OCEANFIRST FINANCIAL CORP
Form 10-K
March 13, 2015
Table of Contents

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, 2014

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

Commission file number: 001-11713

OceanFirst Financial Corp.

(Exact name of registrant as specified in its charter)

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

975 Hooper Avenue, Toms River, New Jersey 08753

(Address of principal executive offices)

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

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

Common Stock, par value $0.01 per share

(Title of class)

The Nasdaq 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 ¨ No x.

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

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

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

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

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

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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 $267,259,000 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 5, 2015 was 16,901,253.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2015 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days from December 31, 2014, are incorporated by reference into Part III of this Form 10-K.

Table of Contents

INDEX

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 (the Bank). At December 31, 2014, the Company had consolidated total assets of $2.4 billion and total stockholders equity of $218.3 million. The Company is a savings and loan holding company 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.

OceanFirst Financial Corp. has been the holding company for OceanFirst 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). 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 single-family, owner-occupied residential mortgage loans, and commercial real estate and other commercial loans which have become a key focus of the Bank. 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, wealth management services, Bankcard 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, investments and mortgage-backed securities, investment maturities, proceeds from the sale of loans, 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 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 , s view , opportunity , potential , or similar expressions or expressions of confidence. The Company s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and 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 and accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Table of Contents

Market Area and Competition

The Bank is a community-oriented financial institution, offering a wide variety of financial services to meet the needs of the communities it serves. The Bank conducts its business through an administrative/branch office located in Toms River, New Jersey, and twenty-two additional branch offices. Eighteen of the offices are located in Ocean County, New Jersey, four offices are in Monmouth County including a Financial Solutions Center in Red Bank also offering lending and wealth management services and one in Middlesex County. The Bank also operates a wealth management office in Manchester, New Jersey. A commercial loan production office was opened in Mercer County in the first quarter of 2015 to better serve the broader central New Jersey market area. Additionally, the Bank expects to open its second branch office in Jackson Township, Ocean County, in the second quarter of 2015. The Bank s deposit gathering and lending activities are concentrated in the markets surrounding its branch office network.

The Bank is the largest and oldest community-based financial institution headquartered in Ocean County, New Jersey, which is located along the central New Jersey shore. The economy in the Bank s primary market area is based upon a mixture of service and retail trade, some of which is based on tourism at the New Jersey shore. 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. In October 2012, the Bank s primary market area was adversely impacted by superstorm Sandy which caused substantial property damage, however, there has been recent evidence of significant rebuilding and improved economic activity as the area recovers.

The Bank s future growth opportunities will be partly influenced by the growth and stability of the local economy and the competitive environment. The Bank faces significant competition both in making loans and in attracting deposits. The State of 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 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.

Acquisition

On February 25, 2015, the Company announced an agreement to acquire Colonial American Bank (Colonial), headquartered in Middletown, New Jersey, in an all stock transaction valued at approximately $11.3 million. Under the terms of the agreement, each outstanding share of Colonial common stock and preferred stock will be exchanged for 0.3736 shares of the Company s common stock, subject to possible adjustment as provided for in the merger agreement. The transaction is expected to close before year-end 2015, subject to certain conditions, including the approval by Colonial s stockholders and customary regulatory approvals.

Colonial operates two full-service banking offices in Middletown and Shrewsbury, New Jersey with total assets of $144 million, including $127 million in total loans and $129 million in total deposits as of December 31, 2014. The combined institution will have $2.5 billion in assets, $1.8 billion in loans and $1.8 billion in deposits, with 25 offices serving the central New Jersey market. Management considers this in-market acquisition an attractive complement to the Red Bank Financial Solutions Center and strengthens the Bank s presence in Monmouth County.

Lending Activities

Loan Portfolio Composition. At December 31, 2014, the Bank had total loans outstanding of $1.723 billion, of which $742.1 million, or 43.1% of total loans were one-to-four family, residential mortgage loans. The remainder

Table of Contents

of the portfolio consisted of $650.0 million of commercial real estate, multi-family and land loans, or 37.7% of total loans; $47.6 million of residential construction loans, or 2.8% of total loans; $199.3 million of consumer loans, primarily home equity loans and lines of credit, or 11.6% of total loans; and, $83.9 million of commercial loans, or 4.9% of total loans. Included in total loans are $4.2 million in loans held-for-sale at December 31, 2014. At that same date, 37.9% of the Bank s total loans had adjustable interest rates. The Bank has generally sold much of its 30-year, fixed-rate, one-to-four family loans into the secondary market primarily to manage interest rate risk.

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

Table of Contents

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,									
	2014		2013		2012		2011		2010	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(dollars in thousands)									
Real estate:										
One-to-four family	$ 742,090	43.07%	$ 751,370	47.79%	$ 809,705	52.24%	$ 882,550	55.55%	$ 955,063	56.63%
Commercial real estate, multi-family and land	649,951	37.73	528,945	33.64	475,155	30.66	460,725	29.00	435,127	25.80
Residential construction	47,552	2.76	30,821	1.96	9,013	0.58	6,657	0.42	13,748	0.82
Consumer (1)	199,349	11.57	200,683	12.76	198,143	12.78	192,918	12.14	205,725	12.20
Commercial and industrial	83,946	4.87	60,545	3.85	57,967	3.74	45,889	2.89	76,692	4.55
Total loans	1,722,888	100.00%	1,572,364	100.00%	1,549,983	100.00%	1,588,739	100.00%	1,686,355	100.00%
Loans in process	(16,731)		(12,715)		(3,639)		(2,559)		(4,055)	
Deferred origination costs, net	3,207		3,526		4,112		4,366		4,862	
Allowance for loan losses	(16,317)		(20,930)		(20,510)		(18,230)		(19,700)	
Total loans, net	1,693,047		1,542,245		1,529,946		1,572,316		1,667,462	
Less:										
Mortgage loans held-for-sale	4,201		785		6,746		9,297		6,674	
Loans receivable, net	$ 1,688,846		$ 1,541,460		$ 1,523,200		$ 1,563,019		$ 1,660,788	
Total loans:										
Adjustable rate	$ 651,566	37.82%	$ 602,976	38.35%	$ 635,264	40.99%	$ 692,332	43.58%	$ 816,058	48.39%
Fixed rate	1,071,322	62.18	969,388	61.65	914,719	59.01	896,407	56.42	870,297	51.61
	$ 1,722,888	100.00%	$ 1,572,364	100.00%	$ 1,549,983	100.00%	$ 1,588,739	100.00%	$ 1,686,355	100.00%

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

Table of Contents

Loan Maturity. The following table shows the contractual maturity of the Bank s total loans at December 31, 2014. The table does not include principal prepayments.

	At December 31, 2014					
	One-to-four family	Commercial real estate, multi-family and land	Residential construction (1)	Consumer	Commercial and industrial	Total Loans Receivable
	(in thousands)					
One year or less	$ 488	$ 125,898	$ 555	$ 1,076	$ 22,747	$ 150,764
After one year:						
More than one year to three years	4,375	124,486		3,789	32,622	165,272
More than three years to five years	16,117	209,434		6,839	28,412	260,802
More than five years to ten years	26,692	182,220	130	37,272	165	246,479
More than ten years to twenty years	200,917	7,913	3,972	149,973		362,775
More than twenty years	493,501		42,895	400		536,796
Total due after December 31, 2015	741,602	524,053	46,997	198,273	61,199	1,572,124
Total amount due	$ 742,090	$ 649,951	$ 47,552	$ 199,349	$ 83,946	1,722,888
Loans in process						(16,731)
Deferred origination costs, net						3,207
Allowance for loan losses						(16,317)
Total loans, net						1,693,047
Less: Mortgage loans held-for-sale						4,201
Loans receivable, net						$ 1,688,846

(1) Residential construction loans are primarily originated on a construction/permanent basis with such loans converting to an amortizing loan following the completion of the construction phase.

The following table sets forth at December 31, 2014, the dollar amount of total loans receivable contractually due after December 31, 2015, and whether such loans have fixed interest rates or adjustable interest rates.

	Due After December 31, 2015		
	Fixed	Adjustable	Total
	(in thousands)		
Real estate loans:			
One-to-four family	$ 397,455	$ 344,147	$ 741,602
Commercial real estate, multi-family and land	418,194	105,859	524,053
Residential construction	31,681	15,316	46,997
Consumer	109,206	89,067	198,273
Commercial and industrial	33,488	27,711	61,199

Total loans receivable	$ 990,024	$ 582,100	$ 1,572,124

Table of Contents

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 December 31, 2014	2013 (in thousands)	2012
Total loans:			
Beginning balance	$ 1,572,364	$ 1,549,983	$ 1,588,739
Loans originated:			
One-to-four family	159,078	225,596	308,792
Commercial real estate, multi-family and land	184,226	124,293	80,106
Residential construction	39,735	23,452	6,511
Consumer	76,354	85,994	92,633
Commercial and industrial	189,571	124,852	120,248
Total loans originated	648,964	584,187	608,290
Loans purchased	20,363		
Total	2,241,691	2,134,170	2,197,029
Less:			
Principal repayments	444,369	448,379	461,613
Sales of loans	62,318	106,550	174,299
Charge-offs (gross)	7,827	3,521	7,084
Transfer to other real estate owned	4,289	3,356	4,050
Total loans	$ 1,722,888	$ 1,572,364	$ 1,549,983

One-to-four family mortgage loan origination volume declined in 2014 as a less than favorable interest rate environment reduced the volume of loan refinancing. This same trend caused loan sales to also decline as the Bank typically sells longer-term, fixed-rate, one-to-four family mortgage loans. Beginning in mid-2013 through the end of 2014, the Bank supplemented its commercial lending team with additional experienced bankers and successfully grew commercial real estate and commercial and industrial loans. Residential construction origination volume increased as the Bank focused on meeting the needs of borrowers rebuilding after superstorm Sandy.

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 their contacts within the local real estate industry, members of the local communities and the Bank s existing or past customers. On occasion the Bank has opportunistically purchased loans originated by other banks.

At December 31, 2014, the Bank s total loans outstanding were $1.723 billion, of which $742.1 million, or 43.1%, 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 $192,000 at December 31, 2014.

The Bank currently offers a number of 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 risks inherent in fixed-rate loans, primarily because as interest rates rise, the payments to 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 which provide for negative amortization. The Bank previously offered interest-only ARM loans on a limited basis, in which the borrower made only interest payments for the first five, seven or ten years of the mortgage loan term and then converted to a fully-amortizing loan until maturity. The interest-only feature resulted in future increases in the borrower s loan payment when the contractually required payments increased due to the required amortization of the principal amount. These payment increases may affect the borrower s ability to repay the loan, and as such, the borrowers were qualified at the fully-amortized payment. The amount of interest-only one-to-four family mortgage loans at December 31, 2014 and 2013 was $17.6 million and $28.8 million, respectively, or 2.4% and 3.8%, respectively, of total one-to-four family mortgages.

The Bank s fixed-rate mortgage loans are currently made for terms from 10 to 30 years. The Bank periodically sells some of the fixed-rate residential mortgage loans that it originates in order to manage interest rate risk. 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 for its portfolio shorter-term, fixed-rate loans and certain longer-term, fixed-rate loans, generally consisting of loans with balances exceeding the conforming loan limits of the government agencies (Jumbo loans) and loans to officers, directors or employees of the Bank. The Bank may retain a portion of its longer-term fixed-rate loans after considering volume and yield and after evaluating interest rate risk and capital management considerations. The retention of fixed-rate mortgage loans may increase the level of interest rate risk exposure of the Bank, as the rates on these loans will not adjust during periods of rising interest rates and the loans can be subject to substantial increases in prepayments during periods of falling interest rates. During the past several years, the Bank has generally sold most of its 30-year, fixed-rate, one-to-four family loans into the secondary market primarily to manage interest rate risk.

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 55.7% at December 31, 2014 based on appraisal values at the time of origination. Title insurance is typically required for first mortgage loans. Mortgage loans originated by the Bank include due-on-sale clauses which provide the Bank with the contractual right to declare the loan immediately due and payable in the event the borrower transfers ownership of the property without the Bank s consent. Due-on-sale clauses are an important means of adjusting the rates on the Bank s fixed-rate mortgage loan portfolio and the Bank has generally exercised its rights under these clauses.

The Bank currently brokers reverse mortgage loans for a third-party originator. Prior to 2013, the Bank closed these loans in its name; however, they were all sold into the secondary market. The loans qualify under the Home Equity Conversion Mortgage program of the Federal Housing Administration and are insured by the Department of Housing and Urban Development. For the year ended December 31, 2014, the Bank recognized fee income on reverse mortgage loans of $493,000, as compared to $714,000 for the year ended December 31, 2013.

Table of Contents

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 effective January 10, 2014. See Risk Factors The Dodd-Frank Act imposes new obligations on originators of residential mortgage loans, such as the Bank .

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 the Bank s primary market area. The Bank s underwriting procedures provide that commercial real estate loans may be made in amounts up to 80% of the appraised value of the property. The Bank currently originates commercial real estate loans with terms of up to ten years and amortization schedules up to thirty years with fixed or adjustable rates. The 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. The Bank has generally required that the properties securing commercial real estate loans have debt service coverage ratios of at least 130%. The Bank generally requires the personal guarantee of the principal borrowers for commercial real estate loans.

The Bank s commercial real estate loan portfolio at December 31, 2014 was $650.0 million, or 37.7% of total loans, as compared to $528.9 million, or 33.6%, of total loans, at December 31, 2013. The Bank successfully grew this market segment primarily through the addition of experienced commercial lenders beginning in mid-2013. The Bank added a new lending team in late 2014 which is located in Mercer County, New Jersey. Of the total commercial real estate portfolio, 45% is considered owner-occupied, whereby the underlying business owner occupies a majority of the property. The largest commercial real estate loan in the Bank s portfolio at December 31, 2014 was a performing loan for which the Bank had an outstanding carrying balance of $15.5 million secured by a first mortgage on a multi-purpose medical office facility. The average size of the Bank s commercial real estate loans at December 31, 2014 was approximately $871,000.

The commercial real estate portfolio includes loans for the construction of commercial properties. Typically, these loans are underwritten based upon commercial leases in place prior to funding. In many cases, commercial construction loans are extended to owners that intend to occupy the property for business operations, in which case the loan is based upon the financial capacity of the related business and the owner of the business. At December 31, 2014, the Bank had an outstanding balance in commercial construction loans of $46.4 million, as compared to $23.7 million at December 31, 2013.

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, 2014 totaled $24.4 million and $8.6 million, respectively, as compared to $11.8 million and $6.2 million, respectively, at December 31, 2013.

Residential Construction Lending. At December 31, 2014, residential construction loans totaled $47.6 million, or 2.8%, of the Bank s total loans outstanding, an increase from $30.8 million, or 2.0% of the Bank s total loans outstanding at December 31, 2013. The increase was due in large part to the additional loan demand from borrowers rebuilding after superstorm Sandy.

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, 2014, the Bank s consumer loans totaled $199.3 million, or 11.6% of the Bank s total loan portfolio. Of the total consumer loan portfolio, home equity loans comprised $109.2 million, or 54.8%; home equity lines of credit comprised $89.6 million, or 44.9%; overdraft line of credit loans totaled $387,000 or 0.2%; and loans on savings accounts totaled $243,000, or 0.1%.

The Bank originates home equity loans typically secured by first or second liens on one-to-two family residences. These loans are originated as fixed-rate loans with terms ranging from 5 to 20 years. Home equity loans are typically made on owner-occupied, one-to-two family residences. Generally, these loans are subject to an 80% loan-to-value limitation, including any other outstanding mortgages or liens. The Bank also offers a variable-rate home equity line of credit which extends a credit line based on the applicant s income, the ability to repay and equity in the home. Home equity lines of credit are secured by a mortgage on the underlying real estate. Generally, the credit line, 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. The Bank also offers home equity lines of credit which require the payment of interest-only during the first five years with fully-amortizing payments thereafter. Generally, the adjustable rate of interest charged is based upon the prime rate of interest (as published in the *Wall Street Journal*), although the range of interest rates charged may vary from 1.0% below prime to 1.5% over prime. The loans have an 18% lifetime cap on interest rate adjustments.

Commercial and Industrial Lending. At December 31, 2014, commercial and industrial loans totaled $83.9 million, or 4.9% 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 requires the personal guarantee of the principal borrowers for all commercial and industrial loans.

A well-defined credit policy has been approved by the Bank s Board of Directors (the Board). This policy discourages high risk credits, while focusing on quality underwriting, sound financial strength and close monitoring. Commercial and industrial business lending, both secured and unsecured, is generally considered to involve a higher degree of risk than secured real estate lending. 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. The Bank s largest commercial and industrial loan at December 31, 2014 was a performing loan to a Monmouth County based publicly-traded company of manufactured housing communities of $10.0 million secured by pledges and assignments of notes receivables. The average size of the Bank s commercial and industrial loans at December 31, 2014 was approximately $307,000.

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 various officers of the Bank or a Management Credit Committee, on a scale which requires approval by personnel with progressively higher levels of responsibility as the loan amount increases. Pursuant to applicable regulations, loans to one borrower generally cannot exceed 15% of the Bank s unimpaired capital, which at December 31, 2014 amounted to $33.5 million. At December 31, 2014, the Bank s maximum loan exposure to a single borrower and related interests was $19.0 million. All of the loans are performing and most of the exposure is secured by a first mortgage on a multi-purpose medical office facility.

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

Table of Contents

loans for others. On October 31, 2014, the Bank sold the servicing rights on residential mortgage loans serviced for Federal agencies, recognizing a net gain of $408,000. All of the remaining loans currently being serviced for others are loans which were originated by the Bank. At December 31, 2014, the Bank was servicing $197.8 million of loans for others. At December 31, 2014, 2013 and 2012, the balance of the Bank s Mortgage Servicing Rights (MSR) totaled $701,000, $4.2 million and $4.6 million, respectively. For the years ended December 31, 2014, 2013 and 2012, loan servicing income totaled $816,000, $748,000 and $538,000, respectively. The Bank evaluates the MSR for impairment on a quarterly basis. No impairment was recognized for the years ended December 31, 2014, 2013 and 2012. The valuation of MSR is determined through a discounted analysis of future cash flows, incorporating numerous assumptions which are subject to significant change in the near term. Generally, a decline in market interest rates will cause expected prepayment speeds to increase resulting in a lower valuation for mortgage servicing rights and ultimately lower future servicing fee income.

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 commence litigation to realize on the collateral, including foreclosure proceedings against any real property that secures the loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or an acceptable workout accommodation is not agreed upon before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. Foreclosure timelines in New Jersey are among the longest in the nation and have remained protracted over the past several years. The Bank offers various modification programs to assist borrowers with financial hardships.

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. At December 31, 2014, the Bank had $34.9 million of assets, including all other real estate owned (OREO), classified as Substandard , no assets classified as Doubtful and no assets classified as Loss . A December 31, 2013, the Bank had $66.2 million of assets classified as Substandard , $859,000 classified as Doubtful and no assets classified 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 $19.0 million at December 31, 2014, as compared to $5.8 million at December 31, 2013. The increase in Special Mention is related to three commercial loans that were downgraded from Pass and two loans that were upgraded from Substandard. 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, including all classified and Special Mention loans, and provide management with objective analysis regarding the quality of these loans throughout the year. The independent firm reviewed more than 70% of the Company s commercial real estate and commercial and industrial loans during 2014. Their conclusion was that the Bank s internal credit reviews are consistent with both Bank policy and general industry practice.

The largest Substandard loan relationship consists of two commercial real estate loans to a hotel, golf and banquet facility with an outstanding balance of $6.5 million, criticized due to delinquent payments, continual losses and covenant violations. The borrower has filed Chapter XI bankruptcy. The largest Special Mention loan

is a $4.5 million commercial real estate loan to a single borrower operating several fitness/health club facilities that is current as to payments. The borrower filed for Chapter XI bankruptcy relating to another bank s legal proceeding on an unrelated property.

Non-Accrual Loans and OREO. The following table sets forth information regarding non-accrual loans and OREO. 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, 2014, 2013 and 2012, respectively, the amount of interest income that would have been recognized on non-accrual loans if such loans had continued to perform in accordance with their contractual terms was $1,630,000, $2,513,000 and $2,370,000, respectively.

	December 31,				
	2014	2013	2012	2011	2010
	(dollars in thousands)				
Non-accrual loans:					
Real estate:					
One-to-four family	$ 3,115	$ 28,213	$ 26,521	$ 29,236	$ 26,945
Commercial real estate, multi-family and land	12,758	12,304	11,567	10,552	5,849
Consumer	1,877	4,328	4,540	3,653	4,626
Commercial and industrial	557	515	746	567	117
Total	18,307	45,360	43,374	44,008	37,537
OREO	4,664	4,345	3,210	1,970	2,295
Total non-performing assets	$ 22,971	$ 49,705	$ 46,584	$ 45,978	$ 39,832
Allowance for loan losses as a percent of total loans receivable (1)	0.95%	1.33%	1.32%	1.15%	1.17%
Allowance for loan losses as a percent of total non-performing loans (2)	89.13	46.14	47.29	41.42	52.48
Non-performing loans as a percent of total loans receivable (1)(2)	1.06	2.88	2.80	2.77	2.23
Non-performing assets as a percent of total assets(2)	0.97	2.21	2.05	2.00	1.77

(1) Total loans includes loans receivable and mortgage loans held-for-sale.
(2) Non-performing assets consist of non-performing loans and OR