

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

**FORM 10-Q**

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

For the quarterly period ended September 30, 2012

☐ **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, NJ  
(Address of principal executive offices)

08753  
(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☒ NO ☐ .

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

Large Accelerated Filer ☐

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 Exchange Act). YES ☐ NO ☒ .

As of November 5, 2012, there were 18,005,046 shares of the Registrant's Common Stock, par value \$.01 per share, outstanding.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### FINANCIAL SUMMARY

| (dollars in thousands, except per share amounts)                         | At or for the Quarter Ended |                   |                    |
|--------------------------------------------------------------------------|-----------------------------|-------------------|--------------------|
|                                                                          | September 30, 2012          | December 31, 2011 | September 30, 2011 |
| <b><u>SELECTED FINANCIAL CONDITION DATA :</u></b>                        |                             |                   |                    |
| Total assets                                                             | \$ 2,304,426                | \$ 2,302,094      | \$ 2,281,792       |
| Loans receivable, net                                                    | 1,545,640                   | 1,563,019         | 1,588,115          |
| Deposits                                                                 | 1,739,974                   | 1,706,083         | 1,687,906          |
| Stockholders' equity                                                     | 219,687                     | 216,849           | 215,897            |
| <b><u>SELECTED OPERATING DATA :</u></b>                                  |                             |                   |                    |
| Net interest income                                                      | 18,000                      | 19,273            | 19,072             |
| Provision for loan losses                                                | 1,400                       | 2,000             | 1,850              |
| Other income                                                             | 4,878                       | 4,214             | 3,731              |
| Operating expenses                                                       | 13,839                      | 13,021            | 13,131             |
| Net income                                                               | 4,959                       | 5,459             | 5,074              |
| Diluted earnings per share                                               | 0.28                        | 0.30              | 0.28               |
| <b><u>SELECTED FINANCIAL RATIOS :</u></b>                                |                             |                   |                    |
| Stockholders' equity per common share                                    | 12.19                       | 11.61             | 11.46              |
| Cash dividend per share                                                  | 0.12                        | 0.12              | 0.12               |
| Stockholders' equity to total assets                                     | 9.53%                       | 9.42%             | 9.46%              |
| Return on average assets (1)                                             | 0.86                        | 0.95              | 0.89               |
| Return on average stockholders' equity (1)                               | 9.08                        | 10.07             | 9.48               |
| Average interest rate spread                                             | 3.18                        | 3.43              | 3.45               |
| Net interest margin                                                      | 3.28                        | 3.53              | 3.55               |
| Operating expenses to average assets (1)                                 | 2.39                        | 2.27              | 2.31               |
| Efficiency ratio                                                         | 60.49                       | 55.44             | 57.58              |
| <b><u>ASSET QUALITY :</u></b>                                            |                             |                   |                    |
| Non-performing loans                                                     | \$ 41,173                   | \$ 44,008         | \$ 48,398          |
| Non-performing assets                                                    | 44,801                      | 45,978            | 49,591             |
| Allowance for loan losses as a percent of total loans receivable (2)     | 1.17%                       | 1.15%             | 1.42%              |
| Allowance for loan losses as a percent of total non-performing loans (2) | 44.42                       | 41.42             | 47.33              |
| Non-performing loans as a percent of total loans receivable (2)          | 2.63                        | 2.77              | 3.00               |
| Non-performing assets as a percent of total assets (2)                   | 1.94                        | 2.00              | 2.17               |

(1) Ratios are annualized

(2) As discussed in the section "Comparison of Operating Results for the Three and Nine Months Ended September 30, 2012 and September 30, 2011 – Provision for Loan Losses", during the fourth quarter of 2011, the Company modified its charge-off policy on problem loans secured by real estate, which accelerated the recognition of loan charge-offs. If the modified charge-off policy was in effect at September 30, 2011, the Company would have recognized a cumulative charge-off of \$5.6 million and reported the following asset quality ratios: allowance for loan losses as a percent of total loans receivable of 1.06%; allowance for loan losses as a percent of total non-performing loans of 38.58%; non-performing loans as a percent of total loans receivable of 2.74%; and non-performing assets as a percent of total assets of 1.93%.

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### Summary

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

Interest-earning assets, both loans and securities, are generally priced against longer-term indices, while interest-bearing liabilities, primarily deposits and borrowings, are generally priced against shorter-term indices. In late 2011 and into the first three quarters of 2012, the Company’s net interest margin contracted as compared to prior linked periods. Due to the low interest rate environment, high loan refinance volume has caused yields on loans and mortgage-backed securities to trend downward. At the same time, the Company’s asset mix has shifted as higher-yielding loans have decreased due to prepayments and the sale of newly originated 30-year fixed-rate one-to-four family loans while lower yielding securities have increased. Based upon current economic conditions, the Federal Reserve has indicated that it intends to keep interest rates at current levels through mid 2015. As a result, management expects the low interest rate environment to continue beyond 2012, causing further pressure on the net interest margin. In addition to the interest rate environment, the Company’s results are affected by national and local economic conditions. Recent economic indicators point to some improvement in the economy, which expanded moderately in 2011 and the first three quarters of 2012, and in overall labor market conditions as the national unemployment rate in 2012 has improved over prior year levels. Despite these signs, the overall economy remains weak and the unemployment rate remains at elevated levels. Additionally, housing values remain significantly below their peak levels in 2006. These economic conditions have generally had an adverse impact on the Company’s results of operations.

Highlights of the Company’s financial results for the three and nine months ended September 30, 2012 were as follows:

Total assets increased to \$2.304 billion at September 30, 2012, from \$2.302 billion at December 31, 2011. Loans receivable, net decreased \$17.4 million at September 30, 2012, as compared to December 31, 2011 primarily due to prepayments and sale of newly originated 30-year fixed-rate one-to-four family loans. Cash and due from banks decreased by \$22.2 million, as the cash and due from banks was invested in investment and mortgage-backed securities available for sale, which collectively increased by \$38.2 million, to \$568.4 million at September 30, 2012, as compared to \$530.2 million at December 31, 2011.

Deposits increased by \$33.9 million at September 30, 2012, as compared to December 31, 2011. An increase of \$67.2 million in core deposits (i.e. all deposits excluding time deposits) was partly offset by a decline of \$33.3 million in time deposits. Federal Home Loan Bank (“FHLB”) advances decreased \$41.0 million, to \$225.0 million at September 30, 2012 from \$266.0 million at December 31, 2011.

Net income for the three and nine months ended September 30, 2012 was adversely impacted by a non-recurring severance expense relating to the departure of the Bank’s former President and Chief Operating Officer of \$747,000, net of related expense savings, or \$468,000, net of tax benefit. The net, after tax amount, reduced diluted earnings per share by \$0.03 for the three and nine months ended September 30, 2012. Excluding this non-recurring expense, diluted earnings per share increased 10.7%, to \$0.31 for the three months ended September 30, 2012. The improvement was primarily due to a decrease in the provision for loan losses, an increase in other income and a reduction in average shares outstanding.

Net interest income for the three months ended September 30, 2012 decreased to \$18.0 million, as compared to \$19.1 million in the same prior year period, reflecting a lower net interest margin partly offset by greater interest-earning assets. The net interest margin decreased to 3.28% for the three months ended September 30, 2012, as compared to 3.55% for the corresponding prior year period.

The provision for loan losses was \$1.4 million for the three months ended September 30, 2012, as compared to \$1.9 million in the same prior year period. The Company’s non-performing loans decreased \$2.8 million, totaling \$41.2 million at September 30, 2012, from \$44.0 million at December 31, 2011.

The Company remains well-capitalized with a tangible common equity ratio of 9.53%.

Return on average stockholders’ equity was 9.08% for the three months ended September 30, 2012, as compared to 9.48% for the corresponding prior year period.

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### Analysis of Net Interest Income

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

The following table sets forth certain information relating to the Company for the three and nine months ended September 30, 2012 and 2011. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown except where noted otherwise. Average balances are derived from average daily balances. The yields and costs include certain fees which are considered adjustments to yields.

|                                                      | FOR THE THREE MONTHS ENDED SEPTEMBER 30, |                  |                                          |                    |                  |                |
|------------------------------------------------------|------------------------------------------|------------------|------------------------------------------|--------------------|------------------|----------------|
|                                                      | 2012                                     |                  |                                          | 2011               |                  |                |
|                                                      | AVERAGE<br>BALANCE                       | INTEREST         | YIELD/<br>COST<br>(dollars in thousands) | AVERAGE<br>BALANCE | INTEREST         | YIELD/<br>COST |
| <b>Assets</b>                                        |                                          |                  |                                          |                    |                  |                |
| Interest-earning assets:                             |                                          |                  |                                          |                    |                  |                |
| Interest-earning deposits and short-term investments | \$ 55,475                                | \$ 15            | 0.11%                                    | \$ 43,922          | \$ 21            | 0.19%          |
| Investment securities (1)                            | 211,065                                  | 521              | 0.99                                     | 151,642            | 363              | 0.96           |
| FHLB stock                                           | 17,695                                   | 197              | 4.45                                     | 18,233             | 202              | 4.43           |
| Mortgage-backed securities (1)                       | 363,388                                  | 2,065            | 2.27                                     | 328,830            | 2,500            | 3.04           |
| Loans receivable, net (2)                            | 1,547,696                                | 18,716           | 4.84                                     | 1,603,735          | 20,357           | 5.08           |
| Total interest-earning assets                        | 2,195,319                                | 21,514           | 3.92                                     | 2,146,362          | 23,443           | 4.37           |
| Non-interest-earning assets                          | 116,227                                  |                  |                                          | 122,660            |                  |                |
| Total assets                                         | <u>\$2,311,546</u>                       |                  |                                          | <u>\$2,269,022</u> |                  |                |
| <b>Liabilities and Stockholders' Equity</b>          |                                          |                  |                                          |                    |                  |                |
| Interest-bearing liabilities:                        |                                          |                  |                                          |                    |                  |                |
| Transaction deposits                                 | \$1,317,658                              | 971              | 0.29                                     | \$1,253,509        | 1,289            | 0.41           |
| Time deposits                                        | 238,133                                  | 936              | 1.57                                     | 270,261            | 1,213            | 1.80           |
| Total                                                | 1,555,791                                | 1,907            | 0.49                                     | 1,523,770          | 2,502            | 0.66           |
| Borrowed funds                                       | 335,231                                  | 1,607            | 1.92                                     | 366,813            | 1,869            | 2.04           |
| Total interest-bearing liabilities                   | 1,891,022                                | 3,514            | 0.74                                     | 1,890,583          | 4,371            | 0.92           |
| Non-interest-bearing deposits                        | 183,780                                  |                  |                                          | 152,030            |                  |                |
| Non-interest-bearing liabilities                     | 18,350                                   |                  |                                          | 12,224             |                  |                |
| Total liabilities                                    | 2,093,152                                |                  |                                          | 2,054,837          |                  |                |
| Stockholders' equity                                 | 218,394                                  |                  |                                          | 214,185            |                  |                |
| Total liabilities and stockholders' equity           | <u>\$2,311,546</u>                       |                  |                                          | <u>\$2,269,022</u> |                  |                |
| Net interest income                                  |                                          | <u>\$ 18,000</u> |                                          |                    | <u>\$ 19,072</u> |                |
| Net interest rate spread (3)                         |                                          |                  | 3.18%                                    |                    |                  | 3.45%          |
| Net interest margin (4)                              |                                          |                  | 3.28%                                    |                    |                  | 3.55%          |

|                                                      | FOR THE NINE MONTHS ENDED SEPTEMBER 30, |          |                                          |                    |          |                |
|------------------------------------------------------|-----------------------------------------|----------|------------------------------------------|--------------------|----------|----------------|
|                                                      | 2012                                    |          |                                          | 2011               |          |                |
|                                                      | AVERAGE<br>BALANCE                      | INTEREST | YIELD/<br>COST<br>(dollars in thousands) | AVERAGE<br>BALANCE | INTEREST | YIELD/<br>COST |
| <b>Assets</b>                                        |                                         |          |                                          |                    |          |                |
| Interest-earning assets:                             |                                         |          |                                          |                    |          |                |
| Interest-earning deposits and short-term investments | \$ 54,133                               | \$ 58    | 0.14%                                    | \$ 27,027          | \$ 45    | 0.22%          |
| Investment securities (1)                            | 191,463                                 | 1,482    | 1.03                                     | 139,734            | 1,004    | 0.96           |
| FHLB stock                                           | 17,749                                  | 626      | 4.70                                     | 17,930             | 647      | 4.81           |
| Mortgage-backed securities (1)                       | 361,198                                 | 6,618    | 2.44                                     | 333,607            | 7,730    | 3.09           |
| Loans receivable, net (2)                            | 1,555,556                               | 57,642   | 4.94                                     | 1,626,568          | 62,546   | 5.13           |
| Total interest-earning assets                        | 2,180,099                               | 66,426   | 4.06                                     | 2,144,866          | 71,972   | 4.47           |
| Non-interest-earning assets                          | 108,665                                 |          |                                          | 117,484            |          |                |
| Total assets                                         | <u>\$2,288,764</u>                      |          |                                          | <u>\$2,262,350</u> |          |                |
| <b>Liabilities and Stockholders' Equity</b>          |                                         |          |                                          |                    |          |                |
| Interest-bearing liabilities:                        |                                         |          |                                          |                    |          |                |
| Transaction deposits                                 | \$1,295,640                             | 2,887    | 0.30                                     | \$1,255,228        | 4,457    | 0.47           |
| Time deposits                                        | 247,704                                 | 3,073    | 1.65                                     | 272,197            | 3,647    | 1.79           |

|                                            |                    |                  |              |                    |                  |              |
|--------------------------------------------|--------------------|------------------|--------------|--------------------|------------------|--------------|
| Total                                      | 1,543,344          | 5,960            | 0.51         | 1,527,425          | 8,104            | 0.71         |
| Borrowed funds                             | <u>340,563</u>     | <u>4,971</u>     | <u>1.95</u>  | <u>371,631</u>     | <u>5,813</u>     | <u>2.09</u>  |
| Total interest-bearing liabilities         | 1,883,907          | <u>10,931</u>    | <u>0.77</u>  | 1,899,056          | <u>13,917</u>    | <u>0.98</u>  |
| Non-interest-bearing deposits              | 169,400            |                  |              | 140,655            |                  |              |
| Non-interest-bearing liabilities           | <u>16,935</u>      |                  |              | <u>15,015</u>      |                  |              |
| Total liabilities                          | 2,070,242          |                  |              | 2,054,726          |                  |              |
| Stockholders' equity                       | <u>218,522</u>     |                  |              | <u>207,624</u>     |                  |              |
| Total liabilities and stockholders' equity | <u>\$2,288,764</u> |                  |              | <u>\$2,262,350</u> |                  |              |
| Net interest income                        |                    | <u>\$ 55,495</u> |              |                    | <u>\$ 58,055</u> |              |
| Net interest rate spread (3)               |                    |                  | <u>3.29%</u> |                    |                  | <u>3.49%</u> |
| Net interest margin (4)                    |                    |                  | <u>3.39%</u> |                    |                  | <u>3.61%</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 loss allowances and includes loans held for sale and non-performing loans.

(3) Net interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average interest-earning assets.

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### Comparison of Financial Condition at September 30, 2012 and December 31, 2011

Total assets at September 30, 2012 were \$2.304 billion, an increase of \$2.3 million, compared to \$2.302 billion at December 31, 2011.

Cash and due from banks decreased by \$22.2 million, to \$55.4 million at September 30, 2012, as compared to \$77.5 million at December 31, 2011. The cash and due from banks was invested in investment and mortgage-backed securities available for sale, which collectively increased by \$38.2 million, to \$568.4 million at September 30, 2012, as compared to \$530.2 million at December 31, 2011.

Loans receivable, net decreased by \$17.4 million, to a balance of \$1.546 billion at September 30, 2012, as compared to a balance of \$1.563 billion at December 31, 2011, primarily due to prepayments and sale of newly originated 30-year fixed-rate one-to-four family loans. Bank owned life insurance increased by \$10.8 million at September 30, 2012, as compared to December 31, 2011, primarily due to an additional investment during the third quarter of 2012.

Total deposits increased \$33.9 million, to \$1.740 billion at September 30, 2012, from \$1.706 billion at December 31, 2011. The mix of deposits changed as non-interest-bearing deposits and savings deposits increased by \$42.7 million and \$17.3 million, respectively, while time deposits decreased \$33.3 million. FHLB advances decreased by \$41.0 million, to \$225.0 million at September 30, 2012, as compared to \$266.0 million at December 31, 2011 due to excess liquidity and cash flows from loans receivable.

Stockholders' equity at September 30, 2012 increased to \$219.7 million, as compared to \$216.8 million at December 31, 2011, primarily due to net income and a reduction in accumulated other comprehensive gain (loss), partly offset by the cash dividend on common stock and by the repurchase of 718,253 shares of common stock for \$10.2 million.

### Comparison of Operating Results for the Three and Nine Months Ended September 30, 2012 and September 30, 2011

#### *General*

Net income for the three months ended September 30, 2012 decreased to \$5.0 million, as compared to net income of \$5.1 million for the corresponding prior year period. Diluted earnings per share was \$0.28 for the three months ended September 30, 2012, unchanged from the corresponding prior year period. Net income for the nine months ended September 30, 2012 increased to \$16.0 million, as compared to \$15.3 million for the corresponding prior year period. Diluted earnings per share was \$0.89 for the nine months ended September 30, 2012, as compared to \$0.84 for the corresponding prior year period. Net income for the three and nine months ended September 30, 2012 was adversely impacted by a non-recurring severance expense relating to the departure of the Bank's former President and Chief Operating Officer of \$747,000, net of related expense savings, or \$468,000, net of tax benefit. The net, after tax amount, reduced diluted earnings per share by \$0.03 for the three and nine months ended September 30, 2012. Excluding this non-recurring expense, diluted earnings per share increased 10.7%, to \$0.31, for the three months ended September 30, 2012 and 9.5%, to \$0.92, for the nine months ended September 30, 2012. The improvements were primarily due to a decrease in the provision for loan losses, an increase in other income, a decrease in operating expenses (after excluding the non-recurring severance expense) and a reduction in average shares outstanding.

#### *Interest Income*

Interest income for the three and nine months ended September 30, 2012 was \$21.5 million and \$66.4 million, respectively, as compared to \$23.4 million and \$72.0 million for the three and nine months ended September 30, 2011. The yield on interest-earning assets declined to 3.92% and 4.06%, respectively, for the three and nine months ended September 30, 2012, as compared to 4.37% and 4.47%, respectively, for the same prior year periods. For the nine months ended September 30, 2012, the yield on loans receivable benefited from a single large commercial loan prepayment fee of \$219,000 which increased the yield on interest-earning assets by 1 basis point. Average interest-earning assets increased by \$49.0 million, or 2.3%, and \$35.2 million, or 1.6%, respectively, for the three and nine months ended September 30, 2012, as compared to the same prior year periods. The increases in average interest-earning assets were primarily due to the increases in average investment and mortgage-backed securities available for sale, which collectively increased \$94.0 million and \$79.3 million, respectively, and the increases in average short-term investments which increased \$11.6 million and \$27.1 million, respectively. These increases were partly offset by a decrease in average loans receivable, net, of \$56.0 million and \$71.0 million, respectively.

#### *Interest Expense*

Interest expense for the three and nine months ended September 30, 2012 was \$3.5 million and \$10.9 million, respectively, as compared to \$4.4 million and \$13.9 million for the three and nine months ended September 30, 2011. The cost of interest-bearing liabilities decreased to 0.74% and 0.77%, respectively, for the three and nine months ended September 30, 2012 as compared to 0.92% and 0.98% in the same prior year periods. Average interest-bearing liabilities increased by \$439,000 and decreased by \$15.1 million, respectively, for the three and nine months ended September 30, 2012, as compared to the same prior year periods. The changes were due to declines in average borrowed funds of \$31.6 million and \$31.1 million, respectively, and average time deposits of \$32.1 million and \$24.5 million as compared to the same prior year periods, partly offset by increases in average transaction deposits of \$64.1 million and \$40.4 million.

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### *Net Interest Income*

Net interest income for the three and nine months ended September 30, 2012 decreased to \$18.0 million and \$55.5 million, respectively, as compared to \$19.1 million and \$58.1 million in the same prior year periods, reflecting a lower net interest margin partly offset by greater interest-earning assets. The net interest margin decreased to 3.28% and 3.39%, respectively, for the three and nine months ended September 30, 2012, from 3.55% and 3.61% in the same prior year periods due to a change in the mix of average interest-earning assets from higher-yielding loans receivable into lower-yielding short-term investments and investment and mortgage-backed securities available for sale. High loan refinance volume also caused yields on loans and mortgage-backed securities to trend downward.

### *Provision for Loan Losses*

For the three and nine months ended September 30, 2012, the provision for loan losses was \$1.4 million and \$4.8 million, respectively, as compared to \$1.9 million and \$5.8 million in the corresponding prior year periods. The lower amounts for the three and nine months ended September 30, 2012 were related to a decrease in non-performing loans for those time periods. Non-performing loans at September 30, 2012 decreased \$2.8 million, or 6.4%, to \$41.2 million from \$44.0 million at December 31, 2011. Net charge-offs for the three and nine months ended September 30, 2012 were \$766,000 and \$4.7 million, respectively, as compared to \$399,000 and \$2.5 million in the same prior year periods. During the fourth quarter of 2011, the Company modified its charge-off policy on problem loans secured by real estate which accelerated the recognition of loan charge-offs. The Company now takes charge-offs in the period the loan, or portion thereof, is deemed uncollectable, generally after the loan becomes 120 days delinquent and a recent appraisal is received which reflects a collateral shortfall. Previously, specific valuation reserves were established until the loan charge-off was recorded upon final resolution of the collateral.

### *Other Income*

Other income increased to \$4.9 million and \$13.7 million, respectively, for the three and nine months ended September 30, 2012, as compared to \$3.7 million and \$11.1 million in the same prior year periods primarily due to an increase in the net gain on the sale of loans, higher fees and service charges and an improvement in the net gain (loss) from other real estate operations. For the nine months ended September 30, 2012, the Company recognized a gain of \$226,000 on the sale of equity securities as compared to the recognition of an other-than-temporary impairment loss on equity securities of \$148,000 for the three and nine months ended September 30, 2011. For the three and nine months ended September 30, 2012, the net gain on the sale of loans increased \$521,000 and \$1.1 million, respectively, due to increases in loan sale volume and strong gain on sale margins. However, the increase in the net gain on the sale of loans for the three and nine months ended September 30, 2012 was adversely affected by an increase of \$100,000 and \$350,000, respectively, in the reserve for repurchased loans primarily due to an increase in repurchase requests on loans previously sold to investors. For the three and nine months ended September 30, 2012, fees and service charges increased \$266,000 and \$531,000, respectively, due to increases in trust revenue, merchant service fees and retail checking account fees. Finally, the net gain (loss) from other real estate operations improved \$120,000 and \$425,000 for the three and nine months ended September 30, 2012, as compared to the same prior year periods. The prior year amount included write-downs in the value of properties previously acquired.

### *Operating Expenses*

Operating expenses increased by \$708,000, to \$13.8 million, and by \$2,000, to \$39.6 million, respectively, for the three and nine months ended September 30, 2012, as compared to \$13.1 million and \$39.6 million, respectively, for the corresponding prior year periods. Excluding the \$747,000 non-recurring severance expense included in compensation and employee benefits, net of related expense savings, for the three and nine months ended September 30, 2012, operating expenses decreased by \$39,000 and \$745,000 respectively, as compared to the corresponding prior year periods. The decrease for the three and nine months ended September 30, 2012 as compared to the corresponding prior year periods was primarily due to lower compensation and employee benefits costs, net of the non-recurring severance cost, which decreased by \$537,000, or 7.5%, to \$6.6 million for the three months ended September 30, 2012 and by \$1.1 million, or 5.0%, to \$20.2 million for the nine months ended September 30, 2012. The decreases were due to a reduction in the incentive plan accrual of \$300,000 for the three and nine months ended September 30, 2012 and were also due to the increase in mortgage loan closings from prior year levels. Higher loan closings in the current period increased deferred loan expense which is reflected as a decrease in compensation expense. Additionally, Federal deposit insurance expense for the nine months ended September 30, 2012 decreased \$440,000 from the corresponding prior year period due to a lower assessment rate and a change in the assessment methodology from deposit-based to a total liability-based assessment. These changes to Federal deposit insurance affected the expense for the first six months of 2012 as compared to the same prior year period.

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### *Provision for Income Taxes*

Income tax expense was \$2.7 million and \$8.8 million, respectively, for the three and nine months ended September 30, 2012, as compared to \$2.7 million and \$8.5 million for the same prior year periods. The effective tax rate was 35.1% and 35.5%, respectively, for the three and nine months ended September 30, 2012, as compared to 35.1% and 35.6%, respectively, in the same prior year periods.

### **Liquidity and Capital Resources**

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

At September 30, 2012 and December 31, 2011, the Company had no overnight borrowings from the FHLB. The Company periodically utilizes overnight borrowings to fund short-term liquidity needs. The Company had total FHLB borrowings of \$225.0 million at September 30, 2012, a decrease from \$266.0 million at December 31, 2011.

The Company's cash needs for the nine months ended September 30, 2012 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale, proceeds from maturities of investment securities available for sale and deposit growth. The cash was principally utilized for loan originations, the purchase of investment and mortgage-backed securities, the purchase of Bank owned life insurance and to reduce FHLB borrowings. The Company's cash needs for the nine months ended September 30, 2011 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale and deposit growth. The cash was principally utilized for loan originations and the purchase of investment and mortgage-backed securities.

In the normal course of business, the Company routinely enters into various off-balance-sheet commitments, primarily relating to the origination and sale of loans. At September 30, 2012, outstanding commitments to originate loans totaled \$78.2 million; outstanding unused lines of credit totaled \$232.8 million; and outstanding commitments to sell loans totaled \$18.1 million. The Company expects to have sufficient funds available to meet current commitments arising in the normal course of business.

Time deposits scheduled to mature in one year or less totaled \$142.3 million at September 30, 2012. Based upon historical experience management estimates that a significant portion of such deposits will remain with the Company.

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

Under the Company's stock repurchase program, shares of OceanFirst Financial Corp. common stock may be purchased in the open market and through other privately negotiated transactions, from time-to-time, depending on market conditions. The repurchased shares are held as treasury stock for general corporate purposes. For the nine months ended September 30, 2012, the Company repurchased 718,253 shares of common stock at a total cost of \$10.2 million compared with no repurchases for the nine months ended September 30, 2011. At September 30, 2012, there were 58,899 shares remaining to be repurchased under the existing stock repurchase program.

Cash dividends on common stock declared and paid during the first nine months of 2012 were \$6.5 million, as compared to \$6.6 million in the same prior year period. On October 18, 2012, the Board of Directors declared a quarterly cash dividend of twelve cents (\$0.12) per common share. The dividend is payable on November 9, 2012 to stockholders of record at the close of business on October 29, 2012.

The primary sources of liquidity specifically available to OceanFirst Financial Corp., the holding company of OceanFirst Bank, are capital distributions from the banking subsidiary and the issuance of preferred and common stock and long-term debt. For the first nine months of 2012, the Company received dividend payments of \$16.5 million from the Bank. The Company's ability to continue to pay dividends will be largely dependent upon capital distributions from the Bank, which may be adversely affected by capital constraints imposed by the applicable regulations. The Company cannot predict whether the Bank will be permitted under applicable regulations to pay a dividend to the Company. If the Bank is unable to pay dividends to the Company, the Company may not have the liquidity necessary to pay a dividend in the future or pay a dividend at the same rate as historically paid, or be able to meet current debt obligations. At September 30, 2012, OceanFirst Financial Corp. held \$16.3 million in cash and \$5.6 million in investment securities available for sale.

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As of September 30, 2012, the Bank exceeded all regulatory capital requirements as follows (in thousands):

|                           | Actual    |       | Required  |       |
|---------------------------|-----------|-------|-----------|-------|
|                           | Amount    | Ratio | Amount    | Ratio |
| Tangible capital          | \$215,132 | 9.34% | \$ 34,560 | 1.50% |
| Core capital              | 215,132   | 9.34  | 92,160    | 4.00  |
| Tier 1 risk-based capital | 215,132   | 14.35 | 59,970    | 4.00  |
| Total risk-based capital  | 233,423   | 15.57 | 119,941   | 8.00  |

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

At September 30, 2012, the Company maintained tangible common equity of \$219.7 million, for a tangible common equity to assets ratio of 9.53%.

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

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate, and liquidity risk or to optimize capital. Customer transactions are used to manage customers’ requests for funding. These financial instruments and commitments include unused lines of credit and commitments to extend credit. The Company also has outstanding commitments to sell loans amounting to \$18.1 million.

The following table shows the contractual obligations of the Company by expected payment period as of September 30, 2012 (in thousands):

| Contractual Obligation                     | Total     | Less than<br>one year | 1-3 years | 3-5 years | More than<br>5 years |
|--------------------------------------------|-----------|-----------------------|-----------|-----------|----------------------|
| Debt Obligations                           | \$324,649 | \$133,149             | \$139,000 | \$30,000  | \$22,500             |
| Commitments to Originate Loans             | 78,158    | 78,158                | —         | —         | —                    |
| Commitments to Fund Unused Lines of Credit | 232,785   | 232,785               | —         | —         | —                    |

Commitments to originate loans and commitments to fund unused lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company’s exposure to credit risk is represented by the contractual amount of the instruments.

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### Non-Performing Assets

The following table sets forth information regarding the Company's non-performing assets consisting of non-performing loans and Other Real Estate Owned ("OREO"). It is the policy of the Company to cease accruing interest on loans 90 days or more past due or in the process of foreclosure.

|                                                                      | September 30,<br>2012  | December 31,<br>2011 |
|----------------------------------------------------------------------|------------------------|----------------------|
|                                                                      | (dollars in thousands) |                      |
| <b>Non-performing loans:</b>                                         |                        |                      |
| Real estate – one-to-four family                                     | \$ 25,475              | \$ 29,193            |
| Commercial real estate                                               | 11,397                 | 10,552               |
| Construction                                                         | —                      | 43                   |
| Consumer                                                             | 3,670                  | 3,653                |
| Commercial                                                           | 631                    | 567                  |
| <b>Total non-performing loans</b>                                    | <b>41,173</b>          | <b>44,008</b>        |
| OREO, net                                                            | 3,628                  | 1,970                |
| <b>Total non-performing assets</b>                                   | <b>\$ 44,801</b>       | <b>\$ 45,978</b>     |
| <br>Delinquent loans 30-89 days                                      | <br>\$ 11,275          | <br>\$ 14,972        |
| Allowance for loan losses as a percent of total loans receivable     | 1.17%                  | 1.15%                |
| Allowance for loan losses as a percent of total non-performing loans | 44.42                  | 41.42                |
| Non-performing loans as a percent of total loans receivable          | 2.63                   | 2.77                 |
| Non-performing assets as a percent of total assets                   | 1.94                   | 2.00                 |

Included in the non-performing loan total at September 30, 2012 was \$14.8 million of troubled debt restructured loans, as compared to \$14.5 million of troubled debt restructured loans at December 31, 2011. Non-performing loans are concentrated in one-to-four family loans which comprise 61.9% of the total. At September 30, 2012, the average weighted loan-to-value ratio of non-performing one-to-four family loans, after any related charge-offs, was 61% using appraisal values at time of origination and 81% using updated appraisal values. Appraisals are updated for all non-performing loans secured by real estate and subsequently updated annually if the loan remains delinquent for an extended period. At September 30, 2012, the average weighted loan-to-value ratio of the total one-to-four family loan portfolio was 57% using appraisal values at time of origination. Based upon sales data for the first nine months of 2012 from the Ocean and Monmouth Counties Multiple Listing Service, home values in the Company's primary market area have declined by approximately 20% from the peak of the market in 2006. Individual home values may move more or less than the average based upon the specific characteristics of the property. There can be no assurance that home values will not decline further, possibly resulting in losses to the Company. The largest non-performing loan relationship consists of several credits totaling \$6.3 million. The loans are collateralized by commercial and residential real estate, all business assets and also carry a personal guarantee. An appraisal performed in May 2011 values the real estate collateral at \$9.2 million. In November 2011, the Company entered into a troubled debt restructuring with the borrower which reduced the interest rate in exchange for additional collateral. The Company's non-performing loans remain at elevated levels partly due to the extended foreclosure process in the State of New Jersey. The protracted foreclosure process delays the Company's ability to resolve non-performing loans through the sale of the underlying collateral. Of the non-performing one-to-four family loans at September 30, 2012, 66% were originated by alternative Bank delivery channels which were previously shuttered. During the third quarter, the Company sold its largest non-performing one-to-four family mortgage loan at a modest recovery above its carrying value of \$2.6 million.

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

|                                                                | September 30,<br>2012 | December 31,<br>2011 |
|----------------------------------------------------------------|-----------------------|----------------------|
| <b>Loans and other assets excluding investment securities:</b> |                       |                      |
| Special Mention                                                | \$ 7,740,000          | \$11,535,000         |
| Substandard                                                    | 73,260,000            | 63,055,000           |
| Doubtful                                                       | 1,035,000             | 75,000               |
| <b>Investment securities:</b>                                  |                       |                      |
| Substandard                                                    | 25,000,000            | 25,000,000           |

The largest Special Mention loan at September 30, 2012 is a commercial real estate mortgage to a local builder for \$1.8 million. The loan is well collateralized by residential property and several vacant lots. The largest Substandard loan relationship is comprised of several credit facilities to a building supply company with an aggregate balance of \$10.1 million, which was current as to payments, but criticized due to poor operating results through 2011. Operating results have significantly improved in 2012. The loans are collateralized by commercial real estate and other business assets. The largest Doubtful asset with a balance of \$1.0 million is a portion of a commercial real estate loan to a self-storage facility. The remaining balance of \$1.2

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million is rated Substandard. In September 2011, the Company entered into a troubled debt restructuring with the borrower which reduced the interest rate and extended the payment term. All scheduled payments under the restructured terms have been made since that date. In addition to loan classifications, the Company classified investment securities with an amortized cost of \$25.0 million and a carrying value of \$18.3 million at September 30, 2012 as Substandard, which represents the amount of investment securities with a credit rating below investment grade from one of the internationally recognized credit rating services. These securities are all current as to principal and interest payments.

### Critical Accounting Policies

Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2011 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the "2011 Form 10-K"), as supplemented by this report, contains a summary of significant accounting policies. Various elements of these accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Certain assets are carried in the consolidated statements of financial condition at fair value or the lower of cost or fair value. Policies with respect to the methodologies used to determine the allowance for loan losses, the reserve for repurchased loans and the valuation of Mortgage Servicing Rights and judgments regarding securities impairment are the most critical accounting policies because they are important to the presentation of the Company's financial condition and results of operations. These judgments and policies involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material differences in the results of operations or financial condition. These critical accounting policies and their application are reviewed periodically and, at least annually, with the Audit Committee of the Board of Directors.

### Private Securities Litigation Reform Act Safe Harbor Statement

In addition to historical information, this quarterly report contains certain forward-looking statements within the meaning of the Private Securities Reform Act of 1995 which are based on certain assumptions and describe future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," "will," "should," "may," "view," "opportunity," "potential," or similar expressions or expressions of probability or confidence. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and the subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, levels of unemployment in the Bank's lending area, real estate market values in the Bank's lending area, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government including policies of the U.S. Treasury and the Board of Governors of the Federal Reserve System, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. These risks and uncertainties are further discussed in the 2011 Form 10-K and subsequent securities filings and should be considered in evaluating forward-looking statements and undue reliance should not be placed on these 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 2011 Form 10-K and Item 1A of this Form 10-Q.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's interest rate sensitivity is monitored through the use of an interest rate risk ("IRR") model. The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at September 30, 2012, which were anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown.

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At September 30, 2012, the Company's one-year gap was negative -4.65 % as compared to negative 0.03% at December 31, 2011.

| At September 30, 2012<br>(dollars in thousands)                                   | 3 Months<br>or Less | More than<br>3 Months to<br>1 Year | More than<br>1 Year to<br>3 Years | More than<br>3 Years to<br>5 Years | More than<br>5 Years | Total             |
|-----------------------------------------------------------------------------------|---------------------|------------------------------------|-----------------------------------|------------------------------------|----------------------|-------------------|
| <b>Interest-earning assets: (1)</b>                                               |                     |                                    |                                   |                                    |                      |                   |
| Interest-earning deposits and short- term investments                             | \$ 33,611           | \$ —                               | \$ —                              | \$ —                               | \$ —                 | \$ 33,611         |
| Investment securities                                                             | 60,713              | 22,491                             | 96,325                            | 35,492                             | 4,992                | 220,013           |
| FHLB stock                                                                        | —                   | —                                  | —                                 | —                                  | 17,148               | 17,148            |
| Mortgage-backed securities                                                        | 64,337              | 39,952                             | 92,050                            | 74,507                             | 76,961               | 347,807           |
| Loans receivable (2)                                                              | 301,491             | 418,107                            | 443,141                           | 186,365                            | 216,243              | 1,565,347         |
| Total interest-earning assets                                                     | 460,152             | 480,550                            | 631,516                           | 296,364                            | 315,344              | 2,183,926         |
| <b>Interest-bearing liabilities:</b>                                              |                     |                                    |                                   |                                    |                      |                   |
| Money market deposit accounts                                                     | 32,938              | 8,939                              | 19,672                            | 14,852                             | 48,180               | 124,581           |
| Savings accounts                                                                  | 39,660              | 20,519                             | 45,306                            | 34,292                             | 106,772              | 246,549           |
| Interest-bearing checking accounts                                                | 580,336             | 62,014                             | 110,941                           | 91,971                             | 102,812              | 948,074           |
| Time deposits                                                                     | 58,189              | 84,106                             | 42,005                            | 44,998                             | 6,315                | 235,613           |
| FHLB advances                                                                     | —                   | 61,000                             | 139,000                           | 25,000                             | —                    | 225,000           |
| Securities sold under agreements to repurchase                                    | 72,149              | —                                  | —                                 | —                                  | —                    | 72,149            |
| Other borrowings                                                                  | 22,500              | —                                  | —                                 | 5,000                              | —                    | 27,500            |
| Total interest-bearing liabilities                                                | 805,772             | 236,578                            | 356,924                           | 216,113                            | 264,079              | 1,879,466         |
| Interest sensitivity gap (3)                                                      | <u>\$(345,620)</u>  | <u>\$ 243,972</u>                  | <u>\$274,592</u>                  | <u>\$ 80,251</u>                   | <u>\$ 51,265</u>     | <u>\$ 304,460</u> |
| Cumulative interest sensitivity gap                                               | <u>\$(345,620)</u>  | <u>\$(101,648)</u>                 | <u>\$172,944</u>                  | <u>\$253,195</u>                   | <u>\$304,460</u>     | <u>\$ 304,460</u> |
| Cumulative interest sensitivity gap as a percent of total interest-earning assets | <u>(15.83)%</u>     | <u>(4.65)%</u>                     | <u>7.92%</u>                      | <u>11.59%</u>                      | <u>13.94%</u>        | <u>13.94%</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.

Additionally, the table below sets forth the Company's exposure to interest rate risk as measured by the change in net portfolio value ("NPV") and net interest income under varying rate shocks as of September 30, 2012 and December 31, 2011. All methods used to measure interest rate sensitivity involve the use of assumptions, which may tend to oversimplify the manner in which actual yields and costs respond to changes in market interest rates. The Company's interest rate sensitivity should be reviewed in conjunction with the financial statements and notes thereto contained in the 2011 Form 10-K.

| Change in Interest Rates in<br>Basis Points (Rate Shock)<br>(dollars in thousands) | September 30, 2012  |          |              |                     |          | December 31, 2011   |          |              |                     |          |
|------------------------------------------------------------------------------------|---------------------|----------|--------------|---------------------|----------|---------------------|----------|--------------|---------------------|----------|
|                                                                                    | Net Portfolio Value |          | NPV<br>Ratio | Net Interest Income |          | Net Portfolio Value |          | NPV<br>Ratio | Net Interest Income |          |
|                                                                                    | Amount              | % Change |              | Amount              | % Change | Amount              | % Change |              | Amount              | % Change |
|                                                                                    |                     |          |              |                     |          |                     |          |              |                     |          |
| 300                                                                                | \$216,286           | (9.2)%   | 9.8%         | \$64,602            | (6.4)%   | \$238,057           | (4.8)%   | 10.9%        | \$65,048            | (11.1)%  |
| 200                                                                                | 232,540             | (2.3)    | 10.3         | 67,135              | (2.7)    | 252,307             | 0.9      | 11.2         | 68,659              | (6.2)    |
| 100                                                                                | 242,101             | 1.7      | 10.5         | 68,486              | (0.8)    | 261,068             | 4.4      | 11.4         | 71,441              | (2.4)    |
| Static                                                                             | 238,074             | —        | 10.2         | 69,030              | —        | 250,109             | —        | 10.7         | 73,189              | —        |
| (100)                                                                              | 201,610             | (15.3)   | 8.5          | 65,118              | (5.7)    | 204,786             | (18.1)   | 8.7          | 67,900              | (7.2)    |

## Item 4. Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective. Disclosure controls and procedures are the controls and other procedures that are designed to ensure that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission ("SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, based on that evaluation, there were no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



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### OceanFirst Financial Corp. Consolidated Statements of Financial Condition (dollars in thousands, except per share amounts)

|                                                                                                                                                                                                  | September 30,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|----------------------|
| <b><u>ASSETS</u></b>                                                                                                                                                                             |                                      |                      |
| Cash and due from banks                                                                                                                                                                          | \$ 55,365                            | \$ 77,527            |
| Investment securities available for sale                                                                                                                                                         | 208,336                              | 165,279              |
| Federal Home Loan Bank of New York stock, at cost                                                                                                                                                | 17,148                               | 18,160               |
| Mortgage-backed securities available for sale                                                                                                                                                    | 360,084                              | 364,931              |
| Loans receivable, net                                                                                                                                                                            | 1,545,640                            | 1,563,019            |
| Mortgage loans held for sale                                                                                                                                                                     | 5,598                                | 9,297                |
| Interest and dividends receivable                                                                                                                                                                | 6,963                                | 6,432                |
| Other real estate owned, net                                                                                                                                                                     | 3,628                                | 1,970                |
| Premises and equipment, net                                                                                                                                                                      | 22,233                               | 22,259               |
| Servicing asset                                                                                                                                                                                  | 4,659                                | 4,836                |
| Bank Owned Life Insurance                                                                                                                                                                        | 52,806                               | 41,987               |
| Other assets                                                                                                                                                                                     | 21,966                               | 26,397               |
| Total assets                                                                                                                                                                                     | <u>\$2,304,426</u>                   | <u>\$2,302,094</u>   |
| <b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>                                                                                                                                               |                                      |                      |
| Deposits                                                                                                                                                                                         | \$1,739,974                          | \$1,706,083          |
| Securities sold under agreements to repurchase with retail customers                                                                                                                             | 72,149                               | 66,101               |
| Federal Home Loan Bank advances                                                                                                                                                                  | 225,000                              | 266,000              |
| Other borrowings                                                                                                                                                                                 | 27,500                               | 27,500               |
| Due to brokers                                                                                                                                                                                   | 1,355                                | 5,186                |
| Advances by borrowers for taxes and insurance                                                                                                                                                    | 7,296                                | 7,113                |
| Other liabilities                                                                                                                                                                                | 11,465                               | 7,262                |
| Total liabilities                                                                                                                                                                                | <u>2,084,739</u>                     | <u>2,085,245</u>     |
| Stockholders' equity:                                                                                                                                                                            |                                      |                      |
| Preferred stock, \$.01 par value, \$1,000 liquidation preference, 5,000,000 shares authorized, no shares issued                                                                                  | —                                    | —                    |
| Common stock, \$.01 par value, 55,000,000 shares authorized, 33,566,772 shares issued and 18,020,046 and 18,682,568 shares outstanding at September 30, 2012 and December 31, 2011, respectively | 336                                  | 336                  |
| Additional paid-in capital                                                                                                                                                                       | 262,590                              | 262,812              |
| Retained earnings                                                                                                                                                                                | 196,184                              | 186,666              |
| Accumulated other comprehensive gain (loss)                                                                                                                                                      | 354                                  | (2,468)              |
| Less: Unallocated common stock held by Employee Stock Ownership Plan                                                                                                                             | (3,976)                              | (4,193)              |
| Treasury stock, 15,546,726 and 14,884,204 shares at September 30, 2012 and December 31, 2011, respectively                                                                                       | (235,801)                            | (226,304)            |
| Common stock acquired by Deferred Compensation Plan                                                                                                                                              | (689)                                | (871)                |
| Deferred Compensation Plan Liability                                                                                                                                                             | 689                                  | 871                  |
| Total stockholders' equity                                                                                                                                                                       | <u>219,687</u>                       | <u>216,849</u>       |
| Total liabilities and stockholders' equity                                                                                                                                                       | <u>\$2,304,426</u>                   | <u>\$2,302,094</u>   |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

|                                                                                                           | For the three months<br>ended September 30, |                 | For the nine months<br>ended September 30, |                 |
|-----------------------------------------------------------------------------------------------------------|---------------------------------------------|-----------------|--------------------------------------------|-----------------|
|                                                                                                           | 2012                                        | 2011            | 2012                                       | 2011            |
|                                                                                                           | (Unaudited)                                 |                 | (Unaudited)                                |                 |
| Interest income:                                                                                          |                                             |                 |                                            |                 |
| Loans                                                                                                     | \$18,716                                    | \$20,357        | \$57,642                                   | \$62,546        |
| Mortgage-backed securities                                                                                | 2,065                                       | 2,500           | 6,618                                      | 7,730           |
| Investment securities and other                                                                           | 733                                         | 586             | 2,166                                      | 1,696           |
| Total interest income                                                                                     | <u>21,514</u>                               | <u>23,443</u>   | <u>66,426</u>                              | <u>71,972</u>   |
| Interest expense:                                                                                         |                                             |                 |                                            |                 |
| Deposits                                                                                                  | 1,907                                       | 2,502           | 5,960                                      | 8,104           |
| Borrowed funds                                                                                            | 1,607                                       | 1,869           | 4,971                                      | 5,813           |
| Total interest expense                                                                                    | <u>3,514</u>                                | <u>4,371</u>    | <u>10,931</u>                              | <u>13,917</u>   |
| Net interest income                                                                                       | 18,000                                      | 19,072          | 55,495                                     | 58,055          |
| Provision for loan losses                                                                                 | 1,400                                       | 1,850           | 4,800                                      | 5,750           |
| Net interest income after provision for loan losses                                                       | <u>16,600</u>                               | <u>17,222</u>   | <u>50,695</u>                              | <u>52,305</u>   |
| Other income:                                                                                             |                                             |                 |                                            |                 |
| Loan servicing income                                                                                     | 130                                         | 96              | 409                                        | 292             |
| Fees and service charges                                                                                  | 3,113                                       | 2,847           | 9,038                                      | 8,507           |
| Net gain on sales of and other than temporary impairment loss on investment securities available for sale | —                                           | (148)           | 226                                        | (148)           |
| Net gain on sales of loans available for sale                                                             | 1,218                                       | 697             | 3,136                                      | 2,066           |
| Net gain (loss) from other real estate owned                                                              | 40                                          | (80)            | (57)                                       | (482)           |
| Income from Bank Owned Life Insurance                                                                     | 376                                         | 317             | 977                                        | 848             |
| Other                                                                                                     | 1                                           | 2               | 5                                          | 4               |
| Total other income                                                                                        | <u>4,878</u>                                | <u>3,731</u>    | <u>13,734</u>                              | <u>11,087</u>   |
| Operating expenses:                                                                                       |                                             |                 |                                            |                 |
| Compensation and employee benefits                                                                        | 7,347                                       | 7,137           | 20,978                                     | 21,293          |
| Occupancy                                                                                                 | 1,279                                       | 1,279           | 3,897                                      | 3,778           |
| Equipment                                                                                                 | 662                                         | 511             | 1,892                                      | 1,803           |
| Marketing                                                                                                 | 451                                         | 456             | 1,231                                      | 1,212           |
| Federal deposit insurance                                                                                 | 533                                         | 563             | 1,587                                      | 2,027           |
| Data processing                                                                                           | 914                                         | 886             | 2,738                                      | 2,672           |
| Legal                                                                                                     | 301                                         | 207             | 726                                        | 634             |
| Check card processing                                                                                     | 425                                         | 320             | 1,061                                      | 924             |
| Accounting and audit                                                                                      | 128                                         | 129             | 448                                        | 442             |
| Other operating expense                                                                                   | 1,799                                       | 1,643           | 5,088                                      | 4,859           |
| Total operating expenses                                                                                  | <u>13,839</u>                               | <u>13,131</u>   | <u>39,646</u>                              | <u>39,644</u>   |
| Income before provision for income taxes                                                                  | 7,639                                       | 7,822           | 24,783                                     | 23,748          |
| Provision for income taxes                                                                                | 2,680                                       | 2,748           | 8,804                                      | 8,466           |
| Net income                                                                                                | <u>\$ 4,959</u>                             | <u>\$ 5,074</u> | <u>\$15,979</u>                            | <u>\$15,282</u> |
| Basic earnings per share                                                                                  | <u>\$ 0.28</u>                              | <u>\$ 0.28</u>  | <u>\$ 0.90</u>                             | <u>\$ 0.84</u>  |
| Diluted earnings per share                                                                                | <u>\$ 0.28</u>                              | <u>\$ 0.28</u>  | <u>\$ 0.89</u>                             | <u>\$ 0.84</u>  |
| Average basic shares outstanding                                                                          | <u>17,561</u>                               | <u>18,227</u>   | <u>17,837</u>                              | <u>18,190</u>   |
| Average diluted shares outstanding                                                                        | <u>17,621</u>                               | <u>18,276</u>   | <u>17,896</u>                              | <u>18,239</u>   |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

|                                                                                                                               | For the three months<br>ended September 30,<br><u>2012</u> <u>2011</u><br>(Unaudited) |                | For the nine months<br>ended September 30,<br><u>2012</u> <u>2011</u><br>(Unaudited) |                 |
|-------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|----------------|--------------------------------------------------------------------------------------|-----------------|
| Net income                                                                                                                    | \$4,959                                                                               | \$5,074        | \$15,979                                                                             | \$15,282        |
| Other comprehensive income:                                                                                                   |                                                                                       |                |                                                                                      |                 |
| Unrealized gain (loss) on securities (net of tax expense (benefit) \$695 and \$2,041 in 2012 and \$(578) and \$3,231 in 2011) | 1,006                                                                                 | (838)          | 2,956                                                                                | 4,678           |
| Reclassification adjustment for gains (losses) included in net income (net of tax expense (benefit) \$92 and \$(60))          | —                                                                                     | 88             | (134)                                                                                | 88              |
| Total comprehensive income                                                                                                    | <u>\$5,965</u>                                                                        | <u>\$4,324</u> | <u>\$18,801</u>                                                                      | <u>\$20,048</u> |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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**OceanFirst Financial Corp.**  
**Consolidated Statements of**  
**Changes in Stockholders' Equity (Unaudited)**  
(in thousands, except per share amounts)

|                                                                                                  | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Gain (Loss) | Employee<br>Stock<br>Ownership<br>Plan | Treasury<br>Stock  | Common<br>Stock<br>Acquired by<br>Deferred<br>Compensation<br>Plan | Deferred<br>Compensation<br>Plan Liability | Total            |
|--------------------------------------------------------------------------------------------------|--------------------|-----------------|----------------------------------|----------------------|------------------------------------------------------|----------------------------------------|--------------------|--------------------------------------------------------------------|--------------------------------------------|------------------|
| Balance at December 31, 2010                                                                     | \$ —               | \$ 336          | \$260,739                        | \$174,677            | \$ (5,560)                                           | \$ (4,484)                             | \$(224,457)        | \$ (946)                                                           | \$ 946                                     | \$201,251        |
| Net income                                                                                       | —                  | —               | —                                | 15,282               | —                                                    | —                                      | —                  | —                                                                  | —                                          | 15,282           |
| Unrealized gain on securities<br>(net of tax expense \$3,231)                                    | —                  | —               | —                                | —                    | 4,678                                                | —                                      | —                  | —                                                                  | —                                          | 4,678            |
| Reclassification adjustment<br>for losses included in net<br>income (net of tax benefit<br>\$60) | —                  | —               | —                                | —                    | 88                                                   | —                                      | —                  | —                                                                  | —                                          | 88               |
| Tax benefit of stock plans                                                                       | —                  | —               | 32                               | —                    | —                                                    | —                                      | —                  | —                                                                  | —                                          | 32               |
| Stock awards                                                                                     | —                  | —               | 779                              | —                    | —                                                    | —                                      | —                  | —                                                                  | —                                          | 779              |
| Treasury stock allocated to<br>restricted stock plan                                             | —                  | —               | (280)                            | 37                   | —                                                    | —                                      | 243                | —                                                                  | —                                          | —                |
| Allocation of ESOP stock                                                                         | —                  | —               | 122                              | —                    | —                                                    | 218                                    | —                  | —                                                                  | —                                          | 340              |
| Cash dividend \$0.36 per share                                                                   | —                  | —               | —                                | (6,590)              | —                                                    | —                                      | —                  | —                                                                  | —                                          | (6,590)          |
| Exercise of stock options                                                                        | —                  | —               | —                                | (1)                  | —                                                    | —                                      | 38                 | —                                                                  | —                                          | 37               |
| Sale of stock for the deferred<br>compensation plan                                              | —                  | —               | —                                | —                    | —                                                    | —                                      | —                  | 42                                                                 | (42)                                       | —                |
| Balance at September 30,<br>2011                                                                 | <u>\$ —</u>        | <u>\$ 336</u>   | <u>\$261,392</u>                 | <u>\$183,405</u>     | <u>\$ (794)</u>                                      | <u>\$ (4,266)</u>                      | <u>\$(224,176)</u> | <u>\$ (904)</u>                                                    | <u>\$ 904</u>                              | <u>\$215,897</u> |
| Balance at December 31, 2011                                                                     | \$ —               | \$ 336          | \$262,812                        | \$186,666            | \$ (2,468)                                           | \$ (4,193)                             | \$(226,304)        | \$ (871)                                                           | \$ 871                                     | \$216,849        |
| Net income                                                                                       | —                  | —               | —                                | 15,979               | —                                                    | —                                      | —                  | —                                                                  | —                                          | 15,979           |
| Unrealized gain on securities<br>(net of tax expense \$1,949)                                    | —                  | —               | —                                | —                    | 2,822                                                | —                                      | —                  | —                                                                  | —                                          | 2,822            |
| Tax expense of stock plans                                                                       | —                  | —               | (482)                            | —                    | —                                                    | —                                      | —                  | —                                                                  | —                                          | (482)            |
| Stock awards                                                                                     | —                  | —               | 396                              | —                    | —                                                    | —                                      | —                  | —                                                                  | —                                          | 396              |
| Treasury stock allocated to<br>restricted stock plan                                             | —                  | —               | (282)                            | 42                   | —                                                    | —                                      | 240                | —                                                                  | —                                          | —                |
| Purchased 718,253 shares of<br>common stock                                                      | —                  | —               | —                                | —                    | —                                                    | —                                      | (10,196)           | —                                                                  | —                                          | (10,196)         |
| Allocation of ESOP stock                                                                         | —                  | —               | 146                              | —                    | —                                                    | 217                                    | —                  | —                                                                  | —                                          | 363              |
| Cash dividend \$0.36 per share                                                                   | —                  | —               | —                                | (6,463)              | —                                                    | —                                      | —                  | —                                                                  | —                                          | (6,463)          |
| Exercise of stock options                                                                        | —                  | —               | —                                | (40)                 | —                                                    | —                                      | 459                | —                                                                  | —                                          | 419              |
| Sale of stock for the deferred<br>compensation plan                                              | —                  | —               | —                                | —                    | —                                                    | —                                      | —                  | 182                                                                | (182)                                      | —                |
| Balance at September 30,<br>2012                                                                 | <u>\$ —</u>        | <u>\$ 336</u>   | <u>\$262,590</u>                 | <u>\$196,184</u>     | <u>\$ 354</u>                                        | <u>\$ (3,976)</u>                      | <u>\$(235,801)</u> | <u>\$ (689)</u>                                                    | <u>\$ 689</u>                              | <u>\$219,687</u> |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

|                                                                                                             | For the nine months<br>ended September 30, |           |
|-------------------------------------------------------------------------------------------------------------|--------------------------------------------|-----------|
|                                                                                                             | 2012                                       | 2011      |
|                                                                                                             | (Unaudited)                                |           |
| Cash flows from operating activities:                                                                       |                                            |           |
| Net income                                                                                                  | \$ 15,979                                  | \$ 15,282 |
| Adjustments to reconcile net income to net cash provided by operating activities:                           |                                            |           |
| Depreciation and amortization of premises and equipment                                                     | 1,953                                      | 1,838     |
| Allocation of ESOP stock                                                                                    | 363                                        | 340       |
| Stock awards                                                                                                | 396                                        | 779       |
| Amortization of servicing asset                                                                             | 1,225                                      | 1,417     |
| Net premium amortization in excess of discount accretion on securities                                      | 2,525                                      | 1,584     |
| Net amortization of deferred costs and discounts on loans                                                   | 650                                        | 651       |
| Provision for loan losses                                                                                   | 4,800                                      | 5,750     |
| Provision for repurchased loans                                                                             | 350                                        | —         |
| Net (gain) loss on sale of other real estate owned                                                          | (151)                                      | 189       |
| Net (gain) on sales of and other-than-temporary impairment loss on investment securities available for sale | (226)                                      | 148       |
| Net gain on sales of loans                                                                                  | (3,486)                                    | (2,066)   |
| Proceeds from sales of mortgage loans held for sale                                                         | 135,426                                    | 96,500    |
| Mortgage loans originated for sale                                                                          | (129,288)                                  | (91,539)  |
| Purchase of Bank Owned Life Insurance                                                                       | (10,000)                                   | —         |
| Proceeds from Bank Owned Life Insurance                                                                     | 158                                        | —         |
| Increase in value of Bank Owned Life Insurance                                                              | (977)                                      | (848)     |
| (Increase) decrease in interest and dividends receivable                                                    | (531)                                      | 42        |
| Decrease (increase) in other assets                                                                         | 2,482                                      | (589)     |
| Increase (decrease) in other liabilities                                                                    | 3,853                                      | (12,762)  |
| Total adjustments                                                                                           | 9,522                                      | 1,434     |
| Net cash provided by operating activities                                                                   | 25,501                                     | 16,716    |
| Cash flows from investing activities:                                                                       |                                            |           |
| Net decrease in loans receivable                                                                            | 8,517                                      | 64,256    |
| Purchase of investment securities available for sale                                                        | (64,324)                                   | (63,260)  |
| Purchase of mortgage-backed securities available for sale                                                   | (88,263)                                   | (55,624)  |
| Principal repayments on mortgage-backed securities available for sale                                       | 89,460                                     | 54,975    |
| Proceeds from maturities of investment securities available for sale                                        | 22,336                                     | —         |
| Proceeds from sale of investment securities available for sale                                              | 1,221                                      | —         |
| Decrease (increase) in Federal Home Loan Bank of New York stock                                             | 1,012                                      | (1,233)   |
| Proceeds from sales of other real estate owned                                                              | 1,905                                      | 2,929     |
| Purchases of premises and equipment                                                                         | (1,927)                                    | (1,814)   |
| Net cash (used in) provided by investing activities                                                         | (30,063)                                   | 229       |

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

|                                                                      | For the nine months<br>ended September 30, |                  |
|----------------------------------------------------------------------|--------------------------------------------|------------------|
|                                                                      | 2012                                       | 2011             |
|                                                                      | (Unaudited)                                |                  |
| Cash flows from financing activities:                                |                                            |                  |
| Increase in deposits                                                 | \$ 33,891                                  | \$ 23,938        |
| Increase in short-term borrowings                                    | 6,048                                      | 3,881            |
| Proceeds from Federal Home Loan Bank advances                        | —                                          | 55,000           |
| Repayments of Federal Home Loan Bank advances                        | (41,000)                                   | (54,000)         |
| Increase (decrease) in advances by borrowers for taxes and insurance | 183                                        | (241)            |
| Exercise of stock options                                            | 419                                        | 37               |
| Purchase of treasury stock                                           | (10,196)                                   | —                |
| Dividends paid – common stock                                        | (6,463)                                    | (6,590)          |
| Tax (expense) benefit of stock plans                                 | (482)                                      | 32               |
| Net cash (used in) provided by financing activities                  | <u>(17,600)</u>                            | <u>22,057</u>    |
| Net (decrease) increase in cash and due from banks                   | (22,162)                                   | 39,002           |
| Cash and due from banks at beginning of period                       | <u>77,527</u>                              | <u>31,455</u>    |
| Cash and due from banks at end of period                             | <u>\$ 55,365</u>                           | <u>\$ 70,457</u> |
| Supplemental Disclosure of Cash Flow Information:                    |                                            |                  |
| Cash paid during the period for:                                     |                                            |                  |
| Interest                                                             | \$ 11,000                                  | \$ 14,171        |
| Income taxes                                                         | 6,118                                      | 16,381           |
| Non-cash activities:                                                 |                                            |                  |
| Transfer of loans receivable to other real estate owned              | <u>3,412</u>                               | <u>2,016</u>     |

See accompanying Notes to Unaudited Consolidated Financial Statements.

**OceanFirst Financial Corp.  
Notes To Unaudited Consolidated Financial Statements**

**Note 1. Basis of Presentation**

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

The interim consolidated financial statements reflect all normal and recurring adjustments which are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the results of operations that may be expected for all of 2012. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statements of financial condition and the results of operations for the period. Actual results could differ from these estimates.

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

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report to Stockholders on Form 10-K for the year ended December 31, 2011.

**Note 2. Earnings per Share**

The following reconciles shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011 (in thousands):

|                                                                                  | Three months ended<br>September 30, |               | Nine months ended<br>September 30, |               |
|----------------------------------------------------------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                                                                  | 2012                                | 2011          | 2012                               | 2011          |
| Weighted average shares issued net of Treasury shares                            | 18,130                              | 18,846        | 18,415                             | 18,840        |
| Less: Unallocated ESOP shares                                                    | (476)                               | (510)         | (484)                              | (519)         |
| Unallocated incentive award shares and shares held by deferred compensation plan | (93)                                | (109)         | (94)                               | (131)         |
| Average basic shares outstanding                                                 | 17,561                              | 18,227        | 17,837                             | 18,190        |
| Add: Effect of dilutive securities:                                              |                                     |               |                                    |               |
| Stock options                                                                    | 19                                  | —             | 18                                 | —             |
| Shares held by deferred compensation plan                                        | 41                                  | 49            | 41                                 | 49            |
| Average diluted shares outstanding                                               | <u>17,621</u>                       | <u>18,276</u> | <u>17,896</u>                      | <u>18,239</u> |

For the three months ended September 30, 2012 and 2011, antidilutive stock options of 1,101,000 and 2,064,000 respectively, were excluded from earnings per share calculations. For the nine months ended September 30, 2012 and 2011 antidilutive stock options of 1,168,000 and 2,042,000, respectively, were excluded from earning per share calculation.

**Note 3. Investment Securities Available for Sale**

The amortized cost and estimated market value of investment securities available for sale at September 30, 2012 and December 31, 2011 are as follows (in thousands):

|                                 | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|---------------------------------|-------------------|------------------------------|-------------------------------|------------------------------|
| September 30, 2012              |                   |                              |                               |                              |
| U.S. agency obligations         | \$138,416         | \$ 1,019                     | \$ —                          | \$139,435                    |
| State and municipal obligations | 21,605            | 12                           | (31)                          | 21,586                       |
| Corporate debt securities       | 55,000            | —                            | (13,286)                      | 41,714                       |
| Equity investments              | 4,992             | 680                          | (71)                          | 5,601                        |
|                                 | <u>\$220,013</u>  | <u>\$ 1,711</u>              | <u>\$(13,388)</u>             | <u>\$208,336</u>             |

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| December 31, 2011               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|---------------------------------|-------------------|------------------------------|-------------------------------|------------------------------|
| U.S. agency obligations         | \$102,059         | \$ 760                       | \$ (43)                       | \$102,776                    |
| State and municipal obligations | 18,526            | 26                           | (8)                           | 18,544                       |
| Corporate debt securities       | 55,000            | —                            | (15,551)                      | 39,449                       |
| Equity investments              | 4,294             | 250                          | (34)                          | 4,510                        |
|                                 | <u>\$179,879</u>  | <u>\$ 1,036</u>              | <u>\$(15,636)</u>             | <u>\$165,279</u>             |

Realized gains on the sale of investment securities available for sale were \$226,000 for the nine months ended September 30, 2012. There were no realized gains or losses on the sale of investment securities available for sale for the three months ended September 30, 2012 and for the three and nine months ended September 30, 2011. The Company recognized an other-than-temporary impairment loss on equity investments of \$148,000 for the three and nine months ended September 30, 2011.

The amortized cost and estimated market value of investment securities available for sale, excluding equity investments, at September 30, 2012 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 September 30, 2012, investment securities available for sale with an amortized cost and estimated market value of \$55.0 million and \$41.7 million, respectively, were callable prior to the maturity date.

| September 30, 2012                     | Amortized<br>Cost | Estimated<br>Market<br>Value |
|----------------------------------------|-------------------|------------------------------|
| Less than one year                     | \$ 28,204         | \$ 28,276                    |
| Due after one year through five years  | 131,817           | 132,745                      |
| Due after five years through ten years | —                 | —                            |
| Due after ten years                    | 55,000            | 41,714                       |
|                                        | <u>\$215,021</u>  | <u>\$202,735</u>             |

The estimated market value and unrealized loss for investment securities available for sale at September 30, 2012 and December 31, 2011 segregated by the duration of the unrealized loss are as follows (in thousands):

|                                 | Less than 12 months          |                      | 12 months or longer          |                      | Total                        |                      |
|---------------------------------|------------------------------|----------------------|------------------------------|----------------------|------------------------------|----------------------|
|                                 | Estimated<br>Market<br>Value | Unrealized<br>Losses | Estimated<br>Market<br>Value | Unrealized<br>Losses | Estimated<br>Market<br>Value | Unrealized<br>Losses |
| September 30, 2012              |                              |                      |                              |                      |                              |                      |
| U.S. Agency obligations         | \$ —                         | \$ —                 | \$ —                         | \$ —                 | \$ —                         | \$ —                 |
| State and municipal obligations | 10,166                       | (31)                 | 96                           | —                    | 10,262                       | (31)                 |
| Corporate debt securities       | —                            | —                    | 41,714                       | (13,286)             | 41,714                       | (13,286)             |
| Equity investments              | 678                          | (71)                 | —                            | —                    | 678                          | (71)                 |
|                                 | <u>\$10,844</u>              | <u>\$ (102)</u>      | <u>\$41,810</u>              | <u>\$(13,286)</u>    | <u>\$52,654</u>              | <u>\$(13,388)</u>    |
| December 31, 2011               |                              |                      |                              |                      |                              |                      |
| U.S. Agency obligations         | \$20,791                     | \$ (43)              | \$ —                         | \$ —                 | \$20,791                     | \$ (43)              |
| State and municipal obligations | 421                          | (1)                  | 1,935                        | (7)                  | 2,356                        | (8)                  |
| Corporate debt securities       | —                            | —                    | 39,449                       | (15,551)             | 39,449                       | (15,551)             |
| Equity investments              | 1,465                        | (34)                 | —                            | —                    | 1,465                        | (34)                 |
|                                 | <u>\$22,677</u>              | <u>\$ (78)</u>       | <u>\$41,384</u>              | <u>\$(15,558)</u>    | <u>\$64,061</u>              | <u>\$(15,636)</u>    |

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At September 30, 2012, the amortized cost, estimated market value and credit rating of the individual corporate debt securities in an unrealized loss position for greater than one year are as follows (in thousands):

| Security Description | Amortized<br>Cost | Estimated<br>Market<br>Value | Credit Rating<br>Moody's/S&P |
|----------------------|-------------------|------------------------------|------------------------------|
| BankAmerica Capital  | \$15,000          | \$10,714                     | Ba2/BB+                      |
| Chase Capital        | 10,000            | 7,656                        | Baa2/BBB                     |
| Wells Fargo Capital  | 5,000             | 4,028                        | A3/A-                        |
| Huntington Capital   | 5,000             | 3,814                        | Baa3/BB+                     |
| Keycorp Capital      | 5,000             | 3,817                        | Baa3/BBB-                    |
| PNC Capital          | 5,000             | 4,107                        | Baa2/BBB                     |
| State Street Capital | 5,000             | 3,847                        | A3/BBB+                      |
| SunTrust Capital     | 5,000             | 3,731                        | Baa3/BB+                     |
|                      | <u>\$55,000</u>   | <u>\$41,714</u>              |                              |

At September 30, 2012, the market value of each corporate debt security was below cost. However, the estimated market value of the corporate debt securities portfolio increased over prior periods. The corporate debt securities are issued by other financial institutions with credit ratings ranging from a high of A3 to a low of Ba2 as rated by one of the internationally recognized credit rating services. These floating-rate securities were purchased during the period May 1998 to September 1998 and have paid coupon interest continuously since issuance. Floating-rate debt securities such as these pay a fixed interest rate spread over 90-day LIBOR. Subsequent to purchase, the required spread increased for these types of securities causing a decline in the market price. The Company concluded that unrealized losses on available for sale securities were only temporarily impaired at September 30, 2012. In concluding that the impairments were only temporary, the Company considered several factors in its analysis. The Company noted that each issuer made all the contractually due payments when required. There were no defaults on principal or interest payments and no interest payments were deferred. All of the financial institutions were also considered well-capitalized. Based on management's analysis of each individual security, the issuers appear to have the ability to meet debt service requirements over the life of the security. Furthermore, although these investment securities are available for sale, the Company does not have the intent to sell these securities and it is more likely than not that the Company will not be required to sell the securities. The Company has held the securities continuously since 1998 and expects to receive its full principal at maturity in 2028 or prior if called by the issuer. The Company has historically not actively sold investment securities and does not utilize the securities portfolio as a source of liquidity. The Company's long range liquidity plans indicate adequate sources of liquidity outside the securities portfolio.

Capital markets in general and the market for these corporate securities in particular have been disrupted since the second half of 2007. In its analysis, the Company considered that the severity and duration of unrecognized losses was at least partly due to the illiquidity caused by market disruptions. Since that time, markets have stabilized partly due to steps taken by the U.S. Treasury, the Federal Reserve Board, the Federal Deposit Insurance Corporation and foreign central banks to restore liquidity and confidence in the capital markets. Each of these issuers has been able to raise capital in recent years and the fair values of these securities have increased since the lows reached in the second half of 2008.

Due to the reasons noted above, especially the continuing restoration of the capital markets, the improved valuation of the corporate securities portfolio from the 2008 lows, the capital position of the issuers and the uninterrupted payment of all contractually due interest, management has determined that only a temporary impairment existed at September 30, 2012.

### **Note 4. Mortgage-Backed Securities Available for Sale**

The amortized cost and estimated market value of mortgage-backed securities available for sale at September 30, 2012 and December 31, 2011 are as follows (in thousands):

| September 30, 2012 | Amortized<br>Cost | Gross<br>Unrealized | Gross<br>Unrealized | Estimated<br>Market<br>Value |
|--------------------|-------------------|---------------------|---------------------|------------------------------|
|                    |                   | Gains               | Losses              |                              |
| FHLMC              | \$108,420         | \$ 930              | \$ (6)              | \$109,344                    |
| FNMA               | 238,522           | 11,202              | —                   | 249,724                      |
| GNMA               | 865               | 151                 | —                   | 1,016                        |
|                    | <u>\$347,807</u>  | <u>\$12,283</u>     | <u>\$ (6)</u>       | <u>\$360,084</u>             |

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| December 31, 2011 | Amortized<br>Cost | Gross<br>Unrealized | Gross<br>Unrealized | Estimated<br>Market<br>Value |
|-------------------|-------------------|---------------------|---------------------|------------------------------|
|                   |                   | Gains               | Losses              |                              |
| FHLMC             | \$ 74,155         | \$ 950              | \$ (48)             | \$ 75,057                    |
| FNMA              | 279,414           | 9,369               | (21)                | 288,762                      |
| GNMA              | 935               | 177                 | —                   | 1,112                        |
|                   | <u>\$354,504</u>  | <u>\$10,496</u>     | <u>\$ (69)</u>      | <u>\$364,931</u>             |

There were no gains or losses realized on the sale of mortgage-backed securities available for sale for the three and nine months ended September 30, 2012 and 2011.

The contractual maturities of mortgage-backed securities available for sale vary; however, the effective lives are expected to be shorter than the contractual maturity date due to principal prepayments.

The estimated market value and unrealized loss for mortgage-backed securities available for sale at September 30, 2012 and December 31, 2011, segregated by the duration of the unrealized loss are as follows (in thousands):

|                    | Less than 12 months |               | 12 months or longer |             | Total           |               |
|--------------------|---------------------|---------------|---------------------|-------------|-----------------|---------------|
|                    | Estimated           | Unrealized    | Estimated           | Unrealized  | Estimated       | Unrealized    |
| September 30, 2012 | Market<br>Value     | Losses        | Market<br>Value     | Losses      | Market<br>Value | Losses        |
| FHLMC              | \$ 8,395            | \$ (6)        | \$ —                | \$ —        | \$ 8,395        | \$ (6)        |
|                    | <u>\$ 8,395</u>     | <u>\$ (6)</u> | <u>\$ —</u>         | <u>\$ —</u> | <u>\$ 8,395</u> | <u>\$ (6)</u> |

|                   | Less than 12 months          |                      | 12 months or longer          |                      | Total                        |                      |
|-------------------|------------------------------|----------------------|------------------------------|----------------------|------------------------------|----------------------|
|                   | Estimated<br>Market<br>Value | Unrealized<br>Losses | Estimated<br>Market<br>Value | Unrealized<br>Losses | Estimated<br>Market<br>Value | Unrealized<br>Losses |
| December 31, 2011 | Market<br>Value              | Losses               | Market<br>Value              | Losses               | Market<br>Value              | Losses               |
| FHLMC             | \$24,662                     | \$ (48)              | \$ —                         | \$ —                 | \$24,662                     | \$ (48)              |
| FNMA              | 15,348                       | (21)                 | —                            | —                    | 15,348                       | (21)                 |
|                   | <u>\$40,010</u>              | <u>\$ (69)</u>       | <u>\$ —</u>                  | <u>\$ —</u>          | <u>\$40,010</u>              | <u>\$ (69)</u>       |

The mortgage-backed securities in loss positions 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 AA+ by one of the internationally-recognized credit rating services. FHLMC and FNMA have been under the conservatorship of the Federal Housing Financial Agency since September 8, 2008. The conservatorships have no specified termination date. Also, FHLMC and FNMA have entered into Stock Purchase Agreements, which following the issuance of Senior Preferred Stock and Warrants to the United States Treasury, provide FHLMC and FNMA funding commitments from the United States Treasury. 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 does not intend to sell these securities and it is more likely than not that the Bank will not be required to sell the securities before recovery of their amortized cost. As a result, the Company concluded that unrealized losses on these available for sale securities were only temporarily impaired at September 30, 2012.

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### Note 5. Loans Receivable, Net

Loans receivable, net at September 30, 2012 and December 31, 2011 consisted of the following (in thousands):

|                                               | September 30, 2012  | December 31, 2011   |
|-----------------------------------------------|---------------------|---------------------|
| Real estate:                                  |                     |                     |
| One-to-four family                            | \$ 822,049          | \$ 873,253          |
| Commercial real estate, multi family and land | 476,513             | 460,725             |
| Residential construction                      | 8,204               | 6,657               |
| Consumer                                      | 201,443             | 192,918             |
| Commercial                                    | 54,673              | 45,889              |
| Total loans                                   | 1,562,882           | 1,579,442           |
| Loans in process                              | (3,133)             | (2,559)             |
| Deferred origination costs, net               | 4,182               | 4,366               |
| Allowance for loan losses                     | (18,291)            | (18,230)            |
| Loans receivable, net                         | <u>\$ 1,545,640</u> | <u>\$ 1,563,019</u> |

At September 30, 2012 and December 31, 2011, loans in the amount of \$41,173,000 and \$44,008,000, respectively, were three or more months delinquent or in the process of foreclosure and the Company was not accruing interest income on these loans. There were no loans ninety days or greater past due and still accruing interest. Non-accrual loans include both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified impaired loans.

The Company defines an impaired loan as all non-accrual commercial real estate, multi-family, land, construction and commercial loans in excess of \$250,000. Impaired loans also include all loans modified as troubled debt restructurings. At September 30, 2012, the impaired loan portfolio totaled \$35,564,000 for which there was a specific allocation in the allowance for loan losses of \$2,494,000. At December 31, 2011, the impaired loan portfolio totaled \$28,491,000 for which there was a specific allocation in the allowance for loan losses of \$2,165,000. The average balance of impaired loans was \$35,802,000 and \$31,131,000 for the three and nine months ended September 30, 2012, respectively, and was \$29,602,000 and \$26,464,000 for the three and nine months ended September 30, 2011.

An analysis of the allowance for loan losses for the three and nine months ended September 30, 2012 and 2011 is as follows (in thousands):

|                                 | Three months ended<br>September 30, |                 | Nine months ended<br>September 30, |                 |
|---------------------------------|-------------------------------------|-----------------|------------------------------------|-----------------|
|                                 | 2012                                | 2011            | 2012                               | 2011            |
| Balance at beginning of period  | \$17,657                            | \$21,454        | \$18,230                           | \$19,700        |
| Provision charged to operations | 1,400                               | 1,850           | 4,800                              | 5,750           |
| Charge-offs                     | (1,694)                             | (403)           | (6,037)                            | (2,565)         |
| Recoveries                      | 928                                 | 4               | 1,298                              | 20              |
| Balance at end of period        | <u>\$18,291</u>                     | <u>\$22,905</u> | <u>\$18,291</u>                    | <u>\$22,905</u> |

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The following table presents an analysis of the allowance for loan losses for the three and nine months ended September 30, 2012 and 2011 and the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2012 and December 31, 2011 (in thousands):

|                                                             | Residential     | Commercial      |                 |                 |                 |                 |
|-------------------------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                                             | Real Estate     | Real Estate     | Consumer        | Commercial      | Unallocated     | Total           |
| <b><u>For the three months ended September 30, 2012</u></b> |                 |                 |                 |                 |                 |                 |
| Allowance for loan losses:                                  |                 |                 |                 |                 |                 |                 |
| Balance at beginning of period                              | \$ 4,768        | \$ 8,614        | \$ 1,648        | \$ 1,110        | \$ 1,517        | \$17,657        |
| Provision (benefit) charged to operations                   | 609             | (90)            | 963             | (577)           | 495             | 1,400           |
| Charge-offs                                                 | (1,126)         | —               | (491)           | (77)            | —               | (1,694)         |
| Recoveries                                                  | 210             | —               | 104             | 614             | —               | 928             |
| Balance at end of period                                    | <u>\$ 4,461</u> | <u>\$ 8,524</u> | <u>\$ 2,224</u> | <u>\$ 1,070</u> | <u>\$ 2,012</u> | <u>\$18,291</u> |
| <b><u>For the three months ended September 30, 2011</u></b> |                 |                 |                 |                 |                 |                 |
| Allowance for loan losses:                                  |                 |                 |                 |                 |                 |                 |
| Balance at beginning of period                              | \$ 6,469        | \$ 7,229        | \$ 4,277        | \$ 945          | \$ 2,534        | \$21,454        |
| Provision (benefit) charged to operations                   | 1,280           | 1,220           | 118             | 12              | (780)           | 1,850           |
| Charge-offs                                                 | (217)           | (180)           | (6)             | —               | —               | (403)           |
| Recoveries                                                  | —               | —               | —               | 4               | —               | 4               |
| Balance at end of period                                    | <u>\$ 7,532</u> | <u>\$ 8,269</u> | <u>\$ 4,389</u> | <u>\$ 961</u>   | <u>\$ 1,754</u> | <u>\$22,905</u> |
| <b><u>For the nine months ended September 30, 2012</u></b>  |                 |                 |                 |                 |                 |                 |
| Allowance for loan losses:                                  |                 |                 |                 |                 |                 |                 |
| Balance at beginning of period                              | \$ 5,370        | \$ 8,474        | \$ 1,461        | \$ 900          | \$ 2,025        | \$18,230        |
| Provision (benefit) charged to operations                   | 2,710           | (57)            | 2,533           | (373)           | (13)            | 4,800           |
| Charge-offs                                                 | (4,030)         | (47)            | (1,882)         | (78)            | —               | (6,037)         |
| Recoveries                                                  | 411             | 154             | 112             | 621             | —               | 1,298           |
| Balance at end of period                                    | <u>\$ 4,461</u> | <u>\$ 8,524</u> | <u>\$ 2,224</u> | <u>\$ 1,070</u> | <u>\$ 2,012</u> | <u>\$18,291</u> |
| <b><u>For the nine months ended September 30, 2011</u></b>  |                 |                 |                 |                 |                 |                 |
| Allowance for loan losses:                                  |                 |                 |                 |                 |                 |                 |
| Balance at beginning of period                              | \$ 5,977        | \$ 6,837        | \$ 3,264        | \$ 962          | \$ 2,660        | \$19,700        |
| Provision (benefit) charged to operations                   | 2,216           | 3,129           | 1,180           | 131             | (906)           | 5,750           |
| Charge-offs                                                 | (672)           | (1,697)         | (56)            | (140)           | —               | (2,565)         |
| Recoveries                                                  | 11              | —               | 1               | 8               | —               | 20              |
| Balance at end of period                                    | <u>\$ 7,532</u> | <u>\$ 8,269</u> | <u>\$ 4,389</u> | <u>\$ 961</u>   | <u>\$ 1,754</u> | <u>\$22,905</u> |

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|                                               | Residential<br>Real Estate | Commercial<br>Real Estate | Consumer         | Commercial       | Unallocated     | Total              |
|-----------------------------------------------|----------------------------|---------------------------|------------------|------------------|-----------------|--------------------|
| <b>September 30, 2012</b>                     |                            |                           |                  |                  |                 |                    |
| Allowance for loan losses:                    |                            |                           |                  |                  |                 |                    |
| Ending allowance balance attributed to loans: |                            |                           |                  |                  |                 |                    |
| Individually evaluated for impairment         | \$ 203                     | \$ 1,952                  | \$ 339           | \$ —             | \$ —            | \$ 2,494           |
| Collectively evaluated for impairment         | 4,258                      | 6,572                     | 1,885            | 1,070            | 2,012           | 15,797             |
| Total ending allowance balance                | <u>\$ 4,461</u>            | <u>\$ 8,524</u>           | <u>\$ 2,224</u>  | <u>\$ 1,070</u>  | <u>\$ 2,012</u> | <u>\$ 18,291</u>   |
| Loans:                                        |                            |                           |                  |                  |                 |                    |
| Loans individually evaluated for impairment   | \$ 21,612                  | \$ 11,557                 | \$ 2,101         | \$ 294           | \$ —            | \$ 35,564          |
| Loans collectively evaluated for impairment   | 808,641                    | 464,956                   | 199,342          | 54,379           | —               | 1,527,318          |
| Total ending loan balance                     | <u>\$830,253</u>           | <u>\$476,513</u>          | <u>\$201,443</u> | <u>\$ 54,673</u> | <u>\$ —</u>     | <u>\$1,562,882</u> |
| <b>December 31, 2011</b>                      |                            |                           |                  |                  |                 |                    |
| Allowance for loan losses:                    |                            |                           |                  |                  |                 |                    |
| Ending allowance balance attributed to loans: |                            |                           |                  |                  |                 |                    |
| Individually evaluated for impairment         | \$ 45                      | \$ 1,978                  | \$ 142           | \$ —             | \$ —            | \$ 2,165           |
| Collectively evaluated for impairment         | 5,325                      | 6,496                     | 1,319            | 900              | 2,025           | 16,065             |
| Total ending allowance balance                | <u>\$ 5,370</u>            | <u>\$ 8,474</u>           | <u>\$ 1,461</u>  | <u>\$ 900</u>    | <u>\$ 2,025</u> | <u>\$ 18,230</u>   |
| Loans:                                        |                            |                           |                  |                  |                 |                    |
| Loans individually evaluated for impairment   | \$ 16,902                  | \$ 10,178                 | \$ 859           | \$ 552           | \$ —            | \$ 28,491          |
| Loans collectively evaluated for impairment   | 863,008                    | 450,547                   | 192,059          | 45,337           | —               | 1,550,951          |
| Total ending loan balance                     | <u>\$879,910</u>           | <u>\$460,725</u>          | <u>\$192,918</u> | <u>\$ 45,889</u> | <u>\$ —</u>     | <u>\$1,579,442</u> |

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A summary of impaired loans at September 30, 2012 and December 31, 2011 is as follows (in thousands):

|                                                            | September 30,<br>2012 | December 31,<br>2011 |
|------------------------------------------------------------|-----------------------|----------------------|
| Impaired loans with no allocated allowance for loan losses | \$ 22,378             | \$ 19,186            |
| Impaired loans with allocated allowance for loan losses    | 13,186                | 9,305                |
|                                                            | <u>\$ 35,564</u>      | <u>\$ 28,491</u>     |
| Amount of the allowance for loan losses allocated          | <u>\$ 2,494</u>       | <u>\$ 2,165</u>      |

The summary of loans individually evaluated for impairment by class of loans as of September 30, 2012 and December 31, 2011 and for the three and nine months ended September 30, 2012 and 2011 follows (in thousands):

|                                            | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Allowance<br>for Loan<br>Losses<br>Allocated |
|--------------------------------------------|--------------------------------|------------------------|----------------------------------------------|
| <u>As of September 30, 2012</u>            |                                |                        |                                              |
| With no related allowance recorded:        |                                |                        |                                              |
| Residential real estate:                   |                                |                        |                                              |
| Originated by Bank                         | \$10,568                       | \$ 10,343              | \$ —                                         |
| Originated by mortgage company             | 7,021                          | 6,854                  | —                                            |
| Originated by mortgage company – non-prime | 2,064                          | 1,773                  | —                                            |
| Commercial real estate:                    |                                |                        |                                              |
| Commercial                                 | 1,707                          | 1,701                  | —                                            |
| Construction and land                      | —                              | —                      | —                                            |
| Consumer                                   | 1,442                          | 1,413                  | —                                            |
| Commercial                                 | 295                            | 294                    | —                                            |
|                                            | <u>\$23,097</u>                | <u>\$22,378</u>        | <u>\$ —</u>                                  |
| With an allowance recorded:                |                                |                        |                                              |
| Residential real estate:                   |                                |                        |                                              |
| Originated by Bank                         | \$ 1,695                       | \$ 1,638               | \$ 119                                       |
| Originated by mortgage company             | 405                            | 405                    | 83                                           |
| Originated by mortgage company – non-prime | 720                            | 599                    | 1                                            |
| Commercial real estate:                    |                                |                        |                                              |
| Commercial                                 | 10,025                         | 9,856                  | 1,952                                        |
| Construction and land                      | —                              | —                      | —                                            |
| Consumer                                   | 688                            | 688                    | 339                                          |
| Commercial                                 | —                              | —                      | —                                            |
|                                            | <u>\$13,533</u>                | <u>\$13,186</u>        | <u>\$ 2,494</u>                              |
| <u>As of December 31, 2011</u>             |                                |                        |                                              |
| With no related allowance recorded:        |                                |                        |                                              |
| Residential real estate:                   |                                |                        |                                              |
| Originated by Bank                         | \$ 9,491                       | \$ 9,247               | \$ —                                         |
| Originated by mortgage Company             | 4,803                          | 4,771                  | —                                            |
| Originated by mortgage company – non-prime | 2,794                          | 2,494                  | —                                            |
| Commercial real estate:                    |                                |                        |                                              |
| Commercial                                 | 1,438                          | 1,405                  | —                                            |
| Construction and land                      | —                              | —                      | —                                            |
| Consumer                                   | 742                            | 717                    | —                                            |
| Commercial                                 | 558                            | 552                    | —                                            |
|                                            | <u>\$19,826</u>                | <u>\$19,186</u>        | <u>\$ —</u>                                  |

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|                                            | Unpaid<br>Principal |                        | Allowance<br>for Loan<br>Losses<br>Allocated |
|--------------------------------------------|---------------------|------------------------|----------------------------------------------|
|                                            | Balance             | Recorded<br>Investment |                                              |
| With an allowance recorded:                |                     |                        |                                              |
| Residential real estate:                   |                     |                        |                                              |
| Originated by Bank                         | \$ —                | \$ —                   | \$ —                                         |
| Originated by mortgage Company             | 402                 | 390                    | 45                                           |
| Originated by mortgage company – non-prime | —                   | —                      | —                                            |
| Commercial real estate:                    |                     |                        |                                              |
| Commercial                                 | 9,105               | 8,773                  | 1,978                                        |
| Construction and land                      | —                   | —                      | —                                            |
| Consumer                                   | 142                 | 142                    | 142                                          |
| Commercial                                 | —                   | —                      | —                                            |
|                                            | <u>\$9,649</u>      | <u>\$ 9,305</u>        | <u>\$ 2,165</u>                              |

  

|                                            | Three months ended September 30,  |                                  |                                   |                                  |
|--------------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                                            | 2012                              |                                  | 2011                              |                                  |
|                                            | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded:        |                                   |                                  |                                   |                                  |
| Residential real estate:                   |                                   |                                  |                                   |                                  |
| Originated by Bank                         | \$10,440                          | \$ 125                           | \$ 9,438                          | \$ 112                           |
| Originated by mortgage Company             | 6,824                             | 68                               | 5,214                             | 72                               |
| Originated by mortgage company – non-prime | 1,960                             | 1                                | —                                 | —                                |
| Commercial real estate:                    |                                   |                                  |                                   |                                  |
| Commercial                                 | 1,710                             | 22                               | 5,464                             | 88                               |
| Construction and land                      | —                                 | —                                | —                                 | —                                |
| Consumer                                   | 1,406                             | 19                               | 698                               | 10                               |
| Commercial                                 | 294                               | 3                                | 302                               | —                                |
|                                            | <u>\$22,634</u>                   | <u>\$ 238</u>                    | <u>\$21,116</u>                   | <u>\$ 282</u>                    |
| With an allowance recorded:                |                                   |                                  |                                   |                                  |
| Residential real estate:                   |                                   |                                  |                                   |                                  |
| Originated by Bank                         | \$ 1,605                          | \$ 14                            | \$ 566                            | \$ —                             |
| Originated by mortgage Company             | 405                               | 7                                | —                                 | —                                |
| Originated by mortgage company – non-prime | 636                               | —                                | 2,742                             | —                                |
| Commercial real estate:                    |                                   |                                  |                                   |                                  |
| Commercial                                 | 9,834                             | 89                               | 5,113                             | 44                               |
| Construction and land                      | —                                 | —                                | —                                 | —                                |
| Consumer                                   | 688                               | 10                               | 65                                | 5                                |
| Commercial                                 | —                                 | —                                | —                                 | —                                |
|                                            | <u>\$13,168</u>                   | <u>\$ 120</u>                    | <u>\$ 8,486</u>                   | <u>\$ 49</u>                     |

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|                                            | Nine months ended September 30,   |                                  |                                   |                                  |
|--------------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                                            | 2012                              |                                  | 2011                              |                                  |
|                                            | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>With no related allowance recorded:</b> |                                   |                                  |                                   |                                  |
| Residential real estate:                   |                                   |                                  |                                   |                                  |
| Originated by Bank                         | \$ 9,291                          | \$ 324                           | \$ 9,559                          | \$ 296                           |
| Originated by mortgage Company             | 5,686                             | 178                              | 5,207                             | 191                              |
| Originated by mortgage company – non-prime | 1,832                             | 3                                | —                                 | —                                |
| Commercial real estate:                    |                                   |                                  |                                   |                                  |
| Commercial                                 | 1,643                             | 66                               | 4,328                             | 128                              |
| Construction and land                      | —                                 | —                                | —                                 | —                                |
| Consumer                                   | 952                               | 38                               | 704                               | 23                               |
| Commercial                                 | 296                               | 7                                | 134                               | —                                |
|                                            | <u>\$19,700</u>                   | <u>\$ 616</u>                    | <u>\$19,932</u>                   | <u>\$ 638</u>                    |
| <b>With an allowance recorded:</b>         |                                   |                                  |                                   |                                  |
| Residential real estate:                   |                                   |                                  |                                   |                                  |
| Originated by Bank                         | \$ 1,050                          | \$ 61                            | \$ 378                            | \$ —                             |
| Originated by mortgage Company             | 135                               | 7                                | —                                 | —                                |
| Originated by mortgage company – non-prime | 674                               | —                                | 2,608                             | —                                |
| Commercial real estate:                    |                                   |                                  |                                   |                                  |
| Commercial                                 | 9,255                             | 277                              | 2,273                             | 74                               |
| Construction and land                      | —                                 | —                                | 1,142                             | —                                |
| Consumer                                   | 317                               | 11                               | 131                               | 5                                |
| Commercial                                 | —                                 | —                                | —                                 | —                                |
|                                            | <u>\$11,431</u>                   | <u>\$ 356</u>                    | <u>\$ 6,532</u>                   | <u>\$ 79</u>                     |

The following table presents the recorded investment in non-accrual loans by class of loans as of September 30, 2012 and December 31, 2011 (in thousands):

|                                            | Recorded Investment in Non-accrual Loans |                   |
|--------------------------------------------|------------------------------------------|-------------------|
|                                            | September 30, 2012                       | December 31, 2011 |
| <b>Residential real estate:</b>            |                                          |                   |
| Originated by Bank                         | \$ 11,579                                | \$ 15,874         |
| Originated by mortgage company             | 10,418                                   | 9,768             |
| Originated by mortgage company – non-prime | 3,478                                    | 3,551             |
| Residential construction                   | —                                        | 43                |
| <b>Commercial real estate:</b>             |                                          |                   |
| Commercial                                 | 11,397                                   | 10,552            |
| Construction and land                      | —                                        | —                 |
| Consumer                                   | 3,670                                    | 3,653             |
| Commercial                                 | 631                                      | 567               |
|                                            | <u>\$ 41,173</u>                         | <u>\$ 44,008</u>  |

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

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The following table presents the aging of the recorded investment in past due loans as of September 30, 2012 and December 31, 2011 by class of loans (in thousands):

|                                            | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater<br>than<br>90 Days<br>Past Due | Total<br>Past Due | Loans Not<br>Past Due | Total              |
|--------------------------------------------|---------------------------|---------------------------|----------------------------------------|-------------------|-----------------------|--------------------|
| <b>September 30, 2012</b>                  |                           |                           |                                        |                   |                       |                    |
| Residential real estate:                   |                           |                           |                                        |                   |                       |                    |
| Originated by Bank                         | \$ 4,940                  | \$1,904                   | \$10,895                               | \$17,739          | \$ 675,675            | \$ 693,414         |
| Originated by mortgage company             | 2,591                     | —                         | 10,230                                 | 12,821            | 111,553               | 124,374            |
| Originated by mortgage company – non-prime | 823                       | 653                       | 2,356                                  | 3,832             | 429                   | 4,261              |
| Residential construction                   | —                         | —                         | —                                      | —                 | 8,204                 | 8,204              |
| Commercial real estate:                    |                           |                           |                                        |                   |                       |                    |
| Commercial                                 | 1,057                     | —                         | 1,965                                  | 3,022             | 461,342               | 464,364            |
| Construction and land                      | —                         | —                         | —                                      | —                 | 12,149                | 12,149             |
| Consumer                                   | 1,510                     | 758                       | 3,335                                  | 5,603             | 195,840               | 201,443            |
| Commercial                                 | —                         | —                         | 338                                    | 338               | 54,335                | 54,673             |
|                                            | <u>\$10,921</u>           | <u>\$3,315</u>            | <u>\$29,119</u>                        | <u>\$43,355</u>   | <u>\$1,519,527</u>    | <u>\$1,562,882</u> |
| <b>December 31, 2011</b>                   |                           |                           |                                        |                   |                       |                    |
| Residential real estate:                   |                           |                           |                                        |                   |                       |                    |
| Originated by Bank                         | \$ 6,449                  | \$2,024                   | \$14,491                               | \$22,964          | \$ 704,925            | \$ 727,889         |
| Originated by mortgage company             | 4,265                     | 1,228                     | 8,710                                  | 14,203            | 126,288               | 140,491            |
| Originated by mortgage company – non-prime | 59                        | —                         | 3,551                                  | 3,610             | 1,263                 | 4,873              |
| Residential construction                   | —                         | —                         | 43                                     | 43                | 6,614                 | 6,657              |
| Commercial real estate:                    |                           |                           |                                        |                   |                       |                    |
| Commercial                                 | 7                         | 746                       | 373                                    | 1,126             | 442,322               | 443,448            |
| Construction and land                      | —                         | —                         | —                                      | —                 | 17,277                | 17,277             |
| Consumer                                   | 2,375                     | 312                       | 3,127                                  | 5,814             | 187,104               | 192,918            |
| Commercial                                 | —                         | —                         | 15                                     | 15                | 45,874                | 45,889             |
|                                            | <u>\$13,155</u>           | <u>\$4,310</u>            | <u>\$30,310</u>                        | <u>\$47,775</u>   | <u>\$1,531,667</u>    | <u>\$1,579,442</u> |

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

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

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

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

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Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass related loans. Loans not rated are included in groups of homogeneous loans. As of September 30, 2012 and December 31, 2011, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows (in thousands):

|                           | Pass             | Special<br>Mention | Substandard      | Doubtful       | Total            |
|---------------------------|------------------|--------------------|------------------|----------------|------------------|
| <b>September 30, 2012</b> |                  |                    |                  |                |                  |
| Commercial real estate:   |                  |                    |                  |                |                  |
| Commercial                | \$425,329        | \$1,775            | \$ 36,225        | \$1,035        | \$464,364        |
| Construction and land     | 11,161           | 506                | 482              | —              | 12,149           |
| Commercial                | 48,912           | —                  | 5,761            | —              | 54,673           |
|                           | <u>\$485,402</u> | <u>\$2,281</u>     | <u>\$ 42,468</u> | <u>\$1,035</u> | <u>\$531,186</u> |
| <b>December 31, 2011</b>  |                  |                    |                  |                |                  |
| Commercial real estate:   |                  |                    |                  |                |                  |
| Commercial                | \$416,706        | \$2,329            | \$ 24,413        | \$ —           | \$443,448        |
| Construction and land     | 15,079           | 2,198              | —                | —              | 17,277           |
| Commercial                | 41,589           | —                  | 4,232            | 68             | 45,889           |
|                           | <u>\$473,374</u> | <u>\$4,527</u>     | <u>\$ 28,645</u> | <u>\$ 68</u>   | <u>\$506,614</u> |

For residential and consumer loan classes, the Company evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2012 and December 31, 2011 (in thousands):

|                           | Residential Real Estate |                                      |                                    |                             |                  |
|---------------------------|-------------------------|--------------------------------------|------------------------------------|-----------------------------|------------------|
|                           | Originated by           |                                      |                                    |                             |                  |
|                           | Originated<br>by Bank   | Originated<br>by mortgage<br>company | mortgage<br>company –<br>non-prime | Residential<br>construction | Consumer         |
| <u>September 30, 2012</u> |                         |                                      |                                    |                             |                  |
| Performing                | \$681,835               | \$113,956                            | \$ 783                             | \$ 8,204                    | \$197,773        |
| Non-performing            | 11,579                  | 10,418                               | 3,478                              | —                           | 3,670            |
|                           | <u>\$693,414</u>        | <u>\$124,374</u>                     | <u>\$ 4,261</u>                    | <u>\$ 8,204</u>             | <u>\$201,443</u> |
| <u>December 31, 2011</u>  |                         |                                      |                                    |                             |                  |
| Performing                | \$712,015               | \$130,723                            | \$ 1,322                           | \$ 6,614                    | \$189,265        |
| Non-performing            | 15,874                  | 9,768                                | 3,551                              | 43                          | 3,653            |
|                           | <u>\$727,889</u>        | <u>\$140,491</u>                     | <u>\$ 4,873</u>                    | <u>\$ 6,657</u>             | <u>\$192,918</u> |

The Company classifies certain loans as troubled debt restructurings (“TDR”) when credit terms to a borrower in financial difficulty are modified. The modifications may include a reduction in rate, an extension in term and/or the capitalization of past due amounts. Included in the non-accrual loan total at September 30, 2012 and December 31, 2011 were \$14,772,000 and \$14,491,000, respectively, of troubled debt restructurings. At September 30, 2012 and December 31, 2011, the Company has allocated \$2,450,000 and \$1,985,000, respectively, of specific reserves to loans which are classified as troubled debt restructurings. Non-accrual loans which become troubled debt restructurings are returned to accrual status after six months of performance. In addition to the troubled debt restructurings included in non-accrual loans, the Company also has loans classified as troubled debt restructuring which are accruing at September 30, 2012 and December 31, 2011, which totaled \$19,621,000 and \$13,118,000, respectively. Accruing troubled debt restructurings were adversely impacted by \$6,511,000 due to the third quarter implementation of new guidance issued by the Bank’s regulator, the Office of the Comptroller of the Currency (“OCC”). The amount now includes one-to-four family and consumer loans where the borrower’s obligation was discharged due to bankruptcy. The updated guidance requires the Company to include certain loans as troubled debt restructurings due to the discharge of the borrower’s debt. These loans continue to make payments as agreed and the Bank retains its security interest in the real estate collateral. Troubled debt restructurings with six months of performance are considered in the allowance for loan losses similar to other performing loans. Troubled debt restructurings which are non-accrual or classified are considered in the allowance for loan losses similar to other non-accrual or classified loans.

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The following table presents information about troubled debt restructurings which occurred during the three and nine months ended September 30, 2012 and troubled debt restructurings modified within the previous year and which defaulted during the three and nine months ended September 30, 2012 (dollars in thousands):

|                                                            | <u>Number of Loans</u> | <u>Pre-modification<br/>Recorded Investment</u> | <u>Post-modification<br/>Recorded Investment</u> |
|------------------------------------------------------------|------------------------|-------------------------------------------------|--------------------------------------------------|
| <b><u>Three months ended September 30, 2012</u></b>        |                        |                                                 |                                                  |
| Troubled Debt Restructurings:                              |                        |                                                 |                                                  |
| Residential real estate:                                   |                        |                                                 |                                                  |
| Originated by Bank                                         | 4                      | \$ 375                                          | \$ 368                                           |
| Originated by mortgage company                             | 1                      | \$ 359                                          | \$ 359                                           |
| Consumer                                                   | 1                      | \$ 56                                           | \$ 56                                            |
|                                                            | <u>Number of Loans</u> | <u>Recorded Investment</u>                      |                                                  |
| Troubled Debt Restructurings Which Subsequently Defaulted: | None                   | None                                            |                                                  |
|                                                            | <u>Number of Loans</u> | <u>Pre-modification<br/>Recorded Investment</u> | <u>Post-modification<br/>Recorded Investment</u> |
| <b><u>Nine months ended September 30, 2012</u></b>         |                        |                                                 |                                                  |
| Troubled Debt Restructurings:                              |                        |                                                 |                                                  |
| Residential real estate:                                   |                        |                                                 |                                                  |
| Originated by Bank                                         | 9                      | \$ 2,029                                        | \$ 1,892                                         |
| Originated by mortgage company                             | 3                      | \$ 978                                          | \$ 978                                           |
| Commercial real estate:                                    |                        |                                                 |                                                  |
| Commercial                                                 | 2                      | \$ 1,315                                        | \$ 1,279                                         |
| Consumer                                                   | 4                      | \$ 185                                          | \$ 185                                           |
|                                                            | <u>Number of Loans</u> | <u>Recorded Investment</u>                      |                                                  |
| Troubled Debt Restructurings Which Subsequently Defaulted: | None                   | None                                            |                                                  |

### **Note 6. Reserve for Repurchased Loans**

An analysis of the reserve for repurchased loans for the three and nine months ended September 30, 2012 and 2011 is as follows (in thousands). The reserve is included in other liabilities in the accompanying statements of financial condition.

|                                          | <u>Three months ended<br/>September 30,</u> |               | <u>Nine months ended<br/>September 30,</u> |               |
|------------------------------------------|---------------------------------------------|---------------|--------------------------------------------|---------------|
|                                          | <u>2012</u>                                 | <u>2011</u>   | <u>2012</u>                                | <u>2011</u>   |
| Balance at beginning of period           | \$ 955                                      | \$ 809        | \$ 705                                     | \$ 809        |
| Provision charged to operations          | 100                                         | —             | 350                                        | —             |
| Loss on loans repurchased or settlements | —                                           | —             | —                                          | —             |
| Balance at end of period                 | <u>\$ 1,055</u>                             | <u>\$ 809</u> | <u>\$ 1,055</u>                            | <u>\$ 809</u> |

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. At September 30, 2012, there were 12 outstanding loan repurchase requests, which the Company is disputing, on loans with a total principal balance of \$3.8 million as compared to four outstanding loan repurchase requests on loans with a principal balance of \$1.2 million at December 31, 2011. The Company prepares a comprehensive analysis of the adequacy of the reserve for repurchased loans at each quarter-end. The reserve includes a specific loss estimate on the outstanding loan repurchase requests based on the estimated fair value of the underlying collateral modified by the likelihood of loss which was estimated based on historical experience. The reserve also includes a general loss estimate based on an estimate of loans likely to be returned for repurchase and the estimated loss on those loans. In establishing the reserve, the Company considers recent and historical experience, product type and volume of loan sales and the general economic environment.

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### **Note 7. Deposits**

The major types of deposits at September 30, 2012 and December 31, 2011 were as follows (in thousands):

| Type of Account           | September 30, 2012  | December 31, 2011   |
|---------------------------|---------------------|---------------------|
| Non-interest-bearing      | \$ 185,157          | \$ 142,436          |
| Interest-bearing checking | 948,074             | 942,402             |
| Money market deposit      | 124,581             | 123,105             |
| Savings                   | 246,549             | 229,241             |
| Time deposits             | 235,613             | 268,899             |
| Total deposits            | <u>\$ 1,739,974</u> | <u>\$ 1,706,083</u> |

Included in time deposits at September 30, 2012 and December 31, 2011, is \$60,922,000 and \$77,053,000, respectively, in deposits of \$100,000 and over.

### **Note 8. Recent Accounting Pronouncements**

Accounting Standards Update No. 2011-05, “Comprehensive Income” requires that all non-owner changes in stockholders’ equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. The option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. The standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and did not have a material effect on the Company’s consolidated financial statements. The Company has included a separate Consolidated Statements of Comprehensive Income as part of these financial statements.

Accounting Standards Update No. 2011-04, “Fair Value Measurement, Amendments to achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs” develops common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”) and International Financial Reporting Standards (“IFRSs”). The amendments are effective for interim and annual periods beginning after December 15, 2011. The adoption of this Accounting Standard Update did not have a material effect on the Company’s consolidated financial statements.

Accounting Standards Update No. 2011-03, “Reconsideration of Effective Control for Repurchase Agreements”, amends Topic 860 (Transfers and Servicing) where an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements, based on whether or not the transferor has maintained effective control. In the assessment of effective control, Accounting Standard Update 2011-03 has removed the criteria that requires transferors to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. Other criteria applicable to the assessment of effective control have not been changed. This guidance is effective for prospective periods beginning on or after December 15, 2011. Early adoption is prohibited. The adoption of this Accounting Standard Update did not have a material effect on the Company’s consolidated financial statements.

### **Note 9. Fair Value Measurements**

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

The Company uses valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability and developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity’s own assumptions about the assumptions market participants would use in pricing the asset or liability and developed based on the best information available in the circumstances. In that regard, a

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fair value hierarchy has been established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Movements within the fair value hierarchy are recognized at the end of the applicable reporting period. There were no transfers between the levels of the fair value hierarchy for the three and nine months ended September 30, 2012. The fair value hierarchy is as follows:

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

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

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

### **Assets and Liabilities Measured at Fair Value**

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

### **Investments and Mortgage-Backed Securities**

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

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

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

### **Other Real Estate Owned and Impaired Loans**

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

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The following table summarizes financial assets and financial liabilities measured at fair value as of September 30, 2012 and December 31, 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

|                                                                                    | Total Fair Value | Fair Value Measurements at Reporting Date Using: |                |                |
|------------------------------------------------------------------------------------|------------------|--------------------------------------------------|----------------|----------------|
|                                                                                    |                  | Level 1 Inputs                                   | Level 2 Inputs | Level 3 Inputs |
| <b>September 30, 2012</b>                                                          |                  |                                                  |                |                |
| Items measured on a recurring basis:                                               |                  |                                                  |                |                |
| Investment securities available for sale:                                          |                  |                                                  |                |                |
| U.S. Agency obligations                                                            | \$139,435        | \$ —                                             | \$ 139,435     | \$ —           |
| State and municipal obligations                                                    | 21,586           | —                                                | 21,586         | —              |
| Corporate debt securities                                                          | 41,714           | —                                                | 41,714         | —              |
| Equity investments                                                                 | 5,601            | 5,601                                            | —              | —              |
| Mortgage-backed securities available for sale                                      | 360,084          | —                                                | 360,084        | —              |
| Items measured on a non-recurring basis:                                           |                  |                                                  |                |                |
| Other real estate owned                                                            | 3,628            | —                                                | —              | 3,628          |
| Loans measured for impairment based on the fair value of the underlying collateral | 9,856            | —                                                | —              | 9,856          |
| <b>December 31, 2011</b>                                                           |                  |                                                  |                |                |
| Items measured on a recurring basis:                                               |                  |                                                  |                |                |
| Investment securities available for sale:                                          |                  |                                                  |                |                |
| U.S. Agency obligations                                                            | \$102,776        | \$ —                                             | \$ 102,776     | \$ —           |
| State and municipal obligations                                                    | 18,544           | —                                                | 18,544         | —              |
| Corporate debt securities                                                          | 39,449           | —                                                | 39,449         | —              |
| Equity investments                                                                 | 4,510            | 4,510                                            | —              | —              |
| Mortgage-backed securities available for sale                                      | 364,931          | —                                                | 364,931        | —              |
| Items measured on a non-recurring basis:                                           |                  |                                                  |                |                |
| Other real estate owned                                                            | 1,513            | —                                                | —              | 1,513          |
| Loans measured for impairment based on the fair value of the underlying collateral | 8,773            | —                                                | —              | 8,773          |

## Assets and Liabilities Disclosed at Fair Value

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

### Cash and Due from Banks

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

### Federal Home Loan Bank of New York Stock

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

### Loans

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

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

### Deposits Other than Time Deposits

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

### Time Deposits

The fair value of time deposits 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.

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### Securities Sold Under Agreements to Repurchase with Retail Customers

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

### Borrowed Funds

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

The book value and estimated fair value of the Bank's significant financial instruments not recorded at fair value as of September 30, 2012 and December 31, 2011 are presented in the following tables (in thousands):

| September 30, 2012                                                   | Book Value | Fair Value Measurements at Reporting Date Using: |                |                |
|----------------------------------------------------------------------|------------|--------------------------------------------------|----------------|----------------|
|                                                                      |            | Level 1 Inputs                                   | Level 2 Inputs | Level 3 Inputs |
| Financial Assets:                                                    |            |                                                  |                |                |
| Cash and due from banks                                              | \$ 55,365  | \$55,365                                         | \$ —           | \$ —           |
| Federal Home Loan Bank of New York stock                             | 17,148     | —                                                | —              | 17,148         |
| Loans receivable and mortgage loans held for sale                    | 1,551,238  | —                                                | —              | 1,593,639      |
| Financial Liabilities:                                               |            |                                                  |                |                |
| Deposits other than time deposits                                    | 1,504,361  | —                                                | 1,504,361      | —              |
| Time deposits                                                        | 235,613    | —                                                | 241,484        | —              |
| Securities sold under agreements to repurchase with retail customers | 72,149     | 72,149                                           | —              | —              |
| Federal Home Loan Bank advances and other borrowings                 | 252,500    | —                                                | 259,561        | —              |

| December 31, 2011                                                    | Book Value | Fair Value Measurements at Reporting Date Using: |                |                |
|----------------------------------------------------------------------|------------|--------------------------------------------------|----------------|----------------|
|                                                                      |            | Level 1 Inputs                                   | Level 2 Inputs | Level 3 Inputs |
| Financial Assets:                                                    |            |                                                  |                |                |
| Cash and due from banks                                              | \$ 77,527  | \$77,527                                         | \$ —           | \$ —           |
| Federal Home Loan Bank of New York stock                             | 18,160     | —                                                | —              | 18,160         |
| Loans receivable and mortgage loans held for sale                    | 1,572,316  | —                                                | —              | 1,598,838      |
| Financial Liabilities:                                               |            |                                                  |                |                |
| Deposits other than time deposits                                    | 1,437,184  |                                                  | 1,437,184      | —              |
| Time deposits                                                        | 268,899    | —                                                | 274,074        | —              |
| Securities sold under agreements to repurchase with retail customers | 66,101     | 66,101                                           | —              | —              |
| Federal Home Loan Bank advances and other borrowings                 | 293,500    | —                                                | 301,778        | —              |

### Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because a limited market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other significant unobservable inputs. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

### **Note 10. Subsequent Event**

On October 29 and 30, 2012, the Company's market area experienced unprecedented storm damage from Sandy. Although the extent of the damage and its impact on the Company cannot be determined at this time, the storm is expected to impact

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the ability of some borrowers to repay their loans and also adversely impact collateral values. As a result, the Company may experience increased levels of non-performing loans and loan losses which may negatively impact earnings. It is also possible that the Bank may experience increased lending volume as area residences and businesses rebuild. As of November 5, 2012 all of the Bank's branches were operating.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

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

### Item 1A. Risk Factors

For a summary of risk factors relevant to the Company, see Part I, Item 1A, "Risk Factors," in the 2011 Form 10-K. There were no material changes to risk factors relevant to the Company's operations since December 31, 2011 except as described below.

On October 29 and 30, 2012, the Company's market area experienced unprecedented storm damage due to Sandy. Although the extent of the damage and its impact on the Company cannot be determined at this time, the storm is expected to impair the ability of some borrowers to repay their loans and also adversely impact collateral values. As a result, the Company may experience increased levels of non-performing loans and loan losses which may negatively impact earnings.

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

On October 31, 2011, the Company announced its intention to repurchase up to 942,306 shares or 5% of its outstanding common stock. Information regarding the Company's common stock repurchases for the three month period ended September 30, 2012 is as follows:

| Period                                       | Total<br>Number of<br>Shares<br>Purchased | Average Price<br>Paid per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs | Maximum<br>Number of Shares<br>that May Yet Be<br>Purchased Under the<br>Plans or Programs |
|----------------------------------------------|-------------------------------------------|---------------------------------|----------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| July 1, 2012 through July 31, 2012           | 1,400                                     | \$ 13.72                        | 1,400                                                                                        | 262,015                                                                                    |
| August 1, 2012 through August 31, 2012       | 125,612                                   | 13.93                           | 125,612                                                                                      | 136,403                                                                                    |
| September 1, 2012 through September 30, 2012 | 77,504                                    | 14.36                           | 77,504                                                                                       | 58,899                                                                                     |

### Item 3. Defaults Upon Senior Securities

Not Applicable

### Item 4. Mine Safety Disclosures

Not Applicable

### Item 5. Other Information

Not Applicable

### Item 6. Exhibits

Exhibits:

- |      |                                                                                                    |
|------|----------------------------------------------------------------------------------------------------|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |

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|       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|-------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 32.0  | Certification pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 101.0 | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements.* |

\* Pursuant to SEC rules, this exhibit will not be deemed filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of that section.

**SIGNATURES**

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

OceanFirst Financial Corp.  
\_\_\_\_\_  
Registrant

DATE: November 9, 2012

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

DATE: November 9, 2012

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

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### Exhibit Index

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| 31.1           | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                                                                         | 38          |
| 31.2           | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                                                                         | 39          |
| 32.0           | Certification pursuant to 18 U.S.C. Section 1350 as added by Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                                                                 | 40          |
| 101.0          | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements.* |             |

\* Pursuant to SEC rules, this exhibit will not be deemed filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of that section.

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John R. Garbarino, certify that:

1. I have reviewed this quarterly report on Form 10-Q of OceanFirst Financial Corp.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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 quarterly report is being prepared;
  - b. Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - d. Disclosed in this quarterly 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 function):
  - 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: November 9, 2012

/s/ John R. Garbarino

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

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael J. Fitzpatrick, certify that:

1. I have reviewed this quarterly report on Form 10-Q of OceanFirst Financial Corp.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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 quarterly report is being prepared;
  - b. Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - d. Disclosed in this quarterly 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 function):
  - 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.

November 9, 2012

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

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADDED BY SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of OceanFirst Financial Corp. (the "Company") on Form 10-Q for the period ending September 30, 2012 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. To my knowledge 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  
November 9, 2012

/s/ Michael J. Fitzpatrick

\_\_\_\_\_  
Michael J. Fitzpatrick  
Chief Financial Officer  
November 9, 2012