniformly for all institutions by seven basis points (to a range from 12 to 50 basis points) for the first quarter of 2009. On February 27, 2009, the FDIC adopted a final rule under which banks in the best risk category will pay initial base rates ranging from 12 to 16 cents per \$100 on an annual basis, beginning on April 1, 2009.

The FDIC also adopted an interim rule imposing a 20 basis point emergency special assessment on the industry on June 30, 2009. The assessment is to be collected on September 30, 2009. The interim rule would also permit the FDIC to impose an emergency special assessment after June 30, 2009, of up to 10 basis point if necessary to maintain public confidence in federal deposit insurance.

In addition, the Emergency Economic Stabilization Act of 2008 temporarily increased the limit on FDIC insurance coverage for deposits to \$250,000 through December 31, 2009, and the FDIC took action to provide coverage for newly-issued senior unsecured debt and non-interest bearing transaction accounts in excess of the \$250,000 limit, for which institutions will be assessed additional premiums.

These actions will significantly increase the Company's non-interest expense in 2009 and in future years as long as the increased premiums are in place.

Recently enacted legislation and other measures undertaken by the Treasury, the Federal Reserve and other governmental agencies may not help stabilize the U.S. financial system or improve the housing market. On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "EESA"), which, among other measures, authorized the Treasury Secretary to establish the Troubled Asset Relief Program ("TARP"). EESA gives broad authority to Treasury to purchase, manage, modify, sell and insure the troubled mortgage related assets that triggered the current economic crisis as well as other "troubled assets." EESA includes additional provisions directed at bolstering the economy, including:

- Authority for the Federal Reserve to pay interest on depository institution balances;

Table of Contents

- Mortgage loss mitigation and homeowner protection;
- Temporary increase in Federal Deposit Insurance Corporation insurance coverage from \$100,000 to \$250,000 through December 31, 2009; and
- Authority to the Securities and Exchange Commission to suspend mark-to-market accounting requirements for any issuer or class of category of transactions.

Pursuant to the TARP, the Treasury has the authority to, among other things, purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. Under the TARP, the Treasury has created the Capital Purchase Program, pursuant to which it is providing access to capital to financial institutions through a standardized program to acquire preferred stock (accompanied by warrants) from eligible financial institutions that will serve as Tier 1 capital.

EESA also contains a number of significant employee benefit and executive compensation provisions, some of which apply to employee benefit plans generally, and others which impose on financial institutions that participate in the TARP program restrictions on executive compensation.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (“ARRA”) which, among other things, amended the executive compensation restrictions of EESA. See “Regulation and Supervision – Capital Purchase Program” for a discussion of the additional restrictions imposed on executive compensation from EESA and ARRA.

Numerous actions, in addition to the EESA, have been taken by the Federal Reserve, Congress, Treasury, the SEC and others to address the liquidity and credit crisis that has followed the sub-prime meltdown that commenced in 2007. These measures include homeowner relief that encourage loan restructuring and modification; the establishment of significant liquidity and credit facilities for financial institutions and investment banks; the lowering of the federal funds rate; emergency action against short selling practices; a temporary guaranty program for money market funds; the establishment of a commercial paper funding facility to provide back-stop liquidity to commercial paper issuers; coordinated international efforts to address illiquidity and other weaknesses in the banking sector.

In addition, the Internal Revenue Service has issued an unprecedented wave of guidance in response to the credit crisis, including a relaxation of limits on the ability of financial institutions that undergo an “ownership change” to utilize their pre-change net operating losses and net unrealized built-in losses. The relaxation of these limits may make it significantly more attractive to acquire financial institutions whose tax basis in their loan portfolios significantly exceeds the fair market value of those portfolios.

On October 14, 2008, the FDIC announced the establishment of a Temporary Liquidity Guarantee Program to provide insurance for all non-interest bearing transaction accounts and guarantees of certain newly issued senior unsecured debt issued by financial institutions (such as the Bank), bank holding companies and savings and loan holding companies (such as the Company). Financial institutions were automatically covered by this program for the 30-day period commencing October 14, 2008 and continue to be covered as long as they did not affirmatively opt out of the program. Under the program, senior unsecured debt issued on or before June 30, 2009 will be insured in the event the issuing institution subsequently fails, or its holding company files for bankruptcy. The debt includes all newly issued unsecured senior debt (e.g., promissory notes, commercial paper and inter-bank funding). The aggregate coverage for an institution may not exceed 125% of its debt outstanding on December 31, 2008 that was scheduled to mature before June 30, 2009. The guarantee will extend to June 30, 2012 even if the maturity of the debt is after that date. The Company did not opt out of the program and therefore is covered by these provisions.

Table of Contents

The actual impact that EESA, ARRA and the President's Homeowner Affordability and Stability Plan, undertaken to alleviate the credit crisis, will have generally on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced, is unknown. The failure of such measures to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect the Company's business, financial condition, results of operations, access to credit or the trading price of the Company's common stock.

Because of participation in the Troubled Asset Relief Program, the Company is subject to several restrictions including restrictions on the ability to declare or pay dividends and repurchase shares as well as restrictions on compensation paid to executives. On January 16, 2009, the Company issued to the U.S. Department of the Treasury, as the initial selling securityholder, series A preferred stock. Pursuant to the terms of the Purchase Agreement, the Company's ability to declare or pay dividends on any of its shares is limited. Specifically, the Company is unable to declare dividend payments on common, junior preferred or *pari passu* preferred shares if the Company is in arrears on the dividends on the series A preferred stock. Further, the Company is not permitted to increase dividends on common stock above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 without the initial selling security holder's approval until the third anniversary of the investment unless all of the series A preferred stock has been redeemed or transferred. In addition, the ability to repurchase shares is restricted. The initial selling security holder's consent generally is required to make any stock repurchase until the third anniversary of the investment by the initial selling security holder unless all of the series A preferred stock has been redeemed or transferred. Further, common, junior preferred or *pari passu* preferred shares may not be repurchased if the Company is in arrears on the series A preferred stock dividends.

In addition, pursuant to the terms of the Purchase Agreement, the Company adopted the initial selling security holder's standards for executive compensation and corporate governance for the period during which the initial selling security holder holds the equity issued pursuant to the Purchase Agreement, including the common stock which may be issued pursuant to the warrant. These standards generally apply to the Chief Executive Officer, Chief Financial Officer and the three next most highly compensated senior executive officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive. In particular, the change to the deductibility limit on executive compensation will likely increase the overall cost of compensation programs in future periods in which the TARP preferred stock remains outstanding.

Under ARRA, the Secretary of the Treasury is to adopt regulations which amend the executive compensation limitations set forth above. These regulations must include the following restrictions that apply during the period in which any obligation arising from financial assistance provided under TARP remains outstanding: (i) limits on compensation that exclude incentives for senior executive officers of TARP recipients to take unnecessary and excessive risks that threaten the value of such recipient; (ii) a provision for recovery of any bonus, retention award or incentive compensation paid to a senior executive officer and any of the next 20 most highly-compensated employees of the TARP recipient based on statements of earnings, revenues, gains or other criteria later found to be materially inaccurate; (iii) a prohibition on such TARP recipient from paying any golden parachute payment to a senior executive officer and any of the next 5 most highly-compensated employees of the TARP recipient; (iv) a prohibition on such TARP recipient paying or accruing any bonus, retention award or incentive compensation, except for the payment of long-term restricted stock that does not fully vest during the period in which any financial assistance provided to the TARP recipient remains outstanding, has a value that is not greater than $\frac{1}{3}$ the total annual compensation of the employee receiving the stock, and is subject to such other terms as determined by the Secretary; (v) a prohibition on any compensation that would encourage the manipulation of the reported earnings of the TARP recipient to enhance compensation of any employee and (vi) a requirement for the establishment of a Board Compensation

Table of Contents

Committee that meets the requirements set forth below. The restrictions in (iv) above apply to the 5 most highly compensated employees of the Company. This restriction does not apply to any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009. The chief executive officer and chief financial officer of the Company must provide a written certification of compliance by the TARP recipient with the requirements described above, which must be filed with the SEC.

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 OTS and by the FDIC, as insurer of deposits. 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.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

The Bank conducts its business through its administrative office, which includes a branch office, and 22 other full service offices located in Ocean, Monmouth and Middlesex Counties, and through a loan production office and a trust and wealth management office.

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, 2003 through December 31, 2008. The graph may not be indicative of possible future performance of the Company's common stock.

Table of Contents



	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
OceanFirst Financial Corp.	100.00	93.96	89.82	93.70	67.68	74.56
All Nasdaq US Stocks	100.00	108.84	111.16	122.11	132.42	63.80
SNL Thrift Index	100.00	108.32	109.05	123.41	71.38	44.11

Notes:

- The lines represent annual index levels derived from compounded daily returns that include all dividends.
- The indexes are reweighted daily, using the market capitalization on the previous trading day.
- If the annual interval, based on the fiscal year end, is not a trading day, the preceding trading day is used.
- The index level for all series was set to \$100 on 12/31/02.

For the years ended December 31, 2008 and 2007, the Company paid an annual cash dividend of \$.80 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 2008 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, 2008 is as follows:

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</u>
October 1, 2008 through October 31, 2008	-0-	—	-0-	489,062
November 1, 2008 through November 30, 2008	-0-	—	-0-	489,062
December 1, 2008 through December 31, 2008	-0-	—	-0-	489,062

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

Table of Contents

Item 6. Selected Financial Data

The above-captioned information appears under “Selected Consolidated Financial and Other Data of the Company” in the Registrant’s 2008 Annual Report to Stockholders on pages 7 and 8 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 2008 Annual Report to Stockholders on pages 9 through 21 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 2008 Annual Report to Stockholders on pages 19 through 21 and is incorporated herein by reference.

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 2008 Annual Report to Stockholders on pages 22 through 40 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 effective. Disclosure controls and procedures are the controls and other procedures that are designed to ensure that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (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.

There were no changes in the Company’s internal control over financial reporting for the year ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

(b) Management Report on Internal Control Over Financial Reporting. The Management Report on Internal Control over Financial Reporting and the Report of Independent Registered Public Accounting Firm appear in the Registrant’s 2008 Annual Report to Stockholders on pages 41 and 42 and are incorporated herein by reference.

Table of Contents

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 7, 2009 under the captions "Corporate Governance," "Proposal 1. Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance."

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 7, 2009 under the captions "Compensation Discussion and Analysis."

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 7, 2009 under the caption "Stock Ownership."

Information regarding the Company's equity compensation plans existing as of December 31, 2008 is as follows:

	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))
Plan category			
Equity compensation plans approved by security holders	1,557,112	\$ 20.55	982,166
Equity compensation plans not approved by security holders	—	—	—
Total	1,557,112	\$ 20.55	982,166

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 7, 2009 under the caption "Transactions with Management."

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 7, 2009 under the caption "Proposal 2. Ratification of Appointment of the Independent Registered Public Accounting Firm."

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 2008 Annual Report to Stockholders.

	<u>PAGE</u>
Report of Independent Registered Public Accounting Firm	40
Consolidated Statements of Financial Condition at December 31, 2008 and 2007	22
Consolidated Statements of Income for the Years Ended December 31, 2008, 2007 and 2006	23
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2008, 2007 and 2006	24
Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006	25
Notes to Consolidated Financial Statements for the Years Ended December 31, 2008, 2007 and 2006	26-39

The remaining information appearing in the 2008 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) and Columbia Home Loans, LLC and OceanFirst Bank as buyer, dated June 27, 2000 (without exhibits) (2)
3.1	Certificate of Incorporation of OceanFirst Financial Corp. (1)
3.1(a)	Certificate of Designations (15)
3.2	Bylaws of OceanFirst Financial Corp. (6)
3.2(a)	Warrant to Purchase up to 380,583 shares of Common Stock (15)
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)
10.1(b)	Amended Employee Stock Ownership Plan (13)
10.1(c)	Form of Matching Contribution Employee Stock Ownership Plan (13)
10.1(d)	Letter Agreement dated January 16, 2009, including Securities Purchase Agreement – Standard Terms incorporated by reference therein, between Company and the United States Department of the Treasury (15)
10.2	OceanFirst Bank Employees' Savings and Profit Sharing Plan (1)
10.2(a)	Form of Waiver executed by each of Messrs. John R. Garbarino, Vito R. Nardelli, Michael J. Fitzpatrick, Joseph R. Iantosca, Joseph J. Lebel, III and John K. Kelly (15)

Table of Contents

10.3	OceanFirst Bank 1995 Supplemental Executive Retirement Plan (1)
10.3(a)	OceanFirst Bank Executive Supplemental Retirement Income Agreement (14)
10.3(b)	Form of Senior Executive Officer Agreement executed by each of Messrs. John R. Garbarino, Vito R. Nardelli, Michael J. Fitzpatrick, Joseph R. Iantosca, Joseph J. Lebel, III and John K. Kelly (15)
10.4	OceanFirst Bank Deferred Compensation Plan for Directors (1)
10.4(a)	OceanFirst Bank New Executive Deferred Compensation Master Agreement (14)
10.5	OceanFirst Bank Deferred Compensation Plan for Officers (1)
10.5(a)	OceanFirst Bank New Director Deferred Compensation Master Agreement (14)
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 (1)
10.10	Form of Employment Agreement between OceanFirst Financial Corp. and certain executive officers (1)
10.13	2000 Stock Option Plan (5)
10.14	Form of Employment Agreement between Columbia Home Loans, LLC and Robert M. Pardes (6)
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)
10.21	Form of Employment Agreement between OceanFirst Financial Corp. and certain executive officers, including Michael J. Fitzpatrick, John R. Garbarino and Vito R. Nardelli (13)
10.22	Form of Employment Agreement between OceanFirst Bank and certain executive officers, including Michael J. Fitzpatrick, John R. Garbarino and Vito R. Nardelli (13)
10.23	Form of Change in Control Agreement between OceanFirst Financial Corp. and certain executive officers, including John K. Kelly, Joseph J. Lebel, III and Joseph R. Iantosca (13)
10.24	Form of Change in Control Agreement between OceanFirst Bank and certain executive officers, including John K. Kelly, Joseph J. Lebel, III and Joseph R. Iantosca (13)
13.0	Portions of 2008 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)
(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

Table of Contents

- (12) Incorporated herein by reference from Form 14-A Definitive Proxy Statement filed on March 14, 2006.
- (13) Incorporated by reference from Exhibit to Form 10-K filed on March 17, 2008.
- (14) Incorporated by reference from Exhibit to Form 8-K filed on September 23, 2008.
- (15) Incorporated by reference from Exhibit to Form 8-K filed January 20, 2009.

Table of Contents

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 6, 2009

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> John R. Garbarino Chairman of the Board, President and Chief Executive Officer (principal executive officer)	March 6, 2009
<u>/s/ Michael J. Fitzpatrick</u> Michael J. Fitzpatrick Executive Vice President and Chief Financial Officer (principal accounting and financial officer)	March 6, 2009
<u>/s/ Joseph J. Burke</u> Joseph J. Burke Director	March 6, 2009
<u>/s/ Angelo Catania</u> Angelo Catania Director	March 6, 2009
<u>/s/ Carl Feltz, Jr.</u> Carl Feltz, Jr. Director	March 6, 2009

Table of Contents

/s/ John W. Chadwick John W. Chadwick Director	March 6, 2009
/s/ Donald E. McLaughlin Donald E. McLaughlin Director	March 6, 2009
/s/ Diane F. Rhine Diane F. Rhine Director	March 6, 2009
/s/ John E. Walsh John E. Walsh Director	March 6, 2009

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.

<u>At December 31,</u> <i>(dollars in thousands)</i>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Selected Financial Condition Data:					
Total assets	\$1,857,946	\$1,927,499	\$2,077,002	\$1,985,357	\$1,914,275
Investment securities available for sale	34,364	57,625	82,384	83,861	83,960
Federal Home Loan Bank of New York stock	20,910	22,941	25,346	21,792	21,250
Mortgage-backed securities available for sale	40,801	54,137	68,369	85,025	124,478
Loans receivable, net	1,648,378	1,675,919	1,701,425	1,654,544	1,472,907
Mortgage loans held for sale	3,903	6,072	82,943	32,044	63,961
Deposits	1,274,132	1,283,790	1,372,328	1,356,568	1,270,535
Federal Home Loan Bank advances	359,900	393,000	430,500	354,900	312,000
Securities sold under agreements to repurchase and other borrowings	89,922	109,307	102,482	118,289	151,072
Stockholders' equity	<u>119,783</u>	<u>124,306</u>	<u>132,320</u>	<u>138,784</u>	<u>137,956</u>
<u>For the Year Ended December 31,</u> <i>(dollars in thousands; except per share amounts)</i>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Selected Operating Data:					
Interest income	\$ 103,405	\$ 114,964	\$ 116,562	\$ 102,799	\$ 90,952
Interest expense	<u>45,382</u>	<u>62,040</u>	<u>58,443</u>	<u>41,873</u>	<u>34,931</u>
Net interest income	58,023	52,924	58,119	60,926	56,021
Provision for loan losses	<u>1,775</u>	<u>700</u>	<u>150</u>	<u>350</u>	<u>300</u>
Net interest income after provision for loan losses	56,248	52,224	57,969	60,576	55,721
Other income	12,823	2,531	13,608	24,090	20,740
Operating expenses	<u>47,447</u>	<u>53,820</u>	<u>52,381</u>	<u>54,834</u>	<u>48,759</u>
Income before provision (benefit) for income taxes	21,624	935	19,196	29,832	27,702
Provision (benefit) for income taxes	<u>6,860</u>	<u>(140)</u>	<u>6,563</u>	<u>10,335</u>	<u>9,757</u>
Net income	<u>\$ 14,764</u>	<u>\$ 1,075</u>	<u>\$ 12,633</u>	<u>\$ 19,497</u>	<u>\$ 17,945</u>
Basic earnings per share	<u>\$ 1.27</u>	<u>\$.09</u>	<u>\$ 1.09</u>	<u>\$ 1.65</u>	<u>\$ 1.48</u>
Diluted earnings per share	<u>\$ 1.26</u>	<u>\$.09</u>	<u>\$ 1.07</u>	<u>\$ 1.60</u>	<u>\$ 1.42</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,

	2008	2007	2006	2005	2004
Selected Financial Ratios and Other Data ⁽¹⁾ :					
Performance Ratios:					
Return on average assets	.78%	.05%	.62%	1.00%	.98%
Return on average stockholders' equity	11.98	.86	9.40	14.43	13.34
Stockholders' equity to total assets	6.45	6.45	6.37	6.99	7.21
Tangible equity to tangible assets	6.45	6.45	6.32	6.93	7.13
Average interest rate spread ⁽²⁾	3.00	2.50	2.69	3.07	3.03
Net interest margin ⁽³⁾	3.24	2.79	2.98	3.30	3.23
Average interest-earning assets to average interest-bearing liabilities	109.47	108.96	109.53	109.74	110.24
Operating expenses to average assets	2.52	2.70	2.56	2.81	2.67
Efficiency ratio ⁽⁴⁾	<u>66.97</u>	<u>97.05</u>	<u>73.03</u>	<u>64.50</u>	<u>63.52</u>
Asset Quality Ratios:					
Non-performing loans as a percent of total loans receivable ⁽⁵⁾⁽⁶⁾	.97	.52	.25	.09	.23
Non-performing assets as a percent of total assets ⁽⁶⁾	.92	.48	.23	.09	.20
Allowance for loan losses as a percent of total loans receivable ⁽⁵⁾	.70	.62	.57	.62	.69
Allowance for loan losses as a percent of total non-performing loans ⁽⁶⁾	<u>72.71</u>	<u>119.76</u>	<u>226.25</u>	<u>655.80</u>	<u>306.42</u>
Per Share Data:					
Cash dividends per common share	\$.80	\$.80	\$.80	\$.80	\$.80
Book value per common share at end of period	9.69	10.07	10.79	10.93	10.59
Tangible book value per common share at end of period	<u>9.69</u>	<u>10.07</u>	<u>10.70</u>	<u>10.83</u>	<u>10.49</u>
Number of full-service customer facilities:	<u>23</u>	<u>20</u>	<u>21</u>	<u>18</u>	<u>17</u>

(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.

The Company conducts business, primarily through its ownership of the Bank which operates its administrative/branch office located in Toms River and twenty-two other branch offices. Eighteen of the offices are located in Ocean County, New Jersey, with four branches in Monmouth County and one in Middlesex County. The Bank also operates one loan production office in Kenilworth, New Jersey and a trust and wealth management office in Manchester New Jersey.

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, reverse mortgage loan originations, loan servicing, merchant check card services, deposit account services, 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 Bank competes with generally larger and out-of-market financial service providers through its local focus and the delivery of superior service.

The Company's strategy has been to consistently grow profitability while limiting credit and interest rate risk exposure. To accomplish these objectives, the Bank has sought to (1) grow commercial loans receivable through 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 Bank assembled an experienced team of business banking professionals responsible for offering commercial loan and deposit services and merchant check card services to local businesses. As a result of this initiative, commercial loans represented 23.4% of the Bank's total loans at December 31, 2008 as compared to 18.0% at December 31, 2003 and only 3.6% at December 31, 1997. Commercial loan growth in 2008 of \$8.6 million, or 2.3%, was less than the Bank's expectations due to an economic recession which limited loan demand for high-quality credits. For 2009, these factors may once again impact the Bank's commercial loan growth. The diversification of the Bank'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 Bank seeks to increase core deposit market share in its primary market area by expanding the branch network and improving market penetration. Over the past thirteen years through December 31, 2008, the Bank has opened fifteen branch offices, eleven in Ocean County and four in Monmouth County. The Bank is continually evaluating additional office sites within its existing market area.

At December 31, 2008, the fifteen most recently opened branches maintained an average core deposit ratio of 76.9%. Core account development has also benefited from the Bank 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 Bank's core deposit ratio has grown to 71.2% at December 31, 2008 as compared to 66.1% at December 31, 2003 and 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 Bank's product line in order to enhance non-interest income. The Bank 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 Bank with fee income opportunities. In early 2005, the alternative investment program was expanded to add Licensed Bank Employees which allows the Bank to capture more of the revenue associated with the sale of investment products. The Bank 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 Bank established a captive subsidiary to recognize fee income from private mortgage insurance. As a result of these initiatives, income from fees and service charges has increased to \$10.8 million for the year ended December 31, 2008 as compared to \$7.9 million for the year ended December 31, 2003 and only \$1.4 million for the year ended December 31, 1997. The average annual increase from December 31, 1997 through December 31, 2008 is 20.6%. In early 2008, the Bank terminated a joint venture agreement with a title insurance agency. During 2003, the Bank began offering reverse mortgage loans. The Bank has been approved by the Federal National Mortgage Association ("FNMA") and another institutional investor as a seller/servicer of reverse mortgage loans. The income from reverse mortgage lending is included in the net gain on sales of loans and securities available for sale.

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 several years included share repurchases and a strong cash dividend payout of earnings. The Company's share repurchase plan was discontinued after the first quarter of 2007 due to the net losses incurred in the fourth quarter of 2006 and the first quarter of 2007. Additionally, the Company decided to build capital levels during 2008 as a result of the economic downturn. From conversion date through December 31, 2008, the Company has repurchased a total of 17.0 million common shares, 62.4% of the shares originally issued in the conversion. The capital management plan successfully reduced the Company's capital ratio from 19.4% at December 31, 1996 to a low of 6.4% at December 31, 2006. At December 31, 2008 the ratio increased to 6.5%.

Summary

During 2008, short-term interest rates declined and the interest rate yield curve steepened as compared to 2007. The changing interest rate environment has generally had a positive impact on the Bank's results of operations and net interest margin. Interest-earning assets, both loans and securities, are generally priced against longer-term indices, while interest-bearing liabilities, primarily deposits and borrowings, are generally priced against short-term indices. Conversely during 2008, there has been a general weakening of the overall economy coupled with declining real estate values. These conditions have had an adverse impact on the Bank's results of operations as non-performing loans and the provision for loan losses have increased.

The Company's earnings for the year ended December 31, 2007 was adversely affected by losses at Columbia Home Loans, LLC ("Columbia"), the Company's mortgage banking subsidiary, relating to the origination of subprime loans. In March 2007, Columbia discontinued the origination of all subprime loans and in September 2007, the Bank discontinued all loan origination activity at Columbia; the offices were closed and all employees were either discharged or reassigned. At December 31, 2008, the Bank was still holding subprime loans with a gross principal balance of \$5.3 million and a carrying value, net of reserves and lower of cost or market adjustment, of \$3.3 million and Alt-A loans with a gross principal balance of \$5.7 million and a carrying value, net of reserves and lower of cost or market adjustment of \$4.9 million.

Critical Accounting Policies

Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2008 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.

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 the Bank's 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 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 impaired 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 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 County, New Jersey and the surrounding area. These concentrations may adversely affect the Bank's loan loss experience should real estate values decline or should the Ocean County area experience an adverse economic downturn.

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, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. In addition, various regulatory agencies, as 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 Bank'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, or a 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 Bank considers recent and historical experience, product type and volume of recent whole loan sales and the general economic environment. Management believes that the Bank 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 Bank'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. Additionally, due to the economic downturn, default rates and servicing costs may increase in future periods which would result in a decline in the fair value of MSR. 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 Bank evaluates whether any securities are other-than-temporarily impaired. In making this determination, the Bank 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, the impairment is charged to income during the period the impairment is found to exist, resulting in a reduction to earnings for that period.

As of December 31, 2008, the Bank 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 market illiquidity and not related to the underlying credit quality of the issuers of the securities. Additionally, the Bank 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 or a determination that a market recovery in the foreseeable future is unlikely.

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, 2008, 2007, and 2006. 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,								
	2008			2007			2006		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
<i>(dollars in thousands)</i>									
Assets:									
Interest-earning assets:									
Interest-earning deposits and short-term investments	\$ 10,496	\$ 191	1.82%	\$ 10,572	\$ 526	4.98%	\$ 8,885	\$ 437	4.92%
Investment securities ⁽¹⁾	60,952	2,948	4.84	68,118	4,561	6.70	83,999	5,122	6.10
FHLB stock	20,156	1,396	6.93	24,110	1,858	7.71	24,575	1,315	5.35
Mortgage-backed securities ⁽¹⁾	46,970	2,210	4.71	62,110	2,775	4.47	77,416	3,304	4.27
Loans receivable, net ⁽²⁾	1,653,413	96,660	5.85	1,729,064	105,244	6.09	1,758,230	106,384	6.05
Total interest-earning assets	1,791,987	103,405	5.77	1,893,974	114,964	6.07	1,953,105	116,562	5.97
Non-interest-earning assets	93,055			100,398			96,752		
Total assets	<u>\$1,885,042</u>			<u>\$1,994,372</u>			<u>\$2,049,857</u>		
Liabilities and Equity:									
Interest-bearing liabilities:									
Money market deposit accounts	\$ 84,605	\$ 1,091	1.29%	\$ 94,374	\$ 1,577	1.67%	\$ 117,935	\$ 1,994	1.69%
Savings accounts	200,761	2,014	1.00	195,948	1,941	.99	219,879	1,730	.79
Interest-bearing checking accounts	500,540	9,688	1.94	435,433	11,343	2.60	379,997	8,216	2.16
Time deposits	408,870	13,963	3.42	491,465	21,725	4.42	534,056	21,461	4.02
Total	1,194,776	26,756	2.24	1,217,220	36,586	3.01	1,251,867	33,401	2.67
FHLB advances	344,302	15,974	4.64	413,352	20,435	4.94	426,792	20,184	4.73
Securities sold under agreements to repurchase	69,664	1,209	1.74	84,303	3,393	4.02	92,930	4,068	4.38
Other borrowings	28,238	1,443	5.11	23,368	1,626	6.96	11,543	790	6.84
Total interest-bearing liabilities	1,636,980	45,382	2.77	1,738,243	62,040	3.57	1,783,132	58,443	3.28
Non-interest-bearing deposits	107,976			112,649			120,482		
Non-interest-bearing liabilities	16,876			18,625			11,875		
Total liabilities	1,761,832			1,869,517			1,915,489		
Stockholders' equity	123,210			124,855			134,368		
Total liabilities and equity	<u>\$1,885,042</u>			<u>\$1,994,372</u>			<u>\$2,049,857</u>		
Net interest income		<u>\$ 58,023</u>			<u>\$ 52,924</u>			<u>\$ 58,119</u>	
Net interest rate spread ⁽³⁾			<u>3.00%</u>			<u>2.50%</u>			<u>2.69%</u>
Net interest margin ⁽⁴⁾			<u>3.24%</u>			<u>2.79%</u>			<u>2.98%</u>
Ratio of interest-earning assets to interest-bearing liabilities	<u>109.47%</u>			<u>108.96%</u>			<u>109.53%</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, 2008 Compared to Year Ended December 31, 2007			Year Ended December 31, 2007 Compared to Year Ended December 31, 2006		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
Interest-earning assets:						
Interest-earning deposits and short-term investments	\$ (4)	\$ (331)	\$ (335)	\$ 84	\$ 5	\$ 89
Investment securities	(443)	(1,170)	(1,613)	(1,032)	471	(561)
FHLB stock	(286)	(176)	(462)	(25)	568	543
Mortgage-backed securities	(707)	142	(565)	(678)	149	(529)
Loans receivable, net	(4,516)	(4,068)	(8,584)	(1,821)	681	(1,140)
Total interest-earning assets	(5,956)	(5,603)	(11,559)	(3,472)	1,874	(1,598)
Interest-bearing liabilities:						
Money market deposit accounts	(152)	(334)	(486)	(394)	(23)	(417)
Savings accounts	52	21	73	(201)	413	212
Interest-bearing checking accounts	1,517	(3,172)	(1,655)	1,305	1,822	3,127
Time deposits	(3,309)	(4,453)	(7,762)	(1,784)	2,047	263
Total	(1,892)	(7,938)	(9,830)	(1,074)	4,259	3,185
FHLB advances	(3,272)	(1,189)	(4,461)	(640)	891	251
Securities sold under agreements to repurchase	(512)	(1,672)	(2,184)	(358)	(317)	(675)
Other borrowings	300	(483)	(183)	822	14	836
Total interest-bearing liabilities	(5,376)	(11,282)	(16,658)	(1,250)	4,847	3,597
Net change in net interest income	<u>\$ (580)</u>	<u>\$ 5,679</u>	<u>\$ 5,099</u>	<u>\$(2,222)</u>	<u>\$(2,973)</u>	<u>\$(5,195)</u>

Comparison of Financial Condition at December 31, 2008 and December 31, 2007

Total assets at December 31, 2008 were \$1.858 billion, a decrease of \$69.6 million, compared to \$1.927 billion at December 31, 2007.

Investment and mortgage-backed securities available for sale decreased \$36.6 million to \$75.2 million at December 31, 2008 as compared to \$111.8 million at December 31, 2007 due to a decline in the fair market value of investment securities and repayment of mortgage-backed securities. Loans receivable, net decreased by \$27.5 million to a balance of \$1.648 billion at December 31, 2008, compared to a balance of \$1.676 billion at December 31, 2007. Increases of \$8.6 million in commercial and commercial real estate loans and \$9.5 million in consumer loans were more than offset by a decline in one-to-four family mortgage loans due to increased prepayments relating to refinancings and the Bank's ongoing strategy to sell newly originated longer-term one-to-four family fixed-rate loans.

Deposit balances decreased \$9.7 million to \$1.274 billion at December 31, 2008 from \$1.284 billion at December 31, 2007. Core deposits, however, increased \$77.1 million which was offset by a \$86.7 million decrease in time deposits as the Bank maintained its disciplined pricing relating to this product. Total Federal Home Loan Bank borrowings decreased by \$45.1 million to \$359.9 million at December 31, 2008 as compared to \$405.0 million at December 31, 2007 primarily due to the reduction in loans receivable, net.

Stockholders' equity at December 31, 2008 decreased to \$119.8 million, compared to \$124.3 million at December 31, 2007. Stockholders' equity was reduced by an increase in accumulated other comprehensive loss and the cash dividend.

Comparison of Operating Results for the Years Ended December 31, 2008 and December 31, 2007

General

Net income increased to \$14.8 million for the year ended December 31, 2008, as compared to net income of \$1.1 million for the year ended December 31, 2007. Diluted earnings per share increased to \$1.26 for the year ended December 31, 2008, as compared to \$.09 for the same prior year period.

Interest Income

Interest income for the year ended December 31, 2008 was \$103.4 million, as compared to \$115.0 million for the year ended December 31, 2007. The yield on interest-earning assets decreased to 5.77% for the year ended December 31, 2008, as compared to 6.07% for the same prior year period. Average interest-earning assets decreased \$102.0 million for the year ended December 31, 2008, as compared to the same prior year period reflective of the discontinuance of Columbia's mortgage banking operations.

Interest Expense

Interest expense for the year ended December 31, 2008 was \$45.4 million, as compared to \$62.0 million for the year ended December 31, 2007. The cost of interest-bearing liabilities decreased to 2.77% for the year ended December 31, 2008, as compared to 3.57%, in the same prior year period. Average interest-bearing liabilities decreased by \$101.3 million for the year ended December 31, 2008, as compared to the same prior year period. The decrease was concentrated in time deposits which declined \$82.6 million, or 16.8%, for the year ended December 31, 2008, as compared to the same prior year period.

Net Interest Income

Net interest income for the year ended December 31, 2008 increased to \$58.0 million, as compared to \$52.9 million in the same prior year period reflecting a higher net interest margin partly offset by lower levels of interest-earning assets. The net interest margin increased to 3.24% for the year ended December 31, 2008 from 2.79% in the same prior year period. The steepening of the interest rate yield curve caused the decrease in the cost of interest-bearing liabilities to outpace the decrease in the yield on interest-earning assets.

Provision for Loan Losses

For the year ended December 31, 2008, the Company's provision for loan losses was \$1,775,000, as compared to \$700,000 for the same prior year period. Non-performing loans increased to \$16.0 million at December 31, 2008 from \$8.7 million at December 31, 2007. The non-performing loan total includes \$1.4 million of loans repurchased due to early payment default that were written down to fair value on date of repurchase and \$3.2 million of loans previously held for sale that were also written down to their fair value. The writedown to fair value included an assessment of each loan's potential credit impairment. As a result, these loans do not currently require an adjustment to the allowance for loan losses. Net charge-offs increased to \$578,000 for the year ended December 31, 2008, as compared to \$470,000 for the same prior year period. Loans receivable, net decreased \$27.5 million at December 31, 2008, as compared to December 31, 2007. The increase in the provision for loan losses was primarily due to the increase in non-performing loans and the increase in net charge-offs.

Other Income

Other income was \$12.8 million for the year ended December 31, 2008, as compared to \$2.5 million for the same prior year period. The net gain on the sale of loans and securities available for sale was \$799,000 for the year ended December 31, 2008, as compared to a net loss of \$11.0 million in the same prior year period. The net gain for the year ended December 31, 2008 includes a \$902,000 net loss on investment securities transactions. The net loss for the year ended December 31, 2007 includes a \$9.4 million charge by Columbia to reduce loans held for sale to their current fair market value, a \$1.3 million loss on the bulk sale of subprime loans and a \$3.5 million charge to supplement the reserve for repurchased loans. The reserve for repurchased loans, which is included in other liabilities in the Company's consolidated statements of financial condition, was \$1.1 million at December 31, 2008. For the year ended December 31, 2008, the Company recognized a reversal of the provision for repurchased loans of \$248,000 and charge-offs of \$1.0 million relating to three loan repurchases and two comprehensive negotiated settlements in lieu of a loan repurchase. At December 31, 2008 there was one outstanding loan repurchase request, which the Company is contesting.

Income from Bank Owned Life Insurance ("BOLI") decreased by \$580,000 for the year ended December 31, 2008 as compared to the same prior year period. Results for the year ended December 31, 2008 were adversely affected by a \$568,000 impairment to certain investment securities held by the BOLI's underlying investment fund. The Company's BOLI is held in a separate account insurance product which is invested in a fixed income portfolio designed to track the Lehman Brothers Aggregate Bond Index.

Fees and service charges decreased \$836,000 for the year ended December 31, 2008, as compared to the same prior year period. For the year ended December 31, 2007 \$1.1 million in reverse mortgage fees were included in fees and service charges. For 2008, this income is included in the net gain on sales of loans. Additionally, income from PMI reinsurance fees decreased \$282,000 for the year ended December 31, 2008 as compared to the same prior year period due to reserves for expected claims. These decreases were partly offset by increases in checking account fees.

Operating Expenses

Operating expenses were \$47.4 million for the year ended December 31, 2008, as compared to \$53.8 million in the same prior year period. The expense reduction is primarily due to the shuttering of Columbia in late 2007 which eliminated most, but not all, of the expenses related to this entity. Also, operating expenses for the year ended December 31, 2007 included an expense of \$1.0 million representing a write-off of the previously established goodwill on the acquisition of Columbia. Operating expenses for the year ended December 31, 2008 also benefited from a reduction in retirement plan expense. Operating expenses for the year ended December 31, 2008 include costs relating to the opening of new branches in Freehold, Waretown and Bayville, New Jersey. Additionally, the Company experienced increased charges relating to the inability to sublet vacant Columbia office space as well as elevated legal fees associated with the shuttering of Columbia. The Federal Deposit Insurance Corp. ("FDIC") has proposed new rules which will increase deposit insurance assessment rates and alter the way it differentiates for risk in the risk-based assessment system. The proposed rule will likely increase the Company's Federal deposit insurance expense beginning in 2009.

Provision for Income Taxes

Income tax provision was \$6.9 million for the year ended December 31, 2008, as compared to a benefit of \$140,000 for the same prior year period. The provision for income taxes for the year ended December 31, 2008 benefited from \$524,000 in state tax refunds relating to OceanFirst Realty Corp. for the years 2002 through 2006. The benefit for the year ended December 31, 2007 was primarily related to the non-taxable income from Bank Owned Life Insurance and the allowable tax deduction for dividends paid by the ESOP.

For the year ended December 31, 2008 state income tax expense benefited from the utilization of the Bank's net operating loss carryforward ("NOL") of \$17.2 million. The NOL was created over time as dividend income from the Bank's subsidiary, OceanFirst Realty Corp., a qualified Real Estate Investment Trust ("REIT") was excluded from the Bank's income. The State of New Jersey has since published a regulation to disallow the dividends received deduction for the direct receipt of a dividend from a REIT to its corporate parent. The state regulatory change and the utilization of the Bank's NOL will likely cause the Company's effective state tax rate to increase to at least 3.6% (2.34% after Federal benefit) in future periods. The Company's effective state tax rate for 2008 was 1.2%, before Federal benefit, and excluding the state tax refunds indicated above.

Comparison of Operating Results for the Years Ended December 31, 2007 and December 31, 2006

General

Net income decreased to \$1.1 million for the year ended December 31, 2007, as compared to net income of \$12.6 million for the year ended December 31, 2006. Diluted earnings per share decreased to \$.09 for the year ended December 31, 2007, as compared to \$1.07 for the same prior year period.

Interest Income

Interest income for the year ended December 31, 2007 was \$115.0 million, as compared to \$116.6 million for the year ended December 31, 2006. The yield on interest-earning assets increased to 6.07% for the year ended December 31, 2007, as compared to 5.97% for the same prior year period. Average interest-earning assets decreased \$59.1 million for the year ended December 31, 2007, as compared to the same prior year period reflective of the discontinuance of Columbia's mortgage banking operations and the decrease in investment and mortgage-backed securities available for sale.

Interest Expense

Interest expense for the year ended December 31, 2007 was \$62.0 million, as compared to \$58.4 million for the year ended December 31, 2006. The cost of interest-bearing liabilities increased to 3.57% for the year ended December 31, 2007, as compared to 3.28%, in the same prior year period. Average interest-bearing liabilities decreased by \$44.9 million for the year ended December 31, 2007, as compared to the same prior year period. The decrease was concentrated in time deposits which declined \$42.6 million, or 8.0%, for the year ended December 31, 2007, as compared to the same prior year period.

Net Interest Income

Net interest income for the year ended December 31, 2007 decreased to \$52.9 million, as compared to \$58.1 million in the same prior year period. The net interest margin decreased to 2.79% for the year ended December 31, 2007 from 2.98% in the same prior year period. The slope of the interest rate yield curve caused the increase in the cost of interest-bearing liabilities to outpace the increase in the yield on interest-earning assets.

Provision for Loan Losses

For the year ended December 31, 2007, the Company's provision for loan losses was \$700,000, as compared to \$150,000 for the same prior year period. Net charge-offs increased to \$470,000 for the year ended December 31, 2007, as compared to \$372,000 for the same prior year period. Loans receivable, net decreased \$25.5 million at December 31, 2007, as compared to December 31, 2006. Non-performing loans increased to \$8.7 million at December 31, 2007 from \$4.5 million at December 31, 2006. The non-performing loan total includes \$1.2 million of repurchased one-to-four family and consumer loans and \$2.8 million of one-to-four family and consumer loans previously held for sale, which were written down to their fair market value. The writedown to fair market value included an assessment of each loan's potential credit impairment. As a result, these loans do not currently require an adjustment to the allowance for loan losses. The increase in the provision for loan losses was primarily due to the increase in net charge-offs and the increase in non-performing loans.

Other Income

Other income was \$2.5 million for the year ended December 31, 2007, as compared to \$13.6 million for the same prior year period. The net loss on the sale of loans was \$11.0 million for the year ended December 31, 2007, as compared to a net gain of \$1.4 million in the same prior year period. The change from the prior year was due to reduced loan sale activity and lower of cost or market charges on loans held for sale partly offset by a reduction to the provision for repurchased loans. The net loss for the year ended December 31, 2007 is partly due to the decision to discontinue the operations of Columbia resulting in a decrease in loan sale activity for the year. Also, included in the loss on sale of loans for the year ended December 31, 2007 are lower of cost or market charges of \$9.4 million incurred by Columbia to reduce loans held for sale to their current fair market value. Additionally, for the year ended December 31, 2007, the net provision for repurchased loans was \$3.5 million which is included as part of the loss on sale of loans, as compared to a provision for repurchased loans of \$9.6 million in the same prior year period.

Fees and service charges increased \$1.2 million for the year ended December 31, 2007, as compared to the same prior year period primarily related to increases in fees from trust services and deposit accounts.

Operating Expenses

Operating expenses were \$53.8 million for the year ended December 31, 2007, as compared to \$52.4 million in the same prior year period. The increase was partly due to the cost of new branches and higher professional fees. Additionally, occupancy expense for the year ended December 31, 2007 included a charge of \$760,000 for lease termination costs at Columbia. For the year ended December 31, 2007 operating expenses include \$1.0 million relating to the write-off of the previously established goodwill on the August 2000 acquisition of Columbia. These increases were partly offset by decreased operating expenses due to the discontinuation of operations at Columbia and lower ESOP expense.

Provision for Income Taxes

Income tax benefit was \$140,000 for the year ended December 31, 2007, as compared to an expense of \$6.6 million for the same prior year period. The benefit for the year ended December 31, 2007 was primarily related to the non-taxable income from Bank Owned Life Insurance and the allowable tax deduction for dividends paid by the ESOP.

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, Federal Home Loan Bank ("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, 2008, the Bank had outstanding overnight borrowings from the FHLB of \$83.9 million, an increase from \$58.0 million in overnight borrowings at December 31, 2007. The Bank 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 \$62.4 million at December 31, 2008 from \$69.8 million at December 31, 2007. Like deposit flows, this funding source is dependent upon demand from the Bank's customer base. The Bank also had other borrowings with the FHLB of \$276.0 million at December 31, 2008, a decrease from \$347.0 million at December 31, 2007.

The Company's cash needs for the year ended December 31, 2008 were primarily satisfied by principal payments on loans and mortgage-backed securities and proceeds from the sale of mortgage loans held for sale. The cash was principally utilized for loan originations, to reduce Federal Home Loan Bank borrowings and to fund deposit outflows. For the year ended December 31, 2007, the cash needs of the Company were primarily satisfied by principal payments on loans and mortgage-backed securities, maturities or calls of investment securities, proceeds from the sale of mortgage loans held for sale and the issuance of debt in the form of trust preferred securities. The cash was principally utilized for loan originations and repurchases, to fund deposit outflows and to reduce Federal Home Loan Bank borrowings.

In the normal course of business, the Bank routinely enters into various commitments, primarily relating to the origination and sale of loans. At December 31, 2008, outstanding commitments to originate loans totaled \$47.3 million; outstanding unused lines of credit totaled \$174.2 million; and outstanding commitments to sell loans totaled \$16.6 million. The Bank 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 \$295.0 million at December 31, 2008. Based upon historical experience, management estimates that a significant portion of such deposits will remain with the Bank.

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. The Company's share repurchase plan was discontinued after the first quarter of 2007 due to net losses incurred in the fourth quarter of 2006 and the first quarter of 2007. Additionally, the Company decided to build capital levels during 2008 as a result of the economic downturn. For the year ended December 31, 2008 there were no stock purchases. For the year ended December 31, 2007, the Company purchased 49,701 shares of common stock at a total cost of \$1.1 million. Cash dividends declared and paid during the year ended December 31, 2008 were \$9.4 million, compared to \$9.3 million declared and paid during the year ended December 31, 2007. On January 21, 2009, the Board of Directors declared a quarterly cash dividend of twenty cents (\$0.20) per common share. The dividend was payable on February 13, 2009 to stockholders of record at the close of business on January 30, 2009.

The primary sources of liquidity specifically available to the Company, are capital distributions from the banking subsidiary, borrowings and issuance of debt and trust preferred securities. For the year ended December 31, 2008, OceanFirst Financial Corp. received a \$3.2 million dividend payment from OceanFirst Bank which was supplemented by existing liquidity. OceanFirst Financial Corp.'s ability to continue to pay dividends and repurchase stock will be partly dependent upon capital distributions from OceanFirst Bank which may be adversely affected by capital restraints imposed by the Office of Thrift Supervision ("OTS"). Pursuant to OTS regulations, a notice is required to be filed with the OTS prior to the Bank paying a dividend to OceanFirst Financial Corp. The OTS has the regulatory authority to require the Bank to maintain tier one core and total risk-based capital ratios that are higher than those required to be "well capitalized", which may restrict the Bank's ability to pay dividends to the Company. If the Company requires dividends from the Bank to meet its liquidity needs, it will file the required notice with the OTS; however, the Company cannot predict whether the OTS will approve the Bank's request to pay a dividend to OceanFirst Financial Corp. The OTS may object to a proposed dividend, notwithstanding the Bank's compliance with its capital requirements, if the dividend raises safety and soundness concerns or if the dividend would violate a prohibition contained in any statute, regulation or agreement between the Bank and the OTS or a condition imposed on the Bank by the OTS. If the OTS objects to the Bank's request to pay a dividend to the Company, the Company may not have the liquidity necessary to pay a dividend in the future or pay a dividend at the same rate as historically paid, or be able to repurchase its stock or meet current debt obligations. At December 31, 2008, OceanFirst Financial Corp. held \$1.4 million in cash and \$2.2 million in investment securities available for sale. Additionally, OceanFirst Financial Corp. has an available line of credit for up to \$4.0 million which was not drawn upon at December 31, 2008.

In January 2009, the Company completed the sale of 38,263 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A totaling \$38.3 million to the U.S. Department of Treasury under the Capital Purchase Program (the "Program") of the Emergency Economic Stabilization Act of 2008. The voluntary equity investment from the U. S. Treasury represents 3% of total risk weighted assets as of September 30, 2008. The Preferred Stock will pay cumulative dividends to the Treasury of 5% a year for the first five years and 9% a year thereafter. In conjunction with the Preferred Stock issuance, the Treasury also received a ten year warrant to purchase 380,853 shares of common stock at an exercise price of \$15.07. Upon receipt, OceanFirst Financial Corp. distributed 50% of the funds to the Bank and retained 50% at the Holding Company.

At December 31, 2008, the Bank exceeded all of its regulatory capital requirements with tangible capital of \$152.4 million, or 8.1%, of the Bank's total adjusted assets, which is above the required level of \$28.2 million or 1.5%; core capital of \$152.4 million or 8.1% of the Bank's total adjusted assets, which is above the required level of \$75.3 million, or 4.0%; and risk-based capital of \$162.9 million, or 12.6% of the Bank's risk-weighted assets, which is above the required level of \$103.1 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 Bank 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 Bank also has outstanding commitments to sell loans amounting to \$16.6 million.

The Bank has entered into loan sale agreements with investors in the normal course of business. The loan sale agreements generally require the Bank 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 Bank's loan sale agreements is adequately provided for in the reserve for repurchased loans included in other liabilities. At December 31, 2008 and 2007 the reserve for repurchased loans amounted to \$1.1 million and \$2.4 million, respectively.

The following table shows the contractual obligations of the Bank by expected payment period as of December 31, 2008 (in thousands). Further discussion of these commitments is included in Notes 9 and 13 to the Consolidated Financial Statements.

Contractual Obligation	More than				
	Total	Less than one year	1-3 years	3-5 years	5 years
Long-Term Debt Obligations	\$303,500	\$108,000	\$133,000	\$35,000	\$ 27,500
Operating Lease Obligations	27,642	2,067	3,710	3,040	18,825
Purchase Obligations	9,409	3,102	5,767	540	—
	<u>\$340,551</u>	<u>\$113,169</u>	<u>\$142,477</u>	<u>\$38,580</u>	<u>\$ 46,325</u>

Long-term debt obligations include 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 Bank 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 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company adopted the statement effective January 1, 2008. The adoption of SFAS No. 159 did not have a material impact on the Company's financial statements as the Company did not choose to measure any additional financial instruments or certain other items at fair value.

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 Company adopted the statement effective January 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the Company's operations. In February 2008, Financial Accounting Standards Board Staff Position ("FSP") No. 157-2, "Effective Date of FASB Statement No. 157" was issued. FSP No. 157-2 delayed the application of SFAS No.157 for non-financial assets and non-financial liabilities until January 1, 2009. In October 2008, FSP No.157-3 "Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active" was issued which clarifies the applications of SFAS No.157 in a market that is not active.

In June 2007, the Emerging Issues Task Force ("EITF") of the FASB issued EITF 06-11 which provides guidance on how an entity should recognize the income tax benefit received on dividends that are (a) paid to employees holding equity-classified nonvested shares, equity-classified nonvested share units, or equity-classified outstanding share options and (b) charge to retained earnings under SFAS No. 123(R). The Company adopted EITF 06-11 effective January 1, 2008. The adoption of EITF 06-11 did not have a material impact on the Company's financial statements.

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

In June 2008, EITF 03-6-1 was issued which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of EITF 03-6-1 is not expected to have a material 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 five REO properties at December 31, 2008. 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, 2008, 2007, 2006, 2005 and 2004, 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 \$913,000, \$210,000, \$189,000, \$115,000 and \$128,000.

<u>At or For The Year Ended December 31,</u> <i>(dollars in thousands)</i>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Non-accrual loans:					
Real estate:					
One-to-four family	\$ 8,696	\$ 6,620	\$ 2,703	\$ 1,084	\$ 1,337
Commercial real estate, multi-family and land	5,527	1,040	286	—	744
Consumer	1,435	586	281	299	784
Commercial	385	495	1,255	212	623
Total	16,043	8,741	4,525	1,595	3,488
REO, net	1,141	438	288	278	288
Total non-performing assets	<u>\$17,184</u>	<u>\$ 9,179</u>	<u>\$ 4,813</u>	<u>\$ 1,873</u>	<u>\$ 3,776</u>
Allowance for loan losses:					
Balance at beginning of year	\$10,468	\$10,238	\$10,460	\$10,688	\$10,802
Less: Net charge-offs	578	470	372	578	414
Add: Provision for loan losses	1,775	700	150	350	300
Balance at end of year	<u>\$11,665</u>	<u>\$10,468</u>	<u>\$10,238</u>	<u>\$10,460</u>	<u>\$10,688</u>
Ratio of net charge-offs during the year to average net loans outstanding during the year	.03%	.03%	.02%	.04%	.03%
Allowance for loan losses as percent of total loans receivable ⁽¹⁾	.70	.62	.57	.62	.69
Allowance for loan losses as a percent of total non-performing loans ⁽²⁾	72.71	119.76	226.25	655.80	306.42
Non-performing loans as a percent of total loans receivable ⁽¹⁾⁽²⁾	.97	.52	.25	.09	.23
Non-performing assets as a percent of total assets ⁽²⁾	<u>.92</u>	<u>.48</u>	<u>.23</u>	<u>.09</u>	<u>.20</u>

(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 non-performing loan total includes \$1.4 million of repurchased one-to-four family and consumer loans and \$3.2 million of one-to-four family and consumer loans previously held for sale, which were written down to their fair market value.

The Bank 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, 2008, the Bank had \$17.2 million of assets, including all REO, classified as "Substandard," \$14,300 of assets classified as "Doubtful" and no assets classified as "Loss." Additionally, "Special Mention" assets totaled \$9.0 million at December 31, 2008. These loans are classified as Special Mention due to past delinquencies or other identifiable weaknesses.

The Substandard category includes two commercial loan relationships totaling \$4.0 million which became non-performing during 2008. The first loan relationship totals \$2.1 million and is adequately secured by commercial real estate collateral and personal guarantees. The second loan relationship totals \$1.9 million and is well secured by commercial real estate collateral. The largest Special Mention relationship comprised several credit facilities to a large, real estate agency with an aggregate balance of \$3.3 million which was current as to payments, but criticized due to declining revenue and operating losses of the borrower. The loans are secured by commercial real estate and the personal guarantee of the principals. A second Special Mention relationship of \$3.2 million is outstanding to a leasing company. The loan is secured by commercial real estate, auto titles, other business assets and personal guarantees. All of the non-performing loans noted above are included in the Substandard category.

The provision for loan losses increased by \$1.1 million for the year ended December 31, 2008, as compared to the prior year primarily due to the increase in non-performing loans and the increase in net charge-offs. Non-performing loans increased by \$7.3 million. As noted above, the non-performing loan total includes \$1.4 million of repurchased loans and \$3.2 million of loans previously held for sale, both of which were written down to their fair market value, which included an assessment of each loan's potential credit impairment. Net charge-offs increased to \$578,000 for the year ended December 31, 2008, as compared to \$470,000 for the same prior year period. Loans receivable, net decreased \$27.5 million at December 31, 2008, as compared to December 31, 2007.

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 Bank's Board of Directors has established an Asset Liability Committee ("ALCO") consisting of members of the Bank's management, responsible for reviewing the 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 Bank 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) managing the maturities of wholesale borrowings. The Bank may also sell fixed-rate mortgage loans into the secondary market. In determining whether to retain fixed-rate mortgages, management considers the Bank's overall interest rate risk position, the volume of such loans, the loan yield and the types and amount of funding sources. The Bank 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 Bank generally attempts to extend the maturity on part of its wholesale borrowings. For the past few years, the Bank has sold most 30 year fixed-rate mortgage loan originations in the secondary market. 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. The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2008, which were anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown. At December 31, 2008, the Company's one-year gap was negative 5.72% as compared to negative 9.57% at December 31, 2007. 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 table is intended to provide an approximation of the projected repricing of assets and liabilities at December 31, 2008, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments 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 37.0% annually. Mortgage-backed securities were projected to prepay at rates between 11.0% and 16.0% annually. Savings accounts, interest-bearing checking accounts and money market deposit accounts were assumed to decay, or run-off, at 1.5% 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.

<u>At December 31, 2008</u> <i>(dollars in thousands)</i>	<u>3 Months or Less</u>	<u>More than 3 Months to 1 Year</u>	<u>More than 1 Year to 3 Years</u>	<u>More than 3 Years to 5 Years</u>	<u>More than 5 Years</u>	<u>Total</u>
Interest-earning assets ⁽¹⁾ :						
Interest-earning deposits and short-term investments	\$ 4,967	\$ —	\$ —	\$ —	\$ —	\$ 4,967
Investment securities	56,826	150	302	—	370	57,648
FHLB stock	—	—	—	—	20,910	20,910
Mortgage-backed securities	6,770	18,234	9,418	5,649	526	40,597
Loans receivable ⁽²⁾	252,930	448,874	563,869	240,253	152,825	1,658,751
Total interest-earning assets	<u>321,493</u>	<u>467,258</u>	<u>573,589</u>	<u>245,902</u>	<u>174,631</u>	<u>1,782,873</u>
Interest-bearing liabilities:						
Money market deposit accounts	3,860	11,581	30,883	38,604	—	84,928
Savings accounts	9,396	28,702	75,167	93,959	—	207,224
Interest-bearing checking accounts	223,426	41,961	111,897	140,050	—	517,334
Time deposits	116,104	178,864	44,396	20,587	7,417	367,368
FHLB advances	113,900	78,000	133,000	35,000	—	359,900
Securities sold under agreements to repurchase and other borrowings	84,922	—	—	—	5,000	89,922
Total interest-bearing liabilities	<u>551,608</u>	<u>339,108</u>	<u>395,343</u>	<u>328,200</u>	<u>12,417</u>	<u>1,626,676</u>
Interest sensitivity gap ⁽³⁾	<u>\$(230,115)</u>	<u>\$ 128,150</u>	<u>\$178,246</u>	<u>\$(82,298)</u>	<u>\$162,214</u>	<u>\$ 156,197</u>
Cumulative interest sensitivity gap	<u>\$(230,115)</u>	<u>\$(101,965)</u>	<u>\$ 76,281</u>	<u>\$ (6,017)</u>	<u>\$156,197</u>	<u>\$ 156,197</u>
Cumulative interest sensitivity gap as a percent of total interest-earning assets	<u>(12.91)%</u>	<u>(5.72)%</u>	<u>4.28%</u>	<u>(0.34)%</u>	<u>8.76%</u>	<u>8.76%</u>

(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 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, 2008 and 2007, 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, 2008, the Company's NPV in a static rate environment is less than the NPV at December 31, 2007 primarily reflecting a decline in the value of corporate securities and core deposits. The changes in net portfolio value and net interest income are within the limitations established by management and approved by the Board of Directors.

Change in Interest Rates in Basis Points (Rate Shock)	December 31, 2008					Change in Interest Rates in Basis Points (Rate Shock)	December 31, 2007				
	Net Portfolio Value			Net Interest Income			Net Portfolio Value			Net Interest Income	
	Amount	% Change	NPV Ratio	Amount	% Change		Amount	% Change	NPV Ratio	Amount	% Change
200	\$106,833	(21.5)%	6.0%	\$55,909	(8.8)%	200	\$125,181	(25.3)%	6.8%	\$51,081	(10.2)%
100	126,459	(7.0)	7.0	59,031	(3.8)	100	149,672	(10.7)	8.0	54,350	(4.4)
Static	136,020	—	7.4	61,331	—	Static	167,675	—	8.7	56,872	—
(100)	136,226	0.2	7.2	59,363	(3.2)	(100)	171,050	2.0	8.8	57,770	1.6
(200)	129,958	(4.5)	6.9	56,937	(7.2)	(200)	163,057	(2.8)	8.4	56,245	(1.1)

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 and Item 1A. Risk Factors of the Company's 2008 Form 10-K.

Consolidated Statements of Financial Condition
(dollars in thousands, except per share amounts)

December 31, 2008 and 2007	2008	2007
Assets		
Cash and due from banks	\$ 18,475	\$ 27,547
Investment securities available for sale (encumbered \$32,000 in 2008 and \$51,728 in 2007) (notes 3, 9, 10 and 14)	34,364	57,625
Federal Home Loan Bank of New York stock, at cost (note 9)	20,910	22,941
Mortgage-backed securities available for sale (encumbered \$40,652 in 2008 and \$53,884 in 2007) (notes 4, 9, 10 and 14)	40,801	54,137
Loans receivable, net (notes 5 and 9)	1,648,378	1,675,919
Mortgage loans held for sale	3,903	6,072
Interest and dividends receivable (note 6)	6,298	6,915
Real estate owned, net	1,141	438
Premises and equipment, net (note 7)	21,336	17,882
Servicing asset (note 5)	7,229	8,940
Bank Owned Life Insurance	39,135	38,430
Other assets (note 10)	15,976	10,653
Total assets	<u>\$1,857,946</u>	<u>\$1,927,499</u>
Liabilities and Stockholders' Equity		
Deposits (note 8)	\$1,274,132	\$1,283,790
Securities sold under agreements to repurchase with retail customers (note 9)	62,422	69,807
Securities sold under agreements to repurchase with the Federal Home Loan Bank (note 9)	—	12,000
Federal Home Loan Bank advances (note 9)	359,900	393,000
Other borrowings (note 9)	27,500	27,500
Advances by borrowers for taxes and insurance	7,581	7,588
Other liabilities (notes 10 and 13)	6,628	9,508
Total liabilities	<u>1,738,163</u>	<u>1,803,193</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 12,364,573 and 12,346,465 shares outstanding at December 31, 2008 and 2007, respectively	272	272
Additional paid-in capital	204,298	203,532
Retained earnings	160,267	154,929
Accumulated other comprehensive loss	(14,462)	(3,211)
Less: Unallocated common stock held by Employee Stock Ownership Plan	(5,069)	(5,360)
Treasury stock, 14,812,799 and 14,830,907 shares at December 31, 2008 and 2007, respectively	(225,523)	(225,856)
Common stock acquired by Deferred Compensation Plan	981	1,307
Deferred Compensation Plan liability	(981)	(1,307)
Total stockholders' equity	<u>119,783</u>	<u>124,306</u>
Total liabilities and stockholders' equity	<u>\$1,857,946</u>	<u>\$1,927,499</u>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income
(in thousands, except per share amounts)

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
Interest income:			
Loans	\$ 96,660	\$105,244	\$106,384
Mortgage-backed securities	2,210	2,775	3,304
Investment securities and other	4,535	6,945	6,874
Total interest income	103,405	114,964	116,562
Interest expense:			
Deposits (note 8)	26,756	36,586	33,401
Borrowed funds (note 9)	18,626	25,454	25,042
Total interest expense	45,382	62,040	58,443
Net interest income	58,023	52,924	58,119
Provision for loan losses (note 5)	1,775	700	150
Net interest income after provision for loan losses	56,248	52,224	57,969
Other income:			
Loan servicing income (note 5)	385	468	515
Fees and service charges	10,838	11,674	10,488
Net gain (loss) and lower of cost or market adjustment on sales of loans and securities available for sale (notes 3, 4 and 13)	799	(11,048)	1,358
Income on Bank Owned Life Insurance	705	1,285	1,143
Net income (loss) from other real estate operations	72	100	(61)
Other	24	52	165
Total other income	12,823	2,531	13,608
Operating expenses:			
Compensation and employee benefits (notes 11 and 12)	24,270	28,469	29,317
Occupancy (note 13)	5,487	5,651	4,850
Equipment	1,981	2,202	2,533
Marketing	1,833	1,482	1,517
Federal deposit insurance	1,104	626	533
Data processing	3,176	3,454	3,416
Legal	2,114	1,089	404
Check card processing	1,058	997	1,018
Accounting and audit	921	619	504
General and administrative	5,503	8,217	8,289
Goodwill impairment	—	1,014	—
Total operating expenses	47,447	53,820	52,381
Income before provision (benefit) for income taxes	21,624	935	19,196
Provision (benefit) for income taxes (note 10)	6,860	(140)	6,563
Net Income	\$ 14,764	\$ 1,075	\$ 12,633
Basic earnings per share (note 1)	\$ 1.27	\$.09	\$ 1.09
Diluted earnings per share (note 1)	\$ 1.26	\$.09	\$ 1.07
Average basic shares outstanding (note 1)	11,667	11,545	11,547
Average diluted shares outstanding (note 1)	11,758	11,648	11,765

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, 2008, 2007 and 2006	Common	Additional	Retained	Accumulated	Employee	Treasury	Common	Deferred	Total
	Stock	Paid-In Capital	Earnings	Other Comprehensive Loss	Stock Ownership Plan	Stock	Stock Acquired by Deferred Compensation Plan	Compensation Plan Liability	
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 awards	—	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
Comprehensive loss:									
Net income	—	—	1,075	—	—	—	—	—	1,075
Other comprehensive income:									
Unrealized holding loss on securities (net of tax benefit \$1,404)	—	—	—	(2,741)	—	—	—	—	(2,741)
Total comprehensive loss	—	—	—	—	—	—	—	—	(1,666)
Stock awards	—	414	—	—	—	—	—	—	414
Treasury stock allocated to restricted stock plan	—	(295)	(3)	—	—	298	—	—	—
Tax benefit of stock plans	—	337	—	—	—	—	—	—	337
Purchase 49,701 shares of common stock	—	—	—	—	—	(1,112)	—	—	(1,112)
Allocation of ESOP stock	—	—	—	—	1,009	—	—	—	1,009
ESOP adjustment	—	1,140	—	—	—	—	—	—	1,140
Cash dividend – \$.80 per share	—	—	(9,262)	—	—	—	—	—	(9,262)
Exercise of stock options	—	—	(1,002)	—	—	2,128	—	—	1,126
Sale of stock for the deferred compensation plan, net	—	—	—	—	—	—	(150)	150	—
Balance at December 31, 2007	272	203,532	154,929	(3,211)	(5,360)	(225,856)	1,307	(1,307)	124,306
Comprehensive income:									
Net income	—	—	14,764	—	—	—	—	—	14,764
Other comprehensive income:									
Unrealized holding loss on securities (net of tax benefit \$7,232)	—	—	—	(11,810)	—	—	—	—	(11,810)
Reclassification adjustment for losses included in net income (net of tax benefit \$343)	—	—	—	559	—	—	—	—	559
Total comprehensive income	—	—	—	—	—	—	—	—	3,513
Stock awards	—	581	—	—	—	—	—	—	581
Treasury stock allocated to restricted stock plan	—	(172)	(24)	—	—	196	—	—	—
Tax benefit of stock plans	—	51	—	—	—	—	—	—	51
Allocation of ESOP stock	—	—	—	—	291	—	—	—	291
ESOP adjustment	—	306	—	—	—	—	—	—	306
Cash dividend – \$.80 per share	—	—	(9,366)	—	—	—	—	—	(9,366)
Exercise of stock options	—	—	(36)	—	—	137	—	—	101
Sale of stock for the deferred compensation plan, net	—	—	—	—	—	—	(326)	326	—
Balance at December 31, 2008	\$ 272	\$204,298	\$160,267	\$ (14,462)	\$ (5,069)	\$(225,523)	\$ 981	\$ (981)	\$119,783

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in thousands)

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
Cash flows from operating activities:			
Net income	\$ 14,764	\$ 1,075	\$ 12,633
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization of premises and equipment	1,752	1,910	2,068
Amortization of ESOP	291	1,009	1,103
ESOP adjustment	306	1,140	1,849
Stock awards	581	414	337
Amortization of servicing asset	2,095	2,190	2,048
Amortization and impairment of intangible assets	—	1,114	158
Net premium amortization in excess of discount accretion on securities	24	93	221
Net premium amortization of deferred fees and discounts on loans	982	968	714
Provision for loan losses	1,775	700	150
Lower of cost or market write-down on loans held for sale	—	9,441	—
(Recovery) provision for repurchased loans	(248)	3,460	9,600
Deferred tax expense (benefit)	4,609	1,088	(2,950)
Net (gain) loss from sale of premises and equipment	(5)	21	—
Net (gain) loss on sales of real estate owned	(149)	(62)	99
Net gain on sales of loans and securities available for sale	(551)	(1,853)	(10,958)
Loans repurchased	—	(1,012)	—
Proceeds from sales of mortgage loans held for sale	103,091	378,847	701,112
Mortgage loans originated for sale	(99,853)	(319,821)	(743,165)
Increase in value of Bank Owned Life Insurance	(705)	(1,285)	(1,143)
Decrease (increase) in interest and dividends receivable	617	1,168	(994)
Increase in other assets	(3,043)	(619)	(793)
(Decrease) increase in other liabilities	(1,625)	(14,919)	12,911
Total adjustments	9,944	63,992	(27,633)
Net cash provided by (used in) operating activities	24,708	65,067	(15,000)
Cash flows from investing activities:			
Net decrease (increase) in loans receivable	23,274	28,079	(47,815)
Loans repurchased	(968)	(14,483)	—
Proceeds from sales of loans repurchased	—	8,666	—
Proceeds from sales of investment securities available for sale	3,122	—	437
Proceeds from sales of mortgage-backed securities available for sale	—	—	6,241
Purchase of investment securities available for sale	(1,087)	(681)	(748)
Purchase of mortgage-backed securities available for sale	—	—	(6,439)
Proceeds from maturities or calls of investment securities available for sale	2,065	20,780	2,584
Principal payments on mortgage-backed securities available for sale	13,431	14,653	17,117
Decrease (increase) in Federal Home Loan Bank of New York stock	2,031	2,405	(3,554)
Net proceeds (disbursements) from sale and acquisition of real estate owned	917	753	(39)
Proceeds from sale of premises and equipment	5	—	—
Purchases of premises and equipment	(5,206)	(1,617)	(4,146)
Net cash provided by (used in) investing activities	37,584	58,555	(36,362)
Cash flows from financing activities:			
(Decrease) increase in deposits	(9,658)	(88,538)	15,760
Increase (decrease) in short-term borrowings	18,515	34,325	(12,707)
Proceeds from Federal Home Loan Bank advances	57,000	20,000	205,000
Repayments of Federal Home Loan Bank advances	(116,000)	(95,000)	(135,000)
Repayments of securities sold under agreements to repurchase	(12,000)	—	(10,000)
Proceeds from other borrowings	—	10,000	12,500
(Decrease) increase in advances by borrowers for taxes and insurance	(7)	(155)	44
Tax benefit of stock plans	51	337	2,129
Exercise of stock options	101	1,126	1,627
Dividends paid	(9,366)	(9,262)	(9,277)
Purchase of treasury stock	—	(1,112)	(17,618)
Net cash (used in) provided by financing activities	(71,364)	(128,279)	52,458
Net (decrease) increase in cash and due from banks	(9,072)	(4,657)	1,096
Cash and due from banks at beginning of year	27,547	32,204	31,108
Cash and due from banks at end of year	\$ 18,475	\$ 27,547	\$ 32,204
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the year for:			
Interest	\$ 45,911	\$ 62,486	\$ 57,538
Income taxes	5,029	227	5,374
Noncash investing activities:			
Transfer of loans held-for-sale to loans held-for-investment	—	9,405	—
Transfer of securities sold under agreements to repurchase to advances	—	22,000	15,000
Transfer of loans receivable to real estate owned	1,471	841	70

See accompanying 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, LLC, 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.

Exit Activities

During 2007, the Bank exited the mortgage banking business operated by Columbia. All loan origination activity was ceased, although the Bank retained Columbia’s loan servicing portfolio. The exit was due to the significant operating losses incurred by Columbia in the fourth quarter of 2006 and the first quarter of 2007 and was completed prior to the end of 2007. Occupancy expenses for the years ended December 31, 2008 and 2007 include \$659,000 and \$760,000 for lease termination costs related to the exit activities in accordance with Financial Accounting Standards Board Statement No. 146, “Accounting for Costs Associated with Exit or Disposal Activities.”

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. The preparation of the accompanying consolidated financial statements in conformity with these accounting principles requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the determination of the reserve for repurchased loans, the valuation of real estate acquired in connection with foreclosures or in settlement of loans, the valuation of mortgage servicing rights and the evaluation of securities for other-than-temporary impairment. These estimates and assumptions are based on management’s best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. We adjust such estimates and assumptions when facts and circumstances dictate. The economic downturn, decline in consumer spending and declining real estate values have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

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 and as part of comprehensive income. In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company’s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Most of the Company’s investment and mortgage-backed securities are fixed income instruments that are not quoted on an exchange, but are bought and sold in active markets. Prices for these instruments are obtained through third party pricing vendors or security industry sources that actively participate in the buying and selling of securities. Prices obtained from these sources include market quotations and matrix pricing. Matrix pricing is a mathematical technique used principally to value certain securities without relying exclusively on quoted prices for the specific securities, but comparing the securities to benchmark or comparable securities. 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.

Other Than Temporary Impairments on Available for Sale Securities

One of the significant estimates related to available for sale securities is the evaluation of investments for other than temporary impairments. If a decline in the fair value of an available for sale security is judged to be other than temporary, a charge is recorded equal to the difference between the fair value and cost or amortized cost basis of the security. In addition, for securities expected to be sold, an other than temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale. The fair value of the other than temporarily impaired investment becomes its new cost basis. For fixed maturities, the Company would accrete the new cost basis to par over the expected remaining life of the security by adjusting the security’s yield.

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer’s financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period.

On a quarterly basis the Company evaluates the securities portfolio for other than temporary impairment. Securities that are in an unrealized loss position are reviewed to determine if an other than temporary impairment is present based on certain quantitative factors. The primary factors considered in evaluating whether a decline in value is other than temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and

the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery. At December 31, 2008, the Company concluded that unrealized losses on available for sale securities were only temporarily impaired.

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. A loan is considered past due when a payment has not been received in accordance with the contractual terms. 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. The Bank periodically sells part of its own mortgage production in order to manage interest rate risk and liquidity. The Bank has generally sold fixed-rate mortgage loans with final maturities in excess of 15 years and, occasionally adjustable-rate loans. Columbia sold virtually all loan production except that the Bank may have purchased adjustable-rate and fixed-rate mortgage loans originated by Columbia for inclusion in its held for investment loan portfolio. The Bank had generally purchased from Columbia adjustable-rate loans with prime credit quality.

In determining whether to retain 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 may also retain mortgage loan production in order to improve yields and increase balance sheet leverage.

During 2007, the Company executed a bulk sale of loans held for sale which also included repurchased loans classified as held for investment. The repurchased loans were sold because the Company intended to reduce its overall exposure to subprime loans. Of the loans held for investment portfolio, only those loans previously repurchased were included in the bulk sale.

Mortgage loans held for sale are carried at the lower of unpaid principal balance, net, or market value on an aggregate basis. Estimated market value is determined based on bid quotations from securities dealers.

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.

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. 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. Any interest and penalties on taxes payable are included as part of the provision for income taxes.

Impact of New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities”. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company adopted the statement effective January 1, 2008. The adoption of SFAS No. 159 did not have a material impact on the Company’s financial statements as the Company did not choose to measure any additional financial instruments or certain other items at fair value.

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 Company adopted the statement effective January 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the Company’s operations. In February 2008, Financial Accounting Standards Board Staff Position (“FSP”) No. 157-2, “Effective Date of FASB Statement No. 157” was issued. FSP No. 157-2 delayed the application of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009. In October 2008, FSP No. 157-3 “Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active” was issued which clarifies the applications of SFAS No. 157 in a market that is not active.

In June 2007, the Emerging Issues Task Force (“EITF”) of the FASB issued EITF 06-11 which provides guidance on how an entity should recognize the income tax benefit received on dividends that are (a) paid to employees holding equity-classified non-vested shares, equity-classified non-vested share units, or equity-classified outstanding share options and (b) charged to retained earnings under SFAS NO. 123(R). The Company adopted EITF 06-11 effective January 1, 2008. The adoption of EITF 06-11 did not have a material impact on the Company’s financial statements.

In June 2008, EITF 03-6-1 was issued which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of EITF 03-6-1 is not expected to have a material impact on the Company’s financial statements.

Stock-based Compensation

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 \$445,000, \$308,000 and \$206,000 of expense for stock option grants for the years ended December 31, 2008, 2007 and 2006, respectively. At December 31, 2008 the Company had \$1.3 million in compensation cost related to non-vested awards not yet recognized. This cost will be recognized over the remaining vesting period of 2.9 years.

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:

	2008	2007	2006
Risk-free interest rate	3.71%	4.63%	4.71%
Expected option life	7 years	7 years	7 years
Expected volatility	22%	21%	22%
Expected dividend yield	4.88%	3.60%	3.49%
Weighted average fair value of an option share granted during the year	\$ 2.39	\$ 4.15	\$ 4.81
Intrinsic value of options exercised during the year (in thousands)	<u>30</u>	<u>1,230</u>	<u>5,866</u>

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. Compensation cost is recognized on a straight line basis over the vesting period.

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 No. 142, “Goodwill and Other Intangible Assets.” SFAS No. 142 eliminated amortization of goodwill and requires that an annual impairment test be performed. The Company determined that there was an impairment to goodwill of \$1.0 million in 2007 based on the significant operating losses incurred by Columbia and the resultant negative equity. The impairment charge is included in operating expenses in the consolidated statements of income. The Company’s intangible assets, primarily core deposit intangibles, were amortized on a straight line basis over a period of ten years through December 31, 2007. The Company had no intangible assets remaining at December 31, 2007.

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 Company’s BOLI is invested in a separate account insurance product which is invested in a fixed income portfolio. The separate account includes stable value protection which maintains realizable value at book value with investment gains and losses amortized over future periods. 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.

The following reconciles shares outstanding for basic and diluted earnings per share for the years ended December 31, 2008, 2007 and 2006 (in thousands):

<u>Year ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Weighted average shares outstanding	12,360	12,324	12,444
Less: Unallocated ESOP shares	(618)	(695)	(821)
Unallocated Incentive award shares and shares held by deferred compensation plan	(75)	(84)	(76)
Average basic shares outstanding	11,667	11,545	11,547
Add: Effect of dilutive securities:			
Stock options	42	39	143
Incentive Awards and shares held by deferred compensation plan	49	64	75
Average diluted shares outstanding	<u>11,758</u>	<u>11,648</u>	<u>11,765</u>

For the years ended December 31, 2008, 2007 and 2006, 1,325,000, 1,297,000 and 638,000 , respectively, antidilutive stock options were excluded from earnings per share calculations.

(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, 2008, 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 4.0%; 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, 2008 and 2007, the Bank was considered well capitalized.

The following is a summary of the Bank’s actual capital amounts and ratios as of December 31, 2008 and 2007 compared to the OTS minimum capital adequacy requirements and the OTS requirements for classification as a well capitalized institution (in thousands).

<u>As of December 31, 2008:</u>	<u>Actual</u>		<u>For capital adequacy purposes</u>		<u>To be well capitalized under prompt corrective action</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Tangible capital	\$152,445	8.1%	\$ 28,219	1.5%	\$ —	— %
Core capital	152,445	8.1	75,251	4.0	94,064	5.0
Tier 1 risk-based capital	152,445	11.8	51,529	4.0	77,294	6.0
Risk-based capital	<u>162,868</u>	<u>12.6</u>	<u>103,058</u>	<u>8.0</u>	<u>128,823</u>	<u>10.0</u>
<u>As of December 31, 2007:</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Tangible capital	\$138,275	7.2%	\$ 28,930	1.5%	\$ —	— %
Core capital	138,275	7.2	77,147	4.0	96,433	5.0
Tier 1 risk-based capital	138,275	10.4	52,961	4.0	79,441	6.0
Risk-based capital	<u>148,440</u>	<u>11.2</u>	<u>105,921</u>	<u>8.0</u>	<u>132,402</u>	<u>10.0</u>

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, 2008 and 2007 are as follows (in thousands):

	<u>Amortized</u>	<u>Gross Unrealized</u>	<u>Gross Unrealized</u>	<u>Estimated</u>
<u>December 31, 2008</u>	<u>Cost</u>	<u>Gains</u>	<u>Losses</u>	<u>Market Value</u>
U. S. agency obligations	\$ 302	\$ 12	\$ —	\$ 314
State and municipal obligations	150	—	—	150
Corporate debt securities	55,000	—	(23,314)	31,686
Equity investments	2,196	25	(7)	2,214
	<u>\$ 57,648</u>	<u>\$ 37</u>	<u>\$(23,321)</u>	<u>\$34,364</u>
	<u>Amortized</u>	<u>Gross Unrealized</u>	<u>Gross Unrealized</u>	<u>Estimated</u>
<u>December 31, 2007</u>	<u>Cost</u>	<u>Gains</u>	<u>Losses</u>	<u>Market Value</u>
U. S. agency obligations	\$ 297	\$ 1	\$ —	\$ 298

State and municipal obligations	1,747	9	—	1,756
Corporate debt securities	54,973	—	(5,299)	49,674
Equity investments	5,586	318	(7)	5,897
	<u>\$ 62,603</u>	<u>\$ 328</u>	<u>\$ (5,306)</u>	<u>\$57,625</u>

Gains realized during 2008, 2007 and 2006 on the sale of investment securities available for sale totaled \$239,000, \$-0-, and \$155,000, respectively. Realized losses during 2008 on the sale of investment securities available for sale totaled \$1,141,000. There were no losses realized during 2007 or 2006 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, 2008 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, 2008, investment securities available for sale with an amortized cost and estimated market value of \$55,000,000 and \$31,686,000, respectively, were callable prior to the maturity date.

	Amortized	Estimated
	Cost	Market Value
December 31, 2008		
Less than one year	\$ 150	\$ 150
Due after one year through five years	302	314
Due after five years through ten years	—	—
Due after ten years	55,000	31,686
	<u>\$ 55,452</u>	<u>\$32,150</u>

Notes to Consolidated Financial Statements (continued)

The estimated market value (carrying amount) of investment securities pledged as required security for deposits and for other purposes required by law amounted to \$314,000 and \$2,054,000 at December 31, 2008 and 2007, respectively. Additionally, the estimated market value (carrying amount) of investment securities pledged as collateral for reverse repurchase agreements amounted to \$31,686,000 and \$49,674,000 at December 31, 2008 and 2007, respectively.

The estimated market value and unrealized loss for investment securities available for sale at December 31, 2008 and 2007, segregated by the duration of the unrealized loss are as follows (in thousands):

December 31, 2008

	Less than 12 months		12 months or longer		Total	
	Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
	Market Value	Losses	Market Value	Losses	Market Value	Losses
Corporate debt securities	\$ —	\$ —	\$31,686	\$ (23,314)	\$31,686	\$ (23,314)
Equity investments	1,819	(7)	—	—	1,819	(7)
	<u>\$ 1,819</u>	<u>\$ (7)</u>	<u>\$31,686</u>	<u>\$ (23,314)</u>	<u>\$33,505</u>	<u>\$ (23,321)</u>

December 31, 2007

	Less than 12 months		12 months or longer		Total	
	Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
	Market Value	Losses	Market Value	Losses	Market Value	Losses
Corporate debt securities	\$ —	\$ —	\$49,674	\$ (5,299)	\$49,674	\$ (5,299)
Equity investments	243	(7)	—	—	243	(7)
	<u>\$ 243</u>	<u>\$ (7)</u>	<u>\$49,674</u>	<u>\$ (5,299)</u>	<u>\$49,917</u>	<u>\$ (5,306)</u>

At December 31, 2008 the market value of each corporate debt security was below cost. The portfolio consisted of eleven \$5.0 million issues spread between eight issuers. 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. All of the financial institutions were considered well-capitalized and continue to make interest payments under the terms of the debt securities. No interest payments have been deferred. Based upon management's analysis, the financial institutions have the ability to meet debt service requirements for the foreseeable future. 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. In addition, the market for these types of securities has become increasingly illiquid and volatile. Although these investment securities are available for sale, the Company has the intent and the ability to hold these securities until maturity or market recovery at which time the Company expects to receive the fully amortized cost. As a result, the Company concluded that unrealized losses on available for sale securities were only temporarily impaired at December 31, 2008.

(4) Mortgage-Backed Securities Available for Sale

The amortized cost and estimated market value of mortgage-backed securities available for sale at December 31, 2008 and 2007 are as follows (in thousands):

	Amortized	Gross Unrealized	Gross Unrealized	Estimated
	Cost	Gains	Losses	Market Value
December 31, 2008				
FHLMC	\$ 9,593	\$ 114	\$ (20)	\$ 9,687
FNMA	29,597	171	(139)	29,629
GNMA	1,407	78	—	1,485
	<u>\$ 40,597</u>	<u>\$ 363</u>	<u>\$ (159)</u>	<u>\$ 40,801</u>
	Amortized	Gross Unrealized	Gross Unrealized	Estimated
	Cost	Gains	Losses	Market Value
December 31, 2007				
FHLMC	\$ 11,845	\$ 64	\$ (47)	\$ 11,862
FNMA	40,559	104	(181)	40,482
GNMA	1,696	97	—	1,793
	<u>\$ 54,100</u>	<u>\$ 265</u>	<u>\$ (228)</u>	<u>\$ 54,137</u>

There were no gains realized on the sale of mortgage-backed securities available for sale during 2008, 2007 or 2006. Losses realized during 2008, 2007 and 2006 on the sale of mortgage-backed securities available for sale totaled \$-0-, \$-0-, and \$148,000, respectively.

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 \$10,573,000 and \$21,172,000 at December 31, 2008 and 2007, respectively. The estimated market value (carrying amount) of mortgage-backed securities pledged as collateral for reverse repurchase agreements amounted to \$30,079,000 and \$32,712,000 at December 31, 2008 and 2007, respectively.

The estimated market value and unrealized loss for mortgage-backed securities available for sale at December 31, 2008 and 2007, segregated by the duration of the unrealized loss are as follows (in thousands):

December 31, 2008

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Estimated</u>	<u>Unrealized</u>	<u>Estimated</u>	<u>Unrealized</u>	<u>Estimated</u>	<u>Unrealized</u>
	<u>Market Value</u>	<u>Losses</u>	<u>Market Value</u>	<u>Losses</u>	<u>Market Value</u>	<u>Losses</u>
FHLMC	\$ 1,105	\$ (10)	\$ 455	\$ (10)	\$ 1,560	\$ (20)
FNMA	5,133	(68)	5,894	(71)	11,027	(139)
	<u>\$ 6,238</u>	<u>\$ (78)</u>	<u>\$ 6,349</u>	<u>\$ (81)</u>	<u>\$12,587</u>	<u>\$ (159)</u>

December 31, 2007

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Estimated</u>	<u>Unrealized</u>	<u>Estimated</u>	<u>Unrealized</u>	<u>Estimated</u>	<u>Unrealized</u>
	<u>Market Value</u>	<u>Losses</u>	<u>Market Value</u>	<u>Losses</u>	<u>Market Value</u>	<u>Losses</u>
FHLMC	\$ 425	\$ (1)	\$ 5,266	\$ (46)	\$ 5,691	\$ (47)
FNMA	—	—	23,405	(181)	23,405	(181)
	<u>\$ 425</u>	<u>\$ (1)</u>	<u>\$28,671</u>	<u>\$ (227)</u>	<u>\$29,096</u>	<u>\$ (228)</u>

The mortgage-backed securities are issued and guaranteed by either FHLMC or FNMA, corporations which are chartered by the United States Government and whose debt obligations are typically rated AAA 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 intent and the ability to hold these securities until maturity or market recovery at which time the Company expects to receive the fully amortized cost. As a result, the Company concluded that unrealized losses on available for sale securities were only temporarily impaired at December 31, 2008.

(5) Loans Receivable, Net

A summary of loans receivable at December 31, 2008 and 2007 follows (in thousands):

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Real estate mortgage:		
One-to-four family	\$1,029,324	\$1,071,976
Commercial real estate, multi-family and land	329,844	326,707
FHA insured & VA guaranteed	6,148	6,639
	<u>1,365,316</u>	<u>1,405,322</u>
Real estate construction	10,561	10,816
Consumer	222,797	213,282
Commercial	59,760	54,279
Total loans	<u>1,658,434</u>	<u>1,683,699</u>
Loans in process	(3,586)	(2,452)
Deferred origination costs, net	5,195	5,140
Allowance for loan losses	<u>(11,665)</u>	<u>(10,468)</u>
	<u>(10,056)</u>	<u>(7,780)</u>
	<u>\$1,648,378</u>	<u>\$1,675,919</u>

At December 31, 2008, 2007 and 2006 loans in the amount of \$16,043,000, \$8,741,000 and \$4,525,000, respectively, were three or more months delinquent or in the process of foreclosure and the Company was not accruing interest income. At December 31, 2008, the impaired loan portfolio consisted of seven commercial real estate loans and one commercial loan totaling \$5,278,000 for which there was a specific allocation in the allowance for loan losses of \$19,000. At December 31, 2007, the impaired loan portfolio consisted of two commercial real estate loans and one commercial loan totaling \$999,000 for which there was no specific or general allocations in the allowance for loan losses due to collateral coverage in excess of the loan amount. The average balance of impaired loans for the years ended December 31, 2008, 2007 and 2006 was \$3,781,000, \$2,608,000 and \$347,000, respectively. If interest income on nonaccrual loans and impaired loans had been current in accordance with their original terms, approximately \$913,000, \$210,000 and \$189,000 of interest income for the years ended December 31, 2008, 2007 and 2006, respectively, would have been recorded. At December 31, 2008, 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, 2008, 2007 and 2006 is as follows (in thousands):

<u>Year Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Balance at beginning of year	\$10,468	\$10,238	\$10,460
Provision charged to operations	1,775	700	150
Charge-offs	(884)	(477)	(569)
Recoveries	306	7	197
Balance at end of year	<u>\$11,665</u>	<u>\$10,468</u>	<u>\$10,238</u>

An analysis of the servicing asset for the years ended December 31, 2008, 2007 and 2006 is as follows (in thousands):

<u>Year Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Balance at beginning of year	\$ 8,940	\$ 9,787	\$ 9,730
Capitalized mortgage servicing rights	384	1,343	2,105
Amortization and impairment charges	<u>(2,095)</u>	<u>(2,190)</u>	<u>(2,048)</u>
Balance at end of year	<u>\$ 7,229</u>	<u>\$ 8,940</u>	<u>\$ 9,787</u>

Loans serviced for others amounted to \$977,410,000 and \$1,026,070,000 at December 31, 2008 and 2007, respectively, all of which relate to residential loans. At December 31, 2008, the servicing asset had an estimated fair value of \$7,777,000 and was valued based on expected future cash flows considering a weighted average discount rate of 9.7%, a weighted average constant prepayment rate on mortgages of 14.9% and a weighted average life of 6.1 years. At December 31, 2007, the servicing asset had an estimated fair value of \$13,995,000 and was valued based on expected future cash flows considering a weighted average discount rate of 8.1%, a weighted average constant prepayment rate on mortgages of 11.9% and a weighted average life of 7.5 years. As of December 31, 2008, estimated future servicing amortization through 2012 based on the prepayment assumptions utilized in the December 31, 2008 valuation, is as follows: \$2,080,000 for 2009, \$1,636,000 for 2010, \$1,272,000 for 2011, \$875,000 for 2012 and \$587,000 for 2013. Actual results will vary depending upon the level of repayments on the loans currently serviced.

The Bank's mortgage loans are used to secure FHLB advances.

(6) Interest and Dividends Receivable

A summary of interest and dividends receivable at December 31, 2008 and 2007 follows (in thousands):

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Loans	\$5,773	\$6,172
Investment securities	349	509
Mortgage-backed securities	176	234
	<u>\$6,298</u>	<u>\$6,915</u>

(7) Premises and Equipment, Net

Premises and equipment at December 31, 2008 and 2007 are summarized as follows (in thousands):

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Land	\$ 3,195	\$ 3,195
Buildings and improvements	23,205	18,834
Leasehold improvements	2,060	1,671
Furniture and equipment	15,069	13,596
Automobiles	315	330
Construction in progress	61	1,089
Total	43,905	38,715
Accumulated depreciation and amortization	(22,569)	(20,833)
	<u>\$ 21,336</u>	<u>\$ 17,882</u>

(8) Deposits

Deposits, including accrued interest payable of \$100,000 and \$174,000 at December 31, 2008 and 2007, respectively, are summarized as follows (in thousands):

December 31,	2008		2007	
	Amount	Weighted Average Cost	Amount	Weighted Average Cost
Non-interest-bearing accounts	\$ 97,278	— %	\$ 103,656	— %
Interest-bearing checking accounts	517,334	1.58	454,666	2.33
Money market deposit accounts	84,928	.89	84,287	1.59
Savings accounts	207,224	.86	187,095	.99
Time deposits	367,368	2.89	454,086	4.36
	<u>\$1,274,132</u>	<u>1.67%</u>	<u>\$1,283,790</u>	<u>2.61%</u>

Included in time deposits at December 31, 2008 and 2007, respectively, is \$75,608,000 and \$98,514,000 in deposits of \$100,000 and over.

Time deposits at December 31, 2008 mature as follows (in thousands):

Year Ended December 31,	
2009	\$ 295,037
2010	33,449
2011	10,946
2012	17,858
2013	2,729
Thereafter	7,349
	<u>\$ 367,368</u>

Interest expense on deposits for the years ended December 31, 2008, 2007 and 2006 is as follows (in thousands):

Year Ended December 31,	2008	2007	2006
Interest-bearing checking accounts	\$ 9,688	\$11,343	\$ 8,216
Money market deposit accounts	1,091	1,577	1,994
Savings accounts	2,014	1,941	1,730
Time deposits	13,963	21,725	21,461
	<u>\$26,756</u>	<u>\$36,586</u>	<u>\$33,401</u>

(9) Borrowed Funds

Borrowed funds are summarized as follows (in thousands):

December 31,	2008		2007	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Federal Home Loan Bank advances	\$359,900	3.73%	\$393,000	4.82%
Securities sold under agreements to repurchase	62,422	1.17	81,807	2.89
Other borrowings	27,500	4.79	27,500	6.84
	<u>\$449,822</u>	<u>3.44%</u>	<u>\$502,307</u>	<u>4.62%</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	
	2008	2007	2008	2007
Average balance	\$344,302	\$413,352	\$69,664	\$84,303
Maximum amount outstanding at any month end	401,900	454,200	78,743	94,199
Average interest rate for the year	4.64%	4.94%	1.74%	4.02%
Amortized cost of collateral:				
Corporate securities	—	—	\$55,000	\$54,973
Mortgage-backed securities	—	—	29,962	32,626
Estimated market value of collateral:				

Corporate securities	—	—	31,686	49,674
Mortgage-backed securities	<u>—</u>	<u>—</u>	<u>30,079</u>	<u>32,712</u>

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, 2008 as follows (in thousands):

<u>Year Ended December 31,</u>	<u>FHLB</u>	<u>Reverse</u>
<u>2009</u>	<u>Advances</u>	<u>Repurchase</u>
	\$191,900	\$ 62,422
2010	85,000	—
2011	48,000	—
2012	15,000	—
2013	<u>20,000</u>	<u>—</u>
	<u>\$359,900</u>	<u>\$ 62,422</u>
Amount callable by lender prior to the maturity date	<u>\$ 15,000</u>	<u>\$ —</u>

During 2007, the Company issued \$10 million of trust preferred securities which carry a floating rate of 175 basis points over 3 month LIBOR adjusted quarterly. Accrued interest is due quarterly with principal due at the maturity date of September 1, 2037. 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, 2008, 2007 and 2006 is as follows (in thousands):

<u>Year Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal Home Loan Bank advances	\$15,873	\$20,334	\$20,184
Securities sold under agreements to repurchase	1,209	3,393	4,068
Other borrowings	<u>1,544</u>	<u>1,727</u>	<u>790</u>
	<u>\$18,626</u>	<u>\$25,454</u>	<u>\$25,042</u>

The Bank has an available overnight line of credit with the FHLB for \$99,387,000 which expires July 31, 2009. The Bank also has available from the FHLB, a one-month overnight repricing line of credit for \$99,387,000 which expires July 31, 2009. 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.

(10) Income Taxes

The provision (benefit) for income taxes for the years ended December 31, 2008, 2007 and 2006 consists of the following (in thousands):

<u>Year Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current:			
Federal	\$2,603	\$ 704	\$ 8,893
State	(413)	29	581
Total current	<u>2,190</u>	<u>733</u>	<u>9,474</u>
Deferred:			
Federal	4,401	(873)	(2,460)
State	269	—	(451)
Total deferred	<u>4,670</u>	<u>(873)</u>	<u>(2,911)</u>
	<u>\$6,860</u>	<u>\$(140)</u>	<u>\$ 6,563</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 \$(6,889,000), \$(1,404,000) and \$520,000 for the years ended December 31, 2008, 2007 and 2006, respectively. Included in stockholders' equity is income tax benefit attributable to stock plans in the amount of \$51,000, \$337,000 and \$2,129,000 for the years ended December 31, 2008, 2007 and 2006, 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, 2008, 2007 and 2006 is as follows (in thousands):

<u>Year Ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Income before provision (benefit) for income taxes	\$21,624	\$ 935	\$19,196
Applicable statutory Federal income tax rate	35.0%	35.0%	35.0%
Computed "expected" Federal income tax expense	\$ 7,568	\$ 327	\$ 6,719
Increase(decrease) in Federal income tax expense resulting from:			
ESOP adjustment	107	399	647
ESOP dividends	(380)	(403)	(397)
Earnings on life insurance	(247)	(450)	(400)
State income taxes net of Federal benefit	(94)	19	85
Other items, net	(94)	(32)	(91)
	<u>\$ 6,860</u>	<u>\$(140)</u>	<u>\$ 6,563</u>

Included in other assets at December 31, 2008 and 2007 is a net deferred tax asset of \$11,276,000 and \$9,057,000, respectively. In addition, at December 31, 2008 and 2007 the Company recorded a current tax receivable (payable) of \$2,319,000 and \$(239,000), 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, 2008 and 2007 are presented in the following table (in thousands):

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Allowance for loan and real estate owned losses per books	\$ 4,765	\$ 4,277
Reserve for repurchased loans	467	979
Valuation allowances for repurchased loans	339	472
Reserve for uncollected interest	392	97
Deferred compensation	874	1,004
Premises and equipment, differences in depreciation	—	942
Other reserves	40	81
Stock plans	456	275
Unrealized loss on securities available for sale	9,428	2,018
Intangible assets	373	439
Lease termination costs	356	274
Partnership investment income	—	259

State alternative minimum tax	1,160	1,160
Federal net operating loss carryforward	—	1,873
State net operating loss carryforward	—	948
Total gross deferred tax assets	18,650	15,098
Less valuation allowance	(1,527)	(2,104)
Deferred tax assets, net	17,123	12,994
Deferred tax liabilities:		
Excess servicing on sale of mortgage loans	(816)	(1,161)
Investments, discount accretion	(433)	(422)
Deferred loan and commitment costs, net	(2,186)	(2,139)
ESOP	(147)	(215)
Premises and equipment, differences in depreciation	(463)	—
Undistributed REIT income	(1,802)	—
Total deferred tax liabilities	(5,847)	(3,937)
Net deferred tax assets	\$11,276	\$ 9,057

The Company has determined that a valuation allowance should be established for state deferred tax assets other than the alternative minimum tax as it was considered more likely than not that the Bank, based on anticipated changes to its corporate structure, would not have sufficient earnings to realize the benefit. At December 31, 2007, a valuation allowance was also established for the state net operating loss carryforward. The Company has determined that it is not required to establish a valuation reserve for the remaining net deferred tax asset 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.

Notes to Consolidated Financial Statements (continued)

Retained earnings at December 31, 2008 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, 2008 the Company had an unrecognized deferred tax liability of \$3,763,000 with respect to this reserve.

A reconciliation of the amount of unrecognized tax benefits for the years ended December 31, 2008 and 2007 follows (in thousands). There were no unrecognized tax benefits for the year ended December 31, 2006. The unrecognized tax benefits for the years ended December 31, 2008 and 2007 would affect the effective income tax rate if recognized.

Year Ended December 31,	2008	2007
Balance at beginning of year	\$ 338	\$—
State tax benefits (settled) originated	(338)	338
Balance at end of year	<u>\$ —</u>	<u>\$338</u>

The tax years that remain subject to examination by the Federal government include the year ended December 31, 2005 and forward. The tax years that remain subject to examination by the State of New Jersey include the years ended December 31, 2004 and forward.

(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. During 2007 and 2006 ESOP shares were 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. This feature was eliminated in 2008. During 2007 and 2006, 22,555 and 19,339 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, 2008 and 2007 contributions to the ESOP, which were used to fund principal and interest payments on the ESOP debt, totaled \$521,000 and \$1,678,000, respectively. During 2008 and 2007, \$527,000 and \$595,000, respectively, of dividends paid on unallocated ESOP shares were used for debt service. At December 31, 2008 and 2007, the loan had an outstanding balance of \$4,683,000 and \$4,807,000, respectively, and the ESOP had unallocated shares of 601,016 and 635,551, respectively. At December 31, 2008, the unallocated shares had a fair value of \$9,977,000. 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, 2008, 2007 and 2006, the Bank recorded compensation expense related to the ESOP of \$597,000, \$2,149,000 and \$2,952,000, respectively, including \$306,000, \$1,140,000 and \$1,849,000, 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, 2008, 2,011,337 shares had been allocated to participants and 34,534 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 63,688 shares remain to be issued at December 31, 2008. 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 918,478 shares remain to be issued at December 31, 2008. 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, 2008, 2007 and 2006 follows:

	2008		2007		2006	
	Number of Shares	Average Exercise Price	Number of Shares	Average Exercise Price	Number of Shares	Average Exercise Price
Outstanding at beginning of year	1,385,203	\$ 21.10	1,495,859	\$ 20.24	1,732,410	\$ 16.90
Granted	217,644	16.87	205,985	21.61	258,800	23.43

Exercised	(8,410)	14.02	(127,416)	10.57	(480,500)	9.94
Forfeited	(37,325)	21.78	(189,225)	21.87	(14,851)	22.62
Outstanding at end of year	<u>1,557,112</u>	<u>\$ 20.55</u>	<u>1,385,203</u>	<u>\$ 21.10</u>	<u>1,495,859</u>	<u>\$ 20.24</u>
Options exercisable	<u>1,062,004</u>	<u> </u>	<u>1,023,238</u>	<u> </u>	<u>1,235,769</u>	<u> </u>

The following table summarizes information about stock options outstanding at December 31, 2008:

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
\$ 9.87 - 12.63	53,503	1.37 years	\$ 12.30	53,503	1.37 years	\$ 12.30
13.06 - 15.04	11,963	2.04	14.16	11,963	2.04	14.16
16.81 - 17.88	521,777	5.62	17.44	308,136	3.16	17.88
18.64 - 23.23	525,588	6.46	22.13	365,921	5.72	22.36
23.44 - 27.11	444,281	5.70	23.49	322,481	5.17	23.50
	<u>1,557,112</u>	<u>5.75 years</u>	<u>\$ 20.55</u>	<u>1,062,004</u>	<u>4.55 years</u>	<u>\$ 20.81</u>

The aggregate intrinsic value for stock options outstanding and stock options exercisable at December 31, 2008 is \$259,000.

(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.

At December 31, 2008, the following commitments and contingent liabilities existed which are not reflected in the accompanying consolidated financial statements (in thousands):

December 31,	2008
Unused consumer and construction loan lines of credit (primarily floating-rate)	\$ 117,795
Unused commercial loan lines of credit (primarily floating-rate)	56,422
Other commitments to extend credit:	
Fixed-Rate	25,877
Adjustable-Rate	6,632
Floating-Rate	<u>14,809</u>

The Company's fixed-rate loan commitments expire within 90 days of issuance and carried interest rates ranging from 4.88% to 7.63% at December 31, 2008.

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. The reserve for repurchased loans was established to provide for expected losses related to outstanding loan repurchase requests and additional repurchase requests which may be received on loans previously sold to investors. In establishing the reserve for repurchased loans, the Company considered all types of sold loans.

An analysis of the reserve for repurchased loans for the years ended December 31, 2008, 2007 and 2006 follows (in thousands).

Year ended December 31,	2008	2007	2006
Balance at beginning of year	\$ 2,398	\$ 9,600	\$ —
(Recovery) provision charged to operations, net	(248)	3,460	9,600
Loss on loans repurchased	(1,007)	(10,662)	—
Balance at end of year	<u>\$ 1,143</u>	<u>\$ 2,398</u>	<u>\$9,600</u>

At December 31, 2008, the Company is obligated under noncancelable operating leases for premises and equipment. Rental expense under these leases aggregated approximately \$2,500,000, \$2,865,000 and \$2,159,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

The projected minimum rental commitments as of December 31, 2008 are as follows (in thousands):

Year ended December 31,	
2009	\$ 2,067
2010	1,867
2011	1,843
2012	1,614
2013	1,426
Thereafter	<u>18,825</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. 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, 2008 was \$172.9 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. During 2008, there has been a weakening in the local economy coupled with declining real estate values. A further decline in real estate values could cause some residential and commercial mortgage loans to become inadequately collateralized, which would expose the Bank to a greater risk of loss.

The Company believes its lending policies and procedures adequately minimize the potential exposure to such 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 Measurements

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair market measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or the most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS No. 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS No. 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

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

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

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

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

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2008 segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (dollars in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Investment securities available for sale	\$ 709	\$33,655	\$ —	\$34,364
Mortgage-backed securities available for sale	\$ —	\$40,801	\$ —	\$40,801

Certain financial assets and financial liabilities are measured at fair value on a non-recurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and liabilities measured at fair value on a non-recurring basis were not significant as of December 31, 2008.

SFAS No. 157 will be applicable to certain non-financial assets and non-financial liabilities measured at fair value on a recurring and non-recurring basis, such as real estate owned, beginning January 1, 2009.

(15) 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 time deposits are 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 significant financial instruments as of December 31, 2008 and 2007 are presented in the following tables (in thousands).

<u>December 31, 2008</u>	<u>Book Value</u>	<u>Fair Value</u>
Financial Assets:		
Cash and due from banks	\$ 18,475	\$ 18,475
Investment securities available for sale	34,364	34,364
Mortgage-backed securities available for sale	40,801	40,801
Federal Home Loan Bank of New York stock	20,910	20,910
Loans receivable and mortgage loans held for sale	1,652,281	1,644,004
Financial Liabilities:		
Deposits	1,274,132	1,277,248
Borrowed funds	<u>449,822</u>	<u>456,365</u>
December 31, 2007		
Financial Assets:		
Cash and due from banks	\$ 27,547	\$ 27,547
Investment securities available for sale	57,625	57,625
Mortgage-backed securities available for sale	54,137	54,137
Federal Home Loan Bank of New York stock	22,941	22,941
Loans receivable and mortgage loans held for sale	1,681,991	1,675,881
Financial Liabilities:		
Deposits	1,283,790	1,283,688
Borrowed funds	<u>502,307</u>	<u>503,431</u>

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 significant unobservable inputs. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions

could significantly affect the estimates.

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

(16) Parent-Only Financial Information

The following condensed statements of financial condition at December 31, 2008 and 2007 and condensed statements of operations and cash flows for the years ended December 31, 2008, 2007 and 2006 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)

<u>December 31,</u>	<u>2008</u>	<u>2007</u>
Assets		
Cash and due from banks	\$ 7	\$ 7
Advances to subsidiary Bank	1,388	5,719
Investment securities	2,214	5,897
ESOP loan receivable	4,683	4,807
Investment in subsidiary Bank	138,696	135,241
Other assets	508	515
Total assets	<u>\$ 147,496</u>	<u>\$ 152,186</u>
Liabilities and Stockholders' Equity		
Borrowings	\$ 27,500	\$ 27,500
Other liabilities	213	380
Stockholders' equity	119,783	124,306
Total liabilities and stockholders' equity	<u>\$ 147,496</u>	<u>\$ 152,186</u>

CONDENSED STATEMENTS OF OPERATIONS

(in thousands)

<u>Year ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Dividend income - Subsidiary Bank	\$ 3,200	\$ —	\$15,000
Dividend income - Investment securities	652	700	485
(Loss) gain on sale- Investment securities	(1,023)	—	155
Interest income - Advances to subsidiary Bank	49	236	106
Interest income - ESOP loan receivable	397	494	608
Total dividend and interest income	3,275	1,430	16,354
Interest expense - borrowings	1,443	1,601	790
Operating expenses	1,279	1,287	1,273
Income before income taxes and undistributed earnings (distribution in excess of earnings) of subsidiary Bank	553	(1,458)	14,291
Benefit for income taxes	1,441	515	253
Income before undistributed earnings (distributions in excess of earnings) of subsidiary Bank	1,994	(943)	14,544
Undistributed earnings (distributions in excess of earnings) of subsidiary Bank	12,770	2,018	(1,911)
Net Income	<u>\$14,764</u>	<u>\$ 1,075</u>	<u>\$12,633</u>

CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

<u>Year ended December 31,</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:			
Net income	\$ 14,764	\$ 1,075	\$ 12,633
Decrease (increase) in advances to subsidiary Bank	4,331	(36)	(2,789)
(Undistributed earnings) distributions in excess of earnings of subsidiary Bank	(12,770)	(2,018)	1,911
Loss (gain) on sale of investment securities	1,023	—	(155)
Change in other assets and other liabilities	(574)	(276)	(183)
Net cash provided by (used in) operating activities	<u>6,774</u>	<u>(1,255)</u>	<u>11,417</u>
Cash flows from investing activities:			
Proceeds from sale of investment securities	3,000	—	436
Purchase of investment securities	(633)	(681)	(463)
Repayments on ESOP loan receivable	124	1,184	1,378
Net cash provided by investing activities	<u>2,491</u>	<u>503</u>	<u>1,351</u>
Cash flows from financing activities:			
Proceeds from borrowings	—	10,000	12,500
Dividends paid	(9,366)	(9,262)	(9,277)
Purchase of treasury stock	—	(1,112)	(17,618)
Exercise of stock options	101	1,126	1,627
Net cash (used in) provided by financing activities	<u>(9,265)</u>	<u>752</u>	<u>(12,768)</u>
Net increase in cash and due from banks	<u>—</u>	<u>—</u>	<u>—</u>
Cash and due from banks at beginning of year	<u>7</u>	<u>7</u>	<u>7</u>
Cash and due from banks at end of year	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>

(17) Subsequent Events

On January 16, 2009, (the “Closing Date”) as part of the U.S. Department of the Treasury (the “Treasury”) Troubled Asset Relief Program (“TARP”) Capital Purchase Program, the Company entered into a Letter Agreement (“Letter Agreement”) and a Securities Purchase Agreement - Standard Terms attached thereto (“Securities Purchase Agreement”) with the Treasury, pursuant to which the Company agreed to issue and sell, and the Treasury agreed to purchase, (i) 38,263 shares (the “Preferred Shares”) of the Company’s Fixed Rate Cumulative Perpetual Stock, Series A, having a liquidation preference of \$1,000 per share, and (ii) a ten-year warrant (the “Warrant”) to purchase up to 380,853 shares of the Company’s common stock, \$0.01 par value (“Common Stock”), at an exercise price of \$15.07 per share, for an aggregate purchase price of \$38,263,000 in cash.

Cumulative dividends on the Preferred Shares will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter, but will be paid only if, as and when declared by the Company’s Board of Directors. The Preferred Shares have no maturity date and rank senior to the Common Stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. Notwithstanding any provision in the Securities Purchase Agreement, the recently enacted American Recovery and Reinvestment Act of 2009 (“ARRA”) permits the Company, with the approval of the Secretary of the Treasury after consultation with the OTS, to redeem the preferred shares without regard to whether the Company has raised gross proceeds from a Qualified Equity Offering or any other source and without regard to any waiting period. In the event the Company would redeem the preferred shares, the Treasury must liquidate warrants at the current market price. Unless both the holder and the Company agree otherwise, the exercise of the Warrant will be a net exercise (i.e., the holder does not pay cash but gives up shares with a market value at the time of exercise equal to the exercise price, resulting in a net settlement with significantly fewer than the 380,853 share of Common Stock being issued). The Securities Purchase Agreement, pursuant to which the Preferred Shares and Warrant were sold, contains limitations on the payment of dividends on the Common Stock (including with respect to the payment of cash dividends in excess of \$.20 per share, which was the amount of the last regular dividend declared by the Company prior to October 14, 2008). There are additional limitations on the Company’s ability to repurchase its common stock and repurchase or redeem its trust preferred securities, and the Company is subjected to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (the “EESA”) and the ARRA.

The Securities Purchase Agreement and all related documents may be amended unilaterally by the Treasury to the extent required to comply with any changes in applicable federal statutes after the execution thereof.

SELECTED CONSOLIDATED QUARTERLY FINANCIAL DATA

(Unaudited)

Quarter ended (dollars in thousands, except per share data)	Dec. 31	Sept. 30	June 30	March 31
2008				
Interest income	\$24,982	\$25,234	\$25,667	\$27,522
Interest expense	10,086	10,604	11,405	13,287
Net interest income	14,896	14,630	14,262	14,235
Provision for loan losses	600	400	400	375
Net interest income after provision for loan losses	14,296	14,230	13,862	13,860
Other income	2,826	3,607	2,620	3,770
Operating expenses	12,182	12,263	11,368	11,634
Income before provision for income taxes	4,940	5,574	5,114	5,996
Provision for income taxes	1,440	1,852	1,579	1,990
Net income	\$ 3,500	\$ 3,722	\$ 3,535	\$ 4,006
Basic earnings per share	\$.30	\$.32	\$.30	\$.34
Diluted earnings per share	\$.30	\$.32	\$.30	\$.34
2007				
Interest income	\$27,816	\$28,223	\$28,553	\$30,372
Interest expense	14,830	15,392	15,854	15,964
Net interest income	12,986	12,831	12,699	14,408
Provision for loan losses	175	75	110	340
Net interest income after provision for loan losses	12,811	12,756	12,589	14,068
Other income (loss)	4,116	4,562	225	(6,372)
Operating expenses	12,376	12,610	13,744	15,090
Income (loss) before provision (benefit) for income taxes	4,551	4,708	(930)	(7,394)
Provision (benefit) for income taxes	1,457	1,582	(1,207)	(1,972)
Net income (loss)	\$ 3,094	\$ 3,126	\$ 277	\$ (5,422)
Basic earnings (loss) per share	\$.27	\$.27	\$.02	\$ (.47)
Diluted earnings (loss) per share	\$.26	\$.27	\$.02	\$ (.47)

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, 2008 and 2007, 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, 2008. 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, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, 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 Company’s internal control over financial reporting as of December 31, 2008, 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 13, 2009 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

KPMG LLP

Short Hills, New Jersey

March 13, 2009

Management Report on Internal Control Over Financial Reporting

Management of OceanFirst Financial Corp. and subsidiary (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, 2008. This assessment was based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this assessment, management believes that, as of December 31, 2008, the Company maintained effective internal control over financial reporting based on those criteria.

The Company’s independent registered public accounting firm has issued an audit report on the effectiveness of the Company’s internal control over financial reporting. This report appears on page 42.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

OceanFirst Financial Corp.:

We have audited OceanFirst Financial Corp.'s and subsidiary (the "Company") internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included 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.

In our opinion, OceanFirst Financial Corp. and subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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, 2008 and 2007, 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, 2008, and our report dated March 13, 2009 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Short Hills, New Jersey

March 13, 2009

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. 333-141746) on Form S-8, pertaining to the OceanFirst Financial Corp. 2006 Stock Incentive Plan, 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, in the registration statement (No. 333-34145) on Form S-8, pertaining to the Retirement Plan for OceanFirst Bank, of OceanFirst Financial Corp., and in the registration statement (No. 333-157366) on Form S-3, pertaining to the Fixed Rate Cumulative Perpetual Preferred Stock, Series A and a warrant to purchase shares of common stock of OceanFirst Financial Corp. of our reports dated March 13, 2009, with respect to the consolidated statements of financial condition of OceanFirst Financial Corp. and subsidiary as of December 31, 2008 and 2007 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, 2008, and the effectiveness of internal control over financial reporting as of December 31, 2008, which reports are incorporated by reference in the December 31, 2008 Annual Report on Form 10-K of OceanFirst Financial Corp.

KPMG LLP

Short Hills, New Jersey
March 13, 2009

**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 13, 2009

/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 13, 2009

/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, 2008 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 13, 2009

/s/ Michael J. Fitzpatrick

Michael J. Fitzpatrick
Chief Financial Officer
March 13, 2009