

UNITY BANCORP INC /NJ/  
Form 10-Q  
August 12, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2009

OR

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 1-12431

Unity Bancorp, Inc.  
(Exact Name of Registrant as Specified in Its Charter)

New Jersey  
(State or Other Jurisdiction of Incorporation or Organization)

22-3282551  
(I.R.S. Employer Identification No.)

64 Old Highway 22, Clinton, NJ  
(Address of Principal Executive Offices)

08809  
(Zip Code)

Registrant's Telephone Number, Including Area Code (908) 730-7630

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, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a nonaccelerated filer (as defined in Exchange Act Rule 12b-2):  
Large accelerated filer  Accelerated filer  Nonaccelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act  
Yes  No

The number of shares outstanding of each of the registrant's classes of common equity stock, as of August 1, 2009  
common stock, no par value: 7,119,438 shares outstanding

---

Table of Contents

## Table of Contents

	Page #
<b>PART I</b>	
<b><u>CONSOLIDATED FINANCIAL INFORMATION</u></b>	
ITEM 1	
<u>Consolidated Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets at June 30, 2009, 2008 and December 31, 2008</u>	1
Consolidated Statements of Income for the three months and six months ended June 30, 2009 and 2008	2
<u>Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2009 and 2008</u>	3
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2009 and 2008</u>	4
<u>Notes to the Consolidated Financial Statements</u>	5
ITEM 2	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
ITEM 3	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	28
ITEM 4T	
<u>Controls and Procedures</u>	28
<b>PART II</b>	
<b><u>OTHER INFORMATION</u></b>	29
ITEM 1	
<u>Legal Proceedings</u>	29
ITEM 1A	
<u>Risk Factors</u>	29
ITEM 2	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
ITEM 3	
<u>Defaults upon Senior Securities</u>	29
ITEM 4	
<u>Submission of Matters to a Vote of Security Holders</u>	29
ITEM 5	
<u>Other Information</u>	29
ITEM 6	
<u>Exhibits</u>	29
<b><u>SIGNATURES</u></b>	30

<u>EXHIBIT INDEX</u>	31
Exhibit 31.1	32
Exhibit 31.2	33
Exhibit 32.1	34

---

Table of ContentsPart 1 - Consolidated Financial Information  
Item 1 - Consolidated Financial Statements (Unaudited)Unity Bancorp, Inc.  
Consolidated Balance Sheets  
(Unaudited)

(In thousands)	June 30, 2009	December 31, 2008	June 30, 2008
<b>ASSETS</b>			
Cash and due from banks	\$ 17,295	\$ 18,902	\$ 20,368
Federal funds sold and interest-bearing deposits	37,232	15,529	33,678
Cash and cash equivalents	54,527	34,431	54,046
Securities:			
Available for sale	132,719	117,348	77,110
Held to maturity (fair value of \$31,634, \$30,088 and \$29,077, respectively)	32,075	32,161	29,862
Total securities	164,794	149,509	106,972
Loans:			
SBA held for sale	23,161	22,181	25,605
SBA held to maturity	82,157	83,127	75,988
SBA 504	72,619	76,802	70,723
Commercial	299,411	308,165	316,579
Residential mortgage	125,466	133,110	95,100
Consumer	62,517	62,561	59,044
Total loans	665,331	685,946	643,039
Less: Allowance for loan losses	10,665	10,326	8,945
Net loans	654,666	675,620	634,094
Premises and equipment, net	12,067	12,580	12,372
Bank owned life insurance	5,890	5,780	5,674
Federal Home Loan Bank stock	5,127	4,857	4,407
Accrued interest receivable	4,263	4,712	4,095
Goodwill and other intangibles	1,566	1,574	1,581
Loan servicing asset	1,142	1,503	1,877
Other assets	9,404	7,744	7,197
Total Assets	\$ 913,446	\$ 898,310	\$ 832,315
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities:</b>			
<b>Deposits:</b>			
Noninterest-bearing demand deposits	\$ 83,639	\$ 74,090	\$ 81,273
Interest-bearing demand deposits	84,842	87,046	88,551
Savings deposits	211,876	134,875	180,665
Time deposits, under \$100,000	239,893	270,275	236,241
Time deposits, \$100,000 and over	111,513	140,831	85,151
Total deposits	731,763	707,117	671,881

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

Borrowed funds	95,000	105,000	95,000
Subordinated debentures	15,465	15,465	15,465
Accrued interest payable	847	805	779
Accrued expenses and other liabilities	3,307	2,120	1,239
Total Liabilities	846,382	830,507	784,364
Commitments and contingencies	-	-	-
Shareholders' equity:			
Preferred stock, no par value, 500 shares authorized	18,305	18,064	-
Common stock, no par value, 12,500 shares authorized	55,264	55,179	52,281
Retained earnings (deficit)	(135)	1,085	1,593
Treasury stock at cost	(4,169)	(4,169)	(4,169)
Accumulated other comprehensive loss, net of tax	(2,201)	(2,356)	(1,754)
Total Shareholders' Equity	67,064	67,803	47,951
Total Liabilities and Shareholders' Equity	\$ 913,446	\$ 898,310	\$ 832,315
Preferred shares	21	21	-
Issued common shares	7,544	7,544	7,520
Outstanding common shares	7,119	7,119	7,095

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Unity Bancorp  
Consolidated Statements of Income  
(unaudited)

(In thousands, except per share amounts)	For the three months ended June 30,		For the six months ended June 30,	
	2009	2008	2009	2008
<b>INTEREST INCOME</b>				
Federal funds sold and interest-bearing deposits	\$29	\$ 111	\$46	\$ 291
Federal Home Loan Bank stock	122	76	118	176
Securities:				
Available for sale	1,509	932	3,188	1,807
Held to maturity	391	398	777	835
Total securities	1,900	1,330	3,965	2,642
Loans:				
SBA	1,564	2,028	3,171	4,356
SBA 504	1,285	1,260	2,516	2,710
Commercial	5,051	5,407	10,067	10,692
Residential mortgage	1,783	1,209	3,646	2,288
Consumer	797	846	1,592	1,747
Total loan interest income	10,480	10,750	20,992	21,793
Total interest income	12,531	12,267	25,121	24,902
<b>INTEREST EXPENSE</b>				
Interest-bearing demand deposits	267	350	537	716
Savings deposits	912	918	1,556	2,267
Time deposits	3,409	3,006	7,133	6,226
Borrowed funds and subordinated debentures	1,085	1,155	2,263	2,220
Total interest expense	5,673	5,429	11,489	11,429
Net interest income	6,858	6,838	13,632	13,473
Provision for loan losses	1,500	650	3,000	1,100
Net interest income after provision for loan losses	5,358	6,188	10,632	12,373
<b>NONINTEREST INCOME (LOSS)</b>				
Service charges on deposit accounts	335	341	665	661
Service and loan fee income	294	302	547	602
Bank owned life insurance	55	53	110	104
Gain on sale of mortgage loans	49	-	113	21
Gain on sale of SBA loans held for sale, net	-	417	29	993
Total other-than-temporary impairment charge on securities	(2,555 )	(255 )	(2,555 )	(255 )
Portion of loss recognized in other comprehensive income (before taxes)	806	-	806	-
Net other-than temporary impairment charge recognized in earnings	(1,749 )	(255 )	(1,749 )	(255 )
Net security gains	2	49	517	119
Other income	107	121	209	238
Total noninterest income (loss)	(907 )	1,028	441	2,483
<b>NONINTEREST EXPENSE</b>				
Compensation and benefits	2,853	2,980	5,477	6,200

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

Occupancy	647	713	1,334	1,414
Processing and communications	482	544	1,023	1,114
Furniture and equipment	471	413	966	801
Professional services	260	143	506	341
Loan collection costs	180	138	379	240
Deposit insurance	708	111	1,009	174
Advertising	151	79	226	141
Other expenses	451	496	838	962
Total noninterest expense	6,203	5,617	11,758	11,387
Income (loss) before provision for income taxes	(1,752 )	1,599	(685 )	3,469
Provision (benefit) for income taxes	(552 )	495	(216 )	1,121
Net (loss) income	(1,200 )	1,104	(469 )	2,348
Preferred stock dividends and discount accretion	372	-	751	-
Income (loss) available to common shareholders	\$(1,572 )	\$ 1,104	\$(1,220 )	\$ 2,348
Net income (loss) per common share - Basic	\$(0.22 )	\$ 0.16	\$(0.17 )	\$ 0.33
- Diluted	(0.22 )	0.15	(0.17 )	0.32
Weighted average common shares outstanding - Basic	7,119	7,092	7,119	7,084
- Diluted	7,168	7,275	7,158	7,274

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.



Table of Contents

Unity Bancorp, Inc.  
 Consolidated Statements of Changes in Shareholders' Equity  
 For the six months ended June 30, 2009 and 2008  
 (Unaudited)

(In thousands)	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, December 31, 2007	\$	7,063	\$ 49,447	\$ 2,472	\$ (4,169)	\$ (490)	\$ 47,260
Comprehensive income:							
Net income				2,348			2,348
Unrealized losses on securities, net of tax						(1,240)	(1,240)
Unrealized losses on cash flow hedge derivatives, net of tax						(24)	(24)
Total comprehensive income							1,084
Dividends on common stock (\$ .10 per share) 5% stock dividend, including cash-in-lieu				(692)			(692)
			2,532	(2,535)			(3)
Issuance of common stock:							
Stock issued, including related tax benefits		21	151				151
Stock-based compensation		11	151				151
Balance, June 30, 2008	\$	7,095	\$ 52,281	\$ 1,593	\$ (4,169)	\$ (1,754)	\$ 47,951

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

(In thousands)	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings (Deficit)	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, December 31, 2008	\$ 18,064	7,119	\$ 55,179	\$ 1,085	\$ (4,169)	\$ (2,356)	\$ 67,803
Comprehensive income:							
Net loss				(469)			(469)
Noncredit unrealized losses on held to maturity debt securities, net of tax						(532)	(532)
Unrealized gains on securities, net of tax						572	572
Unrealized gains on cash flow hedge derivatives, net of tax						115	115
Total comprehensive loss							(314)
Accretion of discount on preferred stock	241			(241)			-
Dividends on preferred stock (5% annually)				(510)			(510)
Issuance of common stock:							
Stock issued, including related tax benefits			(48)				(48)
Stock-based compensation			133				133
Balance, June 30, 2009	\$ 18,305	7,119	\$ 55,264	\$ (135)	\$ (4,169)	\$ (2,201)	\$ 67,064

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.



Table of Contents

Unity Bancorp, Inc.  
Consolidated Statements of Cash Flows  
(Unaudited)

(In thousands)	For the six months ended	
	June 30, 2009	June 30, 2008
<b>OPERATING ACTIVITIES:</b>		
Net (loss) income	\$ (469)	\$ 2,348
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,000	1,100
Net amortization of purchase premiums and discounts on securities	190	30
Depreciation and amortization	803	208
Deferred income tax benefit	(1,412)	(1,249)
Other-than-temporary impairment charges on securities	1,749	255
Net security gains	(517)	(119)
Stock compensation expense	133	151
Gain on sale of SBA loans held for sale, net	(29)	(993)
Gain on sale of mortgage loans	(113)	(21)
Loss on disposal of fixed assets	-	28
Origination of mortgage loans held for sale	(8,718)	(1,739)
Origination of SBA loans held for sale	(1,943)	(20,822)
Proceeds from the sale of mortgage loans held for sale, net	8,831	1,760
Proceeds from the sale of SBA loans held for sale, net	867	20,850
Net change in other assets and liabilities	2,133	(383)
Net cash provided by operating activities	4,505	1,404
<b>INVESTING ACTIVITIES</b>		
Purchases of securities held to maturity	(4,036)	(2,782)
Purchases of securities available for sale	(63,550)	(30,337)
Purchases of Federal Home Loan Bank stock, at cost	(8,469)	(462)
Maturities and principal payments on securities held to maturity	2,640	6,652
Maturities and principal payments on securities available for sale	24,533	12,610
Proceeds from sales of securities available for sale	23,116	3,248
Proceeds from the redemption of Federal Home Loan Bank stock	8,199	450
Proceeds from the sale of other real estate owned	820	309
Net decrease (increase) in loans	18,347	(52,800)
Proceeds from the sale of premises and equipment	-	263
Purchases of premises and equipment	(148)	(911)
Net cash provided by (used in) investing activities	1,452	(63,760)

## FINANCING ACTIVITIES

Net increase in deposits	24,646	70,613
Proceeds from new borrowings	10,000	15,000
Repayments of borrowings	(20,000)	(5,000)
Proceeds from the issuance of common stock	(48)	151
Cash dividends paid on preferred stock	(459)	-
Cash dividends paid on common stock	-	(674)
Net cash provided by financing activities	14,139	80,090
Increase in cash and cash equivalents	20,096	17,734
Cash and cash equivalents at beginning of period	34,431	36,312
Cash and cash equivalents at end of period	\$ 54,527	\$ 54,046

## SUPPLEMENTAL DISCLOSURES

## Cash:

Interest paid	\$ 11,447	\$ 11,285
Income taxes paid	814	851
Noncash investing activities:		
Transfer of loans to other real estate owned	577	470

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Table of Contents

Unity Bancorp, Inc.  
Notes to the Consolidated Financial Statements (Unaudited)  
June 30, 2009

NOTE 1. Significant Accounting Policies

The accompanying consolidated financial statements include the accounts of Unity Bancorp, Inc. (the "Parent Company") and its wholly-owned subsidiary, Unity Bank (the "Bank" or when consolidated with the Parent Company, the "Company"), and reflect all adjustments and disclosures which are generally routine and recurring in nature, and in the opinion of management, necessary for a fair presentation of interim results. Unity Investment Services, Inc., a wholly-owned subsidiary of the Bank, is used to hold part of the Bank's investment portfolio. Unity Participation Company, Inc., a wholly-owned subsidiary of the Bank, is used to hold part of the Bank's loan portfolio. All significant inter-company balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation. The financial information has been prepared in accordance with U.S. generally accepted accounting principles and has not been audited. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the statements of financial condition and revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses. 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 for loan losses may be necessary based on changes in economic conditions. The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission ("SEC"). The results of operations for the three months ended June 30, 2009 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, "we" and "us" and "our" refer to Unity Bancorp, Inc., and its consolidated subsidiary, Unity Bank, depending on the context. Interim financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2008, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Stock Transactions

The Company has incentive and nonqualified option plans, which allow for the grant of options to officers, employees and members of the Board of Directors. In addition, restricted stock is issued under the stock bonus program to reward employees and directors and to retain them by distributing stock over a period of time.

Stock Option Plans

The Company's incentive and nonqualified option plans permit the Board to set vesting requirements. Grants issued to date generally vest over 3 years and must be exercised within 10 years of the date of the grant. The exercise price of each option is the market price on the date of grant. As of June 30, 2009, 1,520,529 shares have been reserved for issuance upon the exercise of options, 872,104 option grants are outstanding, and 572,271 option grants have been exercised, forfeited or expired, leaving 76,154 shares available for grant.

The Company did not grant any options during the three months and six months ended June 30, 2009. Comparatively, 3,150 and 42,263 options were granted during the three months and six months ended June 30, 2008, respectively. The fair value of the options granted during 2008 was estimated on the date of grant using the

Black-Scholes option-pricing model with the following weighted average assumptions:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Number of shares granted	-	3,150	-	42,263
Weighted average exercise price	\$ -	7.48	\$ -	\$ 7.60
Weighted average fair value	\$ -	1.56	\$ -	\$ 1.60
Expected life	-	3.98	-	3.80
Expected volatility	-%	32.02	-%	31.00%
Risk-free interest rate	-%	2.39	-%	2.44%
Dividend yield	-%	2.61	-%	2.51%

In addition to no options being granted, there were no options exercised, forfeited or expired under the Company's stock option plans during the three and six months ended June 30, 2009. Options outstanding and options exercisable at June 30, 2009 are summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at June 30, 2009	872,104	\$ 5.94	4.5	\$ 144,840
Exercisable at June 30, 2009	688,645	\$ 5.89	3.3	\$ 144,840

Statement of Financial Accounting Standards No. 123R, Share Based Payment ("Statement 123R") requires that the fair value of equity awards be recognized as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period). Compensation expense related to stock options totaled \$42 thousand and \$37 thousand for the three months ended June 30, 2009 and 2008, respectively. The related income tax benefit was approximately \$18 thousand and \$16 thousand for each of the three months ended June 30, 2009 and 2008. Compensation expense related to stock options totaled \$71 thousand and \$68 thousand for the six months ended June 30, 2009 and 2008, respectively. The related income tax benefit was approximately \$31 thousand and \$29 thousand for each of the six months ended June 30, 2009 and 2008. As of June 30, 2009, there was approximately \$227 thousand of unrecognized compensation cost related to nonvested, share-based compensation arrangements granted under the Company's stock incentive plans. This cost is expected to be recognized over a weighted-average period of 1.9 years.

There were no options exercised during the three months and six months ended June 30, 2009; consequently, no intrinsic value was realized. During the three months and six months ended June 30, 2008, there were 536 shares exercised with a related intrinsic value (spread between the market value and exercise price) of \$1 thousand.

Table of Contents

## Restricted Stock Awards

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value and amortized into salary expense on a straight line basis over the vesting period. There were no restricted stock awards granted during the three months and six months ended June 30, 2009. There were 1,050 restricted share awards with an average grant date fair value of \$7.48 and 12,600 restricted share awards with an average grant date fair value of \$7.59 granted during the three months and six months ended June 30, 2008, respectively.

Compensation expense related to the restricted stock awards totaled \$45 thousand for the three months ended June 30, 2009 and 2008, respectively. Compensation expense related to the restricted stock awards totaled \$62 thousand and \$83 thousand for the six months ended June 30, 2009 and 2008, respectively. As of June 30, 2009 there was approximately \$228 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. The cost is expected to be recognized over a weighted average period of 1.9 years.

As of June 30, 2009, 121,551 shares of restricted stock were reserved for issuance, of which 44,508 shares are available for grant.

The following table summarizes nonvested restricted stock award activity for the six months ended June 30, 2009:

	Shares	Average Grant Date Fair Value
Nonvested restricted stock at December 31, 2008	50,424	\$ 9.76
Granted	-	-
Vested	(14,630)	11.36
Forfeited	-	-
Nonvested restricted stock at June 30, 2009	35,794	\$ 9.10

## Income Taxes

The Company accounts for income taxes according to the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of



the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is “more-likely-than not” that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the “more-likely-than not” recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are recognized in income tax expense on the income statement.

#### Derivative Instruments and Hedging Activities

The Company uses derivative instruments, such as interest rate swaps, to manage interest rate risk. The Company recognizes all derivative instruments at fair value as either assets or liabilities in other assets or other liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as an accounting hedge, the gain or loss is recognized in trading noninterest income. As of June 30, 2009, all of the Company's derivative instruments qualified as hedging instruments.

For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based on the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. The Company does not have any fair value hedges or hedges of foreign operations.

The Company formally documents the relationship between the hedging instruments and hedged item, as well as the risk management objective and strategy before undertaking a hedge. To qualify for hedge accounting, the derivatives and hedged items must be designated as a hedge. For hedging relationships in which effectiveness is measured, the Company formally assesses, both at inception and on an ongoing basis, if the derivatives are highly effective in offsetting changes in fair values or cash flows of the hedged item. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting is discontinued.

For derivatives that are designated as cash flow hedges, the effective portion of the gain or loss on derivatives is reported as a component of other comprehensive income or loss and subsequently reclassified in interest income in the same period during which the hedged transaction affects earnings. As a result, the change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

The Company will discontinue hedge accounting when it is determined that the derivative is no longer qualifying as an effective hedge; the derivative expires or is sold, terminated or exercised; or the derivative is de-designated as a fair value or cash flow hedge or it is no longer probable that the forecasted transaction will occur by the end of the originally specified time period. If the Company determines that the derivative no longer qualifies as a cash flow or fair value hedge and therefore hedge accounting is discontinued, the derivative will continue to be recorded on the balance sheet at its fair value with changes in fair value included in current earnings.

## Loans Held To Maturity and Loans Held For Sale

Loans held to maturity are stated at the unpaid principal balance, net of unearned discounts and net of deferred loan origination fees and costs. Loan origination fees, net of direct loan origination costs, are deferred and are recognized over the estimated life of the related loans as an adjustment to the loan yield utilizing the level yield method.

Interest is credited to operations primarily based upon the principal amount outstanding. When management believes there is sufficient doubt as to the ultimate collectibility of interest on any loan, interest accruals are discontinued and all past due interest, previously recognized as income, is reversed and charged against current period earnings. Payments received on nonaccrual loans are applied as principal. Loans are returned to an accrual status when collectibility is reasonably assured and when the loan is brought current as to principal and interest.

Loans are reported as past due when either interest or principal is unpaid in the following circumstances: fixed payment loans when the borrower is in arrears for two or more monthly payments; open end credit for two or more billing cycles; and single payment notes if interest or principal remains unpaid for 30 days or more.

Loans are charged off when collection is sufficiently questionable and when the Bank can no longer justify maintaining the loan as an asset on the balance sheet. Loans qualify for charge off when, after thorough analysis, all possible sources of repayment are insufficient. These include: 1) potential future cash flow, 2) value of collateral, and/or 3) strength of co-makers and guarantors. All unsecured loans are charged off upon the establishment of the loan's nonaccrual status. Additionally, all loans classified as a loss or that portion of the loan classified as a loss, are charged off. All loan charge-offs are approved by the Board of Directors.

Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the collectability of principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income.

The Company evaluates its loans for impairment. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company has defined impaired loans to be all troubled debt restructuring and nonaccrual loans. Impairment of a loan is measured based on the present value of expected future cash flows, net of estimated costs to sell, discounted at the loan's effective interest rate. Impairment can also be measured based on a loan's observable market price or the fair value of collateral, net of estimated costs to sell, if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, the Company establishes a valuation allowance, or adjusts existing valuation allowances, with a corresponding charge or credit to the provision for loan losses.

Loans held for sale are SBA loans and are reflected at the lower of aggregate cost or market value.

The Company originates loans to customers under an SBA program that generally provides for SBA guarantees up to 90 percent of each loan. The Company generally sells the guaranteed portion of each loan to a third party and retains the servicing. The premium received on the sale of the guaranteed portion of SBA loans and the present value of future cash flows of the servicing asset are recognized in income. The nonguaranteed portion is generally held in the portfolio. During the third quarter of 2007, the Company announced its strategy to retain more SBA loans in its portfolio due to lower premiums on sales. During late 2008, The Company withdrew from SBA lending as a primary

line of business, but will continue to offer SBA loan products as an additional credit product to customers in the trade areas served by its branches.

Serviced loans sold to others are not included in the accompanying consolidated balance sheets. Income and fees collected for loan servicing are credited to noninterest income when earned, net of amortization on the related servicing asset.

For additional information see the section titled "Loan Portfolio" under Item 2. Management's Discussion and Analysis.

#### Allowance for Loan Losses

The allowance for loan losses is maintained at a level management considers adequate to provide for probable loan losses as of the balance sheet date. The allowance is increased by provisions charged to expense and is reduced by net charge-offs.

The level of the allowance is based on management's evaluation of probable losses in the loan portfolio, after consideration of prevailing economic conditions in the Company's market area, the volume and composition of the loan portfolio, and historical loan loss experience. The allowance for loan losses consists of specific reserves for individually impaired credits, reserves for nonimpaired loans based on historical loss factors and reserves based on general economic factors and other qualitative risk factors such as changes in delinquency trends, industry concentrations or local/national economic trends. This risk assessment process is performed at least quarterly, and, as adjustments become necessary, they are realized in the periods in which they become known.

Although management attempts to maintain the allowance at a level deemed adequate to provide for probable losses, future additions to the allowance may be necessary based upon certain factors including changes in market conditions and underlying collateral values. In addition, various regulatory agencies periodically review the adequacy of the Company's allowance for loan losses. These agencies may require the Company to make additional provisions based on their judgments about information available to them at the time of their examination.

For additional information see the section titled "Allowance for Loan Losses" under Item 2. Management's Discussion and Analysis.

#### NOTE 2. Litigation

From time to time, the Company is subject to legal proceedings and claims in the ordinary course of business. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the business, financial condition, or the results of the operation of the Company.

Table of Contents

## NOTE 3. Earnings per share

Basic net income (loss) per common share is calculated as net income (loss) available to common shareholders divided by the weighted average common shares outstanding during the reporting period. Net income (loss) available to common shareholders is calculated as net income (loss) less accrued dividends and discount accretion related to preferred stock.

Diluted net income (loss) per common share is computed similarly to that of basic net income (loss) per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally stock options, were issued during the reporting period utilizing the Treasury stock method. Diluted earnings per share also considers certain other variables as required by SFAS 123(R).

The following is a reconciliation of the calculation of basic and diluted earnings per share.

(In thousands, except per share data)	Three Months ended June 30,		Six Months ended June 30,	
	2009	2008	2009	2008
Net income (loss)	\$ (1,200 )	\$ 1,104	\$ (469)	\$ 2,348
Less: Preferred stock dividends and discount accretion	372	-	751	-
Net income (loss) available to common shareholders	(1,572 )	1,104	(1,220 )	2,348
Weighted-average common shares outstanding (basic)	7,119	7,092	7,119	7,084
Plus: Effect of dilutive securities	49	183	39	190
Weighted-average common shares outstanding (diluted)	7,168	7,275	7,158	7,274
Net income (loss) per common share:				
Basic	\$ (0.22 )	\$ 0.16	\$ (0.17 )	\$ 0.33
Diluted	(0.22 )	0.15	(0.17 )	0.32
Stock options and common stock warrants excluded from the earnings per share computation as their effect would have been anti-dilutive	1,424	423	1,424	356

The increase in anti-dilutive stock options and common stock warrants in 2009 was due to the issuance of common stock warrants to the U.S. Department of Treasury under the Capital Purchase Program in December 2008.

## NOTE 4. Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. The Company did not recognize or accrue any interest or penalties related to income taxes during the three month and six month periods ended June 30, 2009 and 2008. The Company does not have an accrual for uncertain tax positions as of June 30, 2009, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. The tax years 2005-2008 remain open to examination by the major taxing jurisdictions to which the Company is subject.

## NOTE 5. Other Comprehensive Income (Loss)

(In thousands)

Non-credit unrealized losses of held to maturity debt securities with other-than-temporary impairment	Pre-tax	Tax	After-tax
---	---------	-----	-----------

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

Balance at December 31, 2008			\$	-
Unrealized holding loss on securities arising during the period	(806	)	(274)	(532)
Balance at June 30, 2009			\$	(532)

Net unrealized security losses	Pre-tax	Tax	After-tax
Balance at December 31, 2007			\$(476 )
Unrealized holding loss on securities arising during the period	\$ (1,881)	\$ (720)	(1,161)
Less: Reclassification adjustment for gains included in net income	119	40	79
Net unrealized loss on securities arising during the period	(2,000)	(760)	(1,240)
Balance at June 30, 2008			\$ (1,716)

Balance at December 31, 2008			\$	(1,728)
Unrealized holding loss on securities arising during the period	\$ 1,406	\$ 490		916
Less: Reclassification adjustment for gains included in net income	517	173		344
Net unrealized loss on securities arising during the period	889	317		572
Balance at June 30, 2009			\$	(1,156)

Net unrealized losses on cash flow hedges	Pre-tax	Tax	After-tax
Balance at December 31, 2007			\$(14 )
Unrealized holding loss arising during the period	\$ (39 )	\$ 15	(24 )
Balance at June 30, 2008			(38 )

Balance at December 31, 2008			\$	(628)
Unrealized holding gain arising during the period	\$ 185	\$ 70		115
Balance at June 30, 2009			\$	(513)

Total net unrealized losses on securities and cash flow hedges \$ (2,201 )

Table of Contents

NOTE 6. Fair Value

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards ("SFAS") 157, Fair Value Measurement, which provides a framework for measuring fair value under generally accepted accounting principles. SFAS 157 applies to all financial instruments that are being measured and reported on a fair value basis.

The Company also adopted SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, on January 1, 2008. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement of certain financial assets on a contract-by-contract basis. SFAS 159 requires that the difference between the carrying value before election of the fair value option and the fair value of these instruments be recorded as an adjustment to beginning retained earnings in the period of adoption. We have presently elected not to report any of our existing financial assets or liabilities at fair value and consequently did not have any adoption related adjustments.

Fair Value Measurement

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed as follows:

Level 1 Inputs

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain US Treasury and US Government and agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs

Quoted prices for similar assets or liabilities in active markets.

Quoted prices for identical or similar assets or liabilities.

Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (e.g., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."

Generally, this includes US Government and agency mortgage-backed securities, corporate debt securities, derivative contracts and loans held for sale.

Level 3 Inputs

Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.

These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

## Fair Value on a Recurring Basis

The following is a description of the valuation methodologies used for instruments measured at fair value:

## Available for Sale Securities Portfolio -

The fair value of available for sale securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers (Level 1). If listed prices or quotes are not available, fair value is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

## SBA Servicing Rights –

SBA servicing rights do not trade in an active, open market with readily observable prices. The Company estimates the fair value of SBA servicing rights using discounted cash flow models incorporating numerous assumptions from the perspective of a market participant including market discount rates and prepayment speeds. The fair value of SBA servicing rights as of June 30, 2009 was determined using a discount rate of 15 percent, constant prepayment rates of 15 to 18 CPR, and interest strip multiples ranging from 2.08 to 3.80, depending on each individual credit. Due to the nature of the valuation inputs, SBA servicing rights are classified as Level 3 assets.

## Interest rate swap agreements -

Based on the complex nature of interest rate swap agreements, the markets these instruments trade in are not as efficient and are less liquid than that of Level 1 markets. These markets do, however, have comparable, observable inputs in which an alternative pricing source values these assets or liabilities in order to arrive at a fair value. The fair values of our interest swaps are measured based on the difference between the yield on the existing swaps and the yield on current swaps in the market (i.e. The Yield Book); consequently, they are classified as Level 2 instruments.

There were no changes in the inputs or methodologies used to determine fair value during the quarter ended June 30, 2009 as compared to the quarters ended December 31, 2008 and June 30, 2008. The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2009 and December 31, 2008.

(In thousands)	As of June 30, 2009			
	Level 1	Level 2	Level 3	Total
<b>Financial Assets:</b>				
<b>Securities available for sale:</b>				
U.S. government sponsored entities	\$ -	\$ 1,684	\$ -	\$ 1,684
State and political subdivisions	-	2,856	-	2,856
Residential mortgage-backed securities	1,793	120,785	-	122,578
Commercial mortgage-backed securities	-	4,599	-	4,599
Collateralized debt obligations	-	398	-	398
Other equities	15	589	-	604
Total securities available for sale	1,808	130,911	-	132,719
SBA servicing assets	-	-	1,142	1,142
Total	1,808	130,911	1,142	133,861
<b>Financial Liabilities:</b>				
Interest rate swap agreements	-	829	-	829
Total	\$ -	\$ 829	\$ -	\$ 829





Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

(In thousands)	As of December 31, 2008			
	Level 1	Level 2	Level 3	Total
<b>Financial Assets:</b>				
Securities available for sale:				
U.S. government sponsored entities	\$ -	\$ 4,156	\$ -	\$ 4,156
State and political subdivisions	-	2,718	-	2,718
Residential mortgage-backed securities	38,899	70,680	-	109,579
Commercial mortgage-backed securities	-	-	-	-
Collateralized debt obligations	-	318	-	318
Other equities	16	561	-	577
Total securities available for sale	38,915	78,433	-	117,348
SBA servicing assets	-	-	1,503	1,503
Total	38,915	78,433	1,503	118,851
<b>Financial Liabilities:</b>				
Interest rate swap agreements	-	1,013	-	1,013
Total	\$ -	\$ 1,013	\$ -	\$ 1,013

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis as of June 30, 2009 and 2008 are summarized as follows:

(In thousands)	As of June 30, 2009
Beginning balance December 31, 2008	\$ 1,503
Total net gains (losses) included in:	
Net income	-
Other comprehensive income	-
Purchases, sales, issuances and settlements, net	(361)
Transfers in and/or out of Level 3	-
Ending balance June 30, 2009	\$ 1,142

(In thousands)	As of June 30, 2008	SBA Servicing
	Securities Available for Sale	Asset
Beginning balance December 31, 2007	\$ 2,711	\$ 2,056
Total net gains (losses) included in:		
Net income	-	-
Other comprehensive income	(851)	-
Purchases, sales, issuances and	-	(179)

settlements, net				
Transfers in and/or out of Level 3		-		-
Ending balance June 30, 2008	\$	1,860	\$	1,877

There were no gains and losses (realized and unrealized) included in earnings for Level 3 assets and liabilities held at June 30, 2009 or June 30, 2008.

#### Fair Value on a Nonrecurring Basis

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the FAS 157 hierarchy (as described above) as of June 30, 2009 and December 31, 2008.

As of June 30, 2009 (In thousands)	Level 1	Level 2	Level 3	Total	Total Fair Value Loss during 6 months ended June 30, 2009
<b>Financial Assets:</b>					
SBA loans held for sale	\$ -	\$ 23,823	\$ -	\$ 23,823	\$ -
Other real estate owned ("OREO")	-	-	466	466	-
Impaired loans	\$-	\$ -	\$ 19,713	\$ 19,713	\$ 324
As of December 31, 2008 (In thousands)	Level 1	Level 2	Level 3	Total	Total Fair Value Loss during 12 months ended December 31, 2008
<b>Financial Assets:</b>					
SBA loans held for sale	\$ -	\$ 22,733	\$ -	\$ 22,733	\$ -
Other real estate owned ("OREO")	-	-	710	710	-
Impaired loans	\$-	\$ -	\$ 13,118	\$ 13,118	\$ 585

Table of Contents

SBA Loans – Held for Sale -

The fair value of SBA loans held for sale was determined using a market approach that includes significant other observable inputs (Level 2 Inputs). The Level 2 fair values were estimated using quoted prices for similar assets in active markets.

OREO -

The fair value was determined using appraisals, which may be discounted based on management's review and changes in market conditions (Level 3 Inputs).

Impaired Loans -

The fair value of impaired collateral dependent loans is derived in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Fair value is determined based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. The valuation allowance for impaired loans at June 30, 2009 was \$1.3 million as compared to \$362 thousand at June 30, 2008. During the six months ended June 30, 2009, the valuation allowance for impaired loans increased \$324 thousand from \$957 thousand at December 31, 2008. During the six months ended June 30, 2008, the valuation allowance for impaired loans decreased \$10 thousand from \$372 thousand at December 31, 2007.

Fair Value of Financial Instruments (SFAS 107 Disclosure)

SFAS 107, Disclosures About Fair Value of Financial Instruments ("SFAS 107"), requires the disclosure of the estimated fair value of financial instruments, including those financial instruments for which the Company did not elect the fair value option. The methodology for estimating the fair value of financial assets and liabilities that are measured on a recurring or nonrecurring basis are discussed above. The following methods and assumptions were used to estimate the fair value of other financial instruments for which it is practicable to estimate that value.

Cash and Federal Funds Sold

For these short-term instruments, the carrying value is a reasonable estimate of fair value.

Securities

The fair value of securities is determined in the manner previously discussed above.

Loans

The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the credit, collateral and interest rate risk inherent in the loan, except for previously discussed impaired loans.

Federal Home Loan Bank Stock

Federal Home Loan Bank stock is carried at cost.

Deposit Liabilities

The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using current market rates.

Borrowed Funds & Subordinated Debentures

The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

#### Standby Letters of Credit

At June 30, 2009, the Bank had standby letters of credit outstanding of \$6.5 million, as compared to \$4.5 million at December 31, 2008. The fair value of these commitments is nominal.

The table below presents the estimated fair values of the Company's financial instruments as of June 30, 2009 and December 31, 2008:

(In thousands)	June 30, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash and Federal funds sold	\$ 54,527	\$ 54,527	\$ 34,431	\$ 34,431
Securities available for sale	132,719	132,719	117,348	117,348
Securities held to maturity	32,075	31,634	32,161	30,088
Loans, net of allowance for possible loan losses	654,666	666,501	675,620	696,966
Federal Home Loan Bank stock	5,127	5,127	4,857	4,857
SBA servicing assets	1,142	1,142	1,503	1,503
Accrued interest receivable	4,263	4,263	4,712	4,712
<b>Financial liabilities:</b>				
Deposits	731,763	722,931	707,117	706,475
Borrowed funds and subordinated debentures	110,465	120,091	120,465	130,217
Accrued interest payable	847	847	805	805
Interest rate swap agreements	829	829	1,013	1,013

Table of Contents

## Note 7. Securities

The following table provides the major components of securities available for sale and held to maturity at amortized cost and estimated fair value at June 30, 2009 and December 31, 2008:

(In thousands)	June 30, 2009				December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Securities available for sale:</b>								
US Government sponsored entities	\$ 1,722	\$ -	\$ (38)	\$ 1,684	\$ 4,132	\$ 27	\$ (3)	\$ 4,156
State and political subdivisions	2,946	6	(96)	2,856	2,946	-	(228)	2,718
Residential mortgage-backed securities	123,472	1,015	(1,909)	122,578	109,630	992	(1,043)	109,579
Commercial mortgage-backed securities	4,829	-	(230)	4,599	-	-	-	-
Collateralized debt obligations	975	-	(577)	398	975	-	(657)	318
Other equities	638	9	(43)	604	639	-	(62)	577
<b>Total securities available for sale</b>	<b>\$ 134,582</b>	<b>\$ 1,030</b>	<b>\$ (2,893)</b>	<b>\$ 132,719</b>	<b>\$ 118,322</b>	<b>\$ 1,019</b>	<b>\$ (1,993)</b>	<b>\$ 117,348</b>
<b>Securities held to maturity:</b>								
US Government sponsored entities	\$ 2,000	\$ 107	\$ -	\$ 2,107	\$ 2,000	\$ 119	\$ -	\$ 2,119
State and political subdivisions	3,157	-	(154)	3,003	3,157	-	(251)	2,906
Residential mortgage-backed securities	25,076	345	(891)	24,530	25,450	193	(880)	24,763
Commercial mortgage-backed securities	1,735	118	-	1,853	-	-	-	-
Collateralized debt obligations	107	43	(9)	141	1,554	-	(1,254)	300
<b>Total securities held to maturity</b>	<b>\$ 32,075</b>	<b>\$ 613</b>	<b>\$ (1,054)</b>	<b>\$ 31,634</b>	<b>\$ 32,161</b>	<b>\$ 312</b>	<b>\$ (2,385)</b>	<b>\$ 30,088</b>

The table below provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at June 30, 2009 is primarily distributed by contractual maturity. Mortgage-backed securities and other securities, which may have principal prepayment provisions, are distributed based on contractual maturity. Expected maturities will differ materially from contractual maturities as a result of early prepayments and calls. The total weighted average yield excludes equity securities.

	Within one year	After one year	After five years	After ten years	Total carrying
--	-----------------	----------------	------------------	-----------------	----------------

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

(In thousands)	Amount	Yield	through five years		through ten years		Amount	Yield	Amount	Yield
			Amount	Yield	Amount	Yield				
Available for sale at fair value:										
US Government sponsored entities	\$ -	-%	\$ -	-%	\$ 703	3.39%	\$ 981	4.96%	\$ 1,684	4.30%
State and political subdivisions	-	-	-	-	-	-	2,856	3.91	2,856	3.91
Residential mortgage-backed securities	-	-	2,049	3.60	17,271	4.01	103,258	4.62	122,578	4.51
Commercial mortgage-backed securities	-	-	-	-	-	-	4,599	6.22	4,599	6.22
Collateralized debt obligations	-	-	-	-	-	-	398	1.40	398	1.40
Other equities	-	-	-	-	-	-	604	-	604	-
Total securities available for sale	\$ -	-%	\$ 2,049	3.60%	\$ 17,974	3.98%	\$ 112,696	4.63%	\$ 132,719	4.55%
Held to maturity at cost:										
US Government sponsored entities	\$ -	-%	\$ 2,000	4.99%	\$ -	-%	\$ -	-%	\$ 2,000	4.99%
State and political subdivisions	-	-	-	-	-	-	3,157	4.46	3,157	4.46
Residential mortgage-backed securities	-	-	1,441	4.43	6,201	4.76	17,434	4.67	25,076	4.68
Commercial mortgage-backed securities	-	-	-	-	-	-	1,735	5.69	1,735	5.69
Collateralized debt obligations	-	-	-	-	-	-	107	0.83	107	0.83
Total securities held to maturity	\$ -	-%	\$ 3,441	4.76%	\$ 6,201	4.76%	\$ 22,433	4.70%	\$ 32,075	4.72%

The fair value of securities with unrealized losses by length of time that the individual securities have been in a continuous unrealized loss position at June 30, 2009 and December 31, 2008 are as follows:

(In thousands)	Total Number in Position	Less than 12 months			Greater than 12 months			Total	
		Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	
June 30, 2009									
U.S. Government sponsored entities	4	\$ 1,673	\$ (38)	\$ 11	\$ -	\$ 1,684	\$ (38)		
State and political subdivisions	15	2,858	(77)	2,217	(173)	5,075	(250)		
Residential mortgage-backed	57	49,470	(1,324)	11,240	(1,476)	60,710	(2,800)		

securities							
Commercial mortgage-backed securities	3	4,599	(230)	-	-	4,599	(230)
Collateralized debt obligations	2	-	-	488	(586)	488	(586)
Other equities	4	-	-	582	(43)	582	(43)
Total temporarily impaired investments	85	\$ 58,600	\$ (1,669)	\$ 14,538	\$ (2,278)	\$ 73,138	\$ (3,947)
December 31, 2008							
U.S. Government sponsored entities	3	\$ 2,110	\$ (3)	\$ 11	\$ -	\$ 2,121	\$ (3)
State and political subdivisions	18	5,624	(479)	-	-	5,624	(479)
Residential mortgage-backed securities	59	32,113	(1,024)	11,668	(899)	43,781	(1,923)
Commercial mortgage-backed securities	-	-	-	-	-	-	-
Collateralized debt obligations	3	-	-	618	(1,911)	618	(1,911)
Other equities	4	82	(34)	472	(28)	554	(62)
Total temporarily impaired investments	87	\$ 39,929	\$ (1,540)	\$ 12,769	\$ (2,838)	\$ 52,698	\$ (4,378)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to not sell the investment and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost. The unrealized losses in each of these categories are discussed in the paragraphs that follow:

U.S. Government sponsored entities and state and political subdivision securities: The unrealized losses on investments in securities were caused by the increase in interest rate spreads. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of June 30, 2009.

Residential and commercial mortgage-backed securities: The unrealized losses on investments in mortgage-backed securities were caused by interest rate increases. The majority of contractual cash flows of these securities are guaranteed by Fannie Mae, Ginnie Mae and the Federal Home Loan Mortgage Corporation. It is expected that the securities would not be settled at a price significantly less than the par value of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of June 30, 2009.

Corporate debt securities: The unrealized losses on corporate debt securities were caused by increases in interest rate spreads. The contractual terms of the bonds do not allow the securities to be settled at a price less than the par value of the investments. The decline in face value is attributed to changes in interest rates and the current liquidity in the credit markets and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired as of June 30, 2009.

Other equity securities: Included in this category is stock of other financial institutions. The unrealized losses on other equity securities are caused by decreases in the market prices of the shares. The Company has the ability and intent to hold these shares until a market price recovery; therefore these investments are not considered other-than-temporarily impaired as of June 30, 2009.

#### Other-Than-Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending



on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value.

During 2009, the Company recognized \$1.7 million of credit related other-than-temporary impairment losses on two held to maturity securities due to the deterioration in the underlying collateral. These two pooled trust preferred securities which had a cost basis of \$3.0 million, had been previously written down \$306 thousand in December of 2008. After the above charge the two issues of pooled trust preferred securities have a remaining book value of approximately \$929 thousand. In estimating the present value of the expected cash flows on the two collateralized debt obligations which were other-than-temporarily impaired as of June 30, 2009, the following assumptions were made:

- Moderate conditional repayment rates (“CRR”) were used due to the lack of new trust preferred issuances and the poor conditions of the financial industry. CRR of 2 percent were used for performing issuers and 0 percent for nonperformers.
- Conditional deferral rates (“CDR”) have been established based on the financial condition of the underlying trust preferred issuers in the pools. These ranged from 0.75 percent to 3.50 percent for performing issuers. Nonperforming issues were stated at 100 percent CDR.
- Expected loss severities of 95 percent were assumed (ie. recoveries occur only 5 percent of defaulted securities) for all performing issuers and ranged from 80.25 percent to 87.46 percent for nonperforming issues.
- Internal rates of return (“IRR”) are the pre-tax yield used to discount the future cash flow stream expected from the collateral cash flows. The IRR used was 17 percent.

The following table presents a roll-forward of the credit loss component of the amortized cost of debt securities that we have written down for OTTI and the credit component of the loss that is recognized in earnings. The beginning balance represents the credit loss component for debt securities for which OTTI occurred prior to adoption of the FSP on January 1, 2009. OTTI recognized in earnings subsequent to adoption in 2009 for credit-impaired debt securities is presented as additions in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairments). The credit loss component is reduced if we sell, intend to sell or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive cash flows in excess of what we expected to receive over the remaining life of the credit-impaired debt security, the security matures or is fully written down. Changes in the credit loss component of credit-impaired debt securities were

as follows for the period ended June 30, 2009.

Beginning balance – January 1, 2009	\$ 306
Initial credit impairment	1,749
Subsequent credit impairments	-
Reductions for amounts recognized in earnings due to intent or requirement to sell	-
Reductions for securities sold	-
Reductions for increases in cash flows expected to be collected	-
Ending balance - June 30, 2009	\$ 2,055

Gross realized gains (losses) on sales of securities and other-than-temporary impairment charges for the six months ended June 30, 2008 are detailed below:

Available-for-sale securities:	
Realized gains	\$ 517
Realized (losses)	-
Other than temporary impairment	-
	\$ 517

Held-to-maturity securities:	
Realized gains	-
Realized (losses)	-
Other than temporary impairment	(1,749)
	\$ (1,749)

#### Note 8. Allowance for Loan Losses

The allowance for loan losses is based on estimates. Ultimate losses may vary from current estimates. These estimates are reviewed periodically and, as adjustments become known, they are reflected in operations in the periods in which they become known.

The following is a reconciled summary of the allowance for loan losses for the six months ended June 30, 2009 and 2008:

Allowance for Loan Loss Activity (In thousands)	Six months ended June	
	2009	2008
Balance, beginning of period	\$ 10,326	\$ 8,383
Provision charged to expense	3,000	1,100
	13,326	9,483
Charge-offs	2,890	660
Recoveries	229	122
Net charge-offs	2,661	538
Balance, end of period	\$ 10,665	\$ 8,945

Note 9. New Accounting Pronouncements

On January 1, 2009, FASB Staff Position (“FSP”) EITF 03-6-1, Share Based Payments and Earnings Per Share (“EPS”) became effective. According to the FSP EITF, unvested share based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are considered participating securities under Financial Accounting Standards (“FAS”) No. 128. As such they should be included in the computation of basic EPS using the two class method. At June 30, 2009 the Company had 35,794 shares of nonvested restricted stock which were considered participating securities under FAS No. 128. Adoption of this FSP did not have a material effect on the Company's EPS calculation.

In April 2009, the Financial Accounting Standards Board (FASB) issued three amendments to the fair value measurement, disclosure and other-than-temporary impairment standards. These amendments were in response to concerns raised by constituents, the mark-to-market study conducted for Congress by the Securities and Exchange Commission (SEC), and the recent hearings held by the U.S. House of Representatives on mark-to-market accounting. Each of these accounting standards is effective for interim periods ending after June 15, 2009, and is to be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. The Company has adopted each of these FSPs effective January 1, 2009. There were no adoption related adjustments. Adoption of these FSPs did not have a material effect on the Company's financial position.

- FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly - FSP FAS 157-4 provides additional guidance on: a) determining when the volume and level of activity for the asset or liability has significantly decreased; b) identifying circumstances in which a transaction is not orderly; and c) understanding the fair value measurement implications of both (a) and (b). This FSP requires several new disclosures, including the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, in both interim and annual periods.
- FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments - FSP FAS 115-2 and FAS 124-2 clarifies the interaction of factors that should be considered when determining whether a debt security is other-than-temporarily impaired (“OTTI”). For debt securities, management must assess whether (a) it has the intent to sell the security, or (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. If OTTI exists, but the entity does not intend to sell the security, then the OTTI adjustment is separated into the credit-related impairment portion which is charged to earnings and the other impairment portion which is recognized in other comprehensive income. This FSP also expands and increases the frequency of certain OTTI related disclosures.
- FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments - FSP FAS 107-1 and APB 28-1 require disclosures about the fair value of financial instruments for interim periods of publicly traded companies as well as in annual financial statements. Fair value information along with the significant assumptions used to estimate fair value must be disclosed.

In May 2009, the Financial Accounting Standards Board (FASB) issued the following standard:

- FAS No. 165, Subsequent Events - FAS No. 165 establishes general standards of accounting for and the disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued (i.e., complete in a form and format that complies with generally accepted accounting principles (GAAP) and approved for issuance). However, Statement No. 165 does not apply to subsequent events or transactions that are within the scope of other applicable GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. There are two types of subsequent events to be evaluated under this Statement:

Recognized subsequent events - An entity must recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.

Non-recognized subsequent events - An entity must not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but that arose after the balance sheet date but before financial statements are issued or are available to be issued. Some non-recognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity must disclose the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

Statement No. 165 also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date - that is, whether that date represents the date the financial statements were issued or were available to be issued.

This Statement applies to both interim financial statements and annual financial statements. Statement No. 165 is effective for interim and annual periods ending after June 15, 2009, and should be applied prospectively. Management believes that Statement No. 165 will not result in significant changes in the subsequent events that the Bank reports - either through recognition or disclosure - in its financial statements. Management has evaluated events through August 11, 2009 for disclosure.

In June 2009, the Financial Accounting Standards Board (FASB) issued the following three standards:

- FAS No. 166, Accounting for Transfers of Financial Assets - an amendment of FASB Statement No. 140 - FAS No. 166 addresses concerns that have arisen since the implementation of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement eliminates the concept of "qualifying special-purpose entity" from Statement No. 140 and removes the exception from applying FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities, to qualifying special purpose entities. The Statement clarifies that the objective of paragraph 9 of Statement No. 140 is to determine whether a transferor has surrendered control over transferred financial assets; limits the circumstances in which a financial asset should be derecognized; defines the term participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale and removes the special provisions for guaranteed mortgage securitizations in Statement No. 140 and Statement No. 65 Accounting for Certain Mortgage Banking Activities. This statement also requires enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. This Statement is effective for fiscal years beginning after November 15, 2009 and interim periods thereafter. Early application is prohibited. Management believes that adoption of FAS No. 166 will not have a material impact on the Company's financial position.
- FAS No. 167, Amendments to FASB No. 46(R) - FAS No. 167 amends FASB Interpretation (FIN) No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to require an enterprise to perform an analysis to determine whether the enterprises variable interest or interests give it a controlling financial interest in a variable interest entity (VIE). This analysis identifies the primary beneficiary of a VIE as the enterprise that has both (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Additionally, Statement No. 167 requires an enterprise to assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed when determining whether it has the power to direct the activities of the VIE that most significantly impact the entity's economic performance. Statement No. 167 is effective at the beginning of a company's first fiscal year that begins after November 15, 2009. Earlier application is prohibited. The Statement may be applied retrospectively in previously issued financial statements with a cumulative effect adjustment to retained earnings as of the beginning of the first year restated. Management believes that adoption of FAS No. 167 will not have a material impact on the Company's financial position.
- FAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162 -FAS No. 168 became the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. This Statement supersedes all non-SEC accounting and reporting standards. This Statement is effective for

financial statements issued for interim and annual periods ending after September 15, 2009. Following this Statement, the Financial Accounting Standards Board will no longer issue standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead it will be in the form of Accounting Standards Updates ("ASUs"). Management believes that adoption of FAS No. 168 will not have a material impact on the Company's financial position.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the 2008 consolidated audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008. When necessary, reclassifications have been made to prior period data throughout the following discussion and analysis for purposes of comparability. This Quarterly Report on Form 10-Q contains certain "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, which may be identified by the use of such words as "believe", "expect", "anticipate", "should", "planned", "estimated" "potential". Examples of forward looking statements include, but are not limited to, estimates with respect to the financial condition, results of operations and business of Unity Bancorp, Inc. that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, in addition to those items contained in the Company's Annual Report on Form 10-K under Item IA-Risk Factors, as updated by our subsequent Quarterly Reports on Form 10-Q, the following: changes in general, economic, and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects Unity Bancorp, Inc.'s interest-rate spread or other income anticipated from operations and investments.

### Overview

Unity Bancorp, Inc., (the "Parent Company"), is incorporated in New Jersey and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Its wholly-owned subsidiary, Unity Bank (the "Bank" or, when consolidated with the Parent Company, the "Company") was granted a charter by the New Jersey Department of Banking and Insurance and commenced operations on September 13, 1991. The Bank provides a full range of commercial and retail banking services through 16 branch offices located in Hunterdon, Somerset, Middlesex, Union and Warren counties in New Jersey, and Northampton County in Pennsylvania. These services include the acceptance of demand, savings, and time deposits and the extension of consumer, real estate, Small Business Administration and other commercial credits. Unity Investment Services, Inc., a wholly-owned subsidiary of the Bank, is used to hold part of the Bank's investment portfolio. Unity Participation Company, Inc., a wholly-owned subsidiary of the Bank is used for holding and administering certain loan participations.

Unity (NJ) Statutory Trust II is a statutory business trust and wholly owned subsidiary of Unity Bancorp, Inc. On July 24, 2006, the Trust issued \$10.0 million of trust preferred securities to investors. Unity (NJ) Statutory Trust III is a statutory business trust and wholly owned subsidiary of Unity Bancorp, Inc. On December 19, 2006, the Trust issued \$5.0 million of trust preferred securities to investors. These floating rate securities are treated as subordinated debentures on the Company's financial statements. However, they qualify as Tier I Capital for regulatory capital compliance purposes, subject to certain limitations. In accordance with Financial Accounting Interpretation No. 46, Consolidation of Variable Interest Entities, as revised December 2003, the Company does not consolidate the accounts and related activity of any of its business trust subsidiaries.

### Earnings Summary

Beginning in 2008, we have seen unprecedented financial, credit and capital market stress. Factors such as lack of liquidity in the credit markets, financial institution failures, continued fall-out from the subprime mortgage crisis, asset "fair market" value write-downs, capital adequacy and credit quality concerns resulted in a lack of confidence by the markets in the financial industry. Consumer sentiment remained low and consumer spending contracted due to

concerns over employment, housing and stock market values.

The plight of the financial, credit and capital markets carried over into the first half of 2009 and will likely persist throughout the remainder of the year. Corporate layoffs, hiring freezes and bankruptcies persist and capital spending plans have been postponed. Consumer confidence remains low as individual's uncertainties regarding the labor market have re-prioritized their spending habits and have curbed discretionary spending. The majority of the financial sector continues to trade at a discount to book value due to credit concerns and negative publicity by the news media. Secondary markets for many types of financial assets, including the guaranteed portion of SBA loans, remain very restrictive. Despite this challenging operating environment, the Company believes that it is well-positioned.

Page 15 of 34

---



Table of Contents

Our performance during the second quarter of 2009 included the following accomplishments:

Total assets exceeded \$913 million,  
Continued market share expansion as total loans increased 3.5 percent from one year ago,  
Total deposits increased 8.9 percent from one year ago, and  
The Company remained well-capitalized.

For the three months ended June 30, 2009, the Company reported a net loss of \$1.2 million, a decrease of \$2.3 million from net income of \$1.1 million reported for the same period of 2008. Net loss available to common shareholders, which includes the impact of dividends and accretion of discount on the Company's outstanding preferred stock, was \$1.6 million for the three months ended June 30, 2009. The Company had no outstanding preferred stock in the first half of 2008. For the six months ended June 30, 2009, the Company reported a net loss of \$469 thousand, a decrease of \$2.8 million from net income of \$2.3 million reported for the same period of 2008. Net loss available to common shareholders, which includes the impact of dividends and accretion of discount on the Company's outstanding preferred stock, was \$1.2 million for the six months ended June 30, 2009.

Our results reflect:

An increased provision for loan losses in response to increased credit risk due to continued weakness in the economy,  
A lower level of noninterest income due to significantly reduced net gains on SBA loan sales and a \$1.7 million other-than-temporary impairment charge on securities, and  
Higher operating expenses due to the FDIC special assessment.

The earnings (loss) per share and return (loss) on average common equity ratios shown below are calculated on net income (loss) available to common shareholders.

(In thousands, except per share data)	Three Months ended June 30,		Six Months ended June 30,	
	2009	2008	2009	2008
<b>Net Income (Loss) per Common share:</b>				
Basic	\$ (0.22)	\$ 0.16	\$ (0.17)	\$ 0.33
Diluted	(0.22)	0.15	(0.17)	0.32
Return (loss) on average assets	(0.54)%	0.56%	(0.11)%	0.60%
Return (loss) on average common equity	(12.97)%	9.29%	(5.07)%	9.87%
Efficiency ratio	80.58%	69.59%	76.89%	70.76%

#### Net Interest Income

The primary source of income for the Company is net interest income, the difference between the interest earned on earning assets such as investments and loans, and the interest paid on deposits and borrowings. Factors that impact the Company's net interest income include the interest rate environment, the volume and mix of interest-earning assets and interest-bearing liabilities, and the competitive nature of the Company's market place.

Since June 30, 2008, the Federal Open Market Committee has lowered interest rates 175 basis points in an attempt to stimulate economic activity. These actions have resulted in a Fed Funds target rate of 0.25 percent and a Prime rate of 3.25 percent. These interest rate levels in turn have generated lower yields on earning assets as well as lower funding costs for financial institutions.

For the three months ended June 30, 2009, tax-equivalent interest income increased of \$248 thousand or 2.0 percent to \$12.6 million compared to the same period a year ago. This increase was driven by a higher volume of

interest-earning assets, despite the lower yield on these assets.

- Of the \$248 thousand increase in interest income on a tax-equivalent basis, \$2.8 million can be attributed to a higher volume of earning assets, partially offset by a \$2.6 million decrease due to the reduced yields on the interest-earning assets.
- The yield on interest-earning assets decreased 66 basis points to 5.91 percent for the quarter-ended June 30, 2009 due to the lower overall interest rate environment compared to 2008. Yields on all loan products fell during the period, with the largest declines in the SBA and consumer loan portfolios, repricing 191 and 76 basis points lower, respectively.
- The average volume of interest-earning assets increased \$99.0 million to \$851.9 million in the second quarter of 2009 compared to \$752.9 million for the second quarter of 2008. This was due primarily to a \$49.6 million increase in average loans across all product lines, except commercial loans which declined \$5.5 million, and a \$57.0 million increase in average securities. As loan demand began to subside with the economic downturn, excess liquidity was invested in the securities portfolio as a favorable alternative to federal funds sold.
- There was a shift in the concentration of commercial loans and residential mortgages to the total loan portfolio from the second quarter of 2008 to the second quarter of 2009. The average balances shifted from 50 percent commercial loans and 13 percent residential mortgages in 2008 to 46 percent commercial loans and 19 percent residential mortgages in 2009. The Company anticipates the slowdown of SBA and commercial lending to continue throughout 2009.

Total interest expense was \$5.7 million for the second quarter of 2009, an increase of \$244 thousand or 4.5 percent compared to the same period in 2008. This increase was primarily driven by a large increase in average time deposits, partially offset by the decline in the overall interest rate environment in 2009.

- Of the \$244 thousand increase in interest expense in the second quarter of 2009, \$2.4 million was attributed to a higher volume of interest-bearing liabilities, partially offset by a \$2.2 million decrease due to the lower rates paid on these liabilities.
- The average cost of interest-bearing liabilities decreased 26 basis points to 3.05 percent, primarily due to the repricing of deposits and borrowings in a lower interest rate environment. The cost of interest-bearing deposits decreased 24 basis points to 2.89 percent for the second quarter of 2009 as all product lines repriced lower. The cost of borrowed funds and subordinated debentures decreased 20 basis points to 4.01 percent due to the use of low cost overnight line of credit funding.
- Interest-bearing liabilities averaged \$743.3 million in the second quarter of 2009, an increase of \$82.8 million, or 12.5 percent, compared to the prior year's quarter. The increase in interest-bearing liabilities was a result of increases in all types of interest-bearing deposits, offset in part by a decline in borrowed funds. The largest increase was to time deposits, which increased \$78.7 million or 27.9 percent from the second quarter of 2008 to the second quarter of 2009. Average borrowed funds and subordinated debentures decreased \$3.3 million to \$107.2 million in 2009 compared to \$110.5 million in 2008 due to the maturity of a \$10.0 million repurchase agreement in 2009.

During the quarter-ended June 30, 2009, tax-equivalent net interest income remained relatively flat compared to the same period in 2008, with an increase of \$4 thousand or 0.1 percent. Net interest margin decreased 42 basis points to 3.24 percent for 2009 compared to 3.66 percent in 2008. The net interest spread was 2.85 percent, a 41 basis point decrease from 3.26 percent in 2008. The net interest margin and net interest spread are expected to expand in 2009 as higher cost time deposits reprice in the current low rate environment and more customers shift from time deposits to the Loyalty savings product.

For the six months ended June 30, 2009, tax-equivalent interest income increased of \$183 thousand or 0.7 percent to \$25.2 million. This increase was driven by a higher volume of interest-earning assets, despite the lower yield on these assets.

- Of the \$183 thousand increase in interest income on a tax-equivalent basis, \$4.5 million can be attributed to a higher volume of earning assets, partially offset by a \$4.3 million decrease due to the reduced yields on the interest-earning assets.
- The yield on interest-earning assets decreased 86 basis points to 5.89 percent for the six months ended June 30, 2009 due to the lower overall interest rate environment compared to 2008. Yields on all loan products fell during the period, with the largest declines in SBA, SBA 504 and consumer loan portfolios repricing 261, 87 and 93 basis points lower, respectively.
- The average volume of interest-earning assets increased \$115.5 million to \$859.3 million for the first six months of 2009 compared to \$743.8 million for the comparable period in 2008. This was due primarily to a \$62.5 million increase in average loans across all product lines and a \$62.2 million increase in average securities, partially offset by a \$10.4 million decrease in federal funds sold and interest-bearing deposits. As loan demand began to subside with the economic downturn, excess liquidity was invested in the securities portfolio as a favorable alternative to federal funds sold. The majority of the increase in average loans was to the residential mortgage portfolio, which increased \$49.5 million or 64.1 percent during the period. Growth in the SBA, SBA 504 and commercial portfolios slowed during the period, accounting for only 13.4 percent of the overall increase in average loans. This slowdown is expected to continue throughout 2009.

Total interest expense was \$11.5 million for the six months ended June 30, 2009, an increase of \$60 thousand or 0.5 percent compared to the six months ended June 30, 2008. This increase was primarily driven by an increase in average interest-bearing liabilities, offset almost entirely by the decline in the overall interest rate environment in 2009:

- Of the \$60 thousand increase in interest expense, \$3.8 million was attributed to a higher volume of interest-bearing liabilities, offset almost entirely by a \$3.7 million decrease due to the lower rates paid on these liabilities.
- The average cost of interest-bearing liabilities decreased 45 basis points to 3.07 percent, primarily due to the repricing of deposits and borrowings in a lower interest rate environment. The cost of interest-bearing deposits decreased 42 basis points to 2.96 percent for the first six months of 2009 as all product lines repriced lower. The cost of borrowed funds and subordinated debentures decreased 62 basis points to 3.61 percent due to the use of low cost overnight line of credit funding.
- Interest-bearing liabilities averaged \$752.6 million for the six months ended June 30, 2009, an increase of \$98.9 million, or 15.1 percent, compared to the same period in the prior year. The increase in interest-bearing liabilities was a result of increases in interest-bearing checking, time deposits, and borrowed funds, offset in part by a decline in savings deposits. Average borrowed funds and subordinated debentures increased \$18.9 million to \$124.5 million in 2009 compared to \$105.7 million in 2008 as these funding sources provided favorable pricing compared to alternate sources of funds as market rates fell.

During the six months ended June 30, 2009, tax-equivalent net interest income increased \$123 thousand or 0.9 percent. Net interest margin decreased 44 basis points to 3.21 percent for 2009 compared to 3.65 percent in 2008. The net interest spread was 2.82 percent, a 41 basis point decrease from 3.23 percent in 2008. The net interest margin and net interest spread are expected to expand in 2009 as higher cost time deposits reprice in the current low rate environment and more customers shift from time deposits to the Loyalty savings product.

Table of Contents

Unity Bancorp, Inc.  
Consolidated Average Balance Sheets with Resultant Interest and Rates  
(Unaudited)  
(Tax-equivalent basis, dollars in thousands)

	Three Months Ended					
	June 30, 2009			June 30, 2008		
	Average Balance	Interest	Rate/Yield	Average Balance	Interest	Rate/ Yield
<b>Assets</b>						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits with banks	\$ 14,153	\$ 29	0.82%	\$ 22,351	\$ 111	2.00%
Federal Home Loan Bank stock	4,972	122	9.84	4,400	76	6.95
Securities:						
Available for sale	130,751	1,522	4.66	76,613	961	5.02
Held to maturity	34,457	409	4.75	31,547	416	5.27
Total securities (a)	165,208	1,931	4.68	108,160	1,377	5.09
Loans, net of unearned discount:						
SBA loans	102,255	1,564	6.12	101,006	2,028	8.03
SBA 504 loans	74,209	1,285	6.95	69,308	1,260	7.31
Commercial	303,589	5,051	6.67	309,081	5,407	7.04
Residential mortgages	124,227	1,783	5.74	79,985	1,209	6.05
Consumer	63,280	797	5.05	58,608	846	5.81
Total loans (a),(b)	667,560	10,480	6.29	617,988	10,750	6.99
Total interest-earning assets	\$ 851,893	\$ 12,562	5.91%	\$ 752,899	\$ 12,314	6.57%
Noninterest-earning assets:						
Cash and due from banks	18,397			14,377		
Allowance for loan losses	(11,095)			(8,814)		
Other assets	32,770			31,262		
Total noninterest-earning assets	40,072			36,825		
Total Assets	\$ 891,965			\$ 789,724		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing deposits:						
Interest-bearing checking	\$ 85,313	\$ 267	1.26%	\$ 82,195	\$ 350	1.71%
Savings deposits	189,977	912	1.93	185,674	918	1.99
Time deposits	360,885	3,409	3.79	282,182	3,006	4.28
Total interest-bearing deposits	636,175	4,588	2.89	550,051	4,274	3.13
Borrowed funds and subordinated debentures	107,163	1,085	4.01	110,464	1,155	4.21

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

Total interest-bearing liabilities	743,338	5,673	3.05	660,515	5,429	3.31
Noninterest-bearing liabilities:						
Demand deposits	77,630			78,879		
Other liabilities	4,148			2,553		
Total noninterest-bearing liabilities	81,778			81,432		
Shareholders' equity	66,849			47,777		
Total Liabilities and Shareholders' Equity	\$ 891,965			\$ 789,724		
Net interest spread	\$ 6,889		2.86%	\$ 6,885		3.26%
Tax-equivalent basis adjustment	(31)			(47)		)
Net interest income	\$ 6,858			\$ 6,838		
Net interest margin			3.24%			3.66%

(a) Yields related to securities and loans exempt from federal income taxes are stated on a fully tax-equivalent basis. They are reduced by the nondeductible portion of interest expense, assuming a federal tax rate of 34 percent.

(b) The loan averages are stated net of unearned income, and the averages include loans on which the accrual of interest has been discontinued.

Table of Contents

Unity Bancorp, Inc.  
Consolidated Average Balance Sheets with Resultant Interest and Rates  
(Unaudited)  
(Tax-equivalent basis, dollars in thousands)

	Six Months Ended					
	June 30, 2009			June 30, 2008		
	Average Balance	Interest	Rate/Yield	Average Balance	Interest	Rate/Yield
<b>Assets</b>						
<b>Interest-earning assets:</b>						
Federal funds sold and interest-bearing deposits with banks	\$ 12,249	\$ 46	0.76%	\$ 22,638	\$ 291	2.59%
Federal Home Loan Bank stock	5,451	118	4.37	4,287	176	8.26
<b>Securities:</b>						
Available for sale	134,506	3,214	4.78	73,685	1,869	5.07
Held to maturity	34,221	813	4.75	32,847	871	5.30
Total securities (a)	168,727	4,027	4.77	106,532	2,740	5.14
<b>Loans, net of unearned discount:</b>						
SBA loans	103,641	3,171	6.12	99,810	4,356	8.73
SBA 504 loans	75,538	2,516	6.72	71,827	2,710	7.59
Commercial	304,365	10,067	6.67	303,539	10,692	7.08
Residential mortgages	126,623	3,646	5.76	77,163	2,288	5.93
Consumer	62,717	1,592	5.12	58,045	1,747	6.05
Total loans (a),(b)	672,884	20,992	6.27	610,384	21,793	7.17
Total interest-earning assets	859,311	\$ 25,183	5.89%	\$ 743,841	\$ 25,000	6.75%
<b>Noninterest-earning assets:</b>						
Cash and due from banks	19,009			14,684		
Allowance for loan losses	(11,017)			(8,752)		
Other assets	32,928			30,783		
Total noninterest-earning assets	40,920			36,715		
Total Assets	\$ 900,231			\$ 780,556		
<b>Liabilities and Shareholders' Equity</b>						
<b>Interest-bearing deposits:</b>						
Interest-bearing checking	\$ 85,189	\$ 537	1.27%	\$ 80,597	\$ 716	1.79%
Savings deposits	168,736	1,556	1.86	188,124	2,267	2.42
Time deposits	374,147	7,133	3.84	279,304	6,226	4.48
Total interest-bearing deposits	628,072	9,226	2.96	548,025	9,209	3.38
Borrowed funds and subordinated debentures	124,540	2,263	3.61	105,657	2,220	4.23
Total interest-bearing liabilities	752,612	11,489	3.07	653,682	11,429	3.52

## Noninterest-bearing liabilities:

Demand deposits	76,594	76,794
Other liabilities	3,967	2,372
Total noninterest-bearing liabilities	80,561	79,166
Shareholders' equity	67,058	47,708
Total Liabilities and Shareholders' Equity	\$ 900,231	\$ 780,556

Net interest spread	\$ 13,694	2.82%	\$ 13,571	3.23%
Tax-equivalent basis adjustment	(62)		(98)	
Net interest income	\$ 13,632		\$ 13,473	
Net interest margin		3.21%		3.65%

(a) Yields related to securities and loans exempt from federal income taxes are stated on a fully tax-equivalent basis. They are reduced by the nondeductible portion of interest expense, assuming a federal tax rate of 34 percent.

(b) The loan averages are stated net of unearned income, and the averages include loans on which the accrual of interest has been discontinued.

The rate volume table below presents an analysis of the impact on interest income and expense resulting from changes in average volume and rates over the periods presented. Changes that are not due to volume or rate variances have been allocated proportionally to both, based on their relative absolute values. Amounts have been computed on a fully tax-equivalent basis, assuming a federal income tax rate of 34.0 percent.

Rate Volume Table (In thousands)	Amount of Increase (Decrease)					
	Three months ended June 30, 2009 versus June 30, 2008			Six months ended June 30, 2009 versus June 30, 2008		
	Due to change in:			Due to change in:		
	Volume	Rate	Total	Volume	Rate	Total
<b>Interest Income</b>						
Federal funds sold and interest-bearing deposits	\$ (31)	\$ (51)	\$ (82)	\$ (96)	\$ (149)	\$ (245)
Federal Home Loan Bank stock	11	35	46	101	(159)	(58)
Available for sale securities	1,010	(449)	561	1,662	(317)	1,345
Held to maturity securities	155	(162)	(7)	87	(145)	(58)
Total securities	1,165	(611)	554	1,749	(462)	1,287
SBA	167	(631)	(464)	457	(1,642)	(1,185)
SBA 504	309	(284)	25	328	(522)	(194)
Commercial	(90)	(266)	(356)	85	(710)	(625)
Residential mortgage	979	(405)	574	1,552	(194)	1,358
Consumer	318	(367)	(49)	319	(474)	(155)
Total Loans	1,683	(1,953)	(270)	2,741	(3,542)	(801)
Total interest-earning assets	\$ 2,828	\$ (2,580)	\$ 248	\$ 4,495	\$ (4,312)	\$ 183
<b>Interest Expense</b>						
Interest-bearing checking	\$ 82	\$ (165)	\$ (83)	\$ 107	\$ (286)	\$ (179)
Savings deposit	94	(100)	(6)	(218)	(493)	(711)
Time deposits	2,247	(1,844)	403	3,151	(2,244)	907
Total interest-bearing deposits	2,423	(2,109)	314	3,040	(3,023)	17
Borrowings	(27)	(43)	(70)	738	(695)	43
Total interest-bearing liabilities	2,396	(2,152)	244	3,778	(3,718)	60
Tax equivalent net interest income	\$ 432	\$ (428)	\$ 4	\$ 717	\$ (594)	\$ 123
Tax equivalent adjustment			16			(36)
Increase in net interest income			\$ 20			\$ 159

#### Provision for Loan Losses

The provision for loan losses was \$1.5 million for the three months ended June 30, 2009, an increase of \$850 thousand compared to \$650 thousand for the same period a year ago. For the six months ended June 30, 2009, the



provision for loan losses was \$3.0 million, an increase of \$1.9 million compared to \$1.1 million for the same period a year ago. The increase is directly related to the increase in nonperforming loans and net charge-offs experienced as a result of the continued weakness in the economy both nationally and in our trade area. Additional information may be found under the caption, "Financial Condition-Asset Quality."

Each period's loan loss provision is the result of management's analysis of the loan portfolio and reflects changes in the size and composition of the portfolio, the level of net charge-offs, delinquencies and current economic environment factors. Additional information may be found under the caption, "Financial Condition-Allowance for Loan Losses." The current provision is considered appropriate under management's assessment of the adequacy of the allowance for loan losses.

#### Noninterest Income

Historically, Unity has had a strong source of noninterest income in the form of gains on the sale of SBA loans. However, during 2008, pricing in the secondary market for SBA loans began to deteriorate in response to the credit crisis. As a result of the economic conditions, Unity elected to close its SBA loan production offices outside of its New York, New Jersey and Pennsylvania primary trade areas. Unity has and will continue to offer these products in its trade area as an additional credit product for banking customers within its trade area. This decision resulted in lower levels of noninterest income during the first two quarters of 2009 and will likely reduce noninterest income for the foreseeable future.

In addition, noninterest income was impacted by an other-than-temporary impairment ("OTTI") charge taken during the second quarter of 2009. The Company took an impairment charge of \$1.7 million on two pooled bank trust preferred securities, due to declines in their market value and the uncertainty that they would recover their book value. Changes in the credit worthiness of the underlying issuers may result in additional OTTI charges and realized losses in the future.

Noninterest income (loss) was \$(907) thousand for the three months ended June 30, 2009, a decrease of \$1.9 million compared with the same period in 2008. For the six months ended June 30, 2009, noninterest income was \$441 thousand, a decrease of \$2.0 million, compared to the six months ended June 30, 2008. The components of noninterest income (loss) are as follows:

(In thousands)	Three months ended June 30,			Six months ended June 30,		
	2009	2008	Percent Change	2009	2008	Percent Change
Service charges on deposit accounts	\$ 335	\$ 341	(1.8 )%	\$ 665	\$ 661	0.6 %
Service and loan fee income	294	302	(2.6 )	547	602	(9.1 )
Bank-owned life insurance	55	53	3.8	110	104	5.8
Gain on sale of mortgage loans	49	-	NM	113	21	NM
Gain on sales of SBA loans held for sale, net	-	417	NM	29	993	NM
Net other-than-temporary impairment charges on securities	(1,749 )	(255 )	NM	(1,749 )	(255 )	NM
Net security gains	2	49	NM	517	119	NM
Other income	107	121	(11.6 )	209	238	(12.2 )
	\$ (907)	\$ 1,028	(188.2 )%	\$ 441	\$ 2,483	(82.2 )%

Total noninterest  
income (loss)

NM = not meaningful

Page 20 of 34

---

Table of Contents

Service charges on deposit accounts were relatively flat for the six months ended June 30, 2009 when compared to the same period a year ago, and decreased \$6 thousand for the three months ended June 30, 2009 compared to the three months ended June 30, 2008. This slight decrease during the quarter was due to decreased overdraft fees, partially offset by increased commercial analysis fees.

Service and loan fee income was relatively flat quarter over quarter but decreased \$55 thousand for the six month period ended June 30, 2009 when compared to the same period a year ago. The decrease in loan and servicing fees was the result of significantly lower levels of loan processing fee income, partially offset by increased loan prepayment fees, letter of credit fees, and late charges on SBA loans.

Bank owned life insurance income totaled \$55 thousand and \$110 thousand for the three and six months ended June 30, 2009. These amounts are flat compared to the same periods in the prior year.

Net gains on mortgage loan sales were \$49 thousand for the quarter-ended June 30, 2009 compared to zero gains reported during the second quarter of 2008. For the six months ended June 30, 2009, gains on mortgage loan sales increased \$92 thousand from the prior year. The increase was due to the increased volume of mortgage loans sold, which amounted to \$8.7 million for the six months ended June 30, 2009 compared to \$1.7 million for the prior year's period.

There were no SBA loans sales during the second quarter of 2009. For the six months ended June 30, 2009, net gains on SBA loan sales decreased significantly to \$29 thousand compared to \$993 thousand for the six months ended June 30, 2008, as a result of a substantially lower volume of loans sold and lower premiums on these sales due to market conditions. SBA loan sales totaled \$838 thousand for the six months ended June 30, 2009, compared to \$19.9 million for six months ended June 30, 2008. Management believes that net gains on SBA loans will remain at this lower level for the foreseeable future.

OTTI charges on securities amounted to \$1.7 million for the three and six months ended June 30, 2009, compared to \$255 thousand for the three and six months ended June 30, 2008. At June 30, 2009, the Company's held to maturity portfolio included two pooled bank trust preferred securities. Due to the declines in their market value and the uncertainty that they would recover their book value, the Company took an impairment charge of \$1.7 million on these securities at June 30, 2009. The securities, which had a cost basis of \$3.0 million, had been previously written down by approximately \$306 thousand in December of 2008. After the above charge, the two issues of pooled trust preferred securities have a remaining book value of approximately \$929 thousand. At June 30, 2008, the Company took a \$222 thousand impairment charge on three Federal Home Loan Mortgage Corporation ("FHLMC") perpetual callable preferred securities and a \$33 thousand impairment charge on a bank stock investment due to their declines in market value and the uncertainty that they would recover their book value.

Net security gains of \$2 thousand and \$517 thousand were realized during the three and six months ended June 30, 2009, respectively, compared to net gains of \$49 thousand and \$119 thousand during the prior year's comparable periods. The gains in 2009 were the result of the sale of approximately \$20 million of fixed income securities. The gains in 2008 were primarily due to the sale of fixed rate agency securities.

Other noninterest income decreased \$14 thousand and \$29 thousand for the three and six months ended June 30, 2009, respectively, compared to the same periods in the prior year, primarily due to lower loan referral fees and annuity commissions.

Noninterest Expense

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

In response to the challenging economic environment which began in 2008, the Company took several steps to reduce its operating expenses. The primary cost reduction mechanism was the significant reduction in staffing related to closing our SBA loan production offices outside of our primary trade areas in the fourth quarter of 2008. The effect of this reduction in head-count can be seen in the 11.7 percent decrease in compensation and benefits expense year to date versus the prior year to date. Unfortunately, this and other cost cutting strategies were partially offset by the large increase in FDIC insurance premiums during the year, as well as a special assessment designed to recapitalize the Deposit Insurance Fund. Total noninterest expense increased \$586 thousand or 10.4 percent to \$6.2 million for the three months ended June 30, 2009 compared to a year ago. For the six months ended June 30, 2009, noninterest expense increased \$381 thousand or 3.3% over the prior year. The components of noninterest expense are detailed below:

(In thousands)	Three months ended June 30,			Six months ended June 30		
	2009	2008	Percent Change	2009	2008	Percent Change
Compensation and benefits	\$ 2,853	\$ 2,980	(4.3)%	\$ 5,477	\$ 6,200	(11.7)%
Occupancy	647	713	(9.3)	1,334	1,414	(5.7)
Processing and communications	482	544	(11.4)	1,023	1,114	(8.2)
Furniture and equipment	471	413	14.0	966	801	20.6
Professional services	260	143	81.8	506	341	48.4
Loan collection costs	180	138	30.4	379	240	57.9
Deposit insurance	708	111	NM	1,009	174	NM
Advertising	151	79	91.1	226	141	60.3
Other expenses	451	496	(9.1)	838	962	(12.9)
Total noninterest expense	\$ 6,203	\$ 5,617	10.4 %	\$ 11,758	\$ 11,387	3.3 %

Compensation and benefits expense, the largest component of noninterest expense, decreased \$127 thousand and \$723 thousand for the three and six months ended June 30, 2009 compared to the same periods a year ago. The decrease in compensation and benefits expense was a result of the fourth quarter 2008 staffing reductions undertaken at our SBA loan production offices, partially offset by increased bonus accruals. Full-time equivalent employees fell to 168 at June 30, 2009, compared to 191 at June 30, 2008.

Occupancy expense decreased \$66 thousand and \$80 thousand for the three and six months ended June 30, 2009 compared to the same periods a year ago due to reduced lease and leasehold improvement expenses related to the closure of our Bridgewater, NJ location during the second quarter 2008.

Processing and communications expense decreased \$62 thousand and \$91 thousand for the three and six months ended June 30, 2009 compared to the same periods a year ago. This decrease is primarily the result of cost savings initiatives put in place in the beginning of 2008 in telephone and data processing line costs as well as decreased items processing expenses upon bringing this process in house, partially offset by increased data processing expenses.

Furniture and equipment expense increased \$58 thousand and \$165 thousand for the three and six months ended June 30, 2009, compared to the same periods a year ago due to increased depreciation and maintenance expenses on new equipment and software.

Professional services increased \$117 thousand and \$165 thousand for the three and six months ended June 30, 2009, compared to the same periods a year ago. The current economic environment combined with Sarbanes-Oxley

related compliance has caused our expenses for all professional service areas to increase, including consulting, legal, loan review, tax review and audit fees.

Loan collection costs increased \$42 thousand and \$139 thousand for the three and six months ended June 30, 2009, compared to the same periods a year ago. The increased expenses were due to higher collection expenses associated with a larger volume of delinquent loans.

Table of Contents

Deposit insurance expense increased \$597 thousand and \$835 thousand for the three and six months ended June 30, 2009, compared to the same periods a year ago due to increased assessment rates and a special assessment charge during the second quarter of 2009. In response to the impact of the current economic environment on the banking industry, the FDIC has significantly increased the deposit insurance assessment rates on all banks. In addition, the FDIC imposed a special assessment to recapitalize the Deposit Insurance Fund equal to five basis points of each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. This special assessment is due on September 30, 2009 and amounts to approximately \$408 thousand for the Company. It is probable that the FDIC may vote to impose an additional special assessment later in 2009, if it is deemed necessary.

Advertising expense increased \$72 thousand and \$85 thousand for the three and six months ended June 30, 2009 compared to the same periods in 2008 due to increased deposit and loan promotions and other campaigns via newspaper, billboard and radio advertisements. Additional advertising expenses have been incurred as the Company works to enhance brand recognition.

Other operating expenses decreased \$45 thousand and \$114 thousand for the three and six months ended June 30, 2009, compared to the same periods a year ago due to lower employee travel, meals and entertainment fees, lower insurance costs and lower loan commitment reserve funding expenses. Year to date, there was also a decrease in office supplies and recruitment expenses, when compared to the same period in 2008.

#### Income Tax Expense

For the quarter ended June 30, 2009, the Company recorded an income tax benefit of \$552 thousand, compared to a tax provision of \$495 thousand for the same period a year ago. For the six months ended June 30, 2009, the Company recorded an income tax benefit of \$216 thousand, compared to a tax provision of \$1.1 million for the same period a year ago. The current 2009 tax provision represents an effective tax rate of approximately 31.1 percent as compared to 32.3 percent for the prior year. Management anticipates an effective rate of approximately 31.5 percent for the remainder of 2009.

#### Financial Condition at June 30, 2009

Total assets at June 30, 2009 were \$913.4 million compared to \$898.3 million at year-end 2008 and \$832.3 million a year ago. These increases are attributable to investment purchases funded by new deposit growth, partially offset by a decrease in total loans.

#### Securities

The Company's securities portfolio, which consists of available for sale ("AFS") and held to maturity ("HTM") investments, is maintained for asset-liability management purposes, as well as for liquidity and earnings purposes. Management determines the appropriate security classification of available for sale or held to maturity at the time of purchase.

AFS securities are investments carried at fair value that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk, to take advantage of market conditions that create economically attractive returns and as an additional source of earnings. AFS securities consist primarily of U.S. Government sponsored entities, obligations of state and political subdivisions, and mortgage-backed securities. AFS securities totaled \$132.7 million at June 30, 2009, an increase of \$15.4 million or 13.1 percent, compared to \$117.3 million at December 31, 2008. This net increase was the result of the following:

- \$63.5 million in purchases. During the first six months of 2009, the Company took advantage of favorable credit spreads and purchased primarily mortgage-backed securities and collateralized mortgage obligations (“CMOs”),
- \$19.6 million in sales. Sales consisted of fixed rate mortgage-backed securities and resulted in gains on sales of \$517 thousand,
- \$3.0 million in called agency securities,
- \$24.5 million of principal pay downs,
- \$156 thousand in net amortization of premiums
- \$889 thousand depreciation in the market value of the portfolio. At June 30, 2009, the portfolio had a net unrealized loss of \$1.9 million, compared to a net unrealized loss of \$974 thousand at the year-end 2008. These unrealized gains and losses are reflected net of tax in shareholders’ equity as other comprehensive loss.

At June 30, 2009, available for sale securities included three callable FHLMC perpetual preferred securities with a total book value of \$13 thousand. These securities were initially classified as other-than-temporarily impaired (“OTTI”) in December 2007, at which time a \$607 thousand impairment charge was taken, due to declines in the market value of the securities and the uncertainty that they would recover their book value. During 2008, additional OTTI charges of approximately \$1.2 million were taken on these securities due to further declines in market value and the eventual placement of FHLMC into conservatorship. In addition, the Company sold approximately \$2.1 million in book value of these securities during 2008, resulting in a pretax loss of approximately \$469 thousand.

At June 30, 2009, the Company’s available for sale portfolio included one bank trust preferred security with a book value of \$975 thousand and a market value of \$398 thousand. The Company monitors the credit worthiness of the issuer of this security quarterly. At June 30, 2009, the Company had not taken any OTTI adjustments on this security. Management will continue to monitor the performance of this security and others for impairment as circumstances warrant. Changes in the credit worthiness of the underlying issuers may result in OTTI charges and realized losses in the future.

The average balance of securities available for sale amounted to \$134.5 million for the six-months ended June 30, 2009, compared to \$73.7 million for the same period a year ago. The average yield earned on the available for sale portfolio decreased 29 basis points to 4.78 percent for the six-months ended June 30, 2009, compared to 5.07 percent for the same period a year ago. The weighted average life of the AFS portfolio was 4.16 years and the effective duration of the portfolio was 2.57 years at June 30, 2009, compared to 3.52 years and 2.12 years, respectively, at December 31, 2008.

HTM securities, which are carried at amortized cost, are investments for which there is the positive intent and ability to hold to maturity. The portfolio is comprised primarily of U.S. Government sponsored entities, obligations of state and political subdivisions, and mortgage-backed securities. HTM securities were \$32.1 million at June 30, 2009, a decrease of \$86 thousand or 0.3 percent, from year-end 2008. This net decrease was the result of \$2.6 million in principal pay downs and a \$1.4 million writedown on two pooled bank trust preferred securities that are discussed further in the paragraph below, partially offset by \$4.0 million in purchases.

At June 30, 2009, the Company’s held to maturity portfolio included two pooled bank trust preferred securities that were classified as other-than-temporarily impaired due to the credit deterioration of the underlying collateral and market valuation. A third party analysis of these securities determined that \$1.7 million of the impairment was due to credit deterioration and was charged to earnings while approximately \$800 thousand was non-credit related and was booked to other comprehensive income. These two pooled trust preferred securities, which had a cost basis of \$3.0 million, had been previously written down \$306 thousand in December of 2008. After the above charge the two issues of pooled trust preferred securities have a remaining book value of approximately \$929 thousand. The Company will continue to monitor the performance of these securities and others for impairment as circumstances warrant. Changes in the credit worthiness of the underlying issuers may result in additional OTTI charges and realized

losses in the future.

As of June 30, 2009 and December 31, 2008, the market value of held to maturity securities was \$31.7 million and \$30.1 million, respectively. The average balance of securities held to maturity amounted to \$34.2 million for the six-months ended June 30, 2009, compared to \$32.8 million for the same period a year ago. The average yield earned on held to maturity securities decreased 55 basis points to 4.75 percent for the six-months ended June 30, 2009, compared to 5.30 percent for the same period a year ago. The weighted average life of the HTM portfolio was 6.08 years and the effective duration of the portfolio was 3.31 years at June 30, 2009, compared to 6.45 years and 3.71 years, respectively at December 31, 2008.

Page 22 of 34

---



Approximately 77 percent of the total investment portfolio had a fixed rate of interest at June 30, 2009.

Securities with a carrying value of \$93.1 million and \$69.9 million at June 30, 2009 and December 31, 2008, respectively, were pledged to secure government deposits, other borrowings and for other purposes required or permitted by law. Included in pledged securities is \$2.9 million in securities pledged to secure governmental deposits under the requirements of the New Jersey Department of Banking and Insurance.

#### Loan Portfolio

The loan portfolio, which represents the Company's largest asset group, is a significant source of both interest and fee income. The portfolio consists of Small Business Administration ("SBA"), SBA 504, commercial, residential mortgage and consumer loans. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk.

Total loans decreased \$20.6 million or 3.0 percent to \$665.3 million at June 30, 2009, compared to \$685.9 million at year-end 2008 due to declines in all loan product lines except for SBA loans and consumer loans, which remained relatively flat. The decline is a direct result of the economic downturn and low consumer and business confidence levels, and reflects the impact of loans sales and reduced loan demand. Creditworthy borrowers are cutting back on capital expenditures or postponing their purchases in hopes that the economy will improve. In general, banks are lending less because consumers and businesses are demanding less credit.

The following table sets forth the loan portfolio concentration by major category:

(In thousands)	June 30, 2009		December 31, 2008	
	Balance	Percent	Balance	Percent
SBA	\$ 105,318	16%	\$ 105,308	15%
SBA 504	72,619	11	76,802	11
Commercial	299,411	45	308,165	45
Residential mortgage	125,466	19	133,110	20
Consumer	62,517	9	62,561	9
Total loans	\$ 665,331	100%	\$ 685,946	100%

Average loans increased \$62.5 million or 10.2 percent from \$610.4 million for the six-months ended June 30, 2008, to \$672.9 million for the same period in 2009. The increase in average loans was due to growth in all segments of the portfolio, the largest increase being residential mortgages of \$49.5 million. The yield on the loan portfolio fell 90 basis points to 6.27 percent for the six-months ended June 30, 2009, compared to 7.17 percent for the same period in 2008. This reduced yield throughout the loan portfolio reflects the re-pricing of variable rate, prime-based loan products such as SBA loans and home equity lines of credit as rates fell during the period. The Prime rate fell 175 basis points since June 30, 2008 and has remained at 3.25 percent since December 2008.

SBA loans, on which the SBA provides guarantees of up to 90 percent of the principal balance, were historically sold in the secondary market by the Company with the nonguaranteed portion held in the portfolio as a loan held for investment. However, during the third quarter of 2007, the Company announced a strategic decision to begin retaining a portion of its SBA 7(a) program loans in its portfolio, rather than selling them into the secondary market. During the third and fourth quarters of 2008, as a result of the significant reduced premiums and the recent credit crisis, the Company closed all SBA production offices outside of its New Jersey, Pennsylvania and New York

primary trade area. Consequently, management believes that there will be a significant decline in the volume of new SBA loans and gains on SBA loans will decline substantially for the foreseeable future.

SBA 7(a) loans held for sale, carried at the lower of cost or market, amounted to \$23.2 million at June 30, 2009, an increase of \$980 thousand from \$22.2 million at December 31, 2008. SBA 7(a) loans held to maturity amounted to \$82.2 million at June 30, 2009, a decrease of \$970 thousand from \$83.1 million at December 31, 2008. The yield on SBA loans, which are generally floating and adjust quarterly to the Prime rate, was 6.12 percent for the six-months ended June 30, 2009, compared to 8.73 percent for the same period a year ago.

At June 30, 2009, SBA 504 loans totaled \$72.6 million, a decrease of \$4.2 million from \$76.8 million at December 31, 2008. The SBA 504 program consists of real estate backed commercial mortgages where the Company has the first mortgage and the SBA has the second mortgage on the property. Generally, the Company has a 50 percent loan to value ratio on SBA 504 program loans. The yield on SBA 504 loans was 6.72 percent for the six-months ended June 30, 2009, compared to 7.59 percent for the same period a year ago.

Commercial loans are generally made in the Company's market place for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. These loans amounted to \$299.4 million at June 30, 2009, a decrease of \$8.8 million from \$308.2 million at year-end 2008. This decrease can be attributed to principals paydowns on these loans with minimal new loan volume. The yield on commercial loans was 6.67 percent for the six-months ended June 30, 2009, compared to 7.08 percent for the same period a year ago. The commercial portfolio is expected to remain relatively flat for the remainder of 2009.

Residential mortgage loans consist of loans secured by 1 to 4 family residential properties. These loans amounted to \$125.5 million at June 30, 2009, a decrease of \$7.6 million from \$133.1 million at December 31, 2008. This decrease is primarily due to mortgage loan sales during the first two quarters of 2009 of \$8.7 million, partially offset by new loan volume. The yield on residential mortgages was 5.76 percent for the six-months ended June 30, 2009, compared to 5.93 percent for the same period in 2008. Significant growth occurred in this portfolio during the second half of 2008 due to a new relationship with an established builder of high end residential properties. The Company expects this growth to slow during 2009 due to current market conditions.

Consumer loans consist of home equity loans and loans for the purpose of financing the purchase of consumer goods, home improvements, and other personal needs, and are generally secured by the personal property being purchased. These loans amounted to \$62.5 million at June 30, 2009, a decrease of \$44 thousand from \$62.6 million at year-end 2008. The yield on consumer loans was 5.12 percent for the six-months ended June 30, 2009, compared to 6.05 percent for the same period a year ago. The portfolio is expected to remain flat for the remainder of 2009.

In the normal course of business, the Company may originate loan products whose terms could give rise to additional credit risk. Interest-only loans, loans with high loan-to-value ratios, construction loans with payments made from interest reserves and multiple loans supported by the same collateral (e.g. home equity loans) are examples of such products. However, these products are not material to the Company's financial position and are closely managed via credit controls that mitigate their additional inherent risk. Management does not believe that these products create a concentration of credit risk in the Company's loan portfolio.

Also, the majority of the Company's loans are secured by real estate. The declines in the market values of real estate in the Company's trade area impact the value of the collateral securing its loans. This could lead to greater losses in the event of defaults on loans secured by real estate. Specifically, 85 percent of SBA 7(a) loans are secured by commercial mortgages, 12 percent by other commercial loans and 3 percent by construction and land development. Commercial mortgages secure 99 percent of all SBA 504 loans with only 1 percent secured by construction and land development. Approximately 98 percent of consumer loans are secured by owner-occupied residential mortgages, with the other 3 percent secured by automobiles or other. The detailed allocation of the Company's commercial loan portfolio collateral as of June 30, 2009 is shown in the table below:



Table of Contents

(In thousands)

Portfolio Collateral	Concentration	
	Balance	Percent
Commercial mortgages - owner occupied	\$ 137,495	46%
Commercial mortgages - investment property	113,698	38
Construction and land development	33,433	11
Other commercial loans	14,785	5
Total commercial loans	\$ 299,411	100%

As of June 30, 2009, approximately 11.6 percent of the Company's total loan portfolio consists of loans to various unrelated and unaffiliated borrowers in the Hotel/Motel industry. Such loans are collateralized by the underlying real property financed and/or partially guaranteed by the SBA.

## Asset Quality

Inherent in the lending function is the possibility a customer may not perform in accordance with the contractual terms of the loan. A borrower's inability to pay its obligations according to the contractual terms can create the risk of past due loans and, ultimately, credit losses, especially on collateral deficient loans.

Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the collectability of principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal, until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income. Loans past due 90 days or more and still accruing interest are not included in nonperforming loans.

Credit risk is minimized by loan diversification and adhering to credit administration policies and procedures. Due diligence on loans begins upon the origination of contact regarding a loan with a borrower. Documentation, including a borrower's credit history, materials establishing the value and liquidity of potential collateral, the purpose of the loan, the source of funds for repayment of the loan, and other factors, are analyzed before a loan is submitted for approval. The loan portfolio is then subject to on-going internal reviews for credit quality. In addition, an outside firm is used to conduct independent credit reviews.

The following table sets forth information concerning nonaccrual loans and nonperforming assets at each of the periods indicated:

(In thousands)	June 30, 2009	December 31, 2008	June 30, 2008
Nonperforming loans			
SBA 7(a) (1)	\$ 6,943	\$ 4,228	\$ 2,544
SBA 504	4,375	4,600	2,117
Commercial	5,475	5,247	822

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

Residential mortgage	5,720	1,808	855
Consumer	261	237	283
Total nonperforming loans	22,774	16,120	6,621
OREO	466	710	266
Total nonperforming assets	23,240	16,830	6,887
Past due 90 days or more and still accruing interest			
SBA 7(a)	-	332	-
SBA 504	-	-	-
Commercial	757	146	76
Residential mortgage	-	2,058	-
Consumer	24	-	-
Total	781	2,536	76
Nonperforming loans to total loans	3.42%	2.35%	1.03%
Nonperforming assets to total loans and OREO	3.49%	2.45%	1.07%
Nonperforming assets to total assets	2.54%	1.87%	0.83%
(1) Amount of nonperforming loans guaranteed by the Small Business Administration	\$ 3,214	\$ 1,983	\$ 686

The current state of the economy largely impacts the Company's level of delinquent and nonperforming loans. The recession that began in 2008 continues to put a strain on the Company's borrowers and their ability to pay their loan obligations. Unemployment rates are at the highest level in 25 years and are expected to increase. Unemployment and flat wages have caused consumer spending and demand for goods to decline, impacting the profitability of small businesses. Consequently, the Company's nonperforming loans have increased this quarter albeit at a lower rate of increase than in the first quarter of 2009.

Nonperforming loans amounted to \$22.8 million at June 30, 2009, an increase of \$6.7 million from year-end 2008. This increase was due primarily to the SBA 7(a) and residential mortgage portfolios, most of which are secured by real estate. The rate at which nonperforming loans are increasing slowed during the second quarter of 2009 compared to the first quarter of 2009. The increase from March 31, 2009 to June 30, 2009 was 14.5%, compared to 23.0% from December 31, 2008 to March 31, 2009. Included in nonperforming loans at June 30, 2009, are approximately \$3.2 million of loans guaranteed by the SBA, compared to \$2.0 million at December 31, 2008. In addition, there were \$781 thousand and \$2.5 million in loans past due 90 days or more and still accruing interest at June 30, 2009 and December 31, 2008, respectively.

Other real estate owned ("OREO") properties totaled \$466 thousand at June 30, 2009, a decrease of \$244 thousand from \$710 thousand at year-end 2008.

Potential problem loans are those where information about possible credit problems of borrowers causes management to have doubt as to the ability of such borrowers to comply with loan repayment terms. These loans are not included in nonperforming loans as they continue to perform. Potential problem loans totaled \$1.7 million at June 30, 2009, a decrease of \$1.0 million from December 31, 2008.

Troubled debt restructurings occur when a creditor for economic or legal reasons related to a debtor's financial condition grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate. At June 30, 2009, there were three loans totaling \$7.8 million that were classified as troubled debt restructurings by the Company. These loans are not included in the nonperforming or potential problem loan figures listed above.

Table of Contents

## Allowance for Loan Losses

Management reviews the level of the allowance for loan losses on a quarterly basis. The standardized methodology used to assess the adequacy of the allowance includes the allocation of specific and general reserves. Specific reserves are made to significant individual impaired loans, which have been defined to include all nonaccrual loans. The general reserve is set based upon the historical net charge-off rate adjusted for certain environmental factors such as: delinquency and impairment trends, charge-off and recovery trends, volume and loan term trends, risk and underwriting policy trends, staffing and experience changes, national and local economic trends, industry conditions and credit concentration changes.

During 2009, the Company significantly increased its loan loss provision in response to the inherent credit risk within its loan portfolio and changes to some of the environmental factors noted above. The inherent credit risk was evidenced by the increase in nonperforming loans during the year, as the downturn in the economy impacted borrowers' abilities to pay and factors, such as a weakened housing market, eroded the value of underlying collateral. In addition, net charge-offs increased during the quarter and year-to-date as the Company proactively addressed these issues.

The allowance for loan losses totaled \$10.7 million, \$10.3 million and \$8.9 million at June 30, 2009, December 31, 2008, and June 30, 2008, respectively, with a resulting allowance to total loan ratios of 1.60 percent, 1.51 percent and 1.39 percent, respectively. Net charge-offs amounted to \$1.1 million for the three months ended June 30, 2009, compared to \$355 thousand for the three months ended June 30, 2008. Net charge-offs amounted to \$2.7 million for the six months ended June 30, 2009, compared to \$538 thousand for the six months ended June 30, 2008. The increase in net charge-offs was primarily related to the SBA 7(a), SBA 504, and commercial loan portfolios, most of which is secured by real estate.

The following is a reconciled summary of the allowance for loan losses for the three and six months ended June 30, 2009 and 2008:

Allowance for Loan Loss Activity (In thousands)	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Balance, beginning of period	\$ 10,307	\$ 8,650	\$ 10,326	\$ 8,383
Provision charged to expense	1,500	650	3,000	1,100
Charge-offs:				
SBA	323	249	1,429	513
SBA 504	112	-	312	-
Commercial	798	60	1,047	60
Residential mortgage	33	-	91	25
Consumer	11	56	11	62
Total charge-offs	1,277	365	2,890	660
Recoveries:				
SBA	56	5	89	65
SBA 504	-	-	5	-
Commercial	79	4	132	6
Residential mortgage	-	-	-	-
Consumer	-	1	3	51

Total recoveries	135	10	229	122
Total net charge-offs	1,142	355	2,661	538
Balance, end of period	10,665	\$ 8,945	10,665	\$ 8,945
Selected loan quality ratios:				
Net charge-offs to average loans (annualized)	0.34 %	0.12%	0.80 %	0.18%
Allowance for loan losses to total loans at period end	1.60 %	1.39%	1.60 %	1.39%
Allowance for loan losses to nonperforming loans	46.83 %	135.10%	46.83 %	135.10%

## Deposits

Deposits, which include noninterest and interest-bearing demand deposits and interest-bearing savings and time deposits, are the primary source of the Company's funds. The Company offers a variety of products designed to attract and retain customers, with primary focus on building and expanding relationships.

During the first six months of 2009, total deposits increased \$24.6 million to \$731.8 million at June 30, 2009, from \$707.1 million at December 31, 2008. The increase in deposits was primarily the result of a \$77.0 million increase in savings deposits and a \$9.5 million increase in noninterest-bearing demand deposits, partially offset by a \$59.7 million decrease in time deposits and a \$2.2 million decrease in interest-bearing demand deposits. The increase in savings deposits and decline in time deposits was due to the migration of deposits into our new savings product. This, combined with the Company's new sales initiatives and efforts by branch personnel and administration to bring in deposit relationships, resulted in increased noninterest-bearing demand deposits period over period.

This activity has resulted in a favorable shift in our deposit concentration from 19 percent savings and 58 percent time deposits at December 31, 2008, to 29 percent savings and 48 percent time deposits at June 30, 2009. The concentration of demand deposits equaled 11 percent and interest-bearing demand deposits equaled 12 percent at June 30, 2009 and December 31, 2008, respectively. The Company anticipates a continued migration of deposits from time deposits to savings products throughout 2009.

Table of Contents

## Borrowed Funds and Subordinated Debentures

Borrowed funds and subordinated debentures totaled \$110.5 million at June 30, 2009, a decrease of \$10.0 million or 8.3 percent from December 31, 2008. This net decrease was due to the maturity of a repurchase agreement. As of June 30, 2009, the Company was a party to the following borrowed funds and subordinated debenture transactions:

(In thousands)	June 30, 2009	December 31, 2008
<b>FHLB Borrowings:</b>		
Overnight line of credit	\$ 10,000	\$ 10,000
Fixed rate advances	40,000	40,000
Repurchase agreements	30,000	30,000
Other repurchase agreements	15,000	25,000
Subordinate debentures	15,465	15,465

## Interest Rate Sensitivity

The principal objectives of the asset and liability management function are to establish prudent risk management guidelines, evaluate and control the level of interest-rate risk in balance sheet accounts, determine the level of appropriate risk given the business focus, operating environment, capital, and liquidity requirements, and actively manage risk within the Board approved guidelines. The Company seeks to reduce the vulnerability of the operations to changes in interest rates, and actions in this regard are taken under the guidance of the Asset/Liability Management Committee (“ALCO”) of the Board of Directors. The ALCO reviews the maturities and re-pricing of loans, investments, deposits and borrowings, cash flow needs, current market conditions, and interest rate levels.

The Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity (“EVPE”) models to measure the impact of longer-term asset and liability mismatches beyond two years. The modified duration of equity measures the potential price risk of equity to changes in interest rates. A longer modified duration of equity indicates a greater degree of risk to rising interest rates. Because of balance sheet optionality, an EVPE analysis is also used to dynamically model the present value of asset and liability cash flows with rate shocks of 200 basis points. The economic value of equity is likely to be different as interest rates change. Like the simulation model, results falling outside prescribed ranges require action by the ALCO. The Company’s variance in the economic value of equity, as a percentage of assets with rate shocks of 200 basis points at June 30, 2009, is a decline of 0.64 percent in a rising-rate environment and an decrease of 0.90 percent in a falling-rate environment. Both variances are within the Board-approved guidelines of +/- 3.00 percent. At December 31, 2008, the economic value of equity as a percentage of assets with rate shocks of 200 basis points was a decline of 1.19 percent in a rising-rate environment and an decrease of 1.39 percent in a falling-rate environment.

## Operating, Investing, and Financing Cash

Cash and cash equivalents amounted to \$54.5 million at June 30, 2009, an increase of \$20.1 million from December 31, 2008. Net cash provided by operating activities for the six months ended June 30, 2009, amounted to \$2.5 million, primarily due to proceeds from the sale of mortgage loans, offset by originations of loans held for sale and net losses from operations. Net cash provided by investing activities amounted to \$3.4 million for the six months ended June 30, 2009, primarily due to proceeds from the maturities and sales of securities available for sale and principal repayments



on securities and loans. Net cash used in financing activities amounted to \$14.1 million for the six months ended June 30, 2009, due to increased deposits and proceeds from new borrowings, partially offset by matured and called borrowings and cash dividends paid on preferred stock.

#### Liquidity

The Company's liquidity is a measure of its ability to fund loans, withdrawals or maturities of deposits and other cash outflows in a cost-effective manner.

#### Parent Company

At June 30, 2009, the Parent Company had \$5.6 million in cash and \$99 thousand in marketable securities, valued at fair market value, compared to \$6.1 million in cash and \$94 thousand in marketable securities at December 31, 2008. The decrease in cash at the Parent Company was due to the payment of preferred stock dividends to the U.S. Treasury as part of the Capital Purchase Program and other operating expenses. Expenses at the Parent Company are minimal, and management believes that the Parent Company has adequate liquidity to fund its obligations.

#### Consolidated Bank

The principal sources of funds are deposits, scheduled amortizations and repayments of loan principal, sales and maturities of investment securities and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Due to current market conditions management believes there will be continued pressure on liquidity; however, management believes it has adequate liquidity to fund its obligations.

At June 30, 2009, \$107 million was available for additional borrowings from the FHLB and FRB of New York. Pledging additional collateral in the form of 1-4 family residential mortgages or investment securities can increase these lines. Additional sources of liquidity are the securities available for sale and SBA loans held for sale portfolios, which were \$132.7 million and \$23.2 million at June 30, 2009, respectively.

As of June 30, 2009, deposits included \$15.4 million of Government deposits, as compared to \$18.7 million at December 31, 2008. These deposits are generally short in duration and are sensitive to price competition. The Company believes the current portfolio of these deposits to be appropriate. Included in the portfolio are \$12.5 million of deposits from five municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.

At June 30, 2009, the Bank had \$82.6 million of loan commitments, which will generally either expire or be funded within one year. The Company believes it has the necessary liquidity to honor all commitments. Many of these commitments will expire and never be funded. In addition, approximately \$6.5 million of these commitments are for SBA loans, which may be sold into the secondary market.

Table of Contents

## Regulatory Capital

A significant measure of the strength of a financial institution is its capital base. Federal regulators have classified and defined capital into the following components: (1) Tier I capital, which includes tangible shareholders' equity for common stock and qualifying hybrid instruments; and (2) Tier II capital, which includes a portion of the allowance for loan losses, certain qualifying long-term debt, preferred stock and hybrid instruments, which do not qualify as Tier I capital. Minimum capital levels are regulated by risk-based capital adequacy guidelines, which require an institution to maintain certain capital as a percent of assets, and certain off-balance sheet items adjusted for pre-defined, credit-risk factors (risk-adjusted assets). An institution is required to maintain, at a minimum, Tier I capital as a percentage of risk-adjusted assets of 4.0 percent and combined Tier I and Tier II capital as a percentage of risk-adjusted assets of 8.0 percent.

In addition to the risk-based guidelines, regulators require that an institution, which meets the regulator's highest performance and operation standards maintain a minimum leverage ratio (tier I capital as a percentage of tangible assets) of 4 percent. For those institutions with higher levels of risk or that are experiencing or anticipating significant growth, the minimum leverage ratio will be proportionately increased. Minimum leverage ratios for each institution are evaluated through the ongoing regulatory examination process.

The Company's capital amounts and ratios are presented in the following table.

(In thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions			
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
As of June 30, 2009								
Leverage Ratio	82,822	9.30 %	<sup>3</sup>	35,622	4.00%	<sup>3</sup>	44,527	N/A
Tier I risk-based capital ratio	82,822	11.88 %	<sup>3</sup>	27,897	4.00%	<sup>3</sup>	41,845	N/A
Total risk-based capital ratio	91,565	13.13 %	<sup>3</sup>	55,794	8.00%	<sup>3</sup>	69,742	N/A
As of December 31, 2008								
Leverage Ratio	83,671	9.54%	<sup>3</sup>	35,071	4.00%	<sup>3</sup>	43,839	N/A
Tier I risk-based capital ratio	83,671	12.02%	<sup>3</sup>	27,846	4.00%	<sup>3</sup>	41,769	N/A
Total risk-based capital ratio	92,394	13.27%	<sup>3</sup>	55,692	8.00%	<sup>3</sup>	69,616	N/A

The Bank's capital amounts and ratios are presented in the following table.

(In thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions			
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
As of June 30, 2009								
Leverage Ratio	68,753	7.73%	<sup>3</sup>	35,583	4.00%	<sup>3</sup>	44,478	5.00%
Tier I risk-based capital ratio	68,753	9.87%	<sup>3</sup>	27,858	4.00%	<sup>3</sup>	41,788	6.00%

Total risk-based capital ratio	85,984	12.35%	<sup>3</sup>	55,717	8.00%	<sup>3</sup>	69,646	10.00%
As of December 31, 2008								
Leverage Ratio	69,049	7.88%	<sup>3</sup>	35,043	4.00%	<sup>3</sup>	43,804	5.00%
Tier I risk-based capital ratio	69,049	9.93%	<sup>3</sup>	27,806	4.00%	<sup>3</sup>	41,709	6.00%
Total risk-based capital ratio	86,259	12.41%	<sup>3</sup>	55,612	8.00%	<sup>3</sup>	69,514	10.00%

#### Shareholders' Equity

Shareholders' equity decreased \$739 thousand, or 1.1 percent, to \$67.1 million at June 30, 2009, compared to \$67.8 million at December 31, 2008. This decrease was primarily the result of a \$469 thousand net loss and \$510 thousand in preferred stock dividends accrued during the six months ended June 30, 2009, offset in part by \$155 thousand appreciation in the market value of the securities and cash flow hedges and \$133 thousand in stock related compensation expense.

In accordance with its revised dividend policy announced during the third quarter of 2008, the Company did not declare any dividends during the six months ended June 30, 2009. The revised dividend policy established a targeted dividend payout ratio of 20% of the Company's earnings, subject to adjustment based upon factors existing at the time of the dividend and the Company's projected capital needs. The dividend would be paid once annually, in the next succeeding year. In addition, the Company is subject to limitations on the payment of dividends related to its participation in the U.S. Treasury's Capital Purchase Plan.

On October 21, 2002, the Company authorized the repurchase of up to 10% of its outstanding common stock. The amount and timing of purchases would be dependent upon a number of factors, including the price and availability of the Company's shares, general market conditions and competing alternate uses of funds. There were no shares repurchased during the six months ended June 30, 2009. As of June 30, 2009, the Company had repurchased a total of 556 thousand shares of which 131 thousand shares have been retired, leaving 153 thousand shares remaining to be repurchased under the plan. The Company has suspended its share repurchase program, as required by the U.S. Treasury's Capital Purchase Plan.

Table of Contents

## Derivative Financial Instruments

The Company has stand alone derivative financial instruments in the form of interest rate swap agreements, which derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments, and the value of the derivatives are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instruments, is reflected on the Company's balance sheet as other assets and other liabilities.

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations. The Company deals only with primary dealers.

Derivative instruments are generally either negotiated OTC contracts or standardized contracts executed on a recognized exchange. Negotiated OTC derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise prices and maturity.

## Risk Management Policies – Hedging Instruments

The primary focus of the Company's asset/liability management program is to monitor the sensitivity of the Company's net portfolio value and net income under varying interest rate scenarios to take steps to control its risks. On a quarterly basis, the Company evaluates the effectiveness of entering into any derivative agreement by measuring the cost of such an agreement in relation to the reduction in net portfolio value and net income volatility within an assumed range of interest rates.

## Interest Rate Risk Management – Cash Flow Hedging Instruments

The Company has long-term variable rate debt as a source of funds for use in the Company's lending and investment activities and for other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments. To meet this objective, management enters into interest rate swap agreements whereby the Company receives variable interest rate payments and makes fixed interest rate payments during the contract period.

At June 30, 2009 and 2008 the information pertaining to outstanding interest rate swap agreements used to hedge variable rate debt was as follows:

(Dollars in thousands)	2009	2008
Notional amount	\$ 15,000	\$ 15,000
Weighted average pay rate	4.05%	4.05%
Weighted average receive rate	1.37%	4.55%
Weighted average maturity in years	2.4	3.4
Unrealized loss relating to interest rate swaps	\$ (829)	\$ (62)

These agreements provided for the Company to receive payments at a variable rate determined by a specific index (three month Libor) in exchange for making payments at a fixed rate.

At June 30, 2009, the net unrealized loss relating to interest rate swaps was recorded as a derivative liability. Changes in the fair value of interest rate swaps designated as hedging instruments of the variability of cash flows associated with long-term debt are reported in other comprehensive income. The net spread between the fixed rate of interest which is paid and the variable interest received is classified in interest expense as a yield adjustment in the same period in which the related interest on the long-term debt affects earnings.

#### Impact of Inflation and Changing Prices

The financial statements, and notes thereto, presented elsewhere herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of the operations. Unlike most industrial companies, nearly all the Company's assets and liabilities are monetary. As a result, interest rates have a greater impact on performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

#### ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

During 2009, there have been no significant changes in the Company's assessment of market risk as reported in Item 6 of the Company's Annual Report on Form 10-K for the year ended December 31, 2008. (See Interest Rate Sensitivity in Management's Discussion and Analysis Herein.)

#### ITEM 4.T. Controls and Procedures

- (a) The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2009. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for recording, processing, summarizing and reporting the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms. Such evaluation did not identify any change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2009, has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.
- (b) Changes in internal controls over financial reporting – No significant change in the Company's internal control over financial reporting has occurred during the quarterly period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's control over financial reporting.

Table of Contents

## PART II – OTHER INFORMATION

## Item 1. Legal Proceedings

From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the business, financial condition, or the results of the operation of the Company.

## Item 1.A. Risk Factors

Information regarding this item as of June 30, 2009 appears under the heading, “Risk Factors” within the Company’s Form 10-K for the year ended December 31, 2008.

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

- (a) none
- (b) none
- (c) none

## Item 3. Defaults Upon Senior Securities-None

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

- (a) Election of Directors – The following Director were elected to a three-year term at the Company’s 2009 Annual Meeting held on April 23, 2009, expiring at the Company’s Annual Meeting in 2012.

Director	Shares “For”	% “For”	Shares “Withheld”	% “Withheld”
Dr. Mark S. Brody	5,845,274	98.2%	106,273	1.8%
Charles S. Loring	5,775,265	97.0%	176,282	3.0%
Raj Patel	5,303,397	89.1%	648,150	10.9%

- (b) To consider and approve the following advisory (non-binding) proposal: "Resolved, that the shareholders approve the compensation of the Company's executive officers as described in the tabular disclosure regarding named executive officer compensation (together with the accompanying narrative disclosure) in this proxy.":

Shares "For"	% "For"	Shares "Withheld"	% "Withheld"
5,181,033	92.3%	432,038	7.7%

## Item 5. Other Information - None

## Item 6. Exhibits

(a)

Exhibits

Edgar Filing: UNITY BANCORP INC /NJ/ - Form 10-Q

- Exhibit 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

SIGNATURES

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

UNITY BANCORP, INC.

Dated: August 12, 2009

/s/ Alan J. Bedner, Jr.

ALAN J. BEDNER, JR.

Executive Vice President and Chief Financial Officer



Table of Contents

EXHIBIT INDEX

QUARTERLY REPORT ON FORM 10-Q

EXHIBIT NO.	DESCRIPTION
31.1	Exhibit 31.1-Certification of James A. Hughes. Required by Rule 13a-14(a) or Rule 15d-14(a) and section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Exhibit 31.2-Certification of Alan J. Bedner, Jr. Required by Rule 13a-14(a) or Rule 15d-14(a) and section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Exhibit 32.1-Certification of James A. Hughes and Alan J. Bedner. Required by Rule 13a-14(b) or Rule 15d-14(b) and section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.



