

OCEANFIRST FINANCIAL CORP
Form 10-Q
November 08, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2006

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

Commission file number 0-27428

OceanFirst Financial Corp.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

22-3412577
(I.R.S. Employer Identification No.)

975 Hooper Avenue, Toms River, NJ
(Address of principal executive offices)

08754-2009
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

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YES NO .

As of November 3, 2006, there were 12,355,401 shares of the Registrant's Common Stock, par value \$.01 per share, outstanding.

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OceanFirst Financial Corp.

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Table of Contents**OceanFirst Financial Corp.****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

(dollars in thousands, except per share amounts)

| | September 30, 2006 (Unaudited) | December 31, 2005 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$ 36,967 | \$ 31,108 |
| Investment securities available for sale | 82,050 | 83,861 |
| Federal Home Loan Bank of New York stock, at cost | 24,634 | 21,792 |
| Mortgage-backed securities available for sale | 71,692 | 85,025 |
| Loans receivable, net | 1,714,760 | 1,654,544 |
| Mortgage loans held for sale | 62,206 | 32,044 |
| Interest and dividends receivable | 8,366 | 7,089 |
| Real estate owned, net | 288 | 278 |
| Premises and equipment, net | 17,722 | 16,118 |
| Servicing asset | 9,565 | 9,730 |
| Bank Owned Life Insurance | 36,842 | 36,002 |
| Intangible Assets | 1,195 | 1,272 |
| Other assets | 6,877 | 6,494 |
| Total assets | \$ 2,073,164 | \$ 1,985,357 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Deposits | \$ 1,371,738 | \$ 1,356,568 |
| Securities sold under agreements to repurchase with retail customers | 55,050 | 54,289 |
| Securities sold under agreements to repurchase with the Federal Home Loan Bank | 34,000 | 59,000 |
| Federal Home Loan Bank advances | 428,200 | 354,900 |
| Other borrowings | 17,500 | 5,000 |
| Advances by borrowers for taxes and insurance | 8,788 | 7,699 |
| Other liabilities | 20,878 | 9,117 |
| Total liabilities | 1,936,154 | 1,846,573 |
| Stockholders equity: | | |
| Preferred stock, \$.01 par value, 5,000,000 shares authorized, no shares issued | | |
| Common stock, \$.01 par value, 55,000,000 shares authorized, 27,177,372 shares issued and 12,349,245 and 12,698,505 shares outstanding at September 30, 2006 and December 31, 2005, respectively | 272 | 272 |
| Additional paid-in capital | 201,319 | 197,621 |
| Retained earnings | 168,069 | 164,613 |
| Accumulated other comprehensive loss | (869) | (1,223) |
| Less: Unallocated common stock held by Employee Stock Ownership Plan | (6,645) | (7,472) |
| Treasury stock, 14,828,127 and 14,478,867, shares at September 30, 2006 and December 31, 2005, respectively | (225,136) | (215,027) |
| Common stock acquired by Deferred Compensation Plan | 1,517 | 1,383 |
| Deferred Compensation Plan Liability | (1,517) | (1,383) |
| Total stockholders equity | 137,010 | 138,784 |
| Total liabilities and stockholders equity | \$ 2,073,164 | \$ 1,985,357 |

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See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**OceanFirst Financial Corp.****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

| | For the three months ended September 30, 2006 | | For the nine months ended September 30, 2005 | |
|--|---|-----------------|--|------------------|
| | (Unaudited) | | (Unaudited) | |
| Interest income: | | | | |
| Loans | \$ 27,825 | \$ 24,222 | \$ 79,051 | \$ 68,752 |
| Mortgage-backed securities | 812 | 897 | 2,518 | 2,959 |
| Investment securities and other | 1,679 | 1,209 | 5,102 | 3,799 |
| Total interest income | 30,316 | 26,328 | 86,671 | 75,510 |
| Interest expense: | | | | |
| Deposits | 8,939 | 6,056 | 24,040 | 16,074 |
| Borrowed funds | 6,918 | 4,862 | 18,343 | 13,921 |
| Total interest expense | 15,857 | 10,918 | 42,383 | 29,995 |
| Net interest income | 14,459 | 15,410 | 44,288 | 45,515 |
| Provision for loan losses | 50 | 100 | 100 | 350 |
| Net interest income after provision for loan losses | 14,409 | 15,310 | 44,188 | 45,165 |
| Other income: | | | | |
| Loan servicing income | 136 | 47 | 408 | 148 |
| Fees and service charges | 2,677 | 2,406 | 7,854 | 6,976 |
| Net gain on sales of loans and securities available for sale | 3,515 | 3,535 | 8,474 | 10,079 |
| Net loss from other real estate operations | (60) | | (60) | |
| Income from Bank Owned Life Insurance | 291 | 321 | 840 | 856 |
| Other | 44 | 5 | 55 | 47 |
| Total other income | 6,603 | 6,314 | 17,571 | 18,106 |
| Operating expenses: | | | | |
| Compensation and employee benefits | 7,497 | 8,206 | 22,752 | 23,219 |
| Occupancy | 1,244 | 1,109 | 3,564 | 3,284 |
| Equipment | 767 | 659 | 1,975 | 1,934 |
| Marketing | 531 | 750 | 1,230 | 2,213 |
| Federal deposit insurance | 133 | 126 | 400 | 379 |
| Data processing | 859 | 857 | 2,569 | 2,413 |
| General and administrative | 2,483 | 2,485 | 7,735 | 7,276 |
| Total operating expenses | 13,514 | 14,192 | 40,225 | 40,718 |
| Income before provision for income taxes | 7,498 | 7,432 | 21,534 | 22,553 |
| Provision for income taxes | 2,592 | 2,602 | 7,461 | 7,902 |
| Net income | \$ 4,906 | \$ 4,830 | \$ 14,073 | \$ 14,651 |

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| | | | | |
|------------------------------------|---------|---------|---------|---------|
| Basic earnings per share | \$ 0.43 | \$ 0.41 | \$ 1.22 | \$ 1.24 |
| Diluted earnings per share | \$ 0.42 | \$ 0.40 | \$ 1.18 | \$ 1.20 |
| Average basic shares outstanding | 11,465 | 11,793 | 11,567 | 11,859 |
| Average diluted shares outstanding | 11,689 | 12,184 | 11,880 | 12,251 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**OceanFirst Financial Corp.****Consolidated Statements of****Changes in Stockholders Equity (Unaudited)**

(in thousands, except per share amounts)

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Employee Stock Ownership Plan | Treasury Stock | Common Stock Acquired by Deferred Compensation Plan | Deferred Compensation Plan Liability | Total |
|--|-----------------|----------------------------------|----------------------|---|--|-------------------|--|---|------------|
| Balance at December 31, 2004 | \$ 272 | \$ 193,723 | \$ 157,575 | \$ (667) | \$ (8,652) | \$ (204,295) | \$ 986 | \$ (986) | \$ 137,956 |
| Comprehensive income: | | | | | | | | | |
| Net income | | | 14,651 | | | | | | 14,651 |
| Other comprehensive income: | | | | | | | | | |
| Unrealized loss on securities (net of tax benefit \$405) | | | | (589) | | | | | (589) |
| Total comprehensive income | | | | | | | | | 14,062 |
| Stock award | | 103 | | | | | | | 103 |
| Tax benefit of stock plans | | 1,561 | | | | | | | 1,561 |
| Purchase 611,566 shares of common stock | | | | | | (14,096) | | | (14,096) |
| Allocation of ESOP stock | | | | | 886 | | | | 886 |
| ESOP adjustment | | 1,537 | | | | | | | 1,537 |
| Cash dividend - \$.60 per share | | | (7,120) | | | | | | (7,120) |
| Exercise of stock options | | | (2,656) | | | 4,303 | | | 1,647 |
| Purchase of stock for the deferred compensation plan | | | | | | | 379 | (379) | |
| Balance at September 30, 2005 | \$ 272 | \$ 196,924 | \$ 162,450 | \$ (1,256) | \$ (7,766) | \$ (214,088) | \$ 1,365 | \$ (1,365) | \$ 136,536 |
| Balance at December 31, 2005 | \$ 272 | \$ 197,621 | \$ 164,613 | \$ (1,223) | \$ (7,472) | \$ (215,027) | \$ 1,383 | \$ (1,383) | \$ 138,784 |

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| | | | | | | | | | | | | | | | | | | |
|--|----|-----|----|---------|----|---------|----|-------|----------|----------|----|-----------|----|-------|----|---------|----|---------|
| Comprehensive income: | | | | | | | | | | | | | | | | | | |
| Net income | | | | | | 14,073 | | | | 14,073 | | | | | | | | |
| Other comprehensive income: | | | | | | | | | | | | | | | | | | |
| Unrealized gain on securities (net of tax expense \$244) | | | | | | 354 | | | | 354 | | | | | | | | |
| Total comprehensive income | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | 14,427 | | | | | | | | |
| Stock award | | | | | | 278 | | | | 278 | | | | | | | | |
| Tax benefit of stock plans | | | | | | 2,035 | | | | 2,035 | | | | | | | | |
| Purchase 669,604 shares of common stock | | | | | | | | | (15,288) | (15,288) | | | | | | | | |
| Allocation of ESOP stock | | | | | | | | | 827 | 827 | | | | | | | | |
| ESOP adjustment | | | | | | 1,385 | | | | 1,385 | | | | | | | | |
| Cash dividend - \$.60 per share | | | | | | (6,897) | | | | (6,897) | | | | | | | | |
| Exercise of stock options | | | | | | (3,720) | | | 5,179 | 1,459 | | | | | | | | |
| Purchase of stock for the deferred compensation plan | | | | | | | | | 134 | (134) | | | | | | | | |
| Balance at | | | | | | | | | | | | | | | | | | |
| September 30, 2006 | \$ | 272 | \$ | 201,319 | \$ | 168,069 | \$ | (869) | \$ | (6,645) | \$ | (225,136) | \$ | 1,517 | \$ | (1,517) | \$ | 137,010 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**OceanFirst Financial Corp.****Consolidated Statements of Cash Flows**

(dollars in thousands)

| | For the nine months | |
|--|----------------------------|------------------|
| | ended September 30, | |
| | 2006 | 2005 |
| | (Unaudited) | |
| Cash flows from operating activities: | | |
| Net income | \$ 14,073 | \$ 14,651 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization of premises and equipment | 1,531 | 1,534 |
| Amortization of ESOP | 827 | 886 |
| ESOP adjustment | 1,385 | 1,537 |
| Tax benefit of stock plans | | 1,561 |
| Stock award | 278 | 103 |
| Amortization of servicing asset | 1,509 | 1,719 |
| Amortization of intangible assets | 77 | 78 |
| Net premium amortization in excess of discount accretion on securities | 194 | 655 |
| Net amortization of deferred costs and discounts on loans | 506 | 312 |
| Provision for loan losses | 100 | 350 |
| Net loss on sale of real estate owned | 99 | |
| Net gain on sale of fixed assets | | (28) |
| Net gain on sales of loans and securities | (8,474) | (10,079) |
| Proceeds from sales of mortgage loans held for sale | 514,441 | 549,413 |
| Mortgage loans originated for sale | (537,480) | (544,213) |
| Increase in value of Bank Owned Life Insurance | (840) | (856) |
| Increase in interest and dividends receivable | (1,277) | (1,327) |
| Increase in other assets | (627) | (304) |
| Increase (decrease) in other liabilities | 11,761 | (23,064) |
| Total adjustments | (15,990) | (21,723) |
| Net cash used in operating activities | (1,917) | (7,072) |
| Cash flows from investing activities: | | |
| Net increase in loans receivable | (60,892) | (146,059) |
| Proceeds from sale of investment securities available for sale | 437 | |
| Proceeds from sale of mortgage-backed securities available for sale | 6,241 | |
| Purchase of investment securities available for sale | (748) | (4,427) |
| Purchase of mortgage-backed securities available for sale | (6,439) | |
| Proceeds from maturities of investment securities available for sale | 2,584 | 3,670 |
| Principal payments on mortgage-backed securities available for sale | 13,480 | 30,468 |
| (Increase) decrease in Federal Home Loan Bank of New York stock | (2,842) | 1,800 |
| Net (disbursements) proceeds from acquisition and sale of real estate owned | (39) | 10 |
| Proceeds from sale of fixed assets | | 49 |
| Purchases of premises and equipment | (3,135) | (1,039) |
| Net cash used in investing activities | (51,353) | (115,528) |

Table of Contents**OceanFirst Financial Corp.****Consolidated Statements of Cash Flows (Continued)**

(dollars in thousands)

| | For the nine months | |
|--|----------------------------|------------------|
| | ended September 30, | |
| | 2006 | 2005 |
| | (Unaudited) | |
| Cash flows from financing activities: | | |
| Increase in deposits | \$ 15,170 | \$ 98,879 |
| (Decrease) increase in short-term borrowings | (3,939) | 47,655 |
| Repayments from securities sold under agreements to repurchase with the Federal Home Loan Bank | (10,000) | (11,000) |
| Proceeds from Federal Home Loan Bank advances | 190,000 | 34,000 |
| Repayments of Federal Home Loan Bank advances | (127,000) | (77,000) |
| Proceeds from other borrowings | 12,500 | 5,000 |
| Increase in advances by borrowers for taxes and insurance | 1,089 | 2,228 |
| Exercise of stock options | 1,459 | 1,647 |
| Dividends paid | (6,897) | (7,120) |
| Purchase of treasury stock | (15,288) | (14,096) |
| Tax benefit of stock plans | 2,035 | |
| Net cash provided by financing activities | 59,129 | 80,193 |
| Net increase (decrease) in cash and due from banks | 5,859 | (42,407) |
| Cash and due from banks at beginning of period | 31,108 | 74,021 |
| Cash and due from banks at end of period | \$ 36,967 | \$ 31,614 |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash paid during the period for: | | |
| Interest | \$ 41,689 | \$ 30,524 |
| Income taxes | 3,947 | 17,019 |
| Non cash activities: | | |
| Transfer of securities sold under agreements to repurchase to advances | 15,000 | 36,000 |
| Transfer of loans receivable to real estate owned | 70 | |

See accompanying Notes to Unaudited Consolidated Financial Statements.

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OceanFirst Financial Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements include the accounts of OceanFirst Financial Corp. (the Company) and its wholly-owned subsidiary, OceanFirst Bank (the Bank) and its wholly-owned subsidiaries, Columbia Home Loans, LLC, OceanFirst REIT Holdings, Inc. and OceanFirst Services, LLC.

The interim consolidated financial statements reflect all normal and recurring adjustments which are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results of operations that may be expected for all of 2006.

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

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report to Stockholders on Form 10-K for the year ended December 31, 2005.

Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method under Accounting Principles Board Opinion No. 25 and accordingly recognized no compensation expense for stock option grants under this method. Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement No. 123 (revised 2004) which requires an entity to recognize the grant-date fair value of stock options and other stock-based compensation issued to employees in the income statement. The modified prospective transition method was adopted and, as a result, the income statement includes \$60,000 and \$146,000 of expense for stock option grants for the three and nine months ended September 30, 2006, respectively. Prior periods have not been restated. At September 30, 2006 the Company had \$1.1 million in compensation cost related to non-vested awards not yet recognized. This cost will be recognized over the remaining vesting period of 4.4 years.

As a result of adopting Statement 123(R) on January 1, 2006, the Company's income before income taxes and net income for the three months ended September 30, 2006 are \$60,000 and \$39,000 lower, respectively, and the Company's income before taxes and net income for the nine months ended September 30, 2006 are \$146,000 and \$95,000 lower, respectively, than if it had continued to account for stock-based compensation under Opinion No. 25. Basic and diluted earnings per share for the three months ended September 30, 2006 would have remained unchanged if the Company had not adopted Statement 123(R). For the nine months ended September 30, 2006 basic earnings per share would have remained unchanged and diluted earnings per share would have increased to \$1.19 if the Company had not adopted Statement 123(R).

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The fair value of stock options granted by the Company was estimated through the use of the Black-Scholes option pricing model applying the following assumptions. There were no stock option grants for the three months ended September 30, 2006 and September 30, 2005.

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Risk-free interest rate | N/A | N/A | 4.71% | 3.94% |
| Expected option life | N/A | N/A | 7 years | 6 years |
| Expected volatility | N/A | N/A | 22% | 22% |
| Expected dividend yield | N/A | N/A | 3.49% | 3.40% |
| Weighted average fair value of an option share granted during the period | N/A | N/A | \$ 4.81 | \$ 4.05 |
| Intrinsic value of options exercised during the period (in thousands) | \$ 2,893 | \$ 1,836 | \$ 5,646 | \$ 5,435 |

Had the compensation costs for the Company's stock option plan for the three and nine months ended September 30, 2005 been determined based on the fair value method, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share data):

| | Three months ended | |
|---|-----------------------|---|
| | September 30, 2005 | Nine months ended September 30, 2005 |
| Net income as reported | \$ 4,830 | \$ 14,651 |
| Stock-based compensation expense included in reported net income, net of related tax effects | | 67 |
| Total stock-based compensation expense determined under the fair value based method, net of related tax effects | (171) | (578) |
| Net stock-based compensation expense not included in reported net income, all relating to stock option grants, net of related tax effects | (171) | (511) |
| Net income pro forma | \$ 4,659 | \$ 14,140 |
| Basic earnings per share: | | |
| As reported | \$ 0.41 | \$ 1.24 |
| Pro forma | \$ 0.40 | \$ 1.19 |
| Diluted earnings per share: | | |
| As reported | \$ 0.40 | \$ 1.20 |
| Pro forma | \$ 0.38 | \$ 1.15 |

The Company has established the Amended and Restated OceanFirst Financial Corp. 1997 Incentive Plan (the "Incentive Plan") which authorizes the granting of stock options and awards of common stock and the OceanFirst Financial Corp. 2000 Stock Option Plan which authorizes the granting of stock options. On April 24, 2003 the Company's shareholders ratified an amendment of the OceanFirst Financial Corp. 2000 Stock Option Plan which increased the number of shares available under option. On April 20, 2006, the OceanFirst Financial Corp. 2006 Stock

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Incentive Plan was approved which authorizes the granting of stock options or awards of common stock. All officers, other employees and Outside Directors of the Company and its affiliates are eligible to receive awards under the plans.

Under the Incentive Plan and the Amended 2000 Stock Option Plan the Company is authorized to issue up to 4,153,564 shares subject to option of which 259,642 shares remain to be issued at September 30, 2006. Under the 2006 Stock Incentive Plan, the Company is authorized to issue up to an additional 1,000,000 shares subject to option or, in lieu of options, up to 333,333 shares in the form of stock awards. All options expire 10 years from the date of grant and generally vest at the rate of 20% per year. The exercise price of each option is determined by the market price of the Company's stock on the date of grant. The Company typically issues Treasury shares to satisfy stock option exercises or grants of stock awards.

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A summary of stock option activity for the nine months ended September 30, 2006 follows:

| | Number of Shares | Weighted Average Exercise Price |
|---|------------------|------------------------------------|
| Outstanding at beginning of period | 1,732,410 | \$ 16.90 |
| Granted | 258,800 | 23.43 |
| Exercised | (464,238) | 9.93 |
| Forfeited | (13,727) | 22.63 |
| Outstanding at the end of the period | 1,513,245 | 20.14 |
| Options exercisable | 1,253,156 | \$ 19.46 |

The following table summarizes information about stock options outstanding at September 30, 2006:

| Options Outstanding | | | | Options Exercisable | | | |
|---------------------|---|---------------------------------|---------------------------|---------------------|---|---------------------------------|---------------------------|
| Number of Options | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Aggregate Intrinsic Value | Number of Options | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| 1,513,245 | 6.42 years | \$20.14 | \$3,500,000 | 1,253,156 | 5.82 years | \$19.46 | \$3,500,000 |

Earnings per Share

The following reconciles shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2006 and 2005 (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|--------|---------------------------------------|--------|
| | 2006 | 2005 | 2006 | 2005 |
| Weighted average shares issued net of Treasury shares | 12,345 | 12,748 | 12,481 | 12,852 |
| Less: Unallocated ESOP shares | (804) | (939) | (837) | (974) |
| Unallocated incentive award shares and shares held by deferred compensation plan | (76) | (16) | (77) | (19) |
| Average basic shares outstanding | 11,465 | 11,793 | 11,567 | 11,859 |
| Add: Effect of dilutive securities: | | | | |
| Stock options | 150 | 378 | 240 | 377 |
| Incentive awards and shares held by deferred compensation plan | 74 | 13 | 73 | 15 |
| Average diluted shares outstanding | 11,689 | 12,184 | 11,880 | 12,251 |

Comprehensive Income

For the three month periods ended September 30, 2006 and 2005, total comprehensive income, representing net income plus or minus the change in unrealized gains or losses on securities available for sale amounted to \$5,598,000 and \$4,585,000, respectively. For the nine months ended

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September 30, 2006 and 2005 total comprehensive income amounted to \$14,427,000 and \$14,062,000, respectively.

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Loans receivable, net at September 30, 2006 and December 31, 2005 consisted of the following (in thousands):

| | September 30, 2006 | December 31, 2005 |
|---|--------------------|-------------------|
| Real estate: | | |
| One- to four-family | \$ 1,235,443 | \$ 1,187,226 |
| Commercial real estate, multi-family and land | 302,149 | 281,585 |
| Construction | 18,690 | 22,739 |
| Consumer | 180,601 | 146,911 |
| Commercial | 48,509 | 61,637 |
| | | |
| Total loans | 1,785,392 | 1,700,098 |
| Loans in process | (3,644) | (7,646) |
| Deferred origination costs, net | 5,629 | 4,596 |
| Allowance for loan losses | (10,411) | (10,460) |
| | | |
| Total loans, net | 1,776,966 | 1,686,588 |
| Less: Mortgage loans held for sale | 62,206 | 32,044 |
| | | |
| Loans receivable, net | \$ 1,714,760 | \$ 1,654,544 |

Note 3. Deposits

The major types of deposits at September 30, 2006 and December 31, 2005 were as follows (in thousands):

| Type of Account | September 30, 2006 | December 31, 2005 |
|---------------------------|--------------------|-------------------|
| Non-interest-bearing | \$ 122,714 | \$ 120,188 |
| Interest-bearing checking | 385,390 | 381,787 |
| Money market deposit | 108,022 | 125,169 |
| Savings | 209,032 | 242,689 |
| Time deposits | 546,580 | 486,735 |
| | \$ 1,371,738 | \$ 1,356,568 |

Note 4. Recent Accounting Pronouncements

In March 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 156, Accounting for Servicing of Financial Assets. SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends Statement 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. By electing that option, an entity may simplify its accounting because this Statement permits income statement recognition of the potential offsetting changes in fair value of those servicing assets and servicing liabilities and derivative instruments in the same accounting period. The Statement is effective in the first fiscal year beginning after September 15, 2006 with earlier adoption permitted. The Company does not expect the adoption of Statement No. 156 to have a material impact on its financial statements.

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In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, allows an entity to re-measure and fair value a hybrid financial instrument that contains

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an embedded derivative that otherwise would require bifurcation from the host, if the holder irrevocably elects to account for the whole instrument on a fair value basis. Subsequent changes in the fair value would be recognized in earnings. Statement 155 is effective for financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, with earlier adoption permitted. The Company does not expect the adoption of Statement No. 155 to have a material impact on its financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. The Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109 *Accounting for Income Taxes*. This Interpretation presents a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of Interpretation No. 48 to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157 *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. The Statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of Statement No. 157 to have a material impact on its financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires that the Company quantify misstatements based on their impact on each of its financial statements and related disclosures. SAB 108 is effective as of the end of the Company's 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. The Company does not expect the adoption of SAB 108 to have a material impact on its financial statements.

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

Critical Accounting Policies

Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2005 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, as supplemented by this report, contains a summary of significant accounting policies. Various elements of these accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Certain assets are carried in the consolidated statements of financial condition at fair value or the lower of cost or fair value. Policies with respect to the methodologies used to determine the allowance for loan losses, the valuation of Mortgage Servicing Rights and judgments regarding securities impairment are the most critical accounting policies because they are important to the presentation of the Company's financial condition and results of operations, involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material differences in the results of operations or financial condition. These critical accounting policies and their application are reviewed periodically and, at least annually, with the Audit Committee of the Board of Directors.

Summary

The Company's results of operations are primarily dependent on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investments, and the interest expense on interest-bearing liabilities, such as deposits and borrowings. The Company also generates non-interest income such as income from loan sales, loan servicing, loan originations, merchant credit card

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services, deposit accounts, the sale of alternative investments, trust and asset management services and other fees. The Company's operating expenses primarily consist of compensation and employee benefits, occupancy and equipment, marketing, data processing and general and administrative expenses. The Company's results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

Recent increases in short-term interest rates have outpaced increases in longer-term rates resulting in a flattening and, currently an inversion, of the interest rate yield curve. The continuation of a flat or inverted yield curve through the remainder of 2006 is expected to have a negative impact on the Bank's results of operations and net interest margin as interest-earning assets, both loans and securities, are priced against longer-term indices, while interest-bearing liabilities, primarily deposits and borrowings, are priced against shorter-term indices. The Bank has generally not repriced all core deposits (defined as all deposits other than time deposits) at the same pace as market increases in short-term interest rates. Any upward repricing of core deposits can be expected to have a negative impact on the Bank's results of operations and net interest margin.

While the Bank continues to focus on growing core deposits, the rise in interest rates has made certificates of deposit relatively more attractive as an investment option to the Bank's depositors. The Bank has generally repriced certificates of deposit upwards in line with market rates while core deposit repricing has lagged the rise in short-term rates. As competition for core deposits has intensified, some of the Bank's competitors have aggressively raised their core deposit pricing. In light of these trends, the Bank recorded growth in certificates of deposit during the nine months of 2006 while core deposit balances declined.

The Bank opened its new Barnegat branch in May 2006 and expects to open a new branch in Little Egg Harbor in the fourth quarter of 2006. Additionally, the Bank plans to open at least two new branches in 2007. Finally, the Bank's Whiting branch was relocated to a more convenient and prominent location in July 2006. While the original branch remains open, the Bank anticipates that this location will eventually close.

Analysis of Net Interest Income

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

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The following tables set forth certain information relating to the Company for the three and nine months ended September 30, 2006 and 2005. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown except where noted otherwise. Average balances are derived from average daily balances. The yields and costs include certain fees which are considered adjustments to yields.

| | FOR THE QUARTERS ENDED SEPTEMBER 30, | | | | | |
|--|--------------------------------------|-----------|---|--------------------|-----------|---------------------------|
| | 2006 | | | 2005 | | |
| | AVERAGE BALANCE | INTEREST | AVERAGE YIELD/ COST (Dollars in thousands) | AVERAGE BALANCE | INTEREST | AVERAGE YIELD/ COST |
| Assets | | | | | | |
| Interest-earning assets: | | | | | | |
| Interest-earning deposits and short-term investments | \$ 8,960 | \$ 117 | 5.22% | \$ 8,846 | \$ 76 | 3.44% |
| Investment securities (1) | 83,917 | 1,212 | 5.78 | 85,978 | 887 | 4.13 |
| FHLB stock | 25,940 | 350 | 5.40 | 19,596 | 246 | 5.02 |
| Mortgage-backed securities (1) | 74,679 | 812 | 4.35 | 100,549 | 897 | 3.57 |
| Loans receivable, net (2) | 1,806,060 | 27,825 | 6.16 | 1,663,158 | 24,222 | 5.83 |
| Total interest-earning assets | 1,999,556 | 30,316 | 6.06 | 1,878,127 | 26,328 | 5.61 |
| Non-interest-earning assets | 99,144 | | | 99,493 | | |
| Total assets | \$ 2,098,700 | | | \$ 1,977,620 | | |
| Liabilities and Stockholders Equity | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Transaction deposits | \$ 703,986 | 3,039 | 1.73 | \$ 749,488 | 2,193 | 1.17 |
| Time deposits | 557,093 | 5,900 | 4.24 | 489,411 | 3,863 | 3.16 |
| Total | 1,261,079 | 8,939 | 2.84 | 1,238,899 | 6,056 | 1.96 |
| Borrowed funds | 567,003 | 6,918 | 4.88 | 459,736 | 4,862 | 4.23 |
| Total interest-bearing liabilities | 1,828,082 | 15,857 | 3.47 | 1,698,635 | 10,918 | 2.57 |
| Non-interest-bearing deposits | 124,998 | | | 127,718 | | |
| Non-interest-bearing liabilities | 12,896 | | | 16,468 | | |
| Total liabilities | 1,965,976 | | | 1,842,821 | | |
| Stockholders equity | 132,724 | | | 134,799 | | |
| Total liabilities and stockholders equity | \$ 2,098,700 | | | \$ 1,977,620 | | |
| Net interest income | | \$ 14,459 | | | \$ 15,410 | |
| Net interest rate spread (3) | | | 2.59% | | | 3.04% |
| Net interest margin (4) | | | 2.89% | | | 3.28% |

FOR THE NINE MONTHS ENDED SEPTEMBER 30,

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| | 2006 | | | 2005 | | |
|--|--------------|-----------|----------------|--------------|-----------|----------------|
| | AVERAGE | | AVERAGE | AVERAGE | | AVERAGE |
| | BALANCE | INTEREST | YIELD/ COST | BALANCE | INTEREST | YIELD/ COST |
| Assets | | | | | | |
| Interest-earning assets: | | | | | | |
| Interest-earning deposits and short-term investments | \$ 8,706 | \$ 315 | 4.82% | \$ 12,231 | \$ 269 | 2.93% |
| Investment securities (1) | 84,480 | 3,880 | 6.12 | 86,272 | 2,882 | 4.45 |
| FHLB stock | 24,289 | 907 | 4.98 | 19,921 | 648 | 4.34 |
| Mortgage-backed securities (1) | 79,506 | 2,518 | 4.22 | 111,288 | 2,959 | 3.55 |
| Loans receivable, net (2) | 1,751,643 | 79,051 | 6.02 | 1,600,564 | 68,752 | 5.73 |
| Total interest-earning assets | 1,948,624 | 86,671 | 5.93 | 1,830,276 | 75,510 | 5.50 |
| Non-interest-earning assets | 96,516 | | | 101,048 | | |
| Total assets | \$ 2,045,140 | | | \$ 1,931,324 | | |
| Liabilities and Stockholders Equity | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Transaction deposits | \$ 717,194 | 8,544 | 1.59 | \$ 733,548 | 5,526 | 1.00 |
| Time deposits | 531,557 | 15,496 | 3.89 | 479,624 | 10,548 | 2.93 |
| Total | 1,248,751 | 24,040 | 2.57 | 1,213,172 | 16,074 | 1.77 |
| Borrowed funds | 526,266 | 18,343 | 4.65 | 448,787 | 13,921 | 4.14 |
| Total interest-bearing liabilities | 1,775,017 | 42,383 | 3.18 | 1,661,959 | 29,995 | 2.41 |
| Non-interest-bearing deposits | 124,508 | | | 119,236 | | |
| Non-interest-bearing liabilities | 11,563 | | | 15,117 | | |
| Total liabilities | 1,911,088 | | | 1,796,312 | | |
| Stockholders equity | 134,052 | | | 135,012 | | |
| Total liabilities and stockholders equity | \$ 2,045,140 | | | \$ 1,931,324 | | |
| Net interest income | | \$ 44,288 | | | \$ 45,515 | |
| Net interest rate spread (3) | | | 2.75% | | | 3.09% |
| Net interest margin (4) | | | 3.03% | | | 3.32% |

(1) Amounts are recorded at average amortized cost.

(2) Amount is net of deferred loan fees, undisbursed loan funds, discounts and premiums and estimated loss allowances and includes loans held for sale and non-performing loans.

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

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

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Comparison of Financial Condition at September 30, 2006 and December 31, 2005

Total assets at September 30, 2006 were \$2.073 billion, an increase of \$87.8 million, compared to \$1.985 billion at December 31, 2005.

Loans receivable, net increased by \$60.2 million to a balance of \$1.715 billion at September 30, 2006, compared to a balance of \$1.655 billion at December 31, 2005. Most of the increase was in consumer loans. Mortgage loans held for sale increased \$30.2 million to a balance of \$62.2 million at September 30, 2006 compared to a balance of \$32.0 million at December 31, 2005. The increase occurred at Columbia Home Loans, which re-established its wholesale alternative credit channel during 2006. This production channel was adversely impacted in mid 2005 by staff turnover.

Deposit balances increased \$15.2 million to \$1.372 billion at September 30, 2006 from \$1.357 billion at December 31, 2005. Core deposits decreased by \$44.7 million, while time deposits increased by \$59.8 million.

Total Federal Home Loan Bank (FHLB) borrowings, consisting of securities sold under agreements to repurchase and advances, increased \$48.3 million to \$462.2 million at September 30, 2006, compared to a balance of \$413.9 million at December 31, 2005. The increase was used to fund loan growth. Other borrowings increased \$12.5 million to \$17.5 million at September 30, 2006 compared to a balance of \$5.0 million at December 31, 2005. These borrowings were issued by the Company to primarily fund the repurchase of common stock.

Stockholders' equity at September 30, 2006 decreased to \$137.0 million, compared to \$138.8 million at December 31, 2005. The Company repurchased 669,604 shares of common stock during the nine months ended September 30, 2006 at a total cost of \$15.3 million. The cost of the share repurchases was partly offset by net income, proceeds from stock option exercises and the related tax benefit, and Employee Stock Ownership Plan amortization.

Comparison of Operating Results for the Three and Nine Months Ended September 30, 2006 and September 30, 2005

General

Net income increased to \$4.9 million for the three months ended September 30, 2006 as compared to \$4.8 million for the same prior year period. Net income for the nine months ended September 30, 2006 decreased to \$14.1 million, as compared to \$14.7 million for the same prior year period. Diluted earnings per share increased to \$.42 for the three months ended September 30, 2006, as compared to \$.40 for the same prior year period. Diluted earnings per share for the nine months ended September 30, 2006 decreased to \$1.18 as compared to \$1.20 for the same prior year period. Earnings per share is favorably affected by the Company's share repurchase program, which reduces the average diluted shares outstanding.

Interest Income

Interest income for the three and nine months ended September 30, 2006 was \$30.3 million and \$86.7 million, respectively, compared to \$26.3 million and \$75.5 million, respectively, for the three and nine months ended September 30, 2005. The yield on interest-earning assets increased to 6.06% and 5.93%, respectively, for the three and nine months ended September 30, 2006 as compared to 5.61% and 5.50%, respectively, for the same prior year periods. Average interest-earning assets increased by \$121.4 million and \$118.3 million, respectively, for the three and nine months ended September 30, 2006 as compared to the same prior year periods. The growth was concentrated in average loans receivable which grew \$142.9 million, or 8.6%, for the three months ended September 30, 2006, as compared to the same prior year period. For the nine months ended September 30, 2006 average loans receivable increased \$151.1 million, or 9.4%, as compared to the same prior year period.

Interest Expense

Interest expense for the three and nine months ended September 30, 2006 was \$15.9 million and \$42.4 million, respectively, compared to \$10.9 million and \$30.0 million, respectively, for the three and nine months ended

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September 30, 2005. The cost of interest-bearing liabilities increased to 3.47% and 3.18% for the three and nine months ended September 30, 2006, as compared to 2.57% and 2.41%, respectively, in the same prior year periods. Average interest-bearing liabilities increased by \$129.4 million and \$113.1 million, respectively, for the three and nine months ended September 30, 2006 as compared to the same prior year periods. The growth occurred in average borrowed funds which grew \$107.3 million and average interest-bearing deposits which grew \$22.2 million for the three months ended September 30, 2006 as compared to the same prior year period. For the nine months ended September 30, 2006 average borrowed funds increased \$77.5 million and average interest-bearing deposits increased \$35.6 million as compared to the same prior year period.

Net Interest Income

Net interest income for the three and nine months ended September 30, 2006 decreased to \$14.5 million and \$44.3 million, respectively, as compared to \$15.4 million and \$45.5 million, respectively, in the same prior year periods. The net interest margin decreased to 2.89% and 3.03%, respectively, for the three and nine months ended September 30, 2006 from 3.28% and 3.32%, respectively, in the same prior year periods. The rise in short-term interest rates and the flattening or inversion of the interest rate yield curve caused the increase in the cost of interest-bearing liabilities to outpace the increase in the yield on interest-earning assets.

Provision for Loan Losses

For the three and nine months ended September 30, 2006, the Bank's provision for loan losses was \$50,000 and \$100,000, respectively, compared to \$100,000 and \$350,000, respectively, in the same prior year periods. Although total loans receivable increased, net charge-offs for the nine months ended September 30, 2006 decreased to \$150,000 as compared to \$628,000 for the same prior year period.

Other Income

Other income was \$6.6 million and \$17.6 million, respectively, for the three and nine months ended September 30, 2006, compared to \$6.3 million and \$18.1 million for the same prior year periods. For the three and nine months ended September 30, 2006, the Bank recorded gains of \$3.5 million and \$8.5 million, respectively, on the sale of loans and securities available for sale, as compared to gains of \$3.5 million and \$10.1 million, respectively, in the same prior year periods. Loans sold for the three month period ended September 30, 2006 increased to \$245.7 million from \$212.4 million in the same prior year period. Loans sold for the nine month period ended September 30, 2006 decreased to \$505.5 million from \$538.7 million in the same prior year period. Most of the decline in sales volume for the nine month period ended September 30, 2006 occurred at Columbia Home Loans during the first quarter of 2006. The decline experienced at Columbia was partly reflective of declines experienced industry-wide. In light of continuing pressure on volume and margins, Columbia implemented plans to consolidate lending channels to a more centralized platform designed to improve efficiency and reduce operating costs. As expected, the consolidation temporarily reduced lending capacity and adversely impacted the volume of loan sales. Additionally, staff turnover in the wholesale alternative credit channel adversely affected sales volume. During the second quarter of 2006 Columbia re-established the wholesale alternative credit channel and sales volume was restored to exceed prior year levels, for the second and third quarters.

Fees and service charges increased \$271,000 and \$878,000, respectively, for the three and nine months ended September 30, 2006, as compared to the same prior year periods primarily related to increases in fees generated from reverse mortgage loans, a new emphasis for the Bank, as well as fees from title insurance and trust services.

Operating Expenses

Operating expenses were \$13.5 million and \$40.2 million, respectively, for the three and nine months ended September 30, 2006, as compared to \$14.2 million and \$40.7 million, respectively, in the same prior year periods. The decrease in operating expenses was due to reduced incentive plan accruals and loan-related marketing expense reductions.

Table of Contents**Provision for Income Taxes**

Income tax expense was \$2.6 million and \$7.5 million, respectively, for the three and nine months ended September 30, 2006, as compared to \$2.6 million and \$7.9 million, respectively, for the same prior year periods. The effective tax rate decreased slightly to 34.6% for both the three and nine months ended September 30, 2006 as compared to 35.0% for both the same prior year periods.

Liquidity and Capital Resources

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

At September 30, 2006 the Bank had outstanding overnight borrowings from the FHLB of \$47.2 million as compared to \$51.9 million in overnight borrowings at December 31, 2005. The Bank utilizes the overnight line from time-to-time to fund short-term liquidity needs. The Bank had total FHLB borrowings, including overnight borrowings, of \$462.2 million at September 30, 2006, an increase from \$413.9 million at December 31, 2005. The increase in borrowings was used to fund loan growth.

The Bank's cash needs for the nine months ended September 30, 2006, were primarily satisfied by principal payments on loans and mortgage-backed securities, increased deposits and borrowings and proceeds from the sale of mortgage loans held for sale. The cash was principally utilized for loan originations and the repurchase of common stock. For the nine months ended September 30, 2005, the cash needs of the Bank were primarily satisfied by principal payments on loans and mortgage-backed securities, increased deposits and proceeds from the sale of mortgage loans held for sale. The cash provided was principally used for the origination of loans, a reduction in total borrowings and the repurchase of common stock.

In the normal course of business, the Bank routinely enters into various off-balance sheet commitments, primarily relating to the origination and sale of loans. At September 30, 2006, outstanding commitments to originate loans totaled \$185.5 million; outstanding unused lines of credit totaled \$184.9 million; and outstanding commitments to sell loans totaled \$70.8 million. The Bank expects to have sufficient funds available to meet current commitments arising in the normal course of business.

Time deposits scheduled to mature in one year or less totaled \$436.3 million at September 30, 2006. Based upon historical experience management estimates that a significant portion of such deposits will remain with the Bank.

Under the Company's stock repurchase programs, shares of OceanFirst Financial Corp. common stock may be purchased in the open market and through other privately-negotiated transactions, from time-to-time, depending on market conditions. The repurchased shares are held as treasury stock for general corporate use. For the nine months ended September 30, 2006, the Company purchased 669,604 shares of common stock at a total cost of \$15.3 million compared with purchases of 611,566 shares for the nine months ended September 30, 2005 at a total cost of \$14.1 million. At September 30, 2006, there were 26,080 shares remaining to be repurchased under the existing stock repurchase program. A new repurchase program, the Company's thirteenth, was announced on July 20, 2006. Under this 5% repurchase program, an additional 615,883 shares are available for repurchase. Cash dividends declared and paid during the first nine months of 2006 were \$6.9 million, a decrease from \$7.1 million from the same prior year period due to the reduction in common shares outstanding. On October 18, 2006, the Board of Directors declared a quarterly cash dividend of twenty cents (\$.20) per common share. The dividend is payable on November 10, 2006 to stockholders of record at the close of business on October 27, 2006.

The primary sources of liquidity for OceanFirst Financial Corp., the holding company of OceanFirst Bank, are capital distributions from the banking subsidiary and the issuance of debt instruments. For the first nine months of 2006, OceanFirst Financial Corp. received \$8.0 million in dividend payments from OceanFirst Bank. The Company also received \$12.5 million from the issuance of trust preferred securities. The trust preferred securities carry a floating rate of 166 basis points over 3 month LIBOR and adjust quarterly. Accrued interest is due quarterly with principal due at the maturity date in 2036. The primary use of these funds is the repurchase of

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common stock and the payment of dividends to shareholders. The Company's Board of Directors has approved the issuance of up to an additional \$12.5 million of Tier II capital in the form of trust preferred securities or subordinated debt. OceanFirst Financial Corp.'s ability to continue these activities is partly dependent upon capital distributions from OceanFirst Bank. Applicable Federal law or the Bank's regulator, may limit the amount of capital distributions OceanFirst Bank may make.

At September 30, 2006, the Bank exceeded all of its regulatory capital requirements with tangible capital of \$138.8 million, or 6.7% of total adjusted assets, which is above the required level of \$31.1 million or 1.5%; core capital of \$138.8 million or 6.7% of total adjusted assets, which is above the required level of \$62.3 million, or 3.0%; and risk-based capital of \$148.9 million, or 11.2% of risk-weighted assets, which is above the required level of \$106.7 million or 8.0%. The Bank is considered a well-capitalized institution under the Office of Thrift Supervision's Prompt Corrective Action Regulations.

Off-Balance-Sheet Arrangements and Contractual Obligations

In the normal course of operations, the Bank engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate, and liquidity risk or to optimize capital. Customer transactions are used to manage customers' requests for funding. These financial instruments and commitments include unused consumer lines of credit and commitments to extend credit. The Bank also has outstanding commitments to sell loans amounting to \$70.8 million.

The following table shows the contractual obligations of the Company by expected payment period as of September 30, 2006 (in thousands):

| Contractual Obligation | Total | Less than | | | More than |
|--|--------------|------------------|------------------|------------------|------------------|
| | | One year | 1-3 years | 3-5 years | 5 years |
| Debt Obligations | \$ 534,750 | \$ 180,250 | \$ 224,000 | \$ 113,000 | \$ 17,500 |
| Commitments to Originate Loans | \$ 185,547 | \$ 185,547 | | | |
| Commitments to Fund Unused Lines of Credit | \$ 184,936 | \$ 184,936 | | | |

Debt obligations include borrowings from the FHLB, Securities Sold under Agreements to Repurchase and other borrowings. The borrowings have defined terms and, under certain circumstances, \$55.0 million of the borrowings are callable at the option of the lender.

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

Table of Contents**Non-Performing Assets**

The following table sets forth information regarding the Bank's non-performing assets consisting of non-accrual loans and Real Estate Owned (REO). 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.

| | September 30, 2006 | December 31, 2005 |
|--|------------------------|----------------------|
| | (dollars in thousands) | |
| Non-accrual loans: | | |
| Real estate - One- to four-family | \$ 1,786 | \$ 1,084 |
| Commercial Real Estate | 426 | |
| Consumer | 221 | 299 |
| Commercial | 1,266 | 212 |
| | | |
| Total non-performing loans | 3,699 | 1,595 |
| REO, net | 288 | 278 |
| | | |
| Total non-performing assets | \$ 3,987 | \$ 1,873 |
| | | |
| Allowance for loan losses as a percent of total loans receivable | .58% | .62% |
| Allowance for loan losses as percent of total non-performing loans | 281.45 | 655.80 |
| Non-performing loans as a percent of total loans receivable | .21 | .09 |
| Non-performing assets as a percent of total assets | .19 | .09 |

The Bank also classifies assets in accordance with certain regulatory guidelines. At September 30, 2006 the Bank had \$19.2 million designated as Special Mention, \$5.0 million classified as Substandard and \$95,000 classified as Doubtful as compared to \$15.5 million, \$2.2 million and \$59,000, respectively, designated as Special Mention and classified as Substandard and Doubtful at December 31, 2005. On September 30, 2006, the Bank had one loan for a total of \$1.5 million outstanding to Dwek Branches, LLC, an entity controlled by Solomon Dwek, a local real estate developer. On May 3, 2006, PNC Bank, National Association, commenced an action against Mr. Dwek and certain of his affiliates in the Superior Court of New Jersey, Chancery Division, Monmouth County (PNC Bank, National Assoc. v. Solomon Dwek et al., Docket No.: Mon-C-133-06), to recover funds allegedly improperly transferred by Mr. Dwek from PNC. The Court issued an Order to Show Cause restraining Mr. Dwek from transferring or in any way dissipating his various assets, and subsequently appointed a fiscal agent to, among other things, monitor and preserve the value of the assets of Mr. Dwek and his affiliates. This report is being included in this quarterly report due to the media attention surrounding Mr. Dwek and to clarify the Bank's business relationship with Mr. Dwek. The loan to Dwek Branches LLC is secured by commercial real estate and has been designated as Special Mention, although the loan continues to perform according to terms. During the third quarter, a second loan to Dwek Branches, LLC for \$1.8 million, which had been classified as Substandard, was sold to a real estate investor at no loss to the Bank.

Private Securities Litigation Reform Act Safe Harbor Statement

In addition to historical information, this quarterly report contains certain forward-looking statements 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, or similar expressions. The Company's ability to predict results or the actual future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and the subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Board of Governors of the Federal Reserve System, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and

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undue reliance should not be placed on statements. The Company does not undertake and specifically disclaims any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Further description of the risks and uncertainties to the business are included in Item 1, Business and Item 1A, Risk Factors of the Company's 2005 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's interest rate sensitivity is monitored through the use of an interest rate risk (IRR) model. At March 31, 2006 the Company adopted a new interest rate risk model which is expected to provide improved modeling capabilities. The new model allows for greater disaggregation of data elements, enhanced loan prepayment modeling and greater flexibility. The following tables set forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at September 30, 2006 and December 31, 2005, which were anticipated by the Company, based upon certain assumptions, to reprice or mature in each of the future time periods shown. The Company's results for December 31, 2005 have been restated for comparative purposes using the new IRR model. At September 30, 2006 the Company's one-year gap was negative 1.24% as compared to positive 4.19% at December 31, 2005.

| At September 30, 2006 (dollars in thousands) | 3 Months or Less | More than 3 Months to 1 Year | More than 1 Year to 3 Years | More than 3 Years to 5 Years | More than 5 Years | Total |
|--|---------------------|---------------------------------------|-----------------------------------|------------------------------------|----------------------|-------------------|
| Interest-earning assets: (1) | | | | | | |
| Interest-earning deposits and short-term investments | \$ 16,470 | \$ | \$ | \$ | \$ | \$ 16,470 |
| Investment securities | 75,616 | | 288 | | 6,652 | 82,556 |
| FHLB stock | | | | | 24,634 | 24,634 |
| Mortgage-backed securities | 11,144 | 14,662 | 29,092 | 11,738 | 6,019 | 72,655 |
| Loans receivable (2) | 325,117 | 293,289 | 554,036 | 292,903 | 316,403 | 1,781,748 |
| Total interest-earning assets | 428,347 | 307,951 | 583,416 | 304,641 | 353,708 | 1,978,063 |
| Interest-bearing liabilities: | | | | | | |
| Money market deposit accounts | 4,910 | 14,730 | 39,281 | 49,101 | | 108,022 |
| Savings accounts | 11,490 | 28,221 | 75,254 | 94,067 | | 209,032 |
| Interest-bearing checking accounts | 17,518 | 52,553 | 140,140 | 175,179 | | 385,390 |
| Time deposits | 101,375 | 337,232 | 87,954 | 16,973 | 3,046 | 546,580 |
| FHLB advances | 55,200 | 70,000 | 275,000 | 28,000 | | 428,200 |
| Securities sold under agreements to repurchase | 55,050 | | 34,000 | | | 89,050 |
| Other borrowings | 12,500 | | | | 5,000 | 17,500 |
| Total interest-bearing liabilities | 258,043 | 502,736 | 651,629 | 363,320 | 8,046 | 1,783,774 |
| Interest sensitivity gap (3) | \$ 170,304 | \$(194,785) | \$(68,213) | \$(58,679) | \$ 345,662 | \$ 194,289 |
| Cumulative interest sensitivity gap | \$ 170,304 | \$(24,481) | \$(92,694) | \$(151,373) | \$ 194,289 | \$ 194,289 |
| Cumulative interest sensitivity gap as a percent of total interest-earning assets | 8.61% | (1.24%) | (4.69%) | (7.65%) | 9.82% | 9.82% |

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| Basis Points (Rate Shock) (dollars in thousands) | Ratio | | | | Ratio | | | | | |
|---|------------|---------|------|-----------|--------|------------|---------|-------|-----------|-------|
| | | | | | | | | | | |
| 200 | \$ 170,753 | (17.4)% | 8.7% | \$ 56,747 | (2.7)% | \$ 188,421 | (12.6)% | 10.0% | \$ 60,217 | 0.4% |
| 100 | 191,344 | (7.5) | 9.5 | 57,839 | (0.8) | 205,596 | (4.6) | 10.6 | 60,550 | 1.0 |
| Static | 206,838 | | 10.0 | 58,307 | | 215,479 | | 10.9 | 59,953 | |
| (100) | 209,637 | 1.4 | 10.0 | 57,621 | (1.2) | 212,431 | (1.4) | 10.6 | 58,002 | (3.3) |
| (200) | 194,555 | (5.9) | 9.3 | 54,312 | (6.9) | 195,476 | (9.3) | 9.8 | 54,008 | (9.9) |

Item 4. Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the SEC (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's

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management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, based on that evaluation, no change in the Company's internal control over financial reporting occurred during the quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

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

Item 1A. Risk Factors

No material change.

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

Information regarding the Company's common stock repurchases for the three month period ended September 30, 2006 is as follows:

| Period | Total Number of Shares | | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number |
|--|------------------------|------------------------------|--|---|
| | Purchased (1) | Average price Paid per Share | | of Shares that May Yet Be Purchased Under the Plans or Programs |
| July 1, 2006 through July 31, 2006 | 0 | | 0 | 140,436 |
| August 1, 2006 through August 31, 2006 | 110,133 | 21.41 | 10,000 | 130,436 |
| September 1, 2006 through September 30, 2006 | 104,356 | 21.97 | 104,356 | 26,080 |

(1) Includes 100,133 shares in August 2006 which represent shares tendered by employees to exercise stock options. On October 19, 2005, the Company announced its intention to repurchase up to an additional 636,036 shares, or 5%, of its outstanding common stock. On July 20, 2006, the Company announced its intention to repurchase up to an additional 615,883 shares, or 5%, of its outstanding common stock upon completion of the existing program.

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable

Item 5. Other Information

Not Applicable

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Item 6. Exhibits

Exhibits:

- 3.1 Certificate of Incorporation of OceanFirst Financial Corp.*
- 3.2 Bylaws of OceanFirst Financial Corp.**
- 4.0 Stock Certificate of OceanFirst Financial Corp.*
- 31.1 Rule 13a-14(a)/15d-14(c) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(c) Certification of Chief Financial Officer
- 32.0 Section 1350 Certifications

* Incorporated herein by reference into this document from the Exhibits to Form S-1, Registration Statement, effective May 13, 1996, as amended, Registration No. 33-80123.

** Incorporated herein by reference into this document from the Exhibit to Form 10-K, Annual Report, filed on March 25, 2003.
SIGNATURES

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

OceanFirst Financial Corp.
Registrant

DATE: November 8, 2006

/s/ John R. Garbarino
John R. Garbarino
Chairman of the Board, President
and Chief Executive Officer

DATE: November 8, 2006

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

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| Exhibit | Description | Page |
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| 31.1 | Rule 13a-14(a)/15d-14(c) Certification of Chief Executive Officer | 23 |
| 31.2 | Rule 13a-14(a)/15d-14(c) Certification of Chief Financial Officer | 24 |
| 32.0 | Section 1350 Certifications | 25 |