OCEANFIRST FINANCIAL CORP
Form 10-K
March 18, 2019
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, 2018
¨ 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.)

110 West Front Street, Red Bank, New Jersey 07701
(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 Global Select Market
(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 x No ¨.
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No 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 whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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. x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "non-accelerated filer" , "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised final accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
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 fair 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 $1,417,204,000 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 8, 2019 was 51,398,302.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the Proxy Statement for the 2019 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days from December 31, 2018, 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”) is incorporated under Delaware law and serves as the holding company for OceanFirst Bank N.A. (the “Bank”). At December 31, 2018, the Company had consolidated total assets of $7.5 billion and total stockholders’ equity of $1.0 billion. The Company is subject to regulation by the Board of Governors of the Federal Reserve System (the “FRB”) and the Securities and Exchange Commission (“SEC”). The Bank is subject to regulation and supervision by the Office of the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”). Currently, the Company does not transact any material business other than through its subsidiary, the Bank.

The Company has been the holding company for the Bank since it acquired the stock of the Bank upon the Bank’s conversion from a Federally-chartered mutual savings bank to a Federally-chartered capital stock savings bank in 1996 (the “Conversion”). Effective January 31, 2018, the Bank converted to a national bank charter and the Company became a bank holding company. The conversions on January 31, 2018 do not change the entities which regulate and supervise the Bank and Company. The Bank’s principal business has been, and continues to be, attracting retail and business deposits in the communities surrounding its branch offices and investing those deposits primarily in loans, consisting of commercial real estate and other commercial loans which have become a key focus of the Bank and single-family, owner-occupied residential mortgage loans. The Bank also invests in other types of loans, including residential construction and consumer loans. In addition, the Bank invests in mortgage-backed securities (“MBS”), securities issued by the U.S. Government and agencies thereof, corporate securities and other investments permitted by applicable law and regulations. 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, Bankcard services, wealth management services and the sale of 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, investment maturities, Federal Home Loan Bank (“FHLB”) advances and other borrowings.

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

In addition to historical information, this Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation 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”, similar expressions or expressions of confidence. The Company’s ability to predict results or the actual effect of 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, those items discussed under Item 1A. Risk Factors herein and the following: 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, future natural disasters and increases to flood insurance premiums, the level of prepayments on loans and mortgage-backed securities, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government including policies of the U.S. Treasury and the FRB, 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, accounting principles and guidelines and the Bank’s ability to successfully integrate acquired operations. 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 regional bank, offering a wide variety of financial services to meet the needs of the communities it serves. The Bank operates its business through its branch office and headquarters located in Toms River, its administrative office located in Red Bank, 58 additional branch offices and three deposit production facilities located throughout central and southern New Jersey. The Bank also operates commercial loan production offices in New York City, the Philadelphia area and in Atlantic, Cape May, and Mercer Counties in New Jersey.

The Bank is the largest and oldest community-based financial institution headquartered in Ocean County, New Jersey, approximately midway between New York City and Philadelphia. The economy in the Bank's primary market area, which represents the broader central and southern New Jersey market, 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 areas in and around New York City and Philadelphia. The market area includes a significant number of vacation and second homes in the communities along the New Jersey shore.

The Bank's future growth opportunities will be partly influenced by the growth and stability of its geographic marketplace and the competitive environment. The Bank faces significant competition both in making loans and in attracting deposits. In addition, rapid technological changes and consumer preferences may result in increased competition for the Company's other services, while a number of well-funded technology focused companies are innovating in the payments, distributed ledger, and cryptocurrency networks to disintermediate portions of the traditional banking model. The state of New Jersey, including the Bank's primary market areas of central and southern New Jersey, is an attractive market to many financial institutions. Many of the Bank's competitors are branches of significantly larger institutions headquartered out-of-market which have greater financial resources than the Bank. The Bank's competition for loans comes principally from commercial banks, savings banks, savings and loan associations, credit unions, mortgage banking companies, internet-based providers 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 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. The Bank distinguishes itself from large banking competitors through its local presence and ability to deliver personalized service.

Community Involvement

The Bank proudly promotes a higher quality of life in the communities it serves through employee volunteer efforts and the work of OceanFirst Foundation (the "Foundation"). Employees are continually encouraged to become leaders in their communities and use the Bank's support to help others. Through the Foundation, established in 1996, OceanFirst has granted over $37 million to enrich the lives of local citizens by supporting initiatives in health and human services, education, affordable housing, youth development and the arts.

Acquisitions

On May 2, 2016, the Company completed its acquisition of Cape Bancorp, Inc. ("Cape") which added $1.5 billion to assets, $1.2 billion to loans, and $1.2 billion to deposits. The transaction was a market extension, creating a preeminent New Jersey based community banking franchise operating throughout central and southern New Jersey while also providing a gateway into the demographically attractive Philadelphia metropolitan area.

On November 30, 2016, the Company completed its acquisition of Ocean Shore Holding Company ("Ocean Shore") which added $991.3 million to assets, $773.3 million to loans, and $875.1 million to deposits. The in-market transaction solidified the Bank's position as the premier banking franchise in central and southern New Jersey with a strong core deposit franchise and enhanced operating scale.

On January 31, 2018, the Company completed its acquisition of Sun Bancorp, Inc. ("Sun") which added $2.0 billion to assets, $1.5 billion to loans, and $1.6 billion to deposits. The Sun acquisition was another in-market transaction which enhanced the Bank's position in its central and southern New Jersey markets.

On January 31, 2019, the Company completed its acquisition of Capital Bank of New Jersey ("Capital Bank"). Based on the $24.01 per share closing price of the Company's common stock on January 31, 2019, the total transaction value was $76.8 million. The acquisition added $498 million to assets, $311 million to loans, and $449 million to deposits. This in-market transaction provides the Bank with significant market share in Cumberland and Atlantic counties in New Jersey.

These acquisitions have provided the Company with the opportunity to grow business lines, expand its geographic footprint and improve financial performance. The Company will continue to evaluate potential acquisition opportunities for those that can be expected to create stockholder value.

Lending Activities

Loan Portfolio Composition. At December 31, 2018, the Bank had total loans outstanding of $5.589 billion, of which $2.764 billion, or 49.5% of total loans, were commercial real estate, multi-family and land loans. The remainder of the portfolio consisted of $2.045 billion of one-to-four family residential mortgage loans, or 36.6% of total loans; $475.2 million of consumer loans, primarily home equity loans and lines of credit, or 8.5% of total loans; and, $305.0 million of commercial loans, or 5.5% of total loans. At December 31, 2018 the Bank did not have any loans available-for-sale. At that same date, 35.3% of the Bank's total loans had adjustable interest rates.

The types of loans that the Bank may originate are subject to Federal and state laws 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 FRB, 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, 2018		2017		2016		2015		2014	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Perc of T
	(dollars in thousands)									
Real estate:										
Commercial real estate, multi-family and land	$2,764,024	49.46 %	$1,757,106	44.19 %	$1,668,872	43.72 %	$818,445	41.19 %	$649,951	38.0
One-to-four family	2,044,523	36.58	1,749,166	43.99	1,704,405	44.66	830,497	41.80	772,911	45.3
Consumer [(1)]	475,170	8.50	282,438	7.10	290,676	7.62	193,160	9.72	199,349	11.6
Commercial and industrial	304,996	5.46	187,645	4.72	152,810	4.00	144,788	7.29	83,946	4.92
Total loans	5,588,713	100.00%	3,976,355	100.00%	3,816,763	100.00%	1,986,890	100.00%	1,706,157	100.
Deferred origination costs, net	7,086		5,380		3,414		3,232		3,207	
Allowance for loan losses	(16,577)		(15,721)		(15,183)		(16,722)		(16,317)	
Total loans, net	5,579,222		3,966,014		3,804,994		1,973,400		1,693,047	
Less:										
Loans held for sale	—		241		1,551		2,697		4,201	
Loans receivable, net	$5,579,222		$3,965,773		$3,803,443		$1,970,703		$1,688,846	
Total loans:										
Adjustable rate	$1,974,387	35.33 %	$1,266,817	31.86 %	$1,192,998	31.26 %	$750,816	37.79 %	$634,835	37.2
Fixed rate	3,614,326	64.67	2,709,538	68.14	2,623,765	68.74	1,236,074	62.21	1,071,322	62.7

	$5,588,713	100.00%	$3,976,355	100.00%	$3,816,763	100.00%	$1,986,890	100.00%	$1,706,157	100.

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

Loan Maturity. The following table shows the contractual maturity of the Bank's total loans at December 31, 2018. The table does not include principal prepayments.

	At December 31, 2018				
	Commercial Real Estate, Multi-Family and Land	One-to-Four Family	Consumer	Commercial and Industrial	Total Loans Receivable
	(in thousands)				
One year or less	$320,471	$55,663	$3,297	$ 106,317	$485,748
After one year:					
More than one year to three years	620,387	4,794	7,442	50,408	683,031
More than three years to five years	473,558	16,519	18,840	56,158	565,075
More than five years to ten years	1,095,448	136,825	130,596	61,733	1,424,602
More than ten years to twenty years	199,742	413,266	283,954	12,221	909,183
More than twenty years	54,418	1,417,456	31,041	18,159	1,521,074
Total due after December 31, 2019	2,443,553	1,988,860	471,873	198,679	5,102,965
Total amount due	$2,764,024	$2,044,523	$475,170	$ 304,996	5,588,713
Deferred origination costs, net					7,086
Allowance for loan losses					(16,577)
Loans receivable, net					5,579,222
Less: Loans held for sale					—
Total loans, net					$5,579,222

The following table sets forth at December 31, 2018, the dollar amount of total loans receivable, contractually due after December 31, 2019, and whether such loans have fixed interest rates or adjustable interest rates.

	Due After December 31, 2019		
	Fixed	Adjustable	Total
	(in thousands)		
Real estate loans:			
Commercial real estate, multi-family and land	$1,395,683	$1,047,870	$2,443,553
One-to-four family	1,600,987	387,873	1,988,860
Consumer	269,839	202,034	471,873
Commercial and industrial	84,615	114,064	198,679
Total loans receivable	$3,351,124	$1,751,841	$5,102,965

Origination, Sale and Servicing of Loans. 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 Ended December 31,		
	2018	2017	2016
	(in thousands)		
Total loans:			
Beginning balance	$3,976,355	$3,816,763	$1,986,890
Loans originated:			
Commercial real estate, multi-family and land	327,513	295,519	122,806
One-to-four family	395,387	298,272	163,663
Consumer	68,489	68,872	43,780
Commercial and industrial	87,549	165,191	138,495
Total loans originated	878,938	827,854	468,744
Loans purchased	199,580	37,337	37,561
Net loans acquired in acquisition	1,517,345	—	1,930,853
Total	6,572,218	4,681,954	4,424,048
Less:			
Principal repayments	965,520	680,118	522,226
Sales of loans	13,152	16,371	78,736
Charge-offs (gross)	3,841	5,384	4,490
Transfer to other real estate owned	992	3,726	1,833
Total loans	$5,588,713	$3,976,355	$3,816,763

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 office, industrial or retail facilities. A substantial majority of the Bank's commercial real estate loans are located in its primary market area. The Bank generally originates commercial real estate loans with terms of up to ten years and amortization schedules up to thirty years with fixed or adjustable rates. Fixed rate loans typically contain prepayment penalties over the initial term. 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 and profitability among other factors.

At December 31, 2018, the Bank's total loans outstanding were $5.589 billion, of which $2.764 billion, or 49.5% of total loans, were commercial real estate loans, as compared to $1.757 billion, or 44.2% of total loans, at December 31, 2017. The Bank continues to grow this market segment primarily through the addition of experienced commercial lenders and has commercial lending teams in various New Jersey counties including Atlantic, Cape May, Mercer, Monmouth, and Ocean as well as teams in New York City and the Philadelphia area. Of the total commercial real estate portfolio, 26.8% is considered owner-occupied, whereby the underlying business owner occupies a majority of the property.

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, 2018, the Bank had an outstanding balance in commercial construction loans of $181.7 million, as compared to $108.0 million at December 31, 2017.

The Bank also originates multi-family mortgage loans and land loans on a limited basis. The Bank's multi-family loans and land loans at December 31, 2018 totaled $387.0 million and $8.7 million, respectively, as compared to $90.1 million and $10.9 million, respectively, at December 31, 2017.

One-to-Four Family Mortgage Lending. The Bank offers both fixed-rate and adjustable-rate mortgage ("ARM") 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 in the exclusive employment of the Bank and are largely derived from contacts within the local real estate industry, members of the local communities and the Bank's existing or past customers. On occasion the Bank purchases loans originated by other banks.

At December 31, 2018, $2.045 billion, or 36.6% of total loans, 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 loans was approximately $238,000 at December 31, 2018.

The Bank currently offers several ARM loan programs with interest rates which adjust every three, five or ten years. The Bank's ARM loans generally provide for periodic caps of 2% or 3% and an overall cap of 6% 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 three-, five- or ten-year U.S. Treasury constant maturity yield, with a repricing margin which ranges generally from 2.75% to 3.50% above the index. The Bank also offers three-, five-, seven- and ten-year ARM loans which operate as fixed-rate loans for the first three, five, seven or ten years and then convert to one-year ARM loans for the remainder of the term. The ARM loans are then indexed to a margin of generally 2.75% to 3.50% above the one-year U.S. Treasury constant maturity yield.

Generally, ARM loans pose credit risks different than the 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 ARM loans with an initial fixed period of five years or less must qualify based on the greater of the note rate plus 2% or the fully-indexed rate. Seven- to ten-year ARMs must qualify based on the note rate. The Bank does not originate ARM loans that can result in negative amortization.

The Bank's fixed-rate mortgage loans are currently made for terms from 10 to 30 years. Prior to the fourth quarter of 2014, the Bank generally retained the servicing on loans sold. Currently, servicing rights are generally sold as part of the loan sale. The Bank generally holds its residential loans for its portfolio, and may sell a portion of its longer-term, fixed-rate loans after reviewing 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. Prior to 2017, the Bank generally sold much of its 30-year, fixed-rate, one-to-four family loans in the secondary mortgage market primarily to manage interest rate risk. With the rise in market interest rates and the reduction in refinance volume, the Bank retained most of its 30-year fixed-rate loan originations in 2017 and 2018 to replace repayments on the existing residential mortgage loan portfolio.

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 95% of the appraised value or selling price if private mortgage insurance is obtained. Appraisals are obtained for loans secured by real estate properties. The weighted average loan-to-value ratio of the Bank's one-to-four family mortgage loans was 59% at December 31, 2018 based on appraisal values at the time of origination. Title insurance is typically required for first mortgage loans. Residential 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 residential mortgage loan portfolio and the Bank has generally exercised its rights under these clauses.

The Bank has made, and may continue to make, residential mortgage loans that will not qualify as Qualified Mortgage Loans under the Dodd-Frank Act and the Consumer Financial Protection Bureau ("CFPB") regulations. See "Risk Factors – The Dodd-Frank Act imposes obligations on originators of residential mortgage loans, such as the Bank."

Included in the Bank's one-to-four family loan balance at December 31, 2018, were residential construction loans which totaled $55.3 million. 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 residential construction loans are made to individuals building a residence.

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. The Bank addresses these risks through its underwriting policies and procedures and its experienced staff.

Consumer Loans. At December 31, 2018, the Bank's consumer loans totaled $475.2 million, or 8.5% of the Bank's total loan portfolio. Of the total consumer loan portfolio, home equity loans comprised $158.1 million; home equity lines of credit comprised $195.5 million; student loans comprised $119.3 million; overdraft line of credit loans totaled $1.8 million; and loans on savings accounts and other consumer loans totaled $516,000.

The Bank originates home equity loans typically as fixed-rate loans with terms ranging from 5 to 20 years. The Bank also offers variable-rate home equity lines of credit. Home equity loans and lines of credit are based on the applicant's income and their ability to repay and are secured by a mortgage on the underlying real estate, typically owner-occupied, one-to-four family residences. Generally, the loan when combined with the balance of any applicable first mortgage lien, may not exceed 80% of the appraised value of the property at the time of the loan commitment. The Bank charges an early termination fee should a home equity loan or line of credit be closed within two or 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. Certain home equity lines of credit require the payment of interest-only during the first five years with fully-amortizing payments thereafter. At December 31, 2018, these loans totaled $26.3 million, as compared to $31.2 million at December 31, 2017.

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.

The student loans are targeted at high income, strong credit score borrowers in stable fields, such as doctors, nurses, dentists, lawyers and graduates of the top business schools. These loans are refinancing of other student loans and are made primarily after the borrowers have finished their education, are employed, have a strong credit score and verified income, and have demonstrated an ability and willingness to pay their student loans.

Commercial and Industrial Lending. At December 31, 2018, commercial and industrial ("C&I") loans totaled $305.0 million, or 5.5% of the Bank's total loans outstanding. The Bank originates commercial and industrial loans and lines of credit (including for working capital; fixed asset purchases; and acquisition, receivable and inventory financing) primarily in the Bank's market area. In underwriting commercial and industrial loans and credit lines, the Bank reviews and analyzes financial history and capacity, collateral value, strength and character of the principals, and general payment history of the principal borrowers in coming to a credit decision. The Bank generally originates C&I loans secured by the assets of the business including accounts receivable, inventory, fixtures, etc. The Bank generally requires the personal guarantee of the principal borrowers for all commercial and industrial loans. Risk of loss on a commercial and industrial business loan is dependent largely on the borrower's ability to remain financially able to repay the loan from ongoing operations.

Loan Approval Procedures and Authority. The Board establishes the loan approval policies of the Bank based on total exposure to the individual borrower. The Board has authorized the approval of loans by a minimum of two officers of the Bank or the Management Credit Committee, on a scale which requires approval by personnel with progressively higher levels of credit approval authority as the loan amount increases. Pursuant to applicable regulations, loans to one borrower generally cannot exceed 15% of the Bank's unimpaired capital.

Due to the recent acquisitions, a significant portion of the loan portfolio was underwritten according to the underwriting standards and guidelines of the acquired banks. Acquired loans have been evaluated under OceanFirst's credit risk management policies during pre-closing due diligence and during post-closing risk rating reviews.

In addition to internal credit reviews, the Bank has engaged an independent firm specializing in commercial loan reviews to examine a selection of commercial real estate and commercial and industrial loans, and provide management with objective analysis regarding the quality of these loans throughout the year. The independent firm reviewed 57% of the outstanding loan balances for the Company's commercial real estate and commercial and industrial loans during 2018. Their conclusion was that the Bank's internal credit reviews are consistent with both Bank policy and general industry practice.

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. On October 31, 2014, the Bank sold most of the servicing rights on residential mortgage loans serviced for Federal agencies. All of the remaining loans currently being serviced for others are loans which were originated by the Bank. At December 31, 2018, the Bank was servicing $95.1 million of loans for others.

Delinquencies and Classified Assets. 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 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. The Bank may offer to modify the terms or take other forbearance actions which afford the borrower an opportunity to satisfy the loan terms. 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 120 days or more, the Bank will either; (i) commence litigation to realize on the collateral, including foreclosure proceedings against any real property that secures the loan; or (ii) sell non-performing loans where foreclosure proceedings may or may not have been initiated. 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. Foreclosure timelines in New Jersey are among the longest in the nation and have remained protracted over the past several years.

The Bank’s internal Asset Classification Committee, which is chaired by the Chief Risk Officer, reviews and classifies the Bank’s assets quarterly and reports the results of its review to the Board. As part of this process, the Chief Risk Officer compiles a quarterly list of all criticized and classified loans, and a narrative report of classified commercial and industrial, commercial real estate, multi-family, land and construction loans. The Bank classifies assets in accordance with certain regulatory guidelines and definitions. At December 31, 2018, the Bank had $74.8 million of assets, including all other real estate owned (“OREO”), classified as “Substandard.” There were no assets classified as “Doubtful” or as “Loss.” At December 31, 2017, the Bank had $60.7 million of assets, including all OREO, classified as “Substandard.” There were no assets classified as “Doubtful” or as “Loss.” Assets which do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses, such as past delinquencies, are designated “Special Mention.” Special Mention assets totaled $35.8 million at December 31, 2018, as compared to $25.5 million at December 31, 2017.

Non-Accrual Loans and OREO. The following table sets forth information regarding non-accrual loans and OREO, excluding Purchase Credit Impaired (“PCI”) loans. The Bank obtained PCI loans as part of its acquisitions of Colonial American Bank (“Colonial American”), Cape, Ocean Shore and Sun. PCI loans are accounted for at fair value, based upon the present value of expected future cash flows with no related allowance for loan losses. PCI loans totaled $8.9 million and $1.7 million at December 31, 2018 and 2017, respectively. 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, 2018, 2017 and 2016, 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 $419,000, $639,000, and $391,000, respectively.

	At December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Non-accrual loans:					
Real estate:					
Commercial real estate, multi-family and land	$5,525	$14,243	$2,935	$10,796	$12,758
One-to-four family	7,389	4,190	8,126	5,779	3,115
Consumer	2,914	1,929	2,064	1,576	1,877
Commercial and industrial	1,587	503	441	123	557
Total	17,415	20,865	13,566	18,274	18,307
OREO	1,381	8,186	9,803	8,827	4,664
Total non-performing assets	$18,796	$29,051	$23,369	$27,101	$22,971
Allowance for loan losses as a percent of total loans receivable (1)	0.30 %	0.40 %	0.40 %	0.84 %	0.95 %
Allowance for loan losses as a percent of total non-performing loans (1) (2)	95.19	75.35	111.92	91.51	89.13
Non-performing loans as a percent of total loans receivable (2)	0.31	0.52	0.35	0.91	1.06
Non-performing assets as a percent of total assets (2)	0.25	0.54	0.45	1.05	0.97

(1) The loans acquired from Sun, Ocean Shore, Cape, and Colonial American were recorded at fair value. The net credit mark on these loans, not reflected in the allowance for loan losses, was $31,647, $17,531, $25,973, and $2,202 at December 31, 2018, 2017, 2016, and 2015 respectively. There were no net credit marks on loans at December 31, 2014.

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

Non-performing loans totaled $17.4 million at December 31, 2018, a decrease of $3.5 million, as compared to December 31, 2017. The decrease was primarily due to the sale of one commercial loan relationship during the first quarter of 2018. Non-performing loans at December 31, 2018 and 2017 do not include $8.9 million and $1.7 million, respectively, of PCI loans acquired from Colonial American, Cape, Ocean Shore and Sun. The Company’s OREO totaled $1.4 million at December 31, 2018, a $6.8 million decrease from December 31, 2017. The decrease was primarily due to the sale of a hotel, golf, and banquet facility.

Allowance for Loan Losses. The allowance for loan losses is a valuation account that reflects probable incurred losses in the loan portfolio. The adequacy of the allowance for loan losses is based on management’s evaluation of the Company’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and current economic conditions. Additions to the allowance arise from charges to operations through the provision for loan losses or from the recovery of amounts previously charged-off. The allowance is reduced by loan charge-offs. A description of the methodology used in establishing the allowance for loan losses is set forth in the section “Management’s Discussion and Analysis of Financial Condition and Results of Operations, Critical Accounting Policies, Allowance for Loan Losses.”

As of December 31, 2018 and 2017, the Bank's allowance for loan losses was 0.30% and 0.40% of total loans, respectively. The net credit mark on all acquired loans, not reflected in the allowance for loan losses, was $31.6 million and $17.5 million at December 31, 2018 and 2017, respectively. The allowance for loan losses as a percent of total non-performing loans was 95.19% at December 31, 2018, an increase from 75.35% in the prior year. The Bank had non-accrual loans of $17.4 million at December 31, 2018, a decrease from $20.9 million at December 31, 2017. The Bank will continue to monitor its allowance for loan losses as conditions dictate.

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 December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Balance at beginning of year	$15,721	$15,183	$16,722	$16,317	$20,930
Charge-offs:					
Commercial real estate	2,253	1,049	3,399	103	323
Residential real estate	1,021	3,820	558	295	6,955
Consumer	337	135	349	678	471
Commercial and industrial	230	380	184	59	78
Total	3,841	5,384	4,490	1,135	7,827
Recoveries	1,207	1,477	328	265	584
Net charge-offs	2,634	3,907	4,162	870	7,243
Provision for loan losses	3,490	4,445	2,623	1,275	2,630
Balance at end of year	$16,577	$15,721	$15,183	$16,722	$16,317
Ratio of net charge-offs during the year to average net loans outstanding during the year	0.05 %	0.10 %	0.15 %	0.05 %	0.45 %

The increase in net charge-offs for the year ended December 31, 2016, was primarily due to charge-offs of $2.1 million on the bulk sales of non-performing and under-performing loans. The elevated charge-offs in 2014 were due to the bulk sale of non-performing residential and consumer loans which resulted in a charge-off of $5.0 million on these loans.

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,												
	2018			2017			2016			2015			2014
	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	Amo
Commercial and industrial	$1,609	9.71 %	5.46 %	$1,801	11.45 %	4.72 %	$2,037	13.41 %	4.00 %	$1,639	9.80 %	7.29 %	$863
Commercial real estate	11,047	66.64	49.46	11,127	70.78	44.19	9,360	61.65	43.72	7,165	42.85	41.19	8,935
Residential real estate	2,413	14.56	36.58	1,804	11.48	43.99	2,245	14.79	44.66	6,590	39.41	41.80	4,291
Consumer	486	2.93	8.50	614	3.91	7.10	1,110	7.31	7.62	1,095	6.55	9.72	1,146
Unallocated	1,022	6.16	—	375	2.38	—	431	2.84	—	233	1.39	—	1,082
Total	$16,577	100.00 %	100.00 %	$15,721	100.00 %	100.00 %	$15,183	100.00 %	100.00 %	$16,722	100.00 %	100.00 %	$16,3

Reserve for Repurchased Loans and Loss Sharing Obligations. The reserve for repurchased loans and loss sharing obligations was established to provide for expected losses related to repurchase requests which may be received on residential mortgage loans previously sold to investors. The reserve also includes an estimate of the Bank's obligation under a loss sharing arrangement with the FHLB relating to loans sold into their Mortgage Partnership Finance ("MPF") program. The Company prepares a comprehensive analysis of the adequacy of the reserve for repurchased loans and loss sharing obligations at each quarter-end.

At December 31, 2018 and 2017, the Company maintained a reserve for repurchased loans and loss sharing obligations of $1.3 million and $463,000, respectively. Provisions for losses are charged to gain on sale of loans and credited to the reserve while actual losses are charged to the reserve. Losses were $0, $383,000, and $140,000, respectively, for the years ended December 31, 2018, 2017 and 2016. During 2018, the reserve increased by $1.0 million due to the acquisition of Sun. The Company evaluates the adequacy of the reserve quarterly. As a result of this review, the reserve was decreased by $200,000 during 2018, which was included in other income. Included in the losses on loans repurchased are cash settlements in lieu of repurchases. At December 31, 2018 and 2017, there were no outstanding loan repurchase requests.

Management believes that the Bank has established and maintained the reserve for repurchased loans and loss sharing obligations at adequate levels, however, future adjustments to the reserve may be necessary due to economic, operating or other conditions beyond the Bank’s control.

Investment Activities

The investment policy of the Bank as established by the Board attempts to provide and maintain liquidity, generate a favorable return on investments without incurring undue interest rate and credit risk, and complement the Bank's lending activities. Specifically, the Bank's policies generally limit investments to government and Federal agency-backed securities, municipal securities and corporate debt obligations. The Bank's policies provide that all investment purchases must be evaluated internally for creditworthiness and be approved by two officers (any two of the Senior Vice President/Treasurer, the Executive Vice President/Chief Financial Officer, and the President/Chief Executive Officer). The Company's investment policy mirrors that of the Bank except that it allows for the purchase of equity securities in limited amounts.

Management determines the appropriate classification of securities at the time of purchase. If the Bank has the intent and the ability at the time of purchase to hold securities until maturity, they may be classified as held-to-maturity. Investment and mortgage-backed securities identified as held-to-maturity are carried at cost, adjusted for amortization of premium and accretion of discount, which are recognized as adjustments to interest income. Securities to be held for indefinite periods of time, but not necessarily to maturity are classified as available-for-sale. Such securities are carried at estimated fair value and unrealized gains and losses, net of related tax effect, are excluded from earnings, but are included as a separate component of stockholders' equity. See "Note 4 to the Consolidated Financial Statements."

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

The actual maturity of a mortgage-backed security varies, depending on when the mortgagors repay or prepay the underlying mortgages. Prepayments of the underlying mortgages may shorten the life of the security, thereby affecting its yield to maturity and the related estimated fair value of the mortgage-backed security. The prepayments of the underlying mortgages depend on many factors, including the type of mortgages, the coupon rates, the age of the mortgages, the geographical location of the underlying real estate collateralizing the mortgages, the general levels of market interest rates, and general economic conditions. GNMA mortgage-backed securities that are backed by assumable Federal Housing Administration ("FHA") or Department of Veterans Affairs ("VA") loans generally have a longer life than conventional non-assumable loans underlying FHLMC and FNMA mortgage-backed securities. During periods of falling mortgage interest rates, prepayments generally increase, as opposed to periods of increasing interest rates when prepayments generally decrease. If the interest rate of underlying mortgages significantly exceeds the prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages. Prepayment experience is more difficult to estimate for adjustable-rate mortgage-backed securities.

The Bank has investments in mortgage-backed securities and has utilized such investments to complement its lending activities. The Bank invests in a large variety of mortgage-backed securities, including ARM, balloon and fixed-rate securities and all were directly insured or guaranteed by either FHLMC, FNMA, GNMA or SBA.

The following table sets forth the Bank's mortgage-backed securities activities at amortized cost for the periods indicated:

	For the Year Ended December 31,		
	2018	2017	2016
	(in thousands)		
Beginning balance	$531,110	$462,883	$280,872
Mortgage-backed securities acquired	235,700	—	203,416
Mortgage-backed securities purchased	—	165,501	59,590
Less: Principal repayments	(119,780)	(96,383)	(73,470)

Less: Sales	—	—	(6,394)
Amortization of premium	75	(891)	(1,131)
Ending balance	$647,105	$531,110	$462,883

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

	At December 31,					
	2018		2017		2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(in thousands)					
Mortgage-backed securities:						
FHLMC	$237,703	$232,752	$186,921	$184,135	$144,016	$141,754
FNMA	278,264	272,982	263,103	261,296	217,445	217,130
GNMA	127,611	125,449	75,243	74,379	92,475	92,230
SBA	3,527	3,447	5,843	5,871	8,947	8,975
Total mortgage-backed securities	$647,105	$634,630	$531,110	$525,681	$462,883	$460,089

Investment Securities. At December 31, 2018, the amortized cost of the Company's investment securities totaled $306.3 million, and consisted of $115.5 million of U.S. agency obligations, $124.0 million of state and municipal obligations and $66.8 million of corporate debt securities. Each of the U.S. agency obligations are rated AA+ by Standard and Poor's and Aaa by Moody's. The state and municipal obligations are issued by government entities with current credit ratings that are considered investment grade ranging from a high of AAA to a low of A-. The corporate debt securities include two issues totaling $4.4 million issued by community banks, which are not rated by any of the credit rating services. Excluding these items, the remaining corporate debt securities are issued by various corporate entities with an amortized cost of $62.4 million. Credit ratings range from a high of AA- to a low of BB as rated by one of the internationally-recognized credit rating services. See "Note 4 to the Consolidated Financial Statements."

The following table sets forth certain information regarding the amortized cost and estimated fair value of the Company's investment securities at the dates indicated.

	At December 31,					
	2018		2017		2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(in thousands)					
Investment securities:						
U.S. agency obligations	$115,499	$114,569	$97,346	$96,484	$32,502	$32,253
State and municipal obligations	123,987	122,357	149,958	148,702	39,155	38,309
Corporate debt securities	66,834	61,976	76,024	72,374	77,057	71,141
Total investment securities	$306,320	$298,902	$323,328	$317,560	$148,714	$141,703

The table below sets forth certain information regarding the amortized cost, weighted average yields and contractual maturities, excluding scheduled principal amortization, of the Bank's investment and mortgage-backed securities as of December 31, 2018. Other investments consist of mutual funds that do not have a contractual maturity date and are excluded from the table. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. See "Investment Activities – Mortgage-backed Securities."

	At December 31, 2018					
					Total	
	One Year or Less Amortized Cost	More than One Year to Five Years Amortized Cost	More than Five Years to Ten Years Amortized Cost	More than Ten Years Amortized Cost	Amortized Cost	Estimated Fair Value
	(dollars in thousands)					
Investment securities:						
U.S. agency obligations	$30,012	$85,486	$—	$—	$115,498	$114,569
State and municipal obligations	18,553	64,827	40,608	—	123,988	122,357
Corporate debt securities [1]	1,999	9,052	44,966	10,817	66,834	61,976
Total investment securities	$50,564	$159,365	$85,574	$10,817	$306,320	$298,902
Weighted average yield	1.49 %	1.84 %	3.35 %	5.19 %	2.32 %	
Mortgage-backed securities:						
FHLMC	$—	$2,850	$64,977	$169,876	$237,703	$232,752
FNMA	2	10,818	79,395	188,049	278,264	272,982
GNMA	—	—	2,399	125,212	127,611	125,449
SBA	—	—	—	3,527	3,527	3,447
Total mortgage-backed securities	$2	$13,668	$146,771	$486,664	$647,105	$634,630
Weighted average yield	4.46 %	2.18 %	2.43 %	1.55 %	1.76 %	

(1) $52.8 million of the Bank's corporate debt securities carry interest rates which adjust to a spread over LIBOR on a quarterly basis.

Sources of Funds

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

Deposits. The Bank offers a variety of deposit accounts with a range of interest rates and terms to retail, government and business customers. The Bank's deposits consist of money market accounts, savings accounts, interest-bearing checking accounts, non-interest-bearing accounts and time deposits. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. The Bank's deposits are obtained predominantly from the areas in which its branch offices are located. The Bank relies on its community-banking focus, stressing customer service and long-standing relationships with its customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions could significantly affect the Bank's ability to attract and retain deposits.

At December 31, 2018, the Bank had $124.3 million in time deposits in amounts of $250,000 or more maturing as follows:

Maturity Period	Amount	Weighted Average Rate
	(dollars in thousands)	
Three months or less	$34,134	1.40 %

Over three through six months	10,607	1.40	
Over six through twelve months	25,112	1.65	
Over twelve months	54,452	2.09	
Total	$124,305	1.75	%

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

	For the Year Ended December 31,								
	2018			2017			2016		
	Average Balance	Percent of Total Average Deposits	Average Rate Paid	Average Balance	Percent of Total Average Deposits	Average Rate Paid	Average Balance	Percent of Total Average Deposits	Average Rate Paid
	(dollars in thousands)								
Interest-bearing checking accounts	$2,336,917	40.43 %	0.39 %	$1,796,370	41.96 %	0.25 %	$1,266,135	42.92 %	0.17 %
Money market deposit accounts	571,997	9.90	0.49	410,373	9.59	0.30	316,977	10.75	0.27
Savings accounts	877,179	15.17	0.11	672,315	15.70	0.05	447,484	15.17	0.04
Non-interest-bearing accounts	1,135,602	19.64	—	776,344	18.13	—	497,166	16.85	—
Time deposits	858,978	14.86	1.11	625,847	14.62	1.00	422,026	14.31	1.03
Total average deposits	$5,780,673	100.00%	0.39 %	$4,281,249	100.00%	0.29 %	$2,949,788	100.00%	0.25 %

Borrowings. The Bank has obtained advances from the FHLB for cash management and interest rate risk management purposes or as an alternative to deposit funds and may do so in the future as part of its operating strategy. FHLB term advances are also used to acquire certain other assets as may be deemed appropriate for investment purposes. Advances are collateralized primarily by certain of the Bank's mortgage loans and investment and mortgage-backed securities and secondarily by the Bank's investment in capital stock of the FHLB. The maximum amount that the FHLB will advance to member institutions, including the Bank, fluctuates from time-to-time in accordance with the policies of the FHLB. At December 31, 2018, the Bank had $449.4 million in outstanding advances from the FHLB. The Bank also has outstanding municipal letters of credit issued by the FHLB used to secure government deposits. At December 31, 2018, these municipal letters of credit totaled $950.0 million.

The Bank also borrows funds using securities sold under agreements to repurchase. Under this form of borrowing specific U.S. Government agency and/or mortgage-backed securities are pledged as collateral to secure the borrowing. These pledged securities are held by a third-party custodian. At December 31, 2018, the Bank had borrowed $61.8 million through securities sold under agreements to repurchase.

The Bank can also borrow from the Federal Reserve Bank of Philadelphia ("Reserve Bank") under the primary credit program. Primary credit is available on a short-term basis, typically overnight, at a rate above the Federal Open Market Committee's Federal funds target rate. All extensions of credit by the Reserve Bank must be secured. At December 31, 2018, the Bank had no borrowings outstanding with the Reserve Bank.

Subsidiary Activities

At December 31, 2018, the Bank owned 8 direct subsidiaries:

- OceanFirst REIT Holdings, Inc. was established in 2007 as a wholly-owned subsidiary of the Bank and now acts as the holding company for OceanFirst Management Corp, which was organized in 2016 for the purpose of holding and managing investment securities, including the stock of OceanFirst Realty Corp. OceanFirst Realty Corp. was established in 1997 and invests in qualifying mortgage loans and is intended to qualify as a real estate investment trust, which may, among other things, be utilized by the Company to raise capital in the future.
- 975 Holdings, LLC, Hooper Holdings, LLC, and TRREO Holdings, LLC were established in 2010, 2015, and 2016, respectively, as wholly-owned subsidiaries of the Bank. Casaba Real Estate Holding Corporation and Cohensey Bridge, L.L.C. were acquired by the Bank as wholly-owned subsidiaries as part of its acquisition of Cape in 2016. All of these subsidiaries are maintained for the purpose of taking legal possession of certain repossessed collateral for resale to third parties.
- Prosperis Financial, L.L.C. was acquired by the Bank as a wholly-owned subsidiary as part of its acquisition of Sun in 2018. This subsidiary offered client access to various investment and advisory services and is currently inactive.

- OceanFirst Services, LLC is a wholly-owned subsidiary of the Bank that is now the holding company for OFB Reinsurance, Ltd., which was established in 2002 to reinsure a percentage of the private mortgage insurance ("PMI") risks on one-to-four family residential mortgages originated by the Bank. There are no current reinsurance contracts in force by OFB Reinsurance, Ltd.

In addition to the Bank, the Company has OceanFirst Risk Management, Inc. as a direct subsidiary. OceanFirst Risk Management Inc. is a captive insurance company that insures certain risks relating to the business of the Bank and the Company.

Personnel

As of December 31, 2018, the Bank had 787 full-time employees and 105 part-time employees, for a total of 892 employees. The employees are not represented by a collective bargaining unit and the Bank considers its relationship with its employees to be good.

On January 31, 2019, the Company completed its acquisition of Capital, which added 65 full-time and 8 part time employees, for a total of 73 employees.

REGULATION AND SUPERVISION

General

Prior to January 2018, the Bank was a Federally-chartered savings bank, and the Company was registered as a savings and loan holding company. Effective January 31, 2018, the Bank converted to a national bank charter and the Company became a bank holding company ("BHC") under Section 3 of the Bank Holding Company Act of 1956, as amended (the "BHC Act") and is subject to the requirements of the BHC Act, including required approvals for investments in or acquisitions of banking organizations, or entities involved in activities that are deemed closely related to banking, capital adequacy standards and limitations on nonbanking activities. The Company is registered with the FRB and is required by Federal law to file reports with, and comply with the rules and regulations of the FRB. The Bank is a member of the FHLB System and, with respect to deposit insurance, of the Deposit Insurance Fund ("DIF") managed by the FDIC. The Bank is subject to extensive regulation, examination and supervision by the OCC, as its primary Federal regulator, and the FDIC, as the deposit insurer. The Bank must file reports with the OCC and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to consummating certain transactions such as mergers with, or acquisitions of, other insured depository institutions. The OCC conducts periodic examinations to test the Bank's safety and soundness and compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors and to ensure the safe and sound operation of the Bank. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

In addition, the Company elected to become a financial holding company under the Gramm-Leach Bliley Act amendments to the BHC Act (the "GLBA"). A financial holding company, and the nonbank companies under its control, are permitted to engage in activities considered financial in nature or incidental to financial activities and, if the FRB determines that they pose no risk to the safety or soundness of depository institutions or the financial system in general, activities are considered complementary to financial activities.

The banking industry is highly regulated. Statutory and regulatory controls increase a BHC's cost of doing business and limit the options of its management to deploy assets and maximize income. The following discussion is not intended to be a complete list of all the activities regulated by the banking laws or of the impact of such laws and regulations on the Company or the Bank. It is intended only to briefly summarize some material provisions.

The description of statutory provisions and regulations applicable to national banks and BHCs set forth in this Form 10-K does not purport to be a complete description of such statutes and regulations and their effects on the Bank and the Company, is subject to change and is qualified in its entirety by reference to the actual laws and regulations involved.

The Dodd-Frank Act. The Dodd-Frank Act significantly changed the bank regulatory structure and affects the lending, deposit, investment, compliance and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various Federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The Federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and the full impact of the Dodd-Frank Act are still not yet known. In addition, as a result of the 2016 election, there is some chance that certain provisions of the Dodd-Frank Act may be repealed or amended.

The Dodd-Frank Act created the CFPB with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over all banks with more than $10 billion in assets. Institutions such as the Bank with $10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators (the OCC in the case of the Bank), although the CFPB will have back-up authority over such institutions. The Dodd-Frank Act also weakens the Federal preemption rules that have been applicable for national banks and Federal savings associations, and gives state attorney generals the ability to enforce Federal consumer protection laws.

Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards and prepayments. The Dodd-Frank Act requires originators to make a reasonable and good faith determination based on documented information that a borrower has a reasonable ability to repay a particular mortgage loan over the long term. If the originator cannot meet this standard, the burden is on the lender to demonstrate the appropriateness of its policies and the strength of its controls. The Dodd-Frank Act contains an exception from this Ability-To-Repay rule for "Qualified Mortgages." The rule sets forth specific underwriting criteria for a loan to qualify as a Qualified Mortgage. The criteria generally exclude loans that (1) are interest-only, (2) have excessive upfront points or fees, or (3) have negative amortization features, balloon payments, or terms in excess of 30 years. To be defined as an Ability-To-Repay Qualified Mortgage, the underwriting criteria also impose a maximum debt to income ratio of 43%, based upon documented and verifiable information. If a loan meets these criteria and is not a "higher priced loan" as defined in FRB regulations, the CFPB rule establishes a safe harbor preventing a consumer from asserting the failure of the originator to establish the consumer's Ability-To-Repay. Additionally, conforming fixed-rate loans with a debt-to-income ratio greater than 43% would also qualify as an Ability-To-Repay Qualified Mortgage based upon an automated loan approval from one of the government sponsored mortgage entities. However, a consumer may assert the lender's failure to comply with the Ability-To-Repay rule for all residential mortgage loans other than Qualified Mortgages, and may challenge a lender's determination that a loan was in fact a Qualified Mortgage. The qualified mortgage rule has yet to be fully addressed by the foreclosure courts and depending on the interpretation of these rules, collectability of non-qualifying mortgages could be subject to future action by the courts. See "Risk Factors – The Dodd-Frank Act imposes obligations on originators of residential mortgage loans, such as the Bank."

The Dodd-Frank Act also directed the FRB to issue rules to limit debit card interchange fees (the fees that issuing banks charge merchants each time a consumer uses a debit card) collected by banks with assets of $10 billion or more. The FRB issued a final rule which caps an issuer's debit card interchange base fee at twenty-one cents ($0.21) per transaction and allows an additional 5 basis point charge per transaction to cover fraud losses. The FRB also issued an interim final rule that allows a fraud-prevention adjustment of one cent ($0.01) per transaction conditioned upon an issuer adopting effective fraud prevention policies and procedures. The Bank's average interchange fee per transaction is forty cents ($0.40). The Dodd-Frank Act exempts from the FRB's rule banks with assets less than $10 billion, such as the Bank. Although exempt from the rule, market forces in future periods may result in reduced fees charged by all issuers, regardless of asset size, which may result in reduced revenues for the Bank. For the year ended December 31, 2018, the Bank's revenues from interchange fees was $8.5 million, an increase of $2.2 million from 2017.

The Dodd-Frank Act requires publicly-traded companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and allows greater access by stockholders to the company's proxy material by authorizing the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The legislation also directs the Federal banking agencies to promulgate rules prohibiting excessive compensation paid to bank executives, regardless of whether the company is publicly traded. The SEC has not yet implemented rules giving stockholders access to company proxy statements, and the banking agency rules primarily address incentive compensation. The rules prohibit incentive-based compensation that would encourage inappropriate risks by providing excessive compensation or that would expose the bank to inappropriate risks by providing compensation that could lead to a material financial loss.

It is still uncertain to what extent and how full implementation of and promulgation of rules under the Dodd-Frank Act, will occur and affect the Bank.

Economic Growth, Regulatory Relief and Consumer Protection Act. The Economic Growth, Regulatory Relief and Consumer Protection Act ("EGRGCPA"), adopted in May of 2018, was intended to provide regulatory relief to midsized and regional banks. While many of its provisions are aimed at larger institutions, such as raising the threshold to be considered a systemically important financial institution to $250 billion in assets from $50 billion in assets, many of its provisions will provide regulatory relief to those institutions with $10 billion or more in assets. Among other things, the EGRGPA increased the asset threshold for depository institutions and holding companies to perform stress tests required under Dodd Frank from $10 billion to $250 billion, exempted institutions with less than $10 billion in consolidated assets from the Volker Rule, raised the threshold for the requirement that publicly traded holding companies have a risk committee from $10 billion in consolidated assets to $50 billion in consolidated assets, directed the federal banking agencies to adopt a “community bank leverage ratio,” applicable to institutions and holding companies with less than $10 billion in assets, and to provide that compliance with the new ratio would be deemed compliance with all capital requirements applicable to the institution or holding company, and provided that residential mortgage loans meeting certain criteria and originated by institutions with less than $10 billion in total assets will be deemed to meet the “ability to repay rule” under the Truth in Lending Act. In addition, the EGRGCPA limited the definition of loans that would be subject to the higher risk weighting applicable to High Volatility Commercial Real Estate.

Many of the regulations needed to implement the EGRGCPA have yet to be promulgated by the federal banking agencies, and so it is still uncertain how full implementation of the EGRGCPA will affect the Company and the Bank.

Bank Holding Company Regulation

The Company is a BHC and is supervised by the FRB and is required to file reports with the FRB and provide such additional information as the FRB may require. The Company and its subsidiaries are subject to examination by the FRB.

The BHC Act prohibits the companies which do not elect to become financial holding companies, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to subsidiary banks, except that a BHC may, upon application, engage in, and may own shares of companies engaged in, certain businesses found by the FRB to be so closely related to banking "as to be a proper incident thereto." The BHC Act requires prior approval by the FRB of the acquisition by bank holding companies of more than 5% of the voting stock of any other entity, including another bank. Satisfactory capital ratios and Community Reinvestment Act ("CRA") ratings and anti-money laundering policies are generally prerequisites to obtaining federal regulatory approval to make acquisitions. FRB regulations provide that a BHC is expected to act as a source of financial and managerial strength to its subsidiary bank and to commit resources to support the subsidiary bank in circumstances in which it might not do so absent those regulations.

Holding Company Capital Requirements. The Dodd-Frank Act requires capital rules and the application of the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies. In addition to making bank holding companies subject to the same capital requirements as their bank subsidiaries, these provisions (often referred to as the Collins Amendment to the Dodd-Frank Act) were also intended to eliminate or significantly reduce the use of hybrid capital instruments, especially trust preferred securities, as regulatory capital. The Dodd-Frank Act also requires banking regulators to seek to make capital standards countercyclical, so that the required levels of capital increase in times of economic expansion and decrease in times of economic contraction.

At December 31, 2018, the Company exceeded all regulatory capital requirements currently applicable. The following table presents the Company's capital position at December 31, 2018:

As of December 31, 2018	Actual Capital	Required Capital	Excess Amount	Capital Actual Percent	Required Percent	
OceanFirst Financial Corp:	(dollars in thousands)					
Tier 1 capital (to average assets)	$709,972	$285,199	$424,773	9.96 %	4.000 %	
Common equity Tier 1 (to risk-weighted assets)	647,773	339,791	307,982	12.15	6.375	(1)
Tier 1 capital (to risk-weighted assets)	709,972	419,742	290,230	13.32	7.875	(1)
Total capital (to risk-weighted assets)	762,556	526,343	236,213	14.31	9.875	(1)

(1) Includes the Capital Conservation Buffer of 1.875%

Dividends. The FRB has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank holding companies. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Regulatory pressures to reclassify and charge off loans and to establish additional loan loss reserves can have the effect of reducing current operating earnings and thus impacting an institution's ability to pay dividends. Further, regulatory guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the Company's net income for the past four quarters, net of dividends previously paid over that period is insufficient to fully fund the dividend or the Company's overall rate of earnings retention is inconsistent with the Company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. The policy statement also states that a holding company should inform the FRB supervisory staff prior to redeeming or repurchasing common stock or perpetual preferred stock if the holding company is experiencing financial weaknesses or if the repurchase or redemption would result in a net reduction in the amount of such instruments outstanding from the beginning of the quarter in which the redemption or repurchase occurred compared with the end of such quarter. These regulatory policies may affect the ability of the Company to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

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

Financial Holding Company Status
When the Bank converted to a national bank charter and the Company became a BHC, the Company elected to become a financial holding company. Financial holding companies may engage in a broader scope of activities than a BHC. In addition, financial holding companies may undertake certain activities without prior FRB approval.
A financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. "Financial in nature" activities include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and insurance agency activities; merchant banking; and activities that the FRB determines to be financial in nature or incidental to a financial activity or which are complementary to a financial activity and do not pose a safety and soundness risk.
A financial holding company that engages in activities that are financial in nature or incidental to a financial activity but not previously authorized by the FRB must obtain approval from the FRB before engaging in such activity. Also, a financial holding company may seek FRB approval to engage in an activity that is complementary to a financial activity, if it shows, among other things, that the activity does not pose a substantial risk to the safety and soundness of its insured depository institutions or the financial system.
A financial holding company generally may acquire a company (other than a bank holding company, bank or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature without prior approval from the FRB. Prior FRB approval is required, however, before the financial holding company may acquire control of more than 5% of the voting shares or substantially all of the assets of a BHC, bank or savings association. In addition, under the FRB's merchant banking regulations, a financial holding company is authorized to invest in companies that engage in activities that are not financial in nature, as long as the financial holding company makes its investment with the intention of limiting the duration of the investment, does not manage the company on a day-to-day basis, and the company does not cross-market its products or services with any of the financial holding company's controlled depository institutions.
If any subsidiary bank of a financial holding company ceases to be “well-capitalized” or “well-managed” and fails to correct its condition within the time period that the FRB specifies, the FRB has authority to order the financial holding company to divest its subsidiary banks. Alternatively, the financial holding company may elect to limit its activities and the activities of its subsidiaries to those permissible for a bank holding company that is not a financial holding company. If any subsidiary bank of a financial holding company receives a rating under the CRA of less than “satisfactory,” then the financial holding company is prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations until the rating is raised to “satisfactory” or better.
Regulation of Bank Subsidiary
Business Activities. The operations of the Bank are subject to requirements and restrictions under Federal law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be granted, and limitations on the types of investments that may be made and the types of services which may be offered. Various consumer laws and regulations also affect the operations of the Bank. Approval of the OCC is required for branching, bank mergers in which the continuing bank is a national bank and in connection with certain fundamental corporate changes affecting the Bank. There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, as implemented by Regulation W which govern the extent to which a bank subsidiary may finance or otherwise supply funds to its holding company or its holding company’s non-bank subsidiaries.
Capital Requirements. FDIC regulations require banks to maintain minimum levels of capital including: a common equity Tier 1 capital to risk-based assets ratio of 4.0%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio. These capital requirements were effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Act.
As noted, the risk-based capital standards for banks require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets of at least 4.5%, 6%, and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present

greater risk. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets. Unrealized gains and losses on certain "available-for-sale" securities are included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. The Bank has exercised the opt-out. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations. In assessing an institution's capital adequacy, federal regulators take into consideration, not only these numeric factors, but qualitative factors as well, and have the authority to establish higher capital requirements for individual banks where necessary.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement is being phased in over four years beginning January 1, 2016. The capital conservation buffer requirement is being phased in incrementally, which started at 0.625% on January 1, 2016, and increased to 1.25% on January 1, 2017, 1.875% on January 1, 2018, and 2.50% on January 1, 2019, when the full capital conservation buffer requirement became effective. Both the Bank and the Company are in compliance with the capital conservation buffer requirements applicable to them.

The Federal banking agencies, including the FDIC, have also adopted regulations to require an assessment of an institution's exposure to declines in the economic value of a bank's capital due to changes in interest rates when assessing the bank's capital adequacy. Under such a risk assessment, examiners evaluate a bank's capital for interest rate risk on a case-by-case basis, with consideration of both quantitative and qualitative factors. Institutions with significant interest rate risk may be required to hold additional capital. According to the Federal banking agencies, applicable considerations include: quality of the bank's interest rate risk management process; the overall financial condition of the bank; and the level of other risks at the bank for which capital is needed.

At December 31, 2018, the Bank exceeded all regulatory capital requirements currently applicable. The following table presents the Bank's capital position at December 31, 2018:

As of December 31, 2018	Actual Capital	Required Capital	Excess Amount	Capital Actual Percent	Required Percent	
Bank:	(dollars in thousands)					
Tier 1 capital (to average assets)	$712,900	$284,772	$428,128	10.01%	4.000 %	
Common equity Tier 1 (to risk-weighted assets)	712,900	339,513	373,387	13.39	6.375	(1)
Tier 1 capital (to risk-weighted assets)	712,900	419,398	293,502	13.39	7.875	(1)
Total capital (to risk-weighted assets)	730,484	525,912	204,572	13.72	9.875	(1)

(1) Includes the Capital Conservation Buffer of 1.875%

Prompt Corrective Action. Federal law requires, among other things, that the Federal bank regulatory authorities take "prompt corrective action" with respect to insured depository institutions that do not meet minimum capital requirements. For these purposes, the law establishes five categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. The FDIC's regulations define the five categories as follows:

An institution is classified as "well capitalized" if:

- its ratio of Tier 1 capital to total assets is at least 5%, and it is not subject to any order or directive by the FDIC to meet a specific capital level; and
- its ratio of common equity tier 1 capital to risk-weighted assets is at least 6.5%; and
- its ratio to Tier 1 capital to risk-weighted assets is at least 8%; and
- its ratio of total capital to risk-weighted assets is at least 10%.

An institution is classified as "adequately capitalized" if:

- its ratio of Tier 1 capital to total assets is at least 4%; and
- its ratio of common equity tier 1 capital to risk-weighted assets is at least 6.375%; and
- its ratio to Tier 1 capital to risk-weighted assets is at least 7.875%; and
- its ratio of total capital to risk-weighted assets is at least 9.875%.

An institution is classified as "undercapitalized" if:

- its leverage ratio is less than 4%; and

- its ratio of common equity tier 1 capital to risk-weighted assets is less than 6.375%; and
- its ratio to Tier 1 risk based capital is at less than 7.875%; and
- its ratio of total capital to risk-weighted assets is at least 9.875%.

An institution is classified as “significantly undercapitalized” if:

- its leverage ratio is less than 3%; or

- its ratio of common equity tier 1 capital to risk-weighted assets is less than 4.875%; or
- its ratio to Tier 1 risk based capital is at less than 5.875%; or
- its total risk-based capital is less than 7.875%.

An institution that has a tangible capital to total assets ratio equal to or less than 2% is deemed to be "critically undercapitalized."

The FDIC is required, with some exceptions, to appoint a receiver or conservator for an insured bank if that bank is "critically undercapitalized." The FDIC may also appoint a conservator or receiver for a state bank on the basis of the institution's financial condition or upon the occurrence of certain events, including:

- insolvency, or when the assets of the bank are less than its liabilities to depositors and others;
- substantial dissipation of assets or earnings through violations of law or unsafe or unsound practices;
- existence of an unsafe or unsound condition to transact business;
- likelihood that the bank will be unable to meet the demands of its depositors or to pay its obligations in the normal course of business; and
- insufficient capital, or the incurring or likely incurring of losses that will deplete substantially all of the institution's capital with no reasonable prospect of replenishment of capital without Federal assistance.

Based on the regulatory guidelines, the Bank satisfies the criteria to be "well-capitalized."

Insurance of Deposit Accounts. Deposit accounts at the Bank are insured by the DIF of the FDIC. The Bank is therefore subject to FDIC deposit insurance assessments which are determined using a risk-based system.

In 2011, the FDIC approved a final rule required by the Dodd-Frank Act, that changed the assessment base from domestic deposits to average assets minus average tangible equity, adopted a new large-bank pricing assessment scheme, and set a target size for the DIF. The rule finalized a target size for the DIF at 2% of insured deposits. It also implemented a lower assessment rate schedule when the fund reaches 1.15% (so that the average rate over time should be about 8.5 basis points) and, in lieu of dividends, provided for a lower rate schedule when the reserve ratio reaches 2% and 2.5%. The rule lowered overall assessment rates in order to generate the same approximate amount of revenue under the new larger base as was raised under the old base. The assessment rates in total are between 2.5 and 9 basis points on the broader base for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. Deposit accounts are insured by the FDIC generally up to a maximum of $250,000 per separately insured depositor.

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

In addition to the FDIC assessments, the Financing Corporation ("FICO"), formed in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation, is authorized to impose and collect, through the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO. The bonds issued by the FICO are due to mature in 2017 through 2019.

The total expense incurred in 2018 and 2017 for the deposit insurance assessment and the FICO payments were $2.4 million and $1.6 million, respectively.

Loans to One Borrower. Subject to certain exceptions, a banking institution may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if secured by specified readily-marketable collateral.

Limitation on Capital Distributions. Applicable regulations impose limitations upon all capital distributions by a banking institution, including cash dividends, payments to repurchase its shares and payments to stockholders of another institution in a cash-out merger. Under the regulations, an application to and the approval of the OCC, is required prior to any capital distribution if the total capital distributions for the calendar year exceeds net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OCC. In the event the Bank's capital fell below its regulatory requirements or the FRB or OCC notified it that it was in need of more than normal supervision, the Bank's ability to make capital distributions could be restricted. In addition, the FRB or OCC could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the FRB or OCC determine that such distribution would constitute an unsafe or unsound practice. If the Bank is unable for any reason to pay a dividend to the Company, the Company may not have the liquidity necessary to pay a dividend in the future, pay a dividend at the same rate as historically paid, be able to repurchase stock, or to meet current debt obligations. In addition, capital requirements made applicable to the Company as a result of the Dodd-Frank Act and Basel III may limit the Company's ability to pay dividends or repurchase stock in the future.

Assessments. Banking institutions are required to pay assessments to fund regulatory operations. The assessments, paid on a semi-annual basis, are based upon the institution's total assets, including consolidated subsidiaries as reported in the Bank's latest quarterly regulatory report, as well as the institution's regulatory rating and complexity component. The assessments paid by the Bank for the years ended December 31, 2018 and 2017 totaled $1.3 million and $923,000, respectively.

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

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional FHLBs. Each FHLB provides member institutions with a central credit facility. The Bank, as a member of the FHLB-NY is required to acquire and hold shares of capital stock in that FHLB in an amount at least equal to 0.20% of mortgage-related assets and 4.5% of the specified value of certain transactions with the FHLB. The Bank was in compliance with this requirement with an investment in FHLB-NY stock at December 31, 2018 of $28.8 million.

Federal Reserve System

The Federal Reserve Board regulations require depository institutions to maintain reserves against their transaction accounts (primarily interest-bearing checking and regular checking accounts). The regulations generally provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including $122.3 million; a 10% reserve ratio is applied above $122.3 million. The first $16.0 million of otherwise reservable balances (subject to adjustments by the FRB) are exempt from the reserve requirements. The amounts are adjusted annually. The Bank complies with the foregoing requirements. For 2019, the FRB has set the 3% reserve limit at $124.2 million and the exemption at $16.3 million.

In addition, as a national bank, the Bank is required to hold capital stock of the Federal Reserve Bank of Philadelphia. The required shares may be adjusted up or down based on changes to the Bank's common stock and paid-in surplus. The Bank is in compliance with these requirements, with a total investment in Federal Reserve Bank of Philadelphia stock of $28.0 million at December 31, 2018.

FEDERAL AND STATE TAXATION

Federal Taxation

General. The Company and the Bank report their income on a calendar year basis using the accrual method of accounting, and are subject to Federal income taxation in the same manner as other corporations with some exceptions, including particularly the Bank's reserve for bad debts. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company.

Corporate Alternative Minimum Tax. For tax years before December 31, 2017, the Internal Revenue Code of 1986, as amended (the "Code") imposed a tax on alternative minimum taxable income ("AMTI") at a rate of 20%. Only 90% of AMTI can be offset by net operating loss carryovers. AMTI is increased by an amount equal to 75% of the amount by which the Bank's adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses). On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Reform") was enacted resulting in significant modifications to existing laws, including elimination of the corporate alternative tax.

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

Tax Reform. On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Reform") was enacted resulting in significant modifications to existing law, including a reduction in the statutory rate from 35% in 2017, to 21% in 2018. As a result of the Tax Reform, the Company was required to revalue its deferred tax asset, resulting in a tax benefit of $1.9 million, for the year ended December 31, 2018, and a tax expense of $3.6 million for the year ended December 31, 2017.

State and Local Taxation

New Jersey Taxation. The Bank files New Jersey income tax returns. For New Jersey income tax purposes, the Bank is subject to a tax rate of 9% of taxable income. For this purpose, "taxable income" generally means Federal taxable income, subject to certain adjustments (including addition of interest income on state and municipal obligations).

The Company is required to file a New Jersey income tax return because it does business in New Jersey. For New Jersey tax purposes, regular corporations are presently taxed at a rate equal to 9% of taxable income. New Jersey also imposes a temporary surtax of 2.5% for 2018 and 2019, and 1.5% for 2020 and 2021. For calendar year-end corporations prior to 2019, if the Company meets certain requirements, it was eligible to elect to be taxed as a New Jersey Investment Company at a tax rate presently equal to 3.60% (40% of 9%) of taxable income. The Company did not qualify as a New Jersey Investment Company. In addition, recent changes to New Jersey law require combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey's current status as a separate return state. This change may increase the Company's New Jersey state tax expense in future periods.

OceanFirst REIT Holdings, Inc. files a New Jersey income tax return and qualifies as a New Jersey Investment Company which is taxed at a rate presently equal to 3.60% of taxable income.

New York Taxation. Due to an increase in loan activity both organically and through acquisition, the Bank is required to file a New York State and MTA tax return. The New York return requires consolidation of all entities, including OceanFirst Realty, and New York taxable income, consistent with other states, generally means Federal taxable income subject to certain adjustments. The allocation and apportionment of taxable income to New York state may positively affect the overall tax rate.

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

Item 1A. Risk Factors

An investment in the Company's common stock involves risks. Stockholders should carefully consider the risks described below, together with other information contained in this Annual Report on Form 10-K, before making any purchase or sale decisions regarding the Company's common stock. If any of the following risks actually occur, the Company's financial condition or operating results may be harmed. In that case, the trading price of the Company's common stock may decline, and stockholders may lose part or all of their investment in the Company's common stock.

A downturn in the local economy or in local real estate values could adversely impact profits. Most of the Bank's loans are secured by real estate and are made to borrowers in central and southern New Jersey and the surrounding areas. A downturn in the local economy or a decline in real estate values could increase the amount of non-performing loans and cause residential and commercial mortgage loans to become inadequately collateralized, which could expose the Bank to a greater risk of loss.

Hurricanes and other natural disasters, climate change or increases to flood insurance premiums could adversely affect asset quality and earnings. The Bank's trade area includes counties in New Jersey with extensive coastal regions. These areas may be vulnerable to flooding or other damage from future storms or hurricanes. This damage may be as bad as, or worse than, that suffered during Superstorm Sandy in 2012. Further storms like this, although rare, could negatively impact the Company's results of operations by disrupting operations, adversely impacting the ability of the Company's borrowers to repay their loans, damaging collateral or reducing the value of real estate used as collateral.

Increased emphasis on commercial lending may expose the Bank to increased lending risks. At December 31, 2018, $3.1 billion, or 54.9%, of the Bank's total loans consisted of commercial real estate, multi-family and land loans, and commercial and industrial loans. This portfolio has grown in recent years and the Bank intends to continue to emphasize these types of lending. These types of loans may expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. In addition, many of these loans were acquired through the Company's recent acquisitions, and were not underwritten by the Bank and were made to borrowers with whom the Company and the Bank do not have longstanding relationships.

The long foreclosure timeline in New Jersey continues to adversely impact the Bank’s recoveries on non-performing loans. The Judicial foreclosure process in New Jersey is protracted, which delays the Company’s ability to resolve non-performing loans through the sale of the underlying collateral. The longer timelines were the result of the economic crisis, additional consumer protection initiatives related to the foreclosure process, increased documentary requirements and judicial scrutiny, and, both voluntary and mandatory programs under which lenders may consider loan modifications or other alternatives to foreclosure. These reasons, historical issues at the largest mortgage loan servicers, and the legal and regulatory responses have impacted the foreclosure process and completion time of foreclosures for residential mortgage lenders, which may result in a material adverse effect on collateral values and the Bank’s ability to minimize its losses.

The Company has grown and may continue to grow through acquisitions. To be successful as a larger institution, the Company must successfully integrate the operations and retain the customers of acquired institutions, attract and retain the management required to successfully manage larger operations, and control costs. Since July 31, 2015, the Company has acquired Colonial American, Cape, Ocean Shore and Sun. On January 31, 2019, the Company acquired Capital Bank of New Jersey.

Future results of operations will depend in large part on the Company’s ability to successfully integrate the operations of the acquired institutions and retain the customers of those institutions. If the Company is unable to successfully manage the integration of the separate cultures, customer bases and operating systems of the acquired institutions, and any other institutions that may be acquired in the future, the Company’s results of operations may be adversely affected.

In addition, to successfully manage substantial growth, the Company may need to increase non-interest expenses through additional personnel, leasehold and data processing costs, among others. In order to successfully manage growth, the Company may need to adopt and effectively implement policies, procedures and controls to maintain credit quality, control costs and oversee the Company’s operations. No assurance can be given that the Company will be successful in this strategy.

The Company may be challenged to successfully manage its business as a result of the strain on management and operations that may result from growth. The ability to manage growth will depend on its ability to continue to attract, hire and retain skilled employees. Success will also depend on the ability of officers and key employees to continue to implement and improve operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage employees.

Finally, substantial growth may stress regulatory capital levels, and may require the Company to raise additional capital. No assurance can be given that the Company will be able to raise any required capital, or that it will be able to raise capital on terms that are beneficial to stockholders.

A significant portion of the Company’s loan portfolio has grown through acquisition, and therefore may not have been underwritten to meet the Company’s credit standards. Since these loans were acquired as part of the Company’s acquisitions of other depository institutions, they were not underwritten or originated in accordance with the Company’s credit standards, and the Company does not have long-standing relationships with many of these borrowers. Although the Company reviewed the loan portfolios of each institution acquired as part of the diligence process, and has established reasonable credit marks with regard to all loans acquired, no assurance can be given that the Company will not incur losses in excess of the credit marks with regard to these acquired loans, or that any such losses, if they occur, will not have a material adverse effect on the Company’s business, financial condition and results of operations.

Future acquisition activity could dilute tangible book value. Both nationally and locally, the banking industry is undergoing consolidation marked by numerous mergers and acquisitions. From time-to-time the Company may be presented with opportunities to acquire institutions and/or bank branches which result in discussions and negotiations. Acquisitions typically involve the payment of a premium over book and trading values, and therefore, may result in the dilution of tangible book value per share.

The Dodd-Frank Act imposes obligations on originators of residential mortgage loans, such as the Bank. Among other things, the Dodd-Frank Act requires originators to make a reasonable and good faith determination based on documented information that a borrower has a reasonable ability to repay a particular mortgage loan over the long term. If the originator cannot meet this standard, the burden is on the lender to demonstrate the appropriateness of its policies and the strength of its controls. The Dodd-Frank Act contains an exception from this Ability-To-Repay rule for “Qualified Mortgages.” The rule sets forth specific underwriting criteria for a loan to qualify as a Qualified Mortgage. If a loan meets these criteria and is not a “higher priced loan” as defined in FRB regulations, the CFPB rule establishes a safe harbor preventing a consumer from asserting the failure of the originator to establish the consumer’s Ability-To-Repay. Additionally, conforming fixed-rate loans with a debt-to-income ratio greater than 43% would also qualify as an Ability-To-Repay Qualified Mortgage based upon an automated loan approval from one of the government sponsored mortgage entities. However, a consumer may assert the lender’s failure to comply with the Ability-To-Repay rule for all residential mortgage loans other than Qualified Mortgages, and may challenge whether a loan actually met the criteria to be deemed an Ability-to-Pay Qualified Mortgage. These challenges have yet to be addressed by the courts.

Although the majority of residential mortgages historically originated by the Bank would be considered Qualified Mortgages, the Bank currently originates residential mortgage loans that do not qualify. As a result of the Ability-to-Repay rules, the Bank may experience loan losses, litigation related expenses and delays in taking title to real estate collateral in a foreclosure proceeding if these loans do not perform and borrowers challenge whether the Bank satisfied the Ability-To-Repay rule upon originating the loan.

The Bank’s allowance for loan losses may be inadequate, which could hurt the Company’s earnings. The Bank’s allowance for loan losses may prove to be inadequate to cover actual loan losses and if the Bank is required to increase its allowance, current earnings may be reduced. The Bank provides for losses by reserving what it believes to be an adequate amount to absorb any probable incurred losses. A “charge-off” reduces the Bank’s reserve for possible loan losses. If the Bank’s reserves were insufficient, it would be required to record a larger reserve, which would reduce earnings for that period. Further, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-13, “Measurement of Credit Losses on Financial Instruments,” that will be effective for interim and annual reporting periods beginning after December 15, 2019. This standard will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and provide for the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which could require an increase in the allowance for loan losses, and will greatly increase the amount of data to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in the allowance for loan losses, or expenses incurred to determine the appropriate level of the allowance for loan losses, may have a material adverse effect on the Company’s financial condition and results of operations.

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

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

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

Changes in the estimated fair value of debt securities may reduce stockholders’ equity and net income. At December 31, 2018, the Company maintained a debt securities portfolio of $947.5 million, of which $100.7 million was classified as available-for-sale. The estimated fair value of the available-for-sale debt securities portfolio may increase or decrease depending on the credit quality of the underlying issuer, market liquidity, changes in interest rates and other factors. Stockholders’ equity is increased or decreased by the amount of the change in the unrealized gain or loss (difference between the estimated fair value and the amortized cost) of the available-for-sale debt securities portfolio, net of the related tax expense or benefit, under the category of accumulated other comprehensive income (loss). Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders’ equity, as well as book value per common share. The decrease will occur even though the securities are not sold.

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

At December 31, 2018 the debt securities portfolio included corporate debt securities in an unrealized loss position for greater than one year. The debt securities in a loss position had a book value of $48.0 million and an estimated fair value of $43.0 million. At December 31, 2018, the Company determined that no other-than-temporary impairment charge was required. However, the Company may be required to recognize an other-than-temporary impairment charge related to these securities if circumstances change.

The Bank may be required to repurchase mortgage loans for a breach of representations and warranties, which could harm the Company's earnings. The Company has entered into loan sale agreements with investors in the normal course of business. The loan sale agreements generally require the repurchase of certain loans previously sold in the event of a violation of various representations and warranties customary to the mortgage banking industry. FNMA, FHLMC and investors carefully examine loan documentation on delinquent loans for a possible reason to request a repurchase by the loan originator. A subsequent sale of the repurchased mortgage loan or underlying collateral could typically be at a significant discount to the unpaid principal balance. The Company maintains a reserve for repurchased loans. However, if repurchase activity is greater than anticipated, the reserve may need to be increased to cover actual losses which could harm future earnings.

The Company and the Bank operate in a highly regulated environment and may be adversely affected by changes in laws and regulations. The Company is subject to examination and regulation by the FRB. The Bank is subject to extensive regulation, supervision and examination by the OCC, its primary Federal regulator, and by the FDIC, as insurer of deposits. Such regulation and supervision governs the activities in which an institution and its holding company may engage. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and determination of the level of the allowance for loan losses. The laws and regulations that govern the Company's and the Bank's operations are designed for the protection of depositors and the public, but not the Company's stockholders.

In July of 2010, the Dodd-Frank Act was enacted. The Dodd-Frank Act is a broad legislative initiative that is significantly changing the bank regulatory structure and affecting the operating activities of financial institutions and their holding companies. In addition, the Dodd-Frank Act created the CFPB with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices.

The Dodd-Frank Act also directed the FRB to issue rules to limit debit-card interchange fees, (the fees that issuing banks charge merchants each time a consumer uses a debit card) collected by banks with assets of $10 billion or more. Although the Bank is exempt from this rule, market forces in future periods may result in reduced fees charged by all issuers, regardless of asset size, which may result in reduced revenues for the Bank. For the year ended December 31, 2018, the Bank's revenues from interchange fees were $8.5 million, an increase of $2.2 million from 2017. See "Regulation and Supervision, General, The Dodd-Frank Act."

In July 2013 the FDIC and the other Federal bank regulatory agencies issued a final rule that revised their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. See "Regulation and Supervision, General, The Dodd-Frank Act."

The USA Patriot and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering, terrorist financing and other illicit activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions. Although the Bank has developed policies and procedures designated to comply with these laws and regulations, these policies and procedures may not be totally effective in preventing violations of these laws and regulations.

These provisions, as well as any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, may impact the profitability of the Company's business activities and may change certain business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads, and could expose the Company to additional costs, including increased compliance costs. These changes also may require the Company to invest significant management attention and resources to make any necessary changes to operations in order to comply, and could therefore also materially and adversely affect the Company's business, financial condition and results of operations.

There is no guaranty that the Company will be able to continue to pay a dividend or, if continued, will be able to pay a dividend at the current rate. The Board of Directors of the Company determines at its discretion if, when and the amount of dividends that may be paid on the common stock. In making such determination under the Company's capital management plan, the Board of Directors takes into account various factors including economic conditions, earnings, liquidity needs, the financial condition of the Company, applicable state law, regulatory requirements and other factors deemed relevant by the Board of Directors. Although the Company has a history of paying a quarterly dividend on its common stock, there is no guaranty that such dividends will continue to be paid in the future or at what rate.

Competition from other banks, financial institutions, government-sponsored entities and emerging technological providers in originating loans, attracting deposits and providing various financial services may adversely affect profitability and liquidity. The Company has substantial competition in originating loans, both commercial and consumer, in its market area. This competition comes principally from other banks, savings institutions, mortgage banking companies and other lenders. Many of these competitors enjoy advantages, including greater financial resources and access to capital, stronger regulatory ratios and higher lending limits, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. In addition, rapid technological changes and consumer preferences may result in increased competition for the Bank’s services. Increased competition could reduce the Company’s net income by decreasing the number and size of loans that the Bank originates and the interest rates charged on these loans.

In attracting consumer, business and public fund deposits, the Company faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of its competitors enjoy advantages, including greater financial resources and access to capital, stronger regulatory ratios, stronger asset quality and performance, more aggressive marketing campaigns, better brand recognition and more branch locations. These competitors may offer higher interest rates than the Company, which could decrease the deposits that the Company attracts or require the Company to increase its rates to retain existing deposits or attract new deposits.

In addition, rapid technological changes and consumer preferences may result in increased competition for the Company’s other services. A number of well-funded technology focused companies are innovating the payments, distributed ledger, and cryptocurrency networks and are attempting to disintermediate portions of the traditional banking model. A shift in the mix of payment forms away from the Company’s products and services could have a material adverse effect on the Company’s financial position and results of operations.

The Company has also been active in competing for New Jersey governmental and municipal deposits. At December 31, 2018, these relationships included public school districts, local municipal governments, and cooperative health insurance funds, and such deposits accounted for approximately 24.9% of the Company’s total deposits. The governor of New Jersey has proposed that the state form and own a bank in which governmental and municipal entities may deposit their excess funds, with the state owned bank then financing small businesses and municipal projects in New Jersey. Although this proposal is in the very early stages, should this proposal be adopted and a state owned bank formed, it could impede the Company’s ability to attract and retain governmental and municipal deposits and financing opportunities.

Increased deposit competition could adversely affect the Company’s ability to generate the funds necessary for lending operations. As a result, the Company may need to seek other sources of funds that may be more expensive to obtain which could increase the cost of funds. Public fund deposits from local government entities such as counties, townships, school districts and other municipalities generally have higher average balances and the Bank’s inability to retain such funds could adversely affect liquidity or result in the use of higher-cost funding sources.

Following the financial crisis of 2007-2008 the FRB began a process of lowering short-term interest rates and purchasing long-term Treasury securities and mortgage-backed securities (“quantitative easing”). Quantitative easing ended in 2014 but the FRB did not begin to reduce its bond holdings until 2018 when it began to decrease its bond portfolio by $50 billion per month (“quantitative tightening”). The impact of this portfolio reduction process has been difficult to discern as the FRB steadily increased short-term interest rates throughout 2018 and the GSE’s remained in government conservatorship awaiting reform of the housing finance system. Eventually, the FRB will complete quantitative tightening and Congress will complete reform of the GSE’s. These factors could have mixed, and potentially negative, effects on the ability of the Bank to originate residential mortgage loans and grow its residential mortgage loan portfolios, which could have a materially adverse impact on the Bank’s earnings.

The Company’s inability to tailor its retail delivery model to respond to consumer preferences in banking may negatively affect earnings. The Bank has expanded its market presence through de novo branching and acquisitions. The branch continues to be a very significant source of new business generation, however, consumers continue to migrate much of their routine banking to self-service channels. In recognition of this shift in consumer patterns, the Bank has undertaken a comprehensive review of its branch network, resulting in branch consolidation accompanied by the enhancement of the Bank’s capabilities to serve its customers through channels other than branches. The benefits of this strategy are dependent on the Bank’s ability to realize expected expense reductions without experiencing significant customer attrition.

The Company must continue to attract and retain qualified personnel and maintain cost controls and asset quality. The Company's ability to manage growth successfully will depend on its ability to continue to attract and retain management and loan officers experienced in banking and financial services and familiar with the communities in its market area. The unexpected loss of service of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could adversely affect the Company. If the Company grows too quickly and is not able to attract qualified personnel and maintain cost controls and asset quality, this continued growth could adversely affect the Company.

Risks associated with system failures, interruptions, or breaches of security could disrupt businesses, result in the disclosure of confidential information, damage the reputation of, and create significant financial and legal exposure for the Company. Information technology systems are critical to the Company's business. Various systems are used to manage customer relationships, including deposits and loans, general ledger and securities investments.

Although the Company devotes significant resources to maintain and regularly upgrade its systems and processes that are designed to protect the security of the Company's computer systems, software, networks and other technology assets and the confidentiality, integrity and availability of information belonging to the Company and its customers, there is no assurance that all of the Company's security measures will provide absolute security. This risk is evidenced by recent events where financial institutions and companies engaged in data processing have reported breaches in the security of their websites or other systems, some of which have involved sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, disrupt or degrade service, sabotage systems or cause other damage, often through the introduction of computer viruses or malware, cyberattacks, ransomware and other means. Additionally, there is the risk of distributed denial-of-service or other similar attacks from technically sophisticated and well-resourced third parties which are intended to disrupt online services, as well as data breaches due to cyberattacks which result in unauthorized access to customer data. Despite the Company's efforts to ensure the integrity of its systems, it is possible that the Company may not be able to anticipate or to implement effective preventive measures against all security breaches of these types, especially because the techniques used change frequently or are not recognized until launched, and because cyberattacks can originate from a wide variety of sources, including third parties outside the Company such as persons who are involved with organized crime or associated with external service providers or who may be linked to terrorist organizations or hostile foreign governments, often with seemingly limitless resources. Those parties may also attempt to fraudulently induce employees, customers or other users of the Company's systems to disclose sensitive information in order to gain access to the Company's data or that of its customers or clients. These risks may increase in the future as the Company continues to increase its mobile and other internet-based product offerings and systems.

In addition, a majority of data processing is outsourced to certain third-party providers. If these third-party providers encounter difficulties, or if there is difficulty communicating with them, the ability to adequately process and account for transactions could be affected, and business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various vendors and their personnel. Breaches of security may occur through intentional or unintentional acts by those having authorized or unauthorized access to the Company's confidential or other information or the confidential or other information of the Company's customers, clients or counterparties. While management regularly reviews security assessments that were conducted on the Company's third party service providers that have access to sensitive and confidential information, there can be no assurance that their information security protocols are sufficient to withstand a cyber-attack or other security breach.

The occurrence of any system failures, interruption, or breach of security of the Company's or its vendors' systems could cause serious negative consequences for the Company, including significant disruption of the Company's operations, misappropriation of confidential information of the Company or that of its customers, or damage to computers or systems of the Company and those of its customers and counterparties, and could result in violations of applicable privacy and other laws, financial loss to the Company or to its customers, loss of confidence in the Company's security measures, customer dissatisfaction, significant litigation exposure, and harm to the Company's reputation, all of which could have a material adverse effect on the Company.

The Company may incur impairments to goodwill. At December 31, 2018, the Company had $338.4 million in goodwill which is evaluated for impairment, at least annually. Significant negative industry or economic trends, including declines in the market price the Company's stock, reduced estimates of future cash flows or business disruptions could result in impairments to goodwill. The valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely on projections of future operating performance. The Company operates in competitive environments and projections of future operating results and cash flows may vary significantly from actual results. If the analysis results in impairment to goodwill, an impairment charge to earnings would be recorded in the financial statements during the period in which such impairment is determined to exist. Any such charge could have an adverse effect on the results of operations.

The Company may be adversely affected by changes in U.S. tax laws. Changes in tax laws contained in the Tax Cuts and Jobs Act, enacted in December 2017, include a number of provisions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. Changes include (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense and (iv) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the tax laws may have an adverse effect on the market for, and valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, such as New Jersey. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in the loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in the provision for loan losses, which would reduce profitability and could have a material adverse effect on the Company's business, financial condition and results of operations.

Recent New Jersey legislative changes may increase tax expense. In connection with adopting the 2019 fiscal year budget, the New Jersey legislature adopted, and the Governor signed, legislation that may increase the Company's state income tax liability and overall tax expense. The legislation imposes a temporary surtax on corporations earning New Jersey allocated income in excess of $1 million of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey's current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. The new legislation did not impact the Company's deferred tax asset or state income tax expense for the year ended December 31, 2018. The Company will continue to evaluate the impact of this legislation on tax expense in future periods.

Monetary policies and regulations of the Federal Reserve Board could adversely affect the Company's business, financial condition and results of operations. In addition to being affected by general economic conditions, the Company's earnings and growth are affected by the policies of the Federal Reserve Board. An important function of the Federal Reserve Board is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve Board to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against certain transaction account deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve Board have had a significant effect on the operating results of financial institutions in the past and are expected to continue to do so in the future. The effects of such policies upon the Company's business, financial condition and results of operations cannot be predicted.

The Company is subject to the Community Reinvestment Act ("CRA") and fair lending laws, and failure to comply with these laws could lead to material penalties. The CRA, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. A successful regulatory challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on expansion. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on the Company's business, financial condition and results of operations, and it is not certain whether those amendments will make CRA compliance more difficult or costly.

The Federal Reserve Board may require the Company to commit capital resources to support the Bank. Federal law requires that a holding company act as a source of financial and managerial strength to its subsidiary bank and to commit resources to support such subsidiary bank. Under the "source of strength" doctrine, the Federal Reserve Board may require a holding company to make capital injections into a troubled subsidiary bank and may charge the holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the holding company may not have the resources to provide it and therefore may require the holding company to borrow the funds or raise capital. Any loans by a holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the Company to make a required capital injection becomes more difficult and expensive and could have an adverse effect on the Company's business, financial condition and results of operations.

Changes in card network fees could impact the Company's operations. From time to time, the card networks increase the fees (known as interchange fees) that they charge to acquirers and that the Bank charges its merchants. It is possible that competitive pressures will result in the Bank absorbing a portion of such increases in the future, which would increase costs, reduce profit margin and adversely affect the Company's business and financial condition. In addition, the card networks require certain capital requirements. An increase in the required capital level would further limit the Company's use of capital for other purposes.

Changes in card network rules or standards could adversely affect the Company's business. In order to provide debit card and cash management solutions, the Company is a member of the Visa network. Subsequent to the acquisition of Sun on January 31, 2018, the Company also became a member of the MasterCard network. As such, the Company is subject to card network rules resulting in a variety of fines or penalties that may be assessed on the Company. The termination of membership or any changes in card network rules or standards, including interpretation and implementation of existing rules or standards, could increase the cost of operating merchant servicer business or limit the ability to provide debit card and cash management solutions to or through customers, and could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company will be subject to heightened regulatory requirements if total assets exceed $10 billion. The Company's total assets were $7.5 billion at December 31, 2018 and $8.0 billion at January 31, 2019 after closing on the Capital Bank acquisition. Banks with assets in excess of $10 billion are subject to requirements imposed by the Dodd-Frank Act and its implementing regulations, including: the examination authority of the Consumer Financial Protection Bureau to assess compliance with Federal consumer financial laws, imposition of higher FDIC premiums, reduced debit card interchange fees, and enhanced risk management frameworks, all of which increase operating costs and reduce earnings.

As the Company approaches $10 billion in total consolidated assets, additional costs have been incurred to prepare for the implementation of these imposed requirements. The Company may be required to invest more significant management attention and resources to evaluate and continue to make any changes necessary to comply with the new statutory and regulatory requirements under the Dodd-Frank Act. Further, Federal financial regulators may require accelerated actions and investments to prepare for compliance before $10 billion in total consolidated assets is exceeded, and may suspend or delay certain regulatory actions, such as approving a merger agreement, if preparations are deemed inadequate. Upon reaching this threshold, the Company faces the risk of failing to meet these requirements, which may negatively impact results of operations and financial condition. While the effect of any presently contemplated or future changes in the laws or regulations or their interpretations would have is unpredictable, these changes could be materially adverse to the Company's investors.

Material weaknesses were identified in the Company's internal control related to ineffective information technology general controls and monitoring controls which, if not remediated appropriately or timely, could result in loss of investor confidence and adversely impact the Company's stock price. As disclosed in Part II, Item 9A, management identified material weaknesses in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access over the core banking information technology ("IT") system used for financial reporting and monitoring controls that were designed to address completeness and accuracy of daily reports generated by the core banking IT system. As a result, management concluded that the internal control over financial reporting was not effective as of December 31, 2018. Remedial measures are being implemented and, while there can be no assurance that such efforts will be successful, management plans to remediate the material weaknesses during 2019. These measures may result in additional technology and other expenses. If management is unable to remediate the material weaknesses, or is otherwise unable to maintain effective internal control over financial reporting or disclosure controls and procedures, the ability to record, process and report financial information accurately, and to prepare financial statements within required time periods, could be adversely affected, which may result in litigation or investigations requiring management resources and payment of legal and other expenses.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Bank conducts its business through its branch office and headquarters located in Toms River, its administrative office located in Red Bank, 58 additional branch offices and three deposit production facilities located throughout central and southern New Jersey. The Bank also operates commercial loan production offices in New York City, the Philadelphia area and in Atlantic, Cape May, and Mercer Counties in New Jersey.

On January 31, 2018, the Bank acquired an additional 4 branches and one loan office as part of the Capital Bank acquisition. The Company expects to consolidate 3 branches in the second quarter of 2019, primarily as a result of the merger, and expects to identify at least 4 additional branches for consolidation early in the third quarter of 2019.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures
Not Applicable.

PART II

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

Market Information for Common Stock

OceanFirst Financial Corp.’s common stock is traded on the Nasdaq Global Select Market under the symbol OCFC.

Stock Performance Graph

The following graph shows a comparison of total stockholder return on OceanFirst Financial Corp.’s common stock, based on the market price of the Company’s common stock with the cumulative total return of companies in the Nasdaq Composite Index, the SNL Thrift Index and the SNL Bank Index for the period December 31, 2013 through December 31, 2018. The graph may not be indicative of possible future performance of the Company’s common stock. Cumulative return assumes the reinvestment of dividends and is expressed in dollars based on an initial investment of $100.

	Period Ending					
Index	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
OceanFirst Financial Corp.	100.00	103.05	124.06	191.39	170.96	150.02
Nasdaq Composite Index	100.00	114.75	122.74	133.62	173.22	168.30
SNL Thrift Index	100.00	107.55	120.94	148.14	147.06	123.87
SNL Bank Index	100.00	111.79	113.69	143.65	169.64	140.98

For the years ended December 31, 2018 and 2017, the Company paid an annual cash dividend of $0.62 and $0.60 per share, respectively.

On July 24, 2014, the Company announced authorization by the Board of Directors to repurchase up to 5% of the Company’s outstanding common stock, or 867,923 shares. As of December 31, 2018 there were no shares available for repurchase under this program. On April 27, 2017, the Company announced the authorization by the Board of Directors to repurchase up to an additional 5% of the Company’s outstanding common stock, or 1.6 million shares, of which 1.3 million shares remain available for repurchase at December 31, 2018. Information regarding the Company’s common stock purchases for the three month period ended December 31, 2018 is as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2018 through October 31, 2018	—	$ —	—	1,754,804
November 1, 2018 through November 30, 2018	39,000	24.73	39,000	1,715,804
December 1, 2018 through December 31, 2018	420,251	22.87	420,251	1,295,553

Item 6. Selected Financial Data

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

	At December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Selected Financial Condition Data:					
Total assets	$7,516,154	$5,416,006	$5,166,917	$2,593,068	$2,356,714
Securities available-for-sale, at estimated fair value	100,717	81,581	20,775	29,902	19,804
Securities held-to-maturity, net	846,810	764,062	589,912	394,813	469,417
Equity investments, at estimated fair value	9,655	8,700	—	—	—
Restricted equity investments, at cost	56,784	19,724	19,313	19,978	19,170
Loans receivable, net	5,579,222	3,965,773	3,803,443	1,970,703	1,688,846
Deposits	5,814,569	4,342,798	4,187,750	1,916,678	1,720,135
Federal Home Loan Bank advances	449,383	288,691	250,498	324,385	305,238
Securities sold under agreements to repurchase and other borrowings	161,290	136,187	126,494	98,372	95,312
Stockholders’ equity	1,039,358	601,941	571,903	238,446	218,259

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands; except per share amounts)				
Selected Operating Data:					
Interest income	$276,654	$188,829	$133,425	$85,863	$79,853
Interest expense	36,152	19,611	13,163	9,034	7,505
Net interest income	240,502	169,218	120,262	76,829	72,348
Provision for loan losses	3,490	4,445	2,623	1,275	2,630
Net interest income after provision for loan losses	237,012	164,773	117,639	75,554	69,718
Other income	34,827	27,072	20,412	16,426	18,577
Operating expenses	156,275	112,022	86,182	58,897	57,764
Federal Home Loan Bank advance prepayment fee	—	—	136	—	—
Branch consolidation expense	3,151	6,205	—	—	—
Merger related expenses	26,911	8,293	16,534	1,878	—
Income before provision for income taxes	85,502	65,325	35,199	31,205	30,531
Provision for income taxes	13,570	22,855	12,153	10,883	10,611
Net income	$71,932	$42,470	$23,046	$20,322	$19,920
Basic earnings per share	$1.54	$1.32	$1.00	$1.22	$1.19
Diluted earnings per share	$1.51	$1.28	$0.98	$1.21	$1.19

(continued)

	At or For the Year Ended December 31,				
	2018	2017	2016	2015	2014
Selected Financial Ratios and Other Data (1):					
Performance Ratios:					
Return on average assets (2)	0.98 %	0.80 %	0.62 %	0.82 %	0.86 %
Return on average stockholders' equity(2)	7.31	7.20	6.08	8.92	9.18
Return on average tangible stockholders' equity(2)(3)	11.16	9.82	7.13	8.96	9.18
Stockholders' equity to total assets	13.83	11.11	11.07	9.19	9.26
Tangible stockholders' equity to tangible assets(3)	9.55	8.42	8.30	9.12	9.26
Net interest rate spread (4)	3.53	3.41	3.38	3.18	3.23
Net interest margin (5)	3.68	3.50	3.47	3.28	3.31
Average interest-earning assets to average interest-bearing liabilities	125.97	124.06	122.46	123.80	121.21
Operating expenses to average assets (2)	2.53	2.39	2.76	2.47	2.50
Efficiency ratio (2)(6)	67.68	64.46	73.11	65.17	63.53
Loan to deposit ratio	95.95	91.32	90.82	102.82	98.18
Asset Quality Ratios:					
Non-performing loans as a percent of total loans receivable (7)(8)	0.31	0.52	0.35	0.91	1.06
Non-performing assets as a percent of total assets (8)	0.25	0.54	0.45	1.05	0.97
Allowance for loan losses as a percent of total loans receivable (8)(9)	0.30	0.40	0.40	0.84	0.95
Allowance for loan losses as a percent of total non-performing loans (8)	95.19	75.35	111.92	91.51	89.13
Wealth Management:					
Assets under administration (000's)	$184,476	$233,185	$218,336	$229,039	$225,234
Per Share Data:					
Cash dividends per common share	$0.62	$0.60	$0.54	$0.52	$0.49
Stockholders' equity per common share at end of period	21.68	18.47	17.80	13.79	12.91
Tangible stockholders' equity per common share at end of period (3)	14.26	13.58	12.94	13.67	12.91
Number of full-service customer facilities:	59	46	61	27	23

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

(2) Performance ratios for 2018 include merger related expenses, branch consolidation expenses, and an income tax benefit related to Tax Reform of $28.2 million with an after tax cost of $22.2 million. Performance ratios for 2017 include merger related expenses, branch consolidation expenses, and additional income tax expense related to Tax Reform of $18.1 million with an after tax cost of $13.5 million. Performance ratios for 2016 include merger related expenses and the Federal Home Loan Bank advance prepayment fee totaling $16.7 million with an after tax cost of $11.9 million. Performance ratios for 2015 include merger related expenses of $1.9 million with an after tax cost of $1.3 million.

(3) Tangible stockholders' equity and tangible assets exclude intangible assets relating to goodwill and core deposit intangible.

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

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

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

(7) Total loans receivable includes loans receivable and loans held-for-sale.

Non-performing assets consist of non-performing loans and real estate acquired through foreclosure.

(8) Non-performing loans consist of all loans 90 days or more past due and other loans in the process of foreclosure. It is the Company's policy to cease accruing interest on all such loans and to reverse previously accrued interest.

(9) The loans acquired from Sun, Ocean Shore, Cape, and Colonial American were recorded at fair value. The net credit mark on these loans, not reflected in the allowance for loan losses, was $31.6 million, $17.5 million, $26.0 million, and $2.2 million at December 31, 2018, 2017, 2016, and 2015, respectively. There were no loans acquired and therefore no corresponding credit marks at December 31, 2014.

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

Overview

OceanFirst Financial Corp. has been the holding company for OceanFirst Bank since it acquired the stock of the Bank upon the Bank’s Conversion.

The Company conducts business primarily through its ownership of the Bank which, at December 31, 2018, operated its branch office and headquarters in Toms River, its administrative office located in Red Bank, 58 additional branch offices and three deposit production facilities located throughout central and southern New Jersey. The Bank also operates commercial loan production offices in New York City, the Philadelphia area and in Atlantic, Cape May, and Mercer Counties in New Jersey.

The Company’s results of operations are primarily dependent on net interest income, which is the difference between the interest income earned on the Company’s interest-earning assets, such as loans and investments, and the interest expense on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates non-interest income such as income from Bankcard services, wealth management, deposit account services, the sale of alternative investments, loan originations, loan sales, Bank Owned Life Insurance and other fees. The Company’s operating expenses primarily consist of compensation and employee benefits, occupancy and equipment, marketing, Federal deposit insurance, data processing, check card processing, professional fees and other general and administrative expenses. The Company’s results of operations are also significantly affected by competition, general economic conditions including levels of unemployment and real estate values as well as changes in market interest rates, government policies and actions of regulatory agencies.

Acquisitions

On May 2, 2016, the Company completed its acquisition of Cape Bancorp, Inc. (“Cape”), which added $1.5 billion to assets, $1.2 billion to loans, and $1.2 billion to deposits. Cape’s results of operations are included in the consolidated results for the years ended December 31, 2018 and 2017, but are only included in the results of operations for the period from May 2, 2016 to December 31, 2016.

On November 30, 2016, the Company completed its acquisition of Ocean Shore Holding Company (“Ocean Shore”), which added $991.3 million to assets, $773.3 million to loans, and $875.1 million to deposits. Ocean Shore’s results of operations are included in the consolidated results for the years ended December 31, 2018 and 2017, but are only included in the results of operations for the period from December 1, 2016 to December 31, 2016.

On January 31, 2018, the Company completed its acquisition of Sun Bancorp, Inc. (“Sun”) which added $2.0 billion to assets, $1.5 billion to loans, and $1.6 billion to deposits. Sun’s results of operations are included in the consolidated results for the period from February 1, 2018 to December 31, 2018.

On January 31, 2019, the Company completed its acquisition of Capital Bank of New Jersey (“Capital Bank”). Based on the $24.01 per share closing price of the Company’s common stock on January 31, 2019, the total transaction value was $76.8 million. The acquisition added $498 million to assets, $311 million to loans, and $449 million to deposits. Capital Bank’s results of operations are not included in any of the periods presented herein.

These acquisitions have provided the Company with the opportunity to grow business lines, expand geographic footprint and improve financial performance. Additionally, the transactions have enhanced the Bank’s position as the premier community banking franchise in central and southern New Jersey. The Company will continue to evaluate potential acquisition opportunities for those that are expected to create stockholder value.

Strategy

The Company operates as a full-service community bank delivering commercial and residential financing solutions, deposit services and wealth management throughout the central and southern New Jersey region. The Bank is the largest and oldest community-based financial institution headquartered in Ocean County, New Jersey. The Bank competes with larger, out-of-market financial service providers through its local focus and the delivery of superior service. The Bank also competes with smaller in-market financial service providers by offering a broad array of products and by having an ability to extend larger credits.

The Company’s strategy has been to grow profitability while limiting exposure to credit, interest rate and operational risks. To accomplish these objectives, the Bank has sought to (1) grow commercial loans receivable through the offering of commercial lending services to local businesses; (2) grow core deposits (defined as all deposits other than time deposits) through product offerings appealing to a broadened customer base; and (3) increase non-interest income by expanding the menu of fee-based products and services and investing additional resources in these product lines. The growth in these areas has occurred both organically and through acquisitions.

The Company will focus on prudent growth to create value for stockholders, which may include opportunistic acquisitions. The Company will also continue to build additional operational infrastructure and invest in key personnel in response to growth and changing business conditions. In 2018, the Company raised its minimum hourly pay rate for all employees to $15.00, increased the number of shares available in the employee stock ownership program by 292,592 shares, and supplemented other stock-based compensation.

Growing Commercial Loans

With industry consolidation eliminating most locally-headquartered competitors, the Company fills a void for locally-delivered commercial loan and deposit services. The Bank has added experienced commercial lenders throughout its market area and opened a loan production office in Mercer County in 2015 to better serve the central New Jersey market area. An additional loan production office in the Philadelphia area was acquired on May 2, 2016 as part of the Cape transaction. In addition, in the first half of 2019, the Bank plans to open a loan production office in Philadelphia and expand its existing New York City presence. At December 31, 2018, commercial loans represented 54.9% of the Bank's total loans, as compared to 37.5% at December 31, 2013. Commercial loan products entail a higher degree of credit risk than is involved in one-to-four family residential mortgage lending activity. As a consequence, management continues to employ a well-defined credit policy focusing on quality underwriting and close management and Board monitoring. See "Risk Factors – Increased emphasis on commercial lending may expose the Bank to increased lending risks."

Increasing Core Deposits

The Bank seeks to increase core deposit (all deposits excluding time deposits) market share in its primary market area by improving market penetration. Core account development has benefited from Bank efforts to attract business deposits in conjunction with its commercial lending operations and from an expanded mix of retail core account products. As a result of these efforts the Bank's core deposit ratio was 85.1% at December 31, 2018, and the loan to deposit ratio was 96.0%.

Enhancing Non-Interest Income

Management continues to diversify the Bank's product line and expand related resources in order to enhance non-interest income. The Bank is focused on growth opportunities in areas such as wealth management services and in Bankcard services, which includes interchange revenue, merchant services and ATM fees. The Bank also offers investment products for sale through its retail branch network. In late 2018, the Bank replaced its third party broker/dealer investment sales program with a hybrid robo-advisor product offered by the Bank's partner, Nest Egg, a registered investment adviser. Nest Egg is an investment platform that helps define and reach financial goals by providing access to high quality and cost-effective investments. It includes web-based tools as well as access to personal financial advisors via phone, chat, or video.

Branch Rationalization and Service Delivery

Management continues to evaluate the Bank's branch network for consolidation opportunities. The Bank anticipates at least seven branch consolidations in 2019, three of which are a result of the Capital Bank merger. This follows the consolidation of 17 and 15 branches in 2018 and 2017, respectively. In addition to branch consolidation, the Bank is adapting to the industry wide trend of declining branch activity by transitioning to a universal banker staffing model, with a smaller branch staff handling sales and service transactions, as well as increasing the marketing of products that feature digital and mobile service. In certain locations, routine transactions are handled through "Video Teller Machines," an advanced technology with live team members in a remote location performing transactions for multiple Video Teller Machines. The Bank is also investing in multiple digital services to enhance the customer experience and improve security. At December 31, 2018, all of the branch staff were trained as Certified Digital Bankers to better support customers use and adoption of digital services.

Capital Management

In addition to the objectives described above, the Company actively manages its capital position to improve return on equity. The Company has, over the past few years, implemented or announced, four stock repurchase programs. The most recent plan to repurchase up to 5% of outstanding common stock was announced on April 27, 2017 to repurchase an additional 1.6 million shares. For the year ended December 31, 2018, the Company repurchased 459,251 shares of its common stock under these repurchase programs. At December 31, 2018, 1.3 million shares remain available for repurchase.

Summary

Highlights of the Company's financial results for the year ended December 31, 2018 were as follows:

Total assets increased to $7.516 billion at December 31, 2018, from $5.416 billion at December 31, 2017. Loans receivable, net increased by $1.613 billion at December 31, 2018, as compared to December 31, 2017, while deposits increased $1.472 billion over the same period. The increases were primarily the result of the Sun acquisition.

Net income for the year ended December 31, 2018 was $71.9 million, or $1.51 per diluted share, as compared to net income of $42.5 million, or $1.28 per diluted share for the prior year. Net income for the year ended December 31, 2018 includes merger related expenses, branch consolidation expenses, and income tax benefit from the revaluation of deferred tax assets related to the Tax Cuts and Jobs Act ("Tax Reform"). These items decreased net income, net of tax, for the year ended December 31, 2018 by $22.2 million. Net income for the year ended December 31, 2017 included merger related expenses, branch consolidation expenses, and additional income tax expense related to Tax Reform of $13.5 million, net of tax. These items reduced diluted earnings per share by $0.47 and $0.42, respectively, for the years ended December 31, 2018 and 2017. Excluding these items, net income for the year ended December 31, 2018 increased over the prior year primarily due to the acquisition of Sun and the expense savings from the successful integration during 2017 of Ocean Shore which was acquired on November 30, 2016.

The Company remains well-capitalized with a tangible common equity ratio of 9.55% at December 31, 2018.

Critical Accounting Policies

Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2018 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 estimated fair value or the lower of cost or estimated fair value. Policies with respect to the methodology used to determine the allowance for loan losses are the most critical accounting policies because it is important to the presentation of the Company's financial condition and results of operations, involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material differences in the results of operations or financial condition. Critical accounting policies and their application are reviewed periodically and, at least annually, with the Audit Committee of the Board of Directors.

Allowance for Loan Losses

The allowance for loan losses is a valuation account that reflects probable incurred losses in the loan portfolio. The adequacy of the allowance for loan losses is based on management's evaluation of the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, current economic and regulatory conditions, as well as organizational changes. Additions to the allowance arise from charges to operations through the provision for loan losses or from the recovery of amounts previously charged-off. The allowance is reduced by loan charge-offs. The allowance for loan losses is maintained at an amount management considers sufficient to provide for probable losses.

Acquired loans are marked to fair value on the date of acquisition and are evaluated on a quarterly basis to ensure the necessary purchase accounting updates are made in parallel with the allowance for loan loss calculation. Acquired loans that have been renewed since acquisition are included in the allowance for loan loss calculation since these loans have been underwritten to the Bank's guidelines. Acquired loans that have not been renewed since acquisition, or that have a Purchase Credit Impaired ("PCI") mark, are excluded from the allowance for loan loss calculation. The Bank calculates a general valuation allowance for these excluded acquired loans without a PCI mark and compares that to the remaining general credit and interest rate marks. To the extent the remaining general credit and interest rate marks exceed the calculated general valuation allowance, no additional reserve is required. If the calculated general valuation allowance exceeds the remaining general credit and interest rate marks, the Bank would record an adjustment to the extent necessary.

The Bank's allowance for loan losses includes specific allowances and a general allowance, each updated on a quarterly basis. A specific allowance is determined for all impaired loans (excluding PCI loans). The Bank 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. For collateral dependent loans, the specific allowance represents the difference between the Bank's recorded investment in the loan, net of any interim charge-offs, and the estimated fair value of the collateral, less estimated selling costs. Impairment for all other impaired loans is calculated using the present value of the expected future cash flows.

If a loan becomes 90 days delinquent, the Bank obtains an updated collateral appraisal. For residential real estate loans, the appraisal is updated annually if the loan remains delinquent for an extended period. For non-accrual commercial real estate loans, the Bank assesses whether there has likely been an adverse change in the collateral value supporting the loan. The Bank utilizes information based on its knowledge of changes in real estate conditions in its lending area to identify whether a possible deterioration of collateral value has occurred. Based on the severity of the changes in market conditions, management determines if an updated commercial real estate appraisal is warranted or if downward adjustments to the previous appraisal are warranted. If it is determined that the deterioration of the collateral value is significant enough to warrant ordering a new appraisal, an estimate of the downward adjustments to the existing appraised value is used in assessing if additional specific reserves are necessary until the updated appraisal is received.

A general allowance is determined for all loans that are not individually evaluated for impairment (excluding acquired loans that have not been renewed under the Bank's underwriting criteria). In determining the level of the general allowance, the Bank segments the loan portfolio into the following portfolio segments: residential real estate; consumer; investor-owned commercial real estate; owner-occupied commercial real estate; and commercial and industrial.

The portfolio segments are further segmented by delinquency status or risk rating. An estimated loss factor is then applied to the outstanding principal loan balance of the delinquency status or risk rating category for each portfolio segment. To determine the loss factor, the Bank utilizes historical loss experience adjusted for certain qualitative factors and the loss emergence period.

The Bank's historical loss experience is based on a rolling 24-month look-back period for each portfolio segment. The look-back period was selected based on (1) management's judgment that this period captures sufficient loss events (in both dollar terms and number of individual events) to be relevant; and (2) that the Bank's underwriting criteria and risk characteristics have remained relatively stable throughout this period.

The historical loss experience is adjusted for certain qualitative factors including, but not limited to, (1) delinquency trends, (2) net charge-off trends, (3) nature and volume of the loan portfolio, (4) loan policies and underwriting standards, (5) experience and ability of lending personnel, (6) concentrations of credit, (7) loan review system, and external factors such as (8) changes in current economic conditions, (9) local competition and (10) regulation. Economic factors that the Bank considers in its estimate of the allowance for loan losses include: local and regional trends in economic growth, unemployment and real estate values. The Bank considers the applicability of each of these qualitative factors in estimating the general allowance for each portfolio segment. Each quarter, the Bank considers the current conditions for each of the qualitative factors, as well as a forward looking view on trends and events, to support an assessment unique to each portfolio segment.

The Bank calculates and analyzes the loss emergence period on an annual basis or more frequently if conditions warrant. The Bank's methodology is to use loss events in the past eight quarters to determine the loss emergence period for each loan segment. The loss emergence period is specific to each portfolio segment. It represents the amount of time that has elapsed between (1) the occurrence of a loss event, which resulted in a potential loss and (2) the confirmation of the potential loss, when the Bank records an initial charge-off or downgrades the risk-rating of the loan to substandard.

The Bank also maintains an unallocated portion of the allowance for loan losses. The primary purpose of the unallocated component is to account for the inherent factors that cannot be practically assigned to individual loss categories, including the periodic update of appraisals, subjectivity of the Bank's credit review and risk rating process, and economic conditions that may not be fully captured in the Bank's loss history or qualitative factors.

Upon completion of the aforementioned procedures, an overall management review is performed including ratio analyses to identify divergent trends compared with the Bank's own historical loss experience, the historical loss experience of the Bank's peer group, and management's understanding of general regulatory expectations. Based on that review, management may identify issues or factors that previously had not been considered in the estimation process, which may warrant further analysis or adjustments to estimated loss or qualitative factors applied in the calculation of the allowance for loan losses.

Of the Bank's loan portfolio, 92.4% is secured by real estate, whether residential or commercial. Additionally, most of the Bank's borrowers are located in central and southern 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 difficult economic conditions including increased unemployment or should the area be affected by a natural disaster such as a hurricane or flooding.

Management believes the primary risk characteristics for each portfolio segment are a decline in the general economy, including elevated levels of unemployment, a decline in real estate market values and rising interest rates. Any one or a combination of these events may adversely affect the borrowers' ability to repay the loans, resulting in increased delinquencies, loan charge-offs and higher provisions for loan losses.

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

Analysis of Net Interest Income

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

The following table sets forth certain information relating to the Company for each of the years ended December 31, 2018, 2017 and 2016. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown except where noted otherwise. Average balances are derived from average daily balances. The yields and costs include fees which are considered adjustments to yields.

	For the Year Ended December 31,								
	2018			2017			2016		
(dollars in thousands)	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Assets:									
Interest-earning assets:									
Interest-earning deposits and short-term investments	$102,001	$896	0.88%	$179,960	$1,449	0.81%	$154,830	$693	0.45%
Securities [1]	1,073,454	26,209	2.44	796,392	16,792	2.11	524,152	9,770	1.86
Loans receivable, net [2]									
Commercial	3,012,521	149,965	4.98	1,858,842	87,706	4.72	1,472,421	70,768	4.81
Residential	1,965,395	79,805	4.06	1,726,020	69,784	4.04	1,085,991	41,996	3.87
Home Equity	357,137	17,991	5.04	282,128	13,003	4.61	236,769	10,139	4.28
Other	35,424	1,788	5.05	1,156	95	8.22	957	59	6.17
Allowance for loan loss net of deferred loan fees	(9,972)	—	—	(12,251)	—	—	(13,280)	—	—
Loans receivable, net [2]	5,360,505	249,549	4.66	3,855,895	170,588	4.42	2,782,858	122,962	4.42
Total interest-earning assets	6,535,960	276,654	4.23	4,832,247	188,829	3.91	3,461,840	133,425	3.85
Non-interest-earning assets	828,518			459,926			269,622		
Total assets	$7,364,478			$5,292,173			$3,731,462		
Liabilities and Equity:									
Interest-bearing liabilities:									
Interest-bearing checking	$2,336,917	9,219	0.39%	$1,796,370	4,533	0.25%	$1,266,135	2,114	0.17%
Money market	571,997	2,818	0.49	410,373	1,213	0.30	316,977	858	0.27
Savings	877,179	990	0.11	672,315	345	0.05	447,484	191	0.04
Time deposits	858,978	9,551	1.11	625,847	6,245	1.00	422,026	4,354	1.03
Total	4,645,071	22,578	0.49	3,504,905	12,336	0.35	2,452,622	7,517	0.31
FHLB advances	382,464	7,885	2.06	258,870	4,486	1.73	266,981	4,471	1.67
	66,340	168	0.25	74,712	121	0.16	75,227	102	0.14

Securities sold under agreements to repurchase									
Other borrowings	94,644	5,521	5.83	56,457	2,668	4.73	32,029	1,073	3.35
Total interest-bearing liabilities	5,188,519	36,152	0.70	3,894,944	19,611	0.50	2,826,859	13,163	0.47
Non-interest-bearing deposits	1,135,602			776,344			497,166		
Non-interest-bearing liabilities	56,098			31,004			28,454		
Total liabilities	6,380,219			4,702,292			3,352,479		
Stockholders’ equity	984,259			589,881			378,983		
Total liabilities and equity	$7,364,478			$5,292,173			$3,731,462		
Net interest income		$240,502			$169,218			$120,262	
Net interest rate spread (3)			3.53%			3.41%			3.38%
Net interest margin (4)			3.68%			3.50%			3.47%
Total cost of deposits (including non-interest-bearing deposits)			0.39%			0.29%			0.25%
Ratio of interest-earning assets to interest-bearing liabilities	125.97 %			124.06 %			122.46 %		

(1) Amounts represent debt and equity securities, including FHLB and Federal Reserve Bank stock, and 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.

Rate Volume Analysis

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

	Year Ended December 31, 2018 Compared to Year Ended December 31, 2017 Increase (Decrease) Due to			Year Ended December 31, 2017 Compared to Year Ended December 31, 2016 Increase (Decrease) Due to		
(in thousands)	Volume	Rate	Net	Volume	Rate	Net
Interest-earning assets:						
Interest-earning deposits and short-term investments	$(671)	$118	$(553)	$128	$628	$756
Securities	6,496	2,921	9,417	5,578	1,444	7,022
Loans receivable, net						
Commercial	57,184	5,075	62,259	18,285	(1,347)	16,938
Residential	9,676	345	10,021	25,860	1,928	27,788
Home Equity	3,693	1,295	4,988	2,042	822	2,864
Other	1,744	(51)	1,693	14	22	36
Loans receivable, net	72,297	6,664	78,961	46,201	1,425	47,626
Total interest-earning assets	78,122	9,703				