OCEANFIRST FINANCIAL CORP
Form 10-K
March 15, 2017
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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, 2016
¨ 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 o Accelerated filer x Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x.
The aggregate market fair value of the voting and non-voting common equity held by non-affiliates of the registrant, i.e., persons other than the directors and executive officers of the registrant, was $444,843,000 based upon the closing price of such common equity as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares outstanding of the registrant's Common Stock as of March 8, 2017 was 32,392,685.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2017 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days from December 31, 2016, 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, 2016, the Company had consolidated total assets of $5.2 billion and total stockholders' equity of $572.0 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 Company has been the holding company for the Bank since it acquired the stock of the Bank upon the Bank's conversion from a Federally-chartered mutual savings bank to a Federally-chartered capital stock savings bank in 1996 (the "Conversion"). The Bank's principal business has been and continues to be attracting retail and business deposits in the communities surrounding its branch offices and investing those deposits primarily in loans, consisting of commercial real estate and other commercial loans which have become a key focus of the Bank and single-family, owner-occupied residential mortgage loans. The Bank also invests in other types of loans, including residential construction and consumer loans. In addition, the Bank invests in mortgage-backed securities ("MBS"), securities issued by the U.S. Government and agencies thereof, corporate securities and other investments permitted by applicable law and regulations. The Bank's revenues are derived principally from interest on its loans, and to a lesser extent, interest on its investment and mortgage-backed securities. The Bank also receives income from fees and service charges on loan and deposit products, Bankcard services, wealth management services and the sale of alternative investment products, e.g., mutual funds, annuities and life insurance. The Bank's primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, investment maturities, proceeds from the sale of loans, Federal Home Loan Bank ("FHLB") advances and other borrowings.

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

In addition to historical information, this Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 which are based on certain assumptions and describe future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words "believe", "expect", "intend", "anticipate", "estimate", "project", "will", "should", "may", "view", "opportunity", similar expressions or expressions of confidence. The Company's ability to predict results or the actual effect of plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, those items discussed under Item 1A. Risk Factors herein and the following: changes in interest rates, general economic conditions, levels of unemployment in the Bank's lending area, real estate market values in the Bank's lending area, future natural disasters and increases to flood insurance premiums, the level of prepayments on loans and mortgage-backed securities, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government including policies of the U.S. Treasury and the FRB, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area, accounting principles and guidelines and the Bank's ability to successfully integrate acquired operations. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Market Area and Competition

The Bank is a community-oriented financial institution, offering a wide variety of financial services to meet the needs of the communities it serves. The Bank conducts its business through an administrative/branch office located in Toms River, New Jersey, and sixty additional branch offices and two deposit production facilities located throughout Central and Southern New Jersey. The Bank also operates a wealth management office in Manchester, New Jersey and commercial loan production offices in the Philadelphia area and Mercer County, New Jersey. The Bank’s deposit gathering and lending activities are concentrated in the markets surrounding its branch office network.

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The Bank is the largest and oldest community-based financial institution headquartered in Ocean County, New Jersey, approximately midway between New York City and Philadelphia. The economy in the Bank's primary market area, which represents the broader Central and Southern New Jersey market, is based upon a mixture of service and retail trade. Other employment is provided by a variety of wholesale trade, manufacturing, Federal, state and local government, hospitals and utilities. The area is also home to commuters working in areas in and around New York City and Philadelphia. The market area includes a significant number of vacation and second homes in the communities along the New Jersey shore.

The Bank's future growth opportunities will be partly influenced by the growth and stability of its geographic marketplace and the competitive environment. The Bank faces significant competition both in making loans and in attracting deposits. The state of New Jersey, and the Bank's primary market areas of Central and Southern New Jersey, is an attractive market to many financial institutions. Many of the Bank's competitors are branches of significantly larger institutions headquartered out-of-market which have greater financial resources than the Bank. The Bank's competition for loans comes principally from commercial banks, savings banks, savings and loan associations, credit unions, mortgage banking companies, internet-based providers and insurance companies. Its most direct competition for deposits has historically come from commercial banks, savings banks, savings and loan associations and credit unions although the Bank also faces competition for deposits from short-term money market funds, other corporate and government securities funds, internet-only providers and from other financial service institutions such as brokerage firms and insurance companies. The Bank distinguishes itself from large banking competitors through its local presence and ability to deliver personalized service.

Community Involvement

The Bank proudly promotes a higher quality of life in the communities it serves through employee volunteer efforts and the work of OceanFirst Foundation (the "Foundation"). Employees are continually encouraged to become leaders in their communities and use the Bank's support to help others. Through the Foundation, established in 1996, OceanFirst has donated $30 million to enrich the lives of local citizens by supporting initiatives in health and human services, education, affordable housing, youth development and the arts.

Acquisitions

On July 31, 2015, the Company completed its acquisition of Colonial American Bank ("Colonial American"), which added $142.4 million to assets, $121.2 million to loans, and $123.3 million to deposits. The in-market acquisition strengthened the Bank's position in the attractive Monmouth County, New Jersey marketplace by adding offices in Middletown and Shrewsbury, New Jersey.

On March 11, 2016, the Bank purchased an existing retail branch located in the Toms River market with total deposits of $17.0 million.

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

On November 30, 2016, the Company completed its acquisition of Ocean Shore Holding Company ("Ocean Shore") which added $995.9 million to assets, $875.1 million to deposits, and $774.0 million to loans. The in-market transaction solidified the Bank's position as the premier banking franchise in Central and Southern New Jersey with a strong core deposit franchise and enhanced operating scale.

While the Bank intends to concentrate on integrating its recent acquisitions, reducing non-interest expenses and on organic growth, the Company will continue to evaluate potential acquisition opportunities for those that are expected to create shareholder value.

Lending Activities

Loan Portfolio Composition. At December 31, 2016, the Bank had total loans outstanding of $3.831 billion, of which $1.653 billion, or 43.2% of total loans were one-to-four family, residential mortgage loans. The remainder of the portfolio consisted of $1.669 billion of commercial real estate, multi-family and land loans, or 43.6% of total loans; $65.4 million of residential construction loans, or 1.7% of total loans; $290.7 million of consumer loans, primarily home equity loans and lines of credit, or 7.6% of total loans; and, $152.8 million of commercial loans, or 4.0% of total loans. Included in total loans are $1.6 million in loans held-for-sale at December 31, 2016. At that same date, 31.5% of the Bank’s total loans had adjustable interest rates.

The types of loans that the Bank may originate are subject to Federal and state 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

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competitors. These factors are, in turn, affected by, among other things, economic conditions, monetary policies of the Federal government, including the FRB, and legislative tax policies.

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

	At December 31, 2016		2015		2014		2013		2012	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Perc of T
	(dollars in thousands)									
Real estate:										
One-to-four family	$1,653,246	43.15 %	$793,946	39.68 %	$742,090	43.07 %	$751,370	47.79 %	$809,705	52.2
Commercial real estate, multi-family and land	1,668,872	43.56	818,445	40.90	649,951	37.73	528,945	33.64	475,155	30.6
Residential construction	65,408	1.71	50,757	2.54	47,552	2.76	30,821	1.96	9,013	0.58
Consumer (1)	290,676	7.59	193,160	9.65	199,349	11.57	200,683	12.76	198,143	12.7
Commercial and industrial	152,810	3.99	144,788	7.23	83,946	4.87	60,545	3.85	57,967	3.74
Total loans	3,831,012	100.00%	2,001,096	100.00%	1,722,888	100.00%	1,572,364	100.00%	1,549,983	100.
Loans in process	(14,249)		(14,206)		(16,731)		(12,715)		(3,639)	
Deferred origination costs, net	3,414		3,232		3,207		3,526		4,112	
Allowance for loan losses	(15,183)		(16,722)		(16,317)		(20,930)		(20,510)	
Total loans, net	3,804,994		1,973,400		1,693,047		1,542,245		1,529,946	
Less:										
Loans held for sale	1,551		2,697		4,201		785		6,746	
Loans receivable, net	$3,803,443		$1,970,703		$1,688,846		$1,541,460		$1,523,200	
Total loans:										
Adjustable rate	$1,207,247	31.51 %	$765,022	38.23 %	$651,566	37.82 %	$602,976	38.35 %	$635,264	40.9
Fixed rate	2,623,765	68.49	1,236,074	61.77	1,071,322	62.18	969,388	61.65	914,719	59.0
	$3,831,012	100.00%	$2,001,096	100.00%	$1,722,888	100.00%	$1,572,364	100.00%	$1,549,983	100.

(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, 2016. The table does not include principal prepayments.

	At December 31, 2016					
	One-to-four family	Commercial real estate, multi-family and land	Residential construction [1]	Consumer	Commercial and industrial	Total loans receivable
	(in thousands)					
One year or less	$1,544	$236,204	$ 61,491	$3,813	$ 49,733	$352,785
After one year:						
More than one year to three years	13,662	339,575	3,585	11,066	31,076	398,964
More than three years to five years	13,678	349,286	—	11,466	23,399	397,829
More than five years to ten years	95,764	494,419	—	72,326	21,735	684,244
More than ten years to twenty years	483,080	164,468	—	187,747	10,950	846,245
More than twenty years	1,045,518	84,920	332	4,258	15,917	1,150,945
Total due after December 31, 2017	1,651,702	1,432,668	3,917	286,863	103,077	3,478,227
Total amount due	$1,653,246	$1,668,872	$ 65,408	$290,676	$ 152,810	3,831,012
Loans in process						(14,249)
Deferred origination costs, net						3,414
Allowance for loan losses						(15,183)
Loans receivable, net						3,804,994
Less: Loans held for sale						1,551
Total loans, net						$3,803,443

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

The following table sets forth at December 31, 2016, the dollar amount of total loans receivable, contractually due after December 31, 2017, and whether such loans have fixed interest rates or adjustable interest rates.

	Due After December 31, 2017		
	Fixed	Adjustable	Total
	(in thousands)		
Real estate loans:			
One-to-four family	$1,234,389	$417,313	$1,651,702
Commercial real estate, multi-family and land	944,335	488,333	1,432,668
Residential construction	3,489	428	3,917
Consumer	137,872	148,991	286,863
Commercial and industrial	62,066	41,011	103,077
Total loans receivable	$2,382,151	$1,096,076	$3,478,227

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Origination, Sale and Servicing of Loans. The following table sets forth the Bank's loan originations, purchases, sales, principal repayments and loan activity, including loans held-for-sale, for the periods indicated.

	For the Years Ended December 31,		
	2016	2015	2014
	(in thousands)		
Total loans:			
Beginning balance	$2,001,096	$1,722,888	$1,572,364
Loans originated:			
One-to-four family	135,107	124,225	107,816
Commercial real estate, multi-family and land	122,806	187,454	193,025
Residential construction	42,805	48,558	50,556
Consumer	43,780	48,594	52,070
Commercial and industrial	138,495	76,931	50,833
Total loans originated	482,993	485,762	454,300
Loans purchased	37,561	21,992	20,363
Net loans acquired in acquisition	1,930,853	121,466	—
Total	4,452,503	2,352,108	2,047,027
Less:			
Principal repayments	536,432	294,284	249,704
Sales of loans	78,736	48,614	62,318
Charge-offs (gross)	4,490	1,135	7,828
Transfer to other real estate owned	1,833	6,979	4,289
Total loans	$3,831,012	$2,001,096	$1,722,888

One-to-Four Family Mortgage Lending. The Bank offers both fixed-rate and adjustable-rate mortgage ("ARM") loans secured by one-to-four family residences with maturities up to 30 years. The majority of such loans are secured by property located in the Bank's primary market area. Loan originations are typically generated by commissioned loan representatives in the exclusive employment of the Bank and their contacts within the local real estate industry, members of the local communities and the Bank's existing or past customers. On occasion the Bank purchases loans originated by other banks.

At December 31, 2016, the Bank's total loans outstanding were $3.831 billion, of which $1.653 billion, or 43.2%, 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 loans was approximately $181,000 at December 31, 2016.

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

Generally, ARM loans pose credit risks different than risks inherent in fixed-rate loans, primarily because as interest rates rise, the payments of the borrower rise, thereby increasing the potential for delinquency and default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. In order to minimize risks, borrowers of ARM loans with an initial fixed period of five years or less must qualify based on the greater of the note rate plus 2% or the fully-indexed rate. Seven- to ten-year ARMs must qualify based on the note rate. The Bank does not originate ARM loans which provide for negative amortization.

The Bank's fixed-rate mortgage loans are currently made for terms from 10 to 30 years. Prior to the fourth quarter of 2014, the Bank generally retained the servicing on loans sold. Currently, servicing rights are generally sold as part of the loan sale. The Bank generally holds for its portfolio shorter-term, fixed-rate loans and certain longer-term, fixed-rate loans, generally consisting of loans with balances exceeding the conforming loan limits of the government agencies ("Jumbo" loans) and loans to officers, directors or employees of the Bank. The Bank may retain a portion of its longer-term, fixed-rate loans after considering volume and yield and after evaluating interest rate risk and capital management considerations. The retention of fixed-rate mortgage loans may increase the level of interest rate risk exposure of the Bank, as the rates on these loans will not adjust during periods of rising interest rates and the loans can be subject to substantial increases in prepayments during periods of falling interest rates. During the past several years, the Bank has generally sold

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much of its 30-year, fixed-rate, one-to-four family loans into the secondary market primarily to manage interest rate risk. With the recent rise in market interest rates and the reduction in refinance volume, the Bank anticipates retaining most of its 30-year fixed-rate loan originations in 2017 to replace anticipated repayments of the existing residential loan portfolio.

The Bank's policy is to originate one-to-four family residential mortgage loans in amounts up to 80% of the lower of the appraised value or the selling price of the property securing the loan and up to 95% of the appraised value or selling price if private mortgage insurance is obtained. Appraisals are obtained for loans secured by real estate properties. The weighted average loan-to-value ratio of the Bank's one-to-four family mortgage loans was 55.5% at December 31, 2016 based on appraisal values at the time of origination. Title insurance is typically required for first mortgage loans. Mortgage loans originated by the Bank include due-on-sale clauses which provide the Bank with the contractual right to declare the loan immediately due and payable in the event the borrower transfers ownership of the property without the Bank's consent. Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio and the Bank has generally exercised its rights under these clauses.

The Bank currently brokers reverse mortgage loans for a third-party originator. The loans qualify under the Home Equity Conversion Mortgage program of the Federal Housing Administration and are insured by the Department of Housing and Urban Development. For the year ended December 31, 2016, the Bank recognized fee income on reverse mortgage loans of $95,000, as compared to $233,000 for the year ended December 31, 2015.

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

Commercial Real Estate, Multi-Family and Land Lending. The Bank originates commercial real estate loans that are secured by properties, or properties under construction, generally used for business purposes such as office, industrial or retail facilities. A substantial majority of the Bank's commercial real estate loans are located in its primary market area. The Bank'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 generally originates commercial real estate loans with terms of up to ten years and amortization schedules up to thirty years with fixed or adjustable rates. The loans typically contain prepayment penalties over the initial term. In reaching its decision on whether to make a commercial real estate loan, the Bank considers the net operating income of the property and the borrower's expertise, credit history and profitability among other factors. The Bank has generally required that the properties securing commercial real estate loans have debt service coverage ratios of at least 130%. The Bank generally requires the personal guarantee of the principal borrowers for commercial real estate loans.

The Bank's commercial real estate loan portfolio at December 31, 2016 was $1.669 billion, or 43.6% of total loans, as compared to $818.4 million, or 40.9% of total loans, at December 31, 2015. The Bank continues to grow this market segment primarily through the addition of experienced commercial lenders and has commercial lending teams in Monmouth, Atlantic, Cape May, and Mercer Counties and in the Philadelphia area. Of the total commercial real estate portfolio, 32.0% is considered owner-occupied, whereby the underlying business owner occupies a majority of the property. The average size of the Bank's commercial real estate loans at December 31, 2016 was approximately $778,000.

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, 2016, the Bank had an outstanding balance in commercial construction loans of $123.2 million, as compared to $29.2 million at December 31, 2015. The increase was primarily due to the acquisitions of Cape and Ocean Shore and commercial construction loan origination opportunities in the Bank's local market.

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, 2016 totaled $34.8 million and $7.7 million, respectively, as compared to $28.4 million and $8.0 million, respectively, at December 31, 2015.

Residential Construction Lending. At December 31, 2016, residential construction loans totaled $65.4 million, or 1.7%, of the Bank's total loans outstanding.

The Bank originates residential construction loans primarily on a construction/permanent basis with such loans converting to an amortizing loan following the completion of the construction phase. Most of the Bank's residential construction loans are made to individuals building a residence.

Construction lending, by its nature, entails additional risks compared to one-to-four family mortgage lending, attributable primarily to the fact that funds are advanced based upon a security interest in a project which is not yet complete. The Bank addresses these risks through its underwriting policies and procedures and its experienced staff.

Consumer Loans. At December 31, 2016, the Bank's consumer loans totaled $290.7 million, or 7.6% of the Bank's total loan portfolio. Of the total consumer loan portfolio, home equity loans comprised $149.8 million; home equity lines of credit comprised $143.4 million; overdraft line of credit loans totaled $771,000; loans on savings accounts and other consumer loans totaled $785,000. There was also $4.1 million of unaccreted fair value marks on the consumer loan portfolio.

The Bank originates home equity loans typically as fixed-rate loans with terms ranging from 5 to 20 years. The Bank also offers variable-rate home equity lines of credit. Home equity loans and lines of credit are based on the applicant's income and their ability to repay and are secured by a mortgage on the underlying real estate, typically owner-occupied, one-to-four family residences. Generally, the loan when combined with the balance of any applicable first mortgage lien, may not exceed 80% of the appraised value of the property at the time of the loan commitment. The Bank charges an early termination fee should a home equity loan or line of credit be closed within two or three years of origination. A borrower is required to make monthly payments of principal and interest, at a minimum of $50, based upon a 10-, 15- or 20-year amortization period. Certain home equity lines of credit require the payment of interest-only during the first five years with fully-amortizing payments thereafter. At December 31, 2016, these loans totaled $41.4 million, as compared to $15.7 million at December 31, 2015.

Generally, the adjustable rate of interest charged is based upon the prime rate of interest (as published in the Wall Street Journal), although the range of interest rates charged may vary from 1.0% below prime to 1.5% over prime. The loans have an 18% lifetime cap on interest rate adjustments.

Commercial and Industrial Lending. At December 31, 2016, commercial and industrial ("C&I") loans totaled $152.8 million, or 4.0% of the Bank's total loans outstanding. The Bank originates commercial and industrial loans and lines of credit (including for working capital; fixed asset purchases; and acquisition, receivable and inventory financing) primarily in the Bank's market area. In underwriting commercial and industrial loans and credit lines, the Bank reviews and analyzes financial history and capacity, collateral value, strength and character of the principals, and general payment history of the principal borrowers in coming to a credit decision. The Bank generally originates C&I loans secured by the assets of the business including accounts receivable, inventory, fixtures, etc. The Bank generally requires the personal guarantee of the principal borrowers for all commercial and industrial loans.

Commercial and industrial business lending is generally considered to involve a higher degree of risk than real estate lending. Risk of loss on a commercial and industrial business loan is dependent largely on the borrower's ability to remain financially able to repay the loan from ongoing operations. The average size of the Bank's commercial and industrial loans at December 31, 2016 was approximately $261,000.

Loan Approval Procedures and Authority. The Board establishes the loan approval policies of the Bank based on total exposure to the individual borrower. The Board has authorized the approval of loans by various officers of the Bank or a Management Credit Committee, on a scale which requires approval by personnel with progressively higher levels of responsibility as the loan amount increases. Pursuant to applicable regulations, loans to one borrower generally cannot exceed 15% of the Bank's unimpaired capital. At December 31, 2016 this limit amounted to $66.8 million. At December 31, 2016, the Bank's maximum loan exposure to a single borrower was a $22.3 million relationship secured by pledges and assignments of notes receivables and various real estate collateral.

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

In addition to internal credit reviews, the Bank has engaged an independent firm specializing in commercial loan reviews to examine a selection of commercial real estate and commercial and industrial loans, and provide management with objective analysis regarding the quality of these loans throughout the year. The independent firm reviewed more than 60% of the Company's commercial real estate and commercial and industrial loans during 2016. Their conclusion was that the Bank's internal credit reviews are consistent with both Bank policy and general industry practice.

Loan Servicing. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, making inspections as required of mortgaged premises, contacting delinquent borrowers, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. The Bank also services mortgage loans for others. On October 31, 2014, the Bank sold most of the servicing rights on residential mortgage loans serviced for Federal agencies, recognizing a net gain of $408,000. Smaller sales in 2015 resulted in a net gain of $111,000. All of the remaining loans currently being serviced for others are loans which were originated by the Bank. At December 31, 2016, the Bank was servicing $137.9 million of loans for others. At December 31, 2016, 2015, and 2014, the balance of the Bank's Mortgage Servicing Rights ("MSR") totaled $228,000, $589,000, and $701,000, respectively. For the years ended December 31, 2016, 2015, and 2014, loan servicing income totaled $250,000, $268,000, and $816,000, respectively. The Bank evaluates the MSR for impairment on a quarterly basis. No impairment was recognized for the years ended December 31, 2016, 2015, and 2014. The valuation of MSR is determined through a discounted analysis of future cash flows, incorporating numerous assumptions which are subject to significant change in the near term. Generally, a decline in market interest rates will cause expected prepayment speeds to increase resulting in a lower valuation for mortgage servicing rights and ultimately lower future servicing fee income.

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Delinquencies and Classified Assets. The steps taken by the Bank with respect to delinquencies vary depending on the nature of the loan and period of delinquency. When a borrower fails to make a required payment on a loan, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. The Bank sends the borrower a written notice of non-payment after the loan is first past due. In the event payment is not then received, additional letters and phone calls generally are made. The Bank may offer to modify the terms or take other forbearance actions which afford the borrower an opportunity to satisfy the loan terms. If the loan is still not brought current and it becomes necessary for the Bank to take legal action, which typically occurs after a loan is delinquent at least 120 days or more, the Bank will commence litigation to realize on the collateral, including foreclosure proceedings against any real property that secures the loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or an acceptable workout accommodation is not agreed upon before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. Foreclosure timelines in New Jersey are among the longest in the nation and have remained protracted over the past several years.

The Bank’s internal Asset Classification Committee, which is chaired by the Chief Risk Officer, reviews and classifies the Bank’s assets quarterly and reports the results of its review to the Board. As part of this process, the Chief Risk Officer compiles a quarterly list of all criticized and classified loans, and a narrative report of classified commercial and industrial, commercial real estate, multi-family, land and construction loans. The Bank classifies assets in accordance with certain regulatory guidelines and definitions. At December 31, 2016, the Bank had $70.5 million of assets, including all other real estate owned ("OREO"), classified as “Substandard”, $111,000 classified as “Doubtful” and no assets classified as “Loss.” At December 31, 2015, the Bank had $33.3 million of assets classified as “Substandard,” no assets classified as “Doubtful” and no assets classified as “Loss.” Assets which do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses, such as past delinquencies, are designated “Special Mention.” Special Mention assets totaled $15.7 million at December 31, 2016, as compared to $23.1 at December 31, 2015.

Non-Accrual Loans and OREO. The following table sets forth information regarding non-accrual loans and OREO, excluding Purchase Credit Impaired (“PCI”) loans. The Bank obtained PCI loans as part of its acquisitions of Colonial American, Cape and Ocean Shore. PCI loans are accounted for at fair value, based upon the present value of expected future cash flows with no related allowance for loan losses. PCI loans totaled $7.6 million and $461,000 at December 31, 2016 and 2015, respectively. It is the policy of the Bank to cease accruing interest on loans 90 days or more past due or in the process of foreclosure. For the years ended December 31, 2016, 2015 and 2014, 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 $391,000, $848,000, and $1,630,000, respectively.

	December 31,				
	2016	2015	2014	2013	2012
	(dollars in thousands)				
Non-accrual loans:					
Real estate:					
One-to-four family	$8,126	$5,779	$3,115	$28,213	$26,521
Commercial real estate, multi-family and land	2,935	10,796	12,758	12,304	11,567
Consumer	2,064	1,576	1,877	4,328	4,540
Commercial and industrial	441	123	557	515	746
Total	13,566	18,274	18,307	45,360	43,374
OREO	9,803	8,827	4,664	4,345	3,210
Total non-performing assets	$23,369	$27,101	$22,971		