OCEANFIRST FINANCIAL CORP
Form 10-K
March 30, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______.

Commission file number: 0-27428

OceanFirst Financial Corp.

(Exact name of registrant as specified in its charter)

DELAWARE	**22-3412577**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

975 Hooper Avenue, Toms River, New Jersey 08753

(Address of principal executive offices)

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

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

Common Stock, par value $0.01 per share

(Title of class)

The Nasdaq Stock Market LLC

(Name of each exchange on which registered)

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

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

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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

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PART I

Item 1. Business

General

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

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

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

In addition to historical information, this Form 10-K contains certain forward-looking statements which are based on certain assumptions and describes future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Company s ability to predict results or the actual future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Board of Governors of the Federal Reserve System, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the

Company s market area and accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Company does not undertake and specifically disclaims any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Market Area and Competition

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

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

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

Lending Activities

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Non-Accrual Loans and REO

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

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

(1) REO balances are shown net of related loss allowances.
(2) Total loans includes loans receivable and mortgage loans held for sale.
(3) Non-performing assets consist of non-performing loans and REO. Non-performing loans consist of all loans 90 days or more past due and other loans in the process of foreclosure.

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

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

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

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

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

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

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

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

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

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

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

	At December 31,														
	2006			2005			2004			2003			2002		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans
One-to-Four family	$ 2,828	27.62%	68.77%	$ 2,181	20.85%	69.83%									