OCEANFIRST FINANCIAL CORP
Form 10-K
March 15, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

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

Commission file number: 001-11713

OceanFirst Financial Corp.

(Exact name of registrant as specified in its charter)

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

975 Hooper Avenue, Toms River, 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 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 $247,481,000 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 6, 2013 was 17,787,089.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2013 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days from December 31, 2012, are incorporated by reference into Part III of this Form 10-K.

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PART I

Item 1. Business
General

OceanFirst Financial Corp. (the Company) is incorporated under Delaware law and serves as the holding company for OceanFirst Bank (the Bank). At December 31, 2012, the Company had consolidated total assets of $2.3 billion and total stockholders equity of $219.8 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.

The Bank was originally founded as a state-chartered building and loan association in 1902, and converted to a Federal savings and loan association in 1945 and then a Federally-chartered mutual savings bank in 1989. The Bank converted from mutual to stock ownership in 1996. The Bank s principal business has been and continues to be attracting deposits from the general public in the communities surrounding its branch offices and investing those deposits primarily in single-family, owner-occupied residential mortgage loans and commercial real estate loans. The Bank also invests in other types of loans, including multi-family, construction, consumer and commercial 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 periodically sells part of its mortgage loan production in order to manage interest rate risk and liquidity. Presently, servicing rights are retained in connection with most loan sales. The Bank s revenues are derived principally from interest on its loans, and to a lesser extent, interest on its investment and mortgage-backed securities. The Bank also receives income from fees and service charges on loan and deposit products, and from the sale of trust and asset management services and alternative investment products, e.g., mutual funds, annuities and life insurance. The Bank s primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, proceeds from the sale of loans, Federal Home Loan Bank (FHLB) advances and other borrowings and to a lesser extent, investment maturities.

The Company s 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 o 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, 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.

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Market Area and Competition

The Bank is a community-oriented financial institution, offering a wide variety of financial services to meet the needs of the communities it serves. The Bank conducts its business through an administrative and branch office located in Toms River, New Jersey, and twenty-three additional branch offices concentrated in Ocean and Monmouth Counties, New Jersey. The Bank currently plans a Spring opening of a full service Financial Solutions Center in Red Bank, New Jersey offering deposit, lending and asset management services. An additional branch office, the Bank s second in Jackson, New Jersey, is planned for mid-2013. The Bank s deposit gathering base is concentrated in the communities surrounding its offices while lending activities are concentrated in the markets surrounding its branch office network. The Bank also maintains a trust and asset management office in Manchester, New Jersey.

The Bank is the oldest and largest community-based financial institution headquartered in Ocean County, New Jersey, which is located along the central New Jersey shore. Ocean County is the fastest growing population area in New Jersey and has a significant number of retired residents who have traditionally provided the Bank with a stable source of deposit funds. The economy in the Bank s primary market area is based upon a mixture of service and retail trade, 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 New Jersey suburban areas around New York and Philadelphia.

The Bank faces significant competition both in making loans and in attracting deposits. The State of New Jersey has a high density of financial institutions. Many of 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.

Lending Activities

Loan Portfolio Composition. The Bank s loan portfolio consists primarily of conventional first mortgage loans secured by one-to-four family residences. At December 31, 2012, the Bank had total loans outstanding of $1.550 billion, of which $809.7 million or 52.2% of total loans were one-to-four family, residential mortgage loans. The remainder of the portfolio consisted of $475.2 million of commercial real estate, multi-family and land loans, or 30.7% of total loans; $9.0 million of residential construction loans, or 0.6% of total loans; $198.1 million of consumer loans, primarily home equity loans and lines of credit, or 12.8% of total loans; and $58.0 million of commercial loans, or 3.7% of total loans. Included in total loans are $6.7 million in loans held for sale at December 31, 2012. At that same date, 41.0% 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.

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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,									
	2012		2011		2010		2009		2008	
	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	$ 809,705	52.24%	$ 882,550	55.55%	$ 955,063	56.63%	$ 954,736	57.92%	$ 1,039,375	62.52%
Commercial real estate, multi-family and land	475,155	30.66	460,725	29.00	435,127	25.80	396,883	24.08	329,844	19.84
Residential construction	9,013	0.58	6,657	0.42	13,748	0.82	9,241	0.56	10,561	0.65
Consumer (1)	198,143	12.78	192,918	12.14	205,725	12.20	217,290	13.18	222,797	13.40
Commercial	57,967	3.74	45,889	2.89	76,692	4.55	70,214	4.26	59,760	3.59
Total loans	1,549,983	100.00%	1,588,739	100.00%	1,686,355	100.00%	1,648,364	100.00%	1,662,337	100.00%
Loans in process	(3,639)		(2,559)		(4,055)		(3,466)		(3,586)	
Deferred origination costs, net	4,112		4,366		4,862		4,767		5,195	
Allowance for loan losses	(20,510)		(18,230)		(19,700)		(14,723)		(11,665)	
Total loans, net	1,529,946		1,572,316		1,667,462		1,634,942		1,652,281	
Less:										
Mortgage loans held for sale	6,746		9,297		6,674		5,658		3,903	
Loans receivable, net	$ 1,523,200		$ 1,563,019		$ 1,660,788		$ 1,629,284		$ 1,648,378	
Total loans:										
Adjustable rate	$ 635,264	40.99%	$ 692,332	43.58%	$ 816,058	48.39%	$ 839,285	50.93%	$ 906,674	54.54%
Fixed rate	914,719	59.01	896,407	56.42	870,297	51.61	809,079	49.07	755,663	45.46
	$ 1,549,983	100.00%	$ 1,588,739	100.00%	$ 1,686,355	100.00%	$ 1,648,364	100.00%	$ 1,662,337	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.

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Loan Maturity. The following table shows the contractual maturity of the Bank s total loans at December 31, 2012. The table does not include principal prepayments.

	At December 31, 2012					
	One-to-four family	Commercial real estate, multi-family and land	Residential construction	Consumer	Commercial	Total Loans Receivable
	(In thousands)					
One year or less	$ 553	$ 86,885	$ 9,013	$ 1,094	$ 25,921	$ 123,466
After one year:						
More than one year to three years	2,042	133,017		3,305	14,030	152,394
More than three years to five years	12,447	132,734		6,743	6,552	158,476
More than five years to ten years	51,065	112,295		33,112	11,464	207,936
More than ten years to twenty years	179,539	8,560		153,297		341,396
More than twenty years	564,059	1,664		592		566,315
Total due after December 31, 2013	809,152	388,270		197,049	32,046	1,426,517
Total amount due	$ 809,705	$ 475,155	$ 9,013	$ 198,143	$ 57,967	1,549,983
Loans in process						(3,639)
Deferred origination costs, net						4,112
Allowance for loan losses						(20,510)
Total loans, net						1,529,946
Less: Mortgage loans held for sale						6,746
Loans receivable, net						$ 1,523,200

The following table sets forth at December 31, 2012, the dollar amount of total loans receivable contractually due after December 31, 2013, and whether such loans have fixed interest rates or adjustable interest rates.

	Due After December 31, 2013		
	Fixed	Adjustable	Total
	(In thousands)		
Real estate loans:			
One-to-four family	$ 435,239	$ 373,913	$ 809,152
Commercial real estate, multi-family and land	300,897	87,373	388,270
Consumer	96,726	100,323	197,049
Commercial	21,867	10,179	32,046
Total loans receivable	$ 854,729	$ 571,788	$ 1,426,517

Origination, Sale and Servicing of Loans. The Bank s residential mortgage lending activities are conducted primarily by commissioned loan representatives in the exclusive employment of the Bank. The Bank originates both adjustable-rate and fixed-rate loans. The type of loan originated is dependent upon the relative customer demand for fixed-rate or adjustable-rate mortgage (ARM) loans, which is affected by the current and expected future level of interest rates.

The Bank periodically sells part of its mortgage production in order to manage interest rate risk and liquidity. At December 31, 2012, there were $6.7 million in loans categorized as held for sale which are recorded at the lower of cost or fair market value.

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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,		
	2012	2011	2010
		(In thousands)	
Total loans:			
Beginning balance	$ 1,588,739	$ 1,686,355	$ 1,648,364
Loans originated:			
One-to-four family	312,084	240,640	381,296
Commercial real estate, multi-family and land	80,106	90,144	91,140
Residential construction	3,219	3,841	5,539
Consumer	92,633	74,175	76,846
Commercial	120,248	100,142	124,630
Total loans originated	608,290	508,942	679,451
Total	2,197,029	2,195,297	2,327,815
Less:			
Principal repayments	468,697	469,902	477,536
Sales of loans	174,299	133,739	162,481
Transfer to OREO	4,050	2,917	1,443
Total loans	$ 1,549,983	$ 1,588,739	$ 1,686,355

One-to-Four Family Mortgage Lending. The Bank offers fixed-rate, regular amortizing adjustable-rate and interest-only mortgage loans secured by one-to-four family residences with maturities up to 30 years. The majority of such loans are secured by property located in the Bank s primary market area. Loan originations are typically generated by commissioned loan representatives 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.

At December 31, 2012, the Bank s total loans outstanding were $1.550 billion, of which $809.7 million, or 52.2%, were one-to-four family residential mortgage loans, primarily single family and owner occupied. To a lesser extent and included in this activity are residential mortgage loans secured by seasonal second homes and non-owner occupied investment properties. The average size of the Bank s one-to-four family mortgage loan was approximately $183,000 at December 31, 2012. The Bank currently offers a number of ARM loan programs with interest rates which adjust every one, three, five or ten years. The Bank s ARM loans generally provide for periodic 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 one-, 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 of the borrower rise, thereby increasing the potential for delinquency and default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. In order to minimize risks, borrowers of one-year ARM loans with a loan-to-value ratio of 75% or less are qualified at the fully-indexed rate (the applicable U.S. Treasury index plus the margin, rounded up to the nearest one-eighth of one percent), and borrowers of one-year ARM loans with a loan-to-value ratio over 75% are qualified at the higher of the fully-indexed rate or the initial rate plus the 2% annual interest rate cap. The Bank does not originate ARM loans which provide for negative amortization. The Bank does offer interest-only ARM loans in which the borrower makes only interest payments for the first five, seven or ten years of the mortgage loan term and then convert to a fully-amortizing loan until maturity. Since the interest-only feature will result in future increases in the borrower s loan payment when the contractually required payments increase due to the required amortization of the principal amount and these payment increases will affect the borrower s ability to repay the loan, borrowers are qualified at the fully-amortized payment. The amount of interest-only one-to-four family mortgage loans at December 31, 2012 and 2011 was $37.0 million and $54.9 million, respectively, or 4.6% and 6.2%, 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 sells some of the fixed-rate residential mortgage loans that it originates. The Bank generally retains the servicing on loans sold. The Bank generally retains for its portfolio shorter-term, fixed-rate loans and certain longer-term, fixed-rate loans, generally consisting of loans 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 three 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 56% at December 31, 2012 based on appraisal values at the time of origination. In recent years, a decline in real estate values in the Bank s lending area has generally reduced the collateral value supporting the Bank s loans although the Bank believes that most borrowers continue to have adequate collateral value to support their outstanding loan balance. 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 obtains full verification of income on residential borrowers, however, it previously originated stated income loans on a limited basis through November 2010. These loans were only offered to self-employed borrowers for purposes of financing primary residences and second home properties. The amount of stated income loans at December 31, 2012 and 2011 was $47.3 million and $54.1 million, respectively, or 5.8% and 6.1%, respectively, of total one-to-four family mortgages.

The Bank currently originates reverse mortgage loans which qualify under the Home Equity Conversion Mortgage program of the Federal Housing Administration and which are insured by the Department of Housing and Urban Development. Borrowers must be 62 years old or older; no credit or income verification is necessary to qualify; and although the loan is secured by the borrower s primary residence, no interest or principal payments are required until the home is sold. These loans are all sold into the secondary market and the net gain on the sale of loans available for sale for the years ending December 31, 2012 and 2011 includes $718,000 and $508,000, respectively, of reverse mortgage loans.

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 recently enacted Consumer Financial Protection Bureau (CFPB) regulations effective January 10, 2014. See Risk Factors Increased emphasis on commercial lending, or the Bank s offering of alternative credit products, may expose the Bank to increased lending risks.

Commercial Real Estate, Multi-Family and Land Lending. The Bank originates commercial real estate loans that are secured by properties, or properties under construction, generally used for business purposes such as small office buildings or retail facilities. 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 twenty-five 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, profitability and the term and quantity of leases. The Bank has generally required that the properties securing commercial real estate loans have debt service coverage ratios of at least 130%. The Bank generally requires the personal guarantee of the principal for commercial real estate loans. The Bank s commercial real estate loan portfolio at December 31, 2012 was $475.2 million, or 30.7% of total loans. The largest commercial real estate loan in the Bank s portfolio at December 31, 2012 was a performing loan for which the Bank had an outstanding carrying balance of $16.6 million secured by a first mortgage on dormitories at a major university in the Bank s lending area. The average size of the Bank s commercial real estate loans at December 31, 2012 was approximately $769,000.

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, 2012, the Bank had an outstanding balance in commercial construction loans of $8.3 million.

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, 2012 totaled $18.2 million and $5.5 million, respectively.

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

Residential Construction Lending. At December 31, 2012, residential construction loans totaled $9.0 million, or 0.6%, of the Bank s total loans outstanding. The Bank originates residential construction loans primarily on a construction/permanent basis with such loans converting to an amortizing loan following the completion of the construction phase. Most of the Bank s residential construction loans are made to individuals building their primary residence, while, to a lesser extent, loans are made to finance a second home or to developers known to the Bank in order to build single-family houses for sale, which loans become due and payable over terms generally not exceeding 12 months.

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. The Bank also offers consumer loans. At December 31, 2012, the Bank s consumer loans totaled $198.1 million, or 12.8% of the Bank s total loan portfolio. Of the total consumer loan portfolio, home equity lines of credit comprised $100.9 million, or 50.9%; home equity loans comprised $96.6 million, or 48.8%; overdraft line of credit loans totaled $366,000 or 0.2%; and loans on savings accounts totaled $260,000, 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

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loans are typically made on owner-occupied, one-to-two family residences and generally to Bank customers. 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 and equity in the home. 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. Home equity lines of credit are secured by a mortgage on the underlying real estate. The Bank presently charges no origination fees for these loans, but may in the future charge origination fees for such loans. The Bank does, however, charge early termination fees 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 Bank currently maintains a 4.0% floor rate on new originations. The loans have an 18% lifetime cap on interest rate adjustments.

Commercial Lending. At December 31, 2012, commercial loans totaled $58.0 million, or 3.7% of the Bank s total loans outstanding. The Bank originates commercial 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 loans and credit lines, the Bank will review and analyze financial history and capacity, collateral value, strength and character of the principals, and general payment history of the borrower and principals in coming to a credit decision. The Bank generally requires the personal guarantee of the principal borrowers for all commercial loans.

A well-defined credit policy has been approved by the Bank s Board of Directors (the Board). This policy discourages high risk credits, while focusing on quality underwriting, sound financial strength and close monitoring. Commercial business lending, both secured and unsecured, is generally considered to involve a higher degree of risk than secured real estate lending. Risk of loss on a commercial business loan is dependent largely on the borrower s ability to remain financially able to repay the loan from ongoing operations. If the Bank s estimate of the borrower s financial ability is inaccurate, the Bank may be confronted with a loss of principal on the loan. The Bank s largest commercial loan at December 31, 2012 was a performing loan to a medical group with an outstanding balance of $4.9 million secured by medical equipment and personal guarantees. The average size of the Bank s commercial loans at December 31, 2012 was approximately $235,000.

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. New borrowers with a total exposure in excess of $3.0 million and existing borrowers with a total exposure in excess of $5.0 million require approval by the Management Credit Committee. A minimum of two employees signatures are required to approve residential loans over the conforming loan limits of the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). Pursuant to applicable regulations, loans to one borrower generally cannot exceed 15% of the Bank s unimpaired capital, which at December 31, 2012 amounted to $32.3 million. At December 31, 2012, the Bank s maximum loan exposure to a single borrower and related interests was $17.7 million. This performing loan 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 loans for others. All of the loans currently being serviced for others are loans which have been sold by the Bank or Columbia Home Loans, LLC (Columbia), the Bank s mortgage company which was shuttered in 2007. At December 31, 2012, the Bank was servicing $840.9 million of loans for others. At December 31, 2012, 2011 and 2010, the balance of mortgage servicing rights totaled $4.6 million, $4.8 million and $5.7 million, respectively. For the years ended December 31, 2012, 2011 and 2010, loan servicing income totaled $538,000, $427,000 and $292,000, respectively. The Bank evaluates mortgage servicing rights for impairment on a quarterly basis. No impairment was recognized for the years ended December 31, 2012, 2011 and 2010. The valuation of mortgage servicing rights is determined through a discounted analysis of future cash flows, incorporating numerous assumptions which are subject to significant change in the near term. Generally, a decline in market interest rates will cause expected prepayment speeds to increase resulting in a lower valuation for mortgage servicing rights and ultimately lower future servicing fee income.

Delinquencies and Classified Assets. Management and the Board perform a monthly review of all delinquent loan totals which includes loans sixty days or more past due, and the detail of each loan thirty days or more past due that was originated within the past year. In addition, the Chief Risk Officer compiles a quarterly list of all criticized and classified loans and a narrative report of classified commercial, commercial real estate, multi-family, land and construction loans. The steps taken by the Bank with respect to delinquencies vary depending on the nature of the loan and period of delinquency. When a borrower fails to make a required payment on a loan, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. The Bank generally sends the borrower a written notice of non-payment after the loan is first past due. In the event payment is not then received, additional letters and phone calls generally are made. In the case of residential mortgage loans, the Bank may offer to modify the terms or take other forbearance actions which afford the borrower an opportunity to remain in their home and 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 90 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 have increased significantly over the past few years. The Bank utilized the HOPE NOW loan modification reporting standards through its end date of September 30, 2011, as well as the President s Homeowner Affordability and Stability Plan and other plans to mitigate foreclosure actions. HOPE NOW was an alliance between counselors, mortgage market participants and mortgage servicers to create a unified, coordinated plan to reach and help as many homeowners as possible. The goal of the Homeowner Affordability and Stability Plan and other plans is to incent lenders to engage in sustainable mortgage modifications. The plan provides lenders with incentives to reduce rates on mortgages to a specified affordability level. The plan also provides access to low cost refinancing for responsible homeowners affected by falling home prices.

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. The Bank classifies assets in accordance with certain regulatory guidelines. At December 31, 2012, the Bank had $90.0 million of assets, including all OREO, classified as Substandard, $1.1 million of assets classified as Doubtful and no assets classified as Loss. At December 31, 2011, the Bank had $88.1 million of assets classified as Substandard, $75,000 classified as Doubtful and no assets classified as Loss. Loans and other assets may also be placed on a watch list as Special Mention assets. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated Special Mention. Special Mention assets totaled $6.2 million at December 31, 2012, as compared to $11.5 million at December 31, 2011. Loans are classified as Special Mention due to past delinquencies or other identifiable weaknesses. The largest Special Mention loan is a commercial real estate mortgage to a local builder for $1.8 million which was current as to payments. The loan is well collateralized by residential property and several vacant lots. The largest Substandard loan relationship is comprised of several credit facilities to a marina with an aggregate balance of $6.3 million which was criticized due to poor, but improving, operating results. The loans are collateralized by commercial and residential real estate, all business assets and also carry a personal

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guarantee. The most recent appraisals value the real estate collateral at $9.3 million. In November 2011, the Company entered into a troubled debt restructuring with the borrower which amended the repayment terms and reduced the interest rate in exchange for additional collateral. The loan was renewed in November 2012 at comparable terms. The borrower is current as to payments under the restructured terms but remains classified as a non-accrual loan due to continued uncertainty about the borrower s ability to service the debt. Classified assets exclude loans that were adversely impacted by superstorm Sandy. See Lending Activities Non-Accrual Loans and OREO. In addition to loan classifications, the Company classified investment securities with an amortized cost of $25.0 million and a carrying value of $18.9 million as Substandard, which represents the amount of investment securities with a credit rating below investment grade from one of the internationally-recognized credit rating services.

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, 2012, 2011, 2010, 2009 and 2008, 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 $2,432,000, $2,125,000, $1,467,000, $1,441,000 and $913,000.

			December 31,		
	2012	2011	2010	2009	2008
			(Dollars in thousands)		
Non-accrual loans:					
Real estate:					
One-to-four family	$ 26,521	$ 29,193	$ 26,577	$ 19,142	$ 8,696
Commercial real estate, multi-family and land	11,085	10,552	5,849	5,152	5,527
Residential construction	482	43	368	368	
Consumer	4,540	3,653	4,626	3,031	1,435
Commercial	746	567	117	627	385
Total	43,374	44,008	37,537	28,320	16,043
OREO, net (1)	3,210	1,970	2,295	2,613	1,141
Total non-performing assets	$ 46,584	$ 45,978	$ 39,832	$ 30,933	$ 17,184
Allowance for loan losses as a percent of total loans receivable (2)	1.32%	1.15%	1.17%	0.89%	0.70%
Allowance for loan losses as a percent of total non-performing loans (3)	47.29	41.42	52.48	51.99	72.71
Non-performing loans as a percent of total loans receivable (2)(3)	2.80	2.77	2.23	1.72	0.97
Non-performing assets as a percent of total assets (3)	2.05	2.00	1.77	1.52	0.92

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

The Company s non-performing loans totaled $43.4 million at December 31, 2012, a $634,000 decrease from $44.0 million at December 31, 2011. Included in the non-performing loan total at December 31, 2012 was $18.2 million of troubled debt restructured loans, as compared to $14.5 million of troubled debt restructured loans at December 31, 2011. The largest non-performing loan relationship is a loan to a marina with an aggregate balance of $6.3 million as described on the prior page under Delinquencies and Classified Assets. Non-performing loans are concentrated in one-to-four family loans which comprise 61.1% of the total. At December 31, 2012, the

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average weighted loan-to-value ratio of non-performing one-to-four family loans was 61% using appraisal values at time of origination and 79% using recently updated appraisal values. Appraisals are obtained for all non-performing loans secured by real estate and subsequently updated annually if the loan remains delinquent for an extended period. At December 31, 2012, the average weighted loan-to-value ratio of the total one-to-four family loan portfolio was 56% using appraisal values at time of origination. Based upon sales data for 2012 from the Ocean and Monmouth Counties Multiple Listing Service, residential home values in the Company s primary market area have declined by approximately 21% from the peak of the market in 2006. Individual home values may move more or less than the average based upon the specific characteristics of the property. There can be no assurance that home values will not decline further, possibly resulting in losses to the Company. The largest non-performing one-to-four family loan is a loan for $1.3 million. The loan is secured by a first mortgage on a property with a June 2012 appraised value of $1.7 million. The Company s non-performing loans remain at elevated levels partly due to the extended foreclosure process in the State of New Jersey. This protracted foreclosure process delays the Company s ability to resolve non-performing loans through sale of the underlying collateral. Of the non-performing one-to-four family loans, 62% were originated by alternative Bank delivery channels which were previously shuttered.

On October 29 and 30, 2012 the primary market area of the Bank was adversely impacted by superstorm Sandy. The storm disrupted operations for most businesses in the area and caused substantial property damage. The Bank provided payment deferrals to residential borrowers impacted by the storm for two months without penalty. An additional extension is considered if adequate documentation is presented. At February 28, 2013, 124 residential loan borrowers requested a payment deferment. For this pool of borrowers, the outstanding principal balance is $30.3 million; the average loan size is $244,000; the weighted average loan-to-value ratio is 64% based on appraised values at the time of origination or a more recent valuation, if available; and 70% of these loans are located in a flood zone. The Bank requires flood insurance on all properties in a flood zone. The Bank s practice has been to follow-up with all borrowers who received a storm-related payment delay after 45 days to determine the extent of the financial impact caused by the storm and to establish a repayment plan. Through February 28, 2013, the Bank had followed-up, as planned, with all borrowers. The result was as follows:

	Number of Borrowers	**Amount Outstanding (000 s)**
Loan paid in full	4	$ 1,158
Loan brought current	58	12,393
Repayment plan agreed to loan to be brought current within four months	39	11,656
Borrower indicated financial hardship and requests additional time to remediate; Bank will consider loan modification	15	3,602
Borrowers deferment expired, however, they are either experiencing unrelated financial hardship or are uncooperative; Bank will pursue collection, including possible loss mitigation	8	1,459
	124	$ 30,268

For the 23 borrowers experiencing financial hardship or who are uncooperative, the Bank evaluated its security position by aggregating estimated land value and flood insurance for each property. For the 15 borrowers who indicated financial hardship and who requested additional time to remediate, the weighted average loan-to-value ratio for these loans, using only estimated land value and anticipated flood insurance was 63% and no individual loan-to-value ratio exceeded 79%. For the 8 borrowers with an expired loan deferment who are either experiencing unrelated financial hardship or are uncooperative, the weighted average loan-to-value ratio for these loans, using only estimated land value and anticipated flood insurance was 69% and no individual loan-to-value ratio exceeded 88%.

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The Bank has also contacted most of its commercial loan borrowers. Three commercial real estate borrowers with a combined total outstanding loan balance of $3.6 million have reported substantial property damage. Each of these loans has continued to perform according to their original terms and each maintains a loan-to-value ratio prior to the impact of Sandy of less than 25%, based on appraisal values at the time of origination or a more recent valuation, if available. Additionally, six commercial loan borrowers requested short-term payment relief due to the impact of the storm. The Bank individually evaluated these requests and has allowed each of these borrowers to defer principal payments for up to 90 days. All of these borrowers are performing according to the revised terms.

The Bank has evaluated the impact of the storm relative to the adequacy of the allowance for loan losses. Based on the Bank s evaluation, as described above, there were no loan charge-offs or specific losses identified. The Bank did consider, however, the likely adverse impact of superstorm Sandy on historical loss rates. Although the ultimate amount of loan losses relating to the storm is uncertain and difficult to predict, and information continues to be gathered, the Bank recorded an additional provision for loan losses of $1.8 million for the quarter and year ended December 31, 2012, solely related to the impact of superstorm Sandy.

Allowance for Loan Losses. The allowance for loan losses is a valuation account that reflects probable incurred losses in the loan portfolio. The adequacy of the allowance for loan losses is based on management s evaluation of the Company s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and current economic conditions. Additions to the allowance arise from charges to operations through the provision for loan losses or from the recovery of amounts previously charged-off. The allowance is reduced by loan charge-offs. The Company modified its charge-off policy in 2011 as described below.

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

The Bank s allowance for loan losses includes specific allowances and a general allowance, each updated on a quarterly basis. A specific allowance is determined for all loans which meet the definition of an impaired loan where the value of the underlying collateral can reasonably be evaluated and where the Company has not already taken an interim charge-off. These are generally loans which are secured by real estate. The Bank obtains an updated appraisal for all impaired loans secured by real estate and collateral dependent residential mortgage loans greater than 90 days delinquent. The appraisal is subsequently updated annually if the loan remains delinquent for an extended period. The specific allowance represents the difference between the Bank s recorded investment in the loan, net of any interim charge-off, and the fair value of the collateral, less estimated disposal costs. A general allowance is determined for all other classified and non-classified loans. In determining the level of the general allowance, the Bank segments the loan portfolio into various loan segments and classes as follows:

Loan Portfolio Segment	Loan Class
Residential real estate:	Loans originated by Bank
	Loans originated by mortgage company
	Loans originated by mortgage company non-prime
	Residential construction
Commercial real estate:	Commercial
	Construction and land
Consumer:	Consumer
Commercial:	Commercial

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The mortgage company was shuttered by the Bank in 2007.

The loan portfolio is further segmented by delinquency status and risk rating (Special Mention, Substandard and Doubtful). An estimated loss factor is then applied to each risk tranche. If a loan secured by real estate becomes 90 days delinquent, the Bank obtains an updated appraisal which is subsequently updated annually as foreclosure timelines remain at elevated levels. For these loans, the estimated loss represents the difference between the Bank s recorded investment in the loan and the fair value of the collateral, less estimated selling costs. For loans 90 days delinquent not secured by real estate, the Bank evaluates the fair value of the collateral and the personal guarantees, if any, and identifies an estimated loss for the difference between the Bank s recorded investment in the loan and the fair value of the collateral, less estimated selling costs. For loans which are not 90 days delinquent, a historical loss rate is determined for each loan segment. To determine the loss rate, the Bank utilizes an average of loan losses as a percent of loan principal adjusted for the estimated probability of default. The historical loss rate is adjusted for certain environmental factors including current economic conditions, regulatory environment, local competition, lending personnel, loan policies and underwriting standards, loan review system, delinquency trends, loss trends, nature and volume of the loan portfolio and concentrations of credit. The Bank also considered the likely adverse impact of superstorm Sandy on historical loss rates. Existing economic conditions which the Bank considered to estimate the allowance for loan losses include local trends in economic growth, unemployment and real estate values.

During the fourth quarter of 2011, the Company modified its charge-off policy on problem loans secured by real estate. Historically, the Company established specific valuation reserves for estimated losses for problem real estate related loans when the loans were deemed uncollectible. The specific valuation reserves were based upon the estimated fair value of the underlying collateral, less costs to sell. The actual loan charge-off was not recorded until the foreclosure process was complete. Under the modified policy, losses on loans secured by real estate are charged-off in the period the loans, or portion thereof, are deemed uncollectible, generally after the loan becomes 120 days delinquent and a recent appraisal is received which reflects a collateral shortfall. The modification to the charge-off policy resulted in additional charge-offs in the fourth quarter 2011 of $5.7 million. All of these charge-offs were timely identified in previous periods in the Company s allowance for loan losses process as a specific valuation reserve and were included in the Company s loss experience as part of the evaluation of the allowance for loan losses. Accordingly, the additional charge-offs did not affect the Company s provision for loan losses or net income for 2011 or previous periods.

An overwhelming percentage of the Bank s loan portfolio, 96.2%, is secured by real estate whether one-to-four family, consumer or commercial. Additionally, most of the Bank s borrowers are located in Ocean and Monmouth Counties, New Jersey and the surrounding area. These concentrations may adversely affect the Bank s loan loss experience should local real estate values decline further or should the markets served continue to experience difficult economic conditions including increased unemployment or should the area be affected by a natural disaster such as a hurricane or flooding. See Risk Factors A continued downturn in the local economy or in local real estate values could hurt profits and Risk Factors Superstorm Sandy, or other natural disasters or hurricanes, could adversely affect asset quality and earnings.

Management believes the primary risk characteristics for each portfolio segment are a continued decline in the economy generally, including elevated levels of unemployment, a further decline in real estate market values and possible increases in interest rates. Additionally, superstorm Sandy may adversely affect real estate market values and borrowers ability to repay their obligations. Any one or a combination of these events may adversely affect the borrowers ability to repay the loans, resulting in increased delinquencies, loan charge-offs and future levels of provisions. Accordingly, the Bank has provided for loan losses at the current level to address the current risk in the loan portfolio.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions in the Company s market area. In addition, various regulatory agencies, as an integral part

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of their routine examination process, periodically review the Bank s allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

As of December 31, 2012 and 2011, the Bank s allowance for loan losses was 1.32% and 1.15% respectively, of total loans. The Bank had non-accrual loans of $43.4 million and $44.0 million at December 31, 2012 and 2011, respectively. The Bank will continue to monitor its allowance for loan losses as conditions dictate.

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

	At or for the Year Ended				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Balance at beginning of year	$ 18,230	$ 19,700	$ 14,723	$ 11,665	$ 10,468
Charge-offs:					
Residential real estate	4,679	4,643	1,959	1,603	884
Commercial real estate	47	2,301	324	885	
Consumer	2,282	1,982	736	105	
Commercial	76	323	257	95	
Total	7,084	9,249	3,276	2,688	884
Recoveries	1,464	29	253	46	306
Net charge-offs	5,620	9,220	3,023	2,642	578
Provision for loan losses	7,900	7,750	8,000	5,700	1,775
Balance at end of year	$ 20,510	$ 18,230	$ 19,700	$ 14,723	$ 11,665
Ratio of net charge-offs during the year to average net loans outstanding during the year	0.36%	0.57%	0.18%	0.16%	0.03%

The increase in charge-offs during 2011 was primarily due to the Company s decision to modify its charge-off policy as described above.

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

	At December 31, 2012			2011			2010			2009			2008		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Perc o Lo in E Cate t To Lo
ntial ate	$ 5,241	25.56%	52.82%	$ 5,370	29.46%	55.97%	$ 5,977	30.34%	57.45%	$ 3,654	24.82%	58.48%	$ 3,245	27.82%	6
ercial ate	8,937	43.57	30.66	8,474	46.48	29.00	6,837	34.71	25.80	5,043	34.25	24.08	3,580	30.69	1
ner	2,264	11.04	12.78	1,461	8.01	12.14	3,264	16.57	12.20	2,998	20.36	13.18	1,924	16.49	1
ercial	1,348	6.57	3.74	900	4.94	2.89	962	4.88	4.55	1,725	11.72	4.26	1,442	12.36	
cated	2,720	13.26		2,025	11.11		2,660	13.50		1,303	8.85		1,474	12.64	
	$ 20,510	100.00%	100.00%	$ 18,230	100.00%	100.00%	$ 19,700	100.00%	100.00%	$ 14,723	100.00%	100.00%	$ 11,665	100.00%	10

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Reserve for Repurchased Loans. At December 31, 2012 and 2011, the Company maintained a reserve for repurchased loans of $1.2 million and $705,000, respectively, related to potential losses on loans sold which may have to be repurchased due to a violation of a representation or warranty. The increase from the prior year was due to an additional provision for repurchased loans of $750,000, partly offset by a loss of $252,000 on a single loan repurchased. Provisions for losses are charged to gain on sale of loans and credited to the reserve while actual losses are charged to the reserve. Losses were $252,000, $104,000, and $10,000, respectively, for the years ended December 31, 2012, 2011, and 2010. There were no loans repurchased for the years ended December 31, 2011 and 2010. Included in the losses on loans repurchased are cash settlements in lieu of repurchases. At December 31, 2012, there were twelve outstanding loan repurchase requests on loans with a total principal balance of $3.6 million, which the Company is disputing, as compared to four outstanding loan repurchase requests with a principal balance of $1.2 million at December 31, 2011. For the year ended December 31, 2012, eighteen new repurchase requests were received, nine repurchase requests were resolved at no cost to the Bank and one repurchase request resulted in a repurchased loan.

In order to estimate an appropriate reserve for repurchased loans, the Company considers recent and historical experience, product type and volume of recent whole loan sales, the general economic environment and an estimated loss on repurchase requests received but not yet resolved.

The method used to calculate the reserve for repurchased loans can generally be described as: volume of loans sold multiplied by the estimated percentage of loans expected to be returned for repurchase multiplied by the estimated loss percentage on loans repurchased.

The material assumptions relied on to determine the reserve for repurchased loans are further described below.

A specific reserve was established for projected losses on outstanding repurchase requests. The specific reserve was based on the estimated fair market value of the underlying collateral modified by the likelihood of payment which was estimated based on historical experience.

The Company segmented its volume of sold loans into two portfolios, Bank originated loans and loans originated by Columbia. Each of these portfolios was further segmented by investor type, between loans sold to Government Sponsored Enterprises (GSE) such as FHLMC and FNMA and loans sold to non-GSE investors. Based on actual loan repurchase experience, the Company determined that loans originated by Columbia had significantly more repurchase requests than loans originated by the Bank. Based on this data, the Company considered the population of loans subject to repurchase as Columbia loans originated from January 1, 2005 through its shuttering in 2007 and Bank loans originated in the past five years. The volume of loan originations by Columbia is net of loan volume covered by a prior settlement with the loan investor, as the risk of future repurchases from these loans has been mitigated. Loan balances were assumed to decay, or run-off, at the rate of 12.5% per year.

The Company then applied a return factor to the remaining loan sale volume as determined above. The return factor was determined based on the Company s actual experience for repurchase requests and is equal to the amount of repurchase requests divided by the amount of loans sold.

The calculated return factors were as follows:

	Non-GSE Exposure			GSE Exposure		
	At December 31,					
	2012	2011	2010	2012	2011	2010
Bank	0.10%	0.16%	0.13%	0.04%	0.00%	0.00%
Columbia	0.39%	0.49%	0.97%	0.76%	0.26%	0.81%

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The Company experienced substantial repurchase request volume for Columbia in 2007 which moderated significantly in recent years. As a result of this trend, the Company gave more weight to its more recent experience and less weight to earlier experience.

Finally, to establish the reserve for repurchased loans, estimated loss factors were applied to the estimated amount of repurchase requests. The Company calculated an actual loss experience on currently outstanding and prior repurchase requests of 25.0% and 17.6% for the Bank and Columbia, respectively, at December 31, 2012, and 15.7% and 16.0% for both the Bank and Columbia, respectively, at December 31, 2011 and 2010, although the actual loss factor was modified to consider several economic factors which were likely to adversely impact the Company s loss experience. These factors included continued weakness in the housing market; a nationwide recession with significant decline in employment; and, increasing delinquency and foreclosure rates on single family mortgage loans. Additionally, both FNMA and FHLMC and investors in mortgage-backed securities pools continue to carefully examine loan documentation on loans sold to these agencies and investors by loan originators, such as the Bank, with a goal of putting an increasing amount of delinquent loans back to the originator. After adjustments, the final estimated loss factors used and applied to loans for which no request has been received to date at December 31, 2012, 2011 and 2010 were 40.5%, 26.2% and 26.5%, respectively, for the Bank and 48.1%, 41.2% and 29.0% respectively, for Columbia.

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

Investment Activities

Federally-chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various Federal agencies, certificates of deposit of insured banks and savings institutions, bankers acceptances, repurchase agreements and Federal funds. Subject to various restrictions, Federally-chartered savings institutions may also invest in commercial paper, investment-grade corporate debt securities and mutual funds whose assets conform to the investments that a Federally-chartered savings institution is otherwise authorized to make directly.

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

Management determines the appropriate classification of securities at the time of purchase. If the Bank has the intent and the ability at the time of purchase to hold securities until maturity, they may be classified as held to maturity. Investment and mortgage-backed securities identified as held to maturity are carried at cost, adjusted for amortization of premium and accretion of discount, which are recognized as adjustments to interest inco