OCEANFIRST FINANCIAL CORP
Form 10-Q
May 10, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 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	**22-3412577**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
975 Hooper Avenue, Toms River, NJ	**08753**
(Address of principal executive offices)	**(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 x 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 x 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	x
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 x.

As of May 7, 2012, there were 18,572,441 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 March 31, 2012	December 31, 2011	March 31, 2011
SELECTED FINANCIAL CONDITION DATA:			
Total assets	$ 2,261,214	$ 2,302,094	$ 2,263,283
Loans receivable, net	1,554,862	1,563,019	1,636,251
Deposits	1,680,444	1,706,083	1,645,788
Stockholders equity	220,471	216,849	205,986
SELECTED OPERATING DATA:			
Net interest income	19,105	19,273	19,337
Provision for loan losses	1,700	2,000	1,700
Other income	4,311	4,214	3,459
Operating expenses	12,940	13,021	13,128
Net income	5,647	5,459	5,106
Diluted earnings per share	0.31	0.30	0.28
SELECTED FINANCIAL RATIOS:			
Stockholders equity per common share	11.86	11.61	10.93
Cash dividend per share	0.12	0.12	0.12
Stockholders equity to total assets	9.75%	9.42%	9.10%
Return on average assets (1)	0.99	0.95	0.90
Return on average stockholders equity (1)	10.38	10.07	10.12
Average interest rate spread	3.42	3.43	3.48
Net interest margin	3.52	3.53	3.60
Operating expenses to average assets (1)	2.27	2.27	2.32
Efficiency ratio	55.26	55.44	57.59
ASSET QUALITY:			
Non-performing loans	$ 44,523	$ 44,008	$ 35,686
Non-performing assets	46,561	45,978	37,600
Non-performing loans as a percent of total loans receivable (2)	2.83%	2.77%	2.15%
Non-performing assets as a percent of total assets (2)	2.06	2.00	1.66
Allowance for loan losses as a percent of total loans receivable(2)	1.16	1.15	1.23
Allowance for loan losses as a percent of total non-performing loans (2)	40.97	41.42	57.25

(1) Ratios are annualized

(2) As discussed in the section Comparison of Operating Results for the Three Months Ended March 31, 2012 and March 31, 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. Without the additional cumulative charge-offs of $6.8 million and $5.7 million at March 31, 2012 and December 31, 2011, respectively, the Company would have reported the following asset quality ratios as of March 31, 2012 and December 31, 2011, respectively: non-performing loans as a percent of total loans receivable of 3.26% and 3.12%; non-performing assets as a percent of total assets of 2.35% and 2.24%; allowance for loan losses as a percent of total loans receivable of 1.59% and 1.50%; and allowance for loan losses as a percent of total non-performing loans of 48.79% and 48.12%.

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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 quarter 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 weak demand, prepayments and the sale of newly originated 30-year fixed-rate one-to-four family loans while lower yielding securities have increased. Management expects the low interest rate environment to continue beyond 2012, resulting in 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 quarter of 2012, and in overall labor market conditions as the national unemployment rate has decreased in seven of the last eight months through April 2012. 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 months ended March 31, 2012 were as follows:

Total assets decreased to $2.261 billion at March 31, 2012, from $2.302 billion at December 31, 2011. Loans receivable, net decreased $8.2 million at March 31, 2012, as compared to December 31, 2011 primarily due to weak commercial loan demand, prepayments and sale of newly originated 30-year fixed-rate one-to-four family loans. Cash and due from banks decreased by $39.4 million. Part of the cash and due from banks was invested in mortgage-backed securities which increased $11.5 million, to $376.5 million at March 31, 2012 as compared to $364.9 million at December 31, 2011.

Deposits decreased by $25.6 million, or 1.5%, at March 31, 2012, as compared to December 31, 2011. Additionally, Federal Home Loan Bank (FHLB) advances decreased $21.0 million, to $245.0 million at March 31, 2012 from $266.0 million at December 31, 2011.

Diluted earnings per share increased 10.7%, to $0.31 for the quarter ended March 31, 2012, from $0.28 for the corresponding prior year quarter. The improvement was primarily due to an increase in other income and a decrease in operating expenses.

Net interest income for the three months ended March 31, 2012 decreased to $19.1 million, as compared to $19.3 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 3.52% for the three months ended March 31, 2012, as compared to 3.60% for the corresponding prior year period. Total revenue, however, increased 2.7%, to $23.4 million for the quarter ended March 31, 2012, as compared to $22.8 million for the corresponding prior year period due to an increase in other income.

The provision for loan losses was $1.7 million for the three months ended March 31, 2012, unchanged from the corresponding prior year period. The Company s non-performing loans totaled $44.5 million at March 31, 2012, a $515,000 increase from $44.0 million at December 31, 2011.

The Company remains well-capitalized with a tangible common equity ratio of 9.75%.

Return on average stockholders equity was 10.38% for the three months ended March 31, 2012, as compared to 10.12% 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 months ended March 31, 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 MARCH 31,					
	2012			2011		
	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/ COST	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/ COST
	(dollars in thousands)					
Assets						
Interest-earning assets:						
Interest-earning deposits and short-term investments	$ 49,840	$ 21	.17%	$ 21,996	$ 15	.27%
Investment securities (1)	179,237	490	1.09	126,090	299	.95
FHLB stock	17,900	229	5.12	17,534	250	5.70
Mortgage-backed securities (1)	359,530	2,318	2.58	335,602	2,563	3.05
Loans receivable, net (2)	1,565,956	19,805	5.06	1,647,750	21,164	5.14
Total interest-earning assets	2,172,463	22,863	4.21	2,148,972	24,291	4.52
Non-interest-earning assets	103,620			112,969		
Total assets	$ 2,276,083			$ 2,261,941		
Liabilities and Stockholders Equity						
Interest-bearing liabilities:						
Transaction deposits	$ 1,283,926	916	.29	$ 1,255,244	1,665	.53
Time deposits	255,999	1,102	1.72	279,566	1,244	1.78
Total	1,539,925	2,018	.52	1,534,810	2,909	.76
Borrowed funds	351,311	1,740	1.98	373,792	2,045	2.19
Total interest-bearing liabilities	1,891,236	3,758	.79	1,908,602	4,954	1.04
Non-interest-bearing deposits	151,143			130,227		
Non-interest-bearing liabilities	16,125			21,358		
Total liabilities	2,058,504			2,060,187		
Stockholders equity	217,579			201,754		
Total liabilities and stockholders equity	$ 2,276,083			$ 2,261,941		
Net interest income		$ 19,105			$ 19,337	
Net interest rate spread (3)			3.42%			3.48%

Net interest margin (4)	3.52%	3.60%

(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.

Comparison of Financial Condition at March 31, 2012 and December 31, 2011

Total assets at March 31, 2012 were $2.261 billion, a decrease of $40.9 million, or 1.8%, compared to $2.302 billion at December 31, 2011.

Cash and due from banks decreased by $39.4 million, to $38.1 million at March 31, 2012, as compared to $77.5 million at December 31, 2011. Part of the cash and due from banks was invested in mortgage-backed securities which increased by $11.5 million, to $376.5 million at March 31, 2012, as compared to $364.9 million at December 31, 2011.

Loans receivable, net decreased by $8.2 million, to a balance of $1.555 billion at March 31, 2012, as compared to a balance of $1.563 billion at December 31, 2011, primarily due to weak commercial loan demand, prepayments and sale of newly originated 30-year fixed-rate one-to-four family loans.

Total deposits decreased $25.6 million, or 1.5%, to $1.680 billion at March 31, 2012, from $1.706 billion at December 31, 2011. Additionally, Federal Home Loan Bank advances decreased by $21.0 million to $245.0 million at March 31, 2012, as compared to $266.0 million at December 31, 2011.

Stockholders equity at March 31, 2012 increased by 1.7%, to $220.5 million, as compared to $216.8 million at December 31, 2011, primarily due to net income and a reduction in accumulated other comprehensive loss, partly offset by the cash dividend on common stock and by the repurchase of 113,500 shares of common stock for $1.6 million.

Comparison of Operating Results for the Three Months Ended March 31, 2012 and March 31, 2011

General

Net income for the three months ended March 31, 2012 was $5.6 million, as compared to net income of $5.1 million for the corresponding prior year period, an increase of $541,000 or 10.6%. On a per share basis net income per diluted share was $0.31 for the three months ended March 31, 2012, as compared to $0.28 for the corresponding prior year period.

Interest Income

Interest income for the three months ended March 31, 2012 was $22.9 million, as compared to $24.3 million for the three months ended March 31, 2011. The yield on interest-earning assets declined to 4.21% for the three months ended March 31, 2012, as compared to 4.52% for the same prior year period. For the quarter ended March 31, 2012, the yield on loans receivable benefited from loan prepayment fees of $254,000, most of which was related to a single large commercial loan. The loan prepayment fees increased the yield on interest-earning assets by 5 basis points for the quarter ended March 31, 2012. Average interest-earning assets increased by $23.5 million, or 1.1%, for the three months ended March 31, 2012, as compared to the same prior year period. The increase in average interest-earning assets was due to the increase in average investment and mortgage-backed securities, which together increased $77.1 million, or 16.7%, and the increase in average short-term investments which increased $27.8 million. These increases were partly offset by a decrease in average loans receivable, net, of $81.8 million.

Interest Expense

Interest expense for the three months ended March 31, 2012 was $3.8 million, as compared to $5.0 million for the three months ended March 31, 2011. The cost of interest-bearing liabilities decreased to .79% for the three months ended March 31, 2012 as compared to 1.04% in the same prior year period. Average interest-bearing liabilities decreased by $17.4 million, or .9%, for the three months ended March 31, 2012, as compared to the same prior year period. The decrease was due to declines in average time deposits and average borrowed funds of $23.6 million and $22.5 million, respectively, as compared to the same prior year period, partly offset by an increase of average transaction deposits of $28.7 million.

Net Interest Income

Net interest income for the quarter ended March 31, 2012 decreased to $19.1 million, as compared to $19.3 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 3.52% for the quarter ended March 31, 2012, from 3.60% in the same prior year period 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. High loan refinance volume also caused yields on loans and mortgage-backed securities to trend downward.

Provision for Loan Losses

For the three months ended March 31, 2012, the provision for loan losses was $1.7 million, unchanged from the corresponding prior year period. Non-performing loans increased $515,000, or 1.2%, at March 31, 2012, to $44.5 million from $44.0 million at December 31, 2011. Net charge-offs for the three months ended March 31, 2012 were $1,689,000, as compared to $970,000 in the same prior year period. 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 $4.3 million for the quarter ended March 31, 2012, as compared to $3.5 million in the same prior year period primarily due to a reduction in the net loss from other real estate owned, higher fees and service charges and an increase in the net gain on the sale of loans. The net loss from other real estate owned decreased by $316,000 for the quarter ended March 31, 2012, as compared to the same prior year period. Additionally, for the quarter ended March 31, 2012, fees and service charges increased $221,000 due to increases in trust revenue, merchant service fees and checking account fees. Finally, for the quarter ended March 31, 2012, the net gain on the sale of loans increased $213,000, due to strong gain on sale margins. The net gain on the sale of loans was adversely affected by a $150,000 increase in the reserve for repurchased loans.

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Operating Expenses

Operating expenses decreased by 1.4%, to $12.9 million for the three months ended March 31, 2012, as compared to $13.1 million for the corresponding prior year period. Federal deposit insurance expense for the three months ended March 31, 2012 decreased by $210,000 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. Additionally, compensation and employee benefits costs decreased by $205,000, or 2.9%, to $6.8 million for the three months ended March 31, 2012, as compared to the corresponding prior year period.

Provision for Income Taxes

Income tax expense was $3.1 million for the three months ended March 31, 2012, as compared to $2.9 million for the same prior year period. The effective tax rate decreased to 35.7% for the three months ended March 31, 2012, as compared to 35.9% in the same prior period.

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 March 31, 2012 and December 31, 2011, the Company had no outstanding overnight borrowings from the FHLB. The Company periodically utilizes overnight borrowings to fund short-term liquidity needs. The Company had total FHLB borrowings of $245.0 million at March 31, 2012, a decrease from $266.0 million at December 31, 2011.

The Company s cash needs for the three months ended March 31, 2012 were primarily satisfied by principal payments on loans and mortgage-backed securities and proceeds from the sale of mortgage loans held for sale. The cash was principally utilized for loan originations, the purchase of investment and mortgage-backed securities, deposit outflow and to reduce FHLB borrowings. The Company s cash needs for the three months ended March 31, 2011 were primarily satisfied by principal payments on loans and mortgage-backed securities, proceeds from the sale of mortgage loans held for sale and increased FHLB borrowings. The cash was principally utilized for loan originations, the purchase of investment and mortgage-backed securities and deposit outflow.

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 March 31, 2012, outstanding commitments to originate loans totaled $73.4 million; outstanding unused lines of credit totaled $225.2 million; and outstanding commitments to sell loans totaled $13.8 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 $169.2 million at March 31, 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 trends on a monthly and quarterly basis. Management also monitors cash on a daily basis to determine the liquidity needs of the Bank. Additionally, management performs a liquidity stress test in several 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 three months ended March 31, 2012, the Company repurchased 113,500 shares of common stock at a total cost of $1.6 million compared with no repurchases for the three months ended March 31, 2011. At March 31, 2012, there were 663,652 shares remaining to be repurchased under the existing stock repurchase program.

Cash dividends on common stock declared and paid during the first three months of 2012 were $2.2 million, unchanged as compared to the same prior year period. On April 18, 2012, the Board of Directors declared a quarterly cash dividend of twelve cents ($0.12) per common share. The dividend is payable on May 11, 2012 to stockholders of record at the close of business on April 30, 2012.

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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 three months of 2012, the Company received a dividend payment of $5.5 million from the Bank. At March 31, 2012, the Company had received notice from the Federal Reserve Bank of Philadelphia that it does not object to the payment of $11.1 million in dividends from the Bank to the Company over the next two quarters although the Federal Reserve reserved the right to revoke its decision at any time if a safety and soundness concern arises throughout the period. 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 March 31, 2012, OceanFirst Financial Corp. held $16.1 million in cash and $4.5 million in investment securities available for sale.

As of March 31, 2012, the Bank exceeded all regulatory capital requirements as follows (in thousands):

	Actual		Required	
	Amount	Ratio	Amount	Ratio
Tangible capital	$ 214,607	9.51%	$ 33,867	1.50%
Core capital	214,607	9.51	90,313	4.00
Tier 1 risk-based capital	214,607	14.55	59,016	4.00
Total risk-based capital	232,848	15.78	118,032	8.00

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

At March 31, 2012, the Company maintained tangible common equity of $220.5 million, for a tangible common equity to assets ratio of 9.75%.

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 $13.8 million.

The following table shows the contractual obligations of the Company by expected payment period as of March 31, 2012 (in thousands):

Contractual Obligation	Total	Less than one year	1-3 years	3-5 years	More than 5 years
Debt Obligations	$ 341,294	$ 88,794	$ 146,000	$ 84,000	$ 22,500
Commitments to Originate Loans	73,381	73,381			
Commitments to Fund Unused Lines of Credit	225,202	225,202			

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.

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.

	March 31, 2012	December 31, 2011
	(dollars in thousands)	
Non-performing loans:		
Real estate one-to-four family	$ 28,962	$ 29,193
Commercial real estate	10,584	10,552
Construction		43
Consumer	4,067	3,653
Commercial	910	567
Total non-performing loans	44,523	44,008
OREO, net	2,038	1,970
Total non-performing assets	$ 46,561	$ 45,978
Delinquent loans 30-89 days	$ 9,401	$ 14,972
Allowance for loan losses as a percent of total loans receivable	1.16%	1.15%
Allowance for loan losses as percent of total non-performing loans	40.97	41.42
Non-performing loans as a percent of total loans receivable	2.83	2.77
Non-performing assets as a percent of total assets	2.06	2.00

Included in the non-performing loan total at March 31, 2012 was $16.2 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 65.0% of the total. At March 31, 2012, the average weighted loan-to-value ratio of non-performing one-to-four family loans, after any related charge-offs, was 62% using appraisal values at time of origination and 80% 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 March 31, 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 quarter of 2012 from the Ocean and Monmouth Counties Multiple Listing Service, home values in the Company s primary market area have declined by approximately 23% 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 $9.1 million. In November 2011, the Company entered into a troubled debt restructuring with the borrower which capitalized delinquent interest and 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 March 31, 2012, 72% were originated by alternative Bank delivery channels which were previously shuttered.

The Company classifies loans and other assets in accordance with regulatory guidelines. At March 31, 2012, the Company had $11.5 million in loans designated as Special Mention, $69.6 million in loans classified as Substandard and $352,000 in other assets classified as Doubtful, as compared to $11.5 million, $63.1 million and $74,600, respectively, at December 31, 2011. The largest Special Mention loan relationship at March 31, 2012 is comprised of several credit facilities to a commercial lending borrower specializing in residential home building and ownership of commercial office properties totaling $1.8 million. The loans are current as to payments but criticized due to poor operating results. The loans are collateralized by residential and commercial real estate. The largest Substandard loan relationship is comprised of several credit facilities to a building supply company with an aggregate balance of $9.3 million, which was current as to payments, but criticized due to poor, but improving, operating results. The loans are collateralized by commercial real estate and other business assets. In addition to loan classifications, the Company classified investment securities with an amortized cost of $25.0 million and a carrying value of $18.1 million 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, may, view, opportunity, potential, or similar expressions or expressions of probability or confidence. The Company s ability to predict results 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 March 31, 2012, which were anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown. At March 31, 2012, the Company s one-year gap was negative 0.50% as compared to negative 0.03% at December 31, 2011.

At March 31, 2012 (dollars in thousands)	3 Months or Less	More than 3 Months to 1 Year	More than 1 Year to 3 Years	More than 3 Years to 5 Years	More than 5 Years	Total
Interest-earning assets: (1)						
Interest-earning deposits and short-term investments	$ 12,020	$	$	$	$	$ 12,020
Investment securities	64,853	23,078	86,521		4,294	178,746
FHLB stock					17,747	17,747
Mortgage-backed securities	52,753	54,675	105,397	65,573	87,478	365,876
Loans receivable (2)	311,064	431,446	468,413	182,785	179,121	1,572,829
Total interest-earning assets	440,690	509,199	660,331	248,358	288,640	2,147,218
Interest-bearing liabilities:						
Money market deposit accounts	38,399	9,127	20,077	15,149	49,020	131,772
Savings accounts	28,361	21,837	45,006	34,065	106,061	235,330
Interest-bearing checking accounts	520,857	61,426	111,039	91,743	117,719	902,784
Time deposits	71,419	97,827	33,449	38,849	11,412	252,956
FHLB advances	20,000		146,000	79,000		245,000
Securities sold under agreements to repurchase	68,794					68,794

Other borrowings	22,500			5,000		27,500
Total interest-bearing liabilities	770,330	190,217	355,571	263,806	284,212	1,864,136
Interest sensitivity gap (3)	$ (329,640)	$ 318,982	$ 304,760	$ (15,448)	$ 4,428	$ 283,082
Cumulative interest sensitivity gap	$ (329,640)	$ (10,658)	$ 294,102	$ 278,654	$ 283,082	$ 283,082
Cumulative interest sensitivity gap as a percent of total interest-earning assets	(15.35)%	(0.50)%	13.70%	12.98%	13.18%	13.18%

(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.

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(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 March 31, 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.

	March 31, 2012					December 31, 2011			
	Net Portfolio Value			Net Interest Income		Net Portfolio Value			Net Interest Income
Change in Interest Rates in Basis Points (Rate Shock)	Amount	% Change	NPV Ratio	Amount	% Change	Amount	% Change	NPV Ratio	