

UNITY BANCORP INC /NJ/
Form 10-Q
May 13, 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 March 31, 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 May 1, 2009
common stock, no par value: 7,119,438 shares outstanding

Table of Contents

Table of Contents

| | Page # |
|--|--|
| PART I | |
| <u>CONSOLIDATED FINANCIAL INFORMATION</u> | |
| ITEM 1 | |
| | <u>Consolidated Financial Statements (Unaudited)</u> |
| | <u>Consolidated Balance Sheets at March 31, 2009, 2008 and December 31, 2008</u> |
| | 1 |
| | <u>Consolidated Statements of Income for the three months ended March 31, 2009 and 2008</u> |
| | 2 |
| | <u>Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2009 and 2008</u> |
| | 3 |
| | <u>Consolidated Statements of Cash Flows for the three months ended March 31, 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> |
| | 14 |
| ITEM 3 | <u>Quantitative and Qualitative Disclosures about Market Risk</u> |
| | 25 |
| ITEM 4T | <u>Controls and Procedures</u> |
| | 25 |
| PART II | |
| <u>OTHER INFORMATION</u> | 26 |
| ITEM 1 | <u>Legal Proceedings</u> |
| | 26 |
| ITEM 1A | <u>Risk Factors</u> |
| | 26 |
| ITEM 2 | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> |
| | 26 |
| ITEM 3 | <u>Defaults upon Senior Securities</u> |
| | 26 |
| ITEM 4 | <u>Submission of Matters to a Vote of Security Holders</u> |
| | 26 |
| ITEM 5 | <u>Other Information</u> |
| | 26 |
| ITEM 6 | <u>Exhibits</u> |
| | 26 |
| <u>SIGNATURES</u> | 27 |

| | |
|----------------------|----|
| <u>EXHIBIT INDEX</u> | 28 |
| Exhibit 31.1 | 29 |
| Exhibit 31.2 | 30 |
| Exhibit 32.1 | 31 |

Table of Contents

Part 1 - Consolidated Financial Information

Item 1 - Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.
Consolidated Balance Sheets
(Unaudited)

| (In thousands) | March 31, 2009 | December 31, 2008 | March 31, 2008 |
|---|-------------------|----------------------|-------------------|
| ASSETS | | | |
| Cash and due from banks | \$ 17,896 | \$ 18,902 | \$ 19,698 |
| Federal funds sold and interest-bearing deposits | 12,329 | 15,529 | 44,042 |
| Cash and cash equivalents | 30,225 | 34,431 | 63,740 |
| Securities: | | | |
| Available for sale | 122,873 | 117,348 | 79,726 |
| Held to maturity (market value of \$33,313, \$30,088 and \$34,577, respectively) | 35,149 | 32,161 | 34,622 |
| Total securities | 158,022 | 149,509 | 114,348 |
| Loans: | | | |
| SBA held for sale | 22,559 | 22,181 | 23,632 |
| SBA held to maturity | 80,008 | 83,127 | 71,798 |
| SBA 504 | 75,556 | 76,802 | 70,446 |
| Commercial | 303,991 | 308,165 | 302,249 |
| Residential mortgage | 125,007 | 133,110 | 76,734 |
| Consumer | 62,781 | 62,561 | 58,084 |
| Total loans | 669,902 | 685,946 | 602,943 |
| Less: Allowance for loan losses | 10,307 | 10,326 | 8,650 |
| Net loans | 659,595 | 675,620 | 594,293 |
| Premises and equipment, net | 12,329 | 12,580 | 12,067 |
| Bank Owned Life Insurance | 5,835 | 5,780 | 5,622 |
| Federal Home Loan Bank stock | 4,947 | 4,857 | 4,170 |
| Accrued interest receivable | 4,328 | 4,712 | 4,131 |
| Goodwill and other intangibles | 1,570 | 1,574 | 1,585 |
| Loan servicing asset | 1,320 | 1,503 | 1,990 |
| Other assets | 8,506 | 7,744 | 5,928 |
| Total Assets | \$ 886,677 | \$ 898,310 | \$ 807,874 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Liabilities: | | | |
| Deposits: | | | |
| Noninterest-bearing demand deposits | \$ 75,857 | \$ 74,090 | \$ 80,960 |
| Interest bearing demand deposits | 85,390 | 87,046 | 76,256 |
| Savings deposits | 163,606 | 134,875 | 188,628 |
| Time deposits, under \$100,000 | 258,890 | 270,275 | 211,739 |
| Time deposits, \$100,000 and over | 119,523 | 140,831 | 84,699 |
| Total deposits | 703,266 | 707,117 | 642,282 |

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

| | | | |
|--|------------|------------|------------|
| Borrowed funds | 97,000 | 105,000 | 95,000 |
| Subordinated debentures | 15,465 | 15,465 | 15,465 |
| Accrued interest payable | 841 | 805 | 794 |
| Accrued expenses and other liabilities | 2,580 | 2,120 | 6,437 |
| Total Liabilities | 819,152 | 830,507 | 759,978 |
| Commitments and contingencies | - | - | - |
| Shareholders' equity: | | | |
| Preferred stock, no par value, 500 shares authorized | 18,194 | 18,064 | - |
| Common stock, no par value, 12,500 shares authorized | 55,179 | 55,179 | 49,600 |
| Retained earnings | 1,437 | 1,085 | 3,379 |
| Treasury stock at cost | (4,169) | (4,169) | (4,169) |
| Accumulated other comprehensive loss, net of tax | (3,116) | (2,356) | (914) |
| Total Shareholders' Equity | 67,525 | 67,803 | 47,896 |
| Total Liabilities and Shareholders' Equity | \$ 886,677 | \$ 898,310 | \$ 807,874 |
| Preferred shares | 21 | 21 | - |
| Issued common shares | 7,544 | 7,544 | 7,509 |
| Outstanding common shares | 7,119 | 7,119 | 7,084 |

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

Unity Bancorp, Inc.
Consolidated Statements of Income
(Unaudited)

| (In thousands, except per share data) | For the three months ended March 31, | |
|---|--------------------------------------|--------|
| | 2009 | 2008 |
| INTEREST INCOME | | |
| Fed funds sold and interest on deposits | \$ 13 | \$ 180 |
| Federal Home Loan Bank stock | - | 100 |
| Securities: | | |
| Available for sale | 1,679 | 875 |
| Held to maturity | 386 | 437 |
| Total securities | 2,065 | 1,312 |
| Loans: | | |
| SBA | 1,607 | 2,328 |
| SBA 504 | 1,231 | 1,450 |
| Commercial | 5,016 | 5,285 |
| Residential mortgage | 1,864 | 1,079 |
| Consumer | 794 | 901 |
| Total loan interest income | 10,512 | 11,043 |
| Total interest income | 12,590 | 12,635 |
| INTEREST EXPENSE | | |
| Interest bearing demand deposits | 270 | 366 |
| Savings deposits | 644 | 1,349 |
| Time deposits | 3,723 | 3,220 |
| Borrowed funds and subordinated debentures | 1,179 | 1,065 |
| Total interest expense | 5,816 | 6,000 |
| Net interest income | 6,774 | 6,635 |
| Provision for loan losses | 1,500 | 450 |
| Net interest income after provision for loan losses | 5,274 | 6,185 |
| NONINTEREST INCOME | | |
| Service charges on deposit accounts | 330 | 320 |
| Service and loan fee income | 252 | 300 |
| Gain on sale of mortgage loans | 64 | 21 |
| Gain on sale of SBA loans held for sale, net | 29 | 576 |
| Bank owned life insurance | 55 | 51 |
| Net securities gains | 515 | 70 |
| Other income | 103 | 117 |
| Total noninterest income | 1,348 | 1,455 |
| NONINTEREST EXPENSES | | |
| Compensation and benefits | 2,624 | 3,220 |
| Occupancy | 687 | 701 |
| Processing and communications | 541 | 570 |
| Furniture and equipment | 495 | 388 |
| Deposit insurance | 301 | 63 |
| Professional services | 246 | 198 |
| Loan collection costs | 198 | 102 |
| Advertising | 75 | 62 |

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

| | | | | |
|-------|--|---------|----|-------|
| Other | | 388 | | 466 |
| | Total noninterest expenses | 5,555 | | 5,770 |
| | Income before provision for income taxes | 1,067 | | 1,870 |
| | Provision for income taxes | 336 | | 626 |
| | Net income | 731 | | 1,244 |
| | Preferred stock dividends and discount accretion | 379 | | - |
| | Income available to common shareholders | \$ 352 | \$ | 1,244 |
| | Net income per share - Basic | \$ 0.05 | \$ | 0.18 |
| | - Diluted | \$ 0.05 | \$ | 0.17 |
| | Weighted average common shares outstanding - Basic | 7,119 | | 7,076 |
| | - Diluted | 7,148 | | 7,271 |

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 three months ended March 31, 2009 and 2008
 (Unaudited)

| (In thousands) | Preferred Stock | Common Stock Shares | Common Stock Amount | Retained Earnings | Treasury Stock | Accumulated Comprehensive Other Loss | Total Shareholders' Equity |
|---|--------------------|------------------------|------------------------|----------------------|-------------------|---|----------------------------------|
| Balance, December 31, 2007 | \$ | 7,063 | \$ 49,447 | \$ 2,472 | \$ (4,169) | \$ (490) | \$ 47,260 |
| Comprehensive income: | | | | | | | |
| Net Income | | | | 1,244 | | | 1,244 |
| Net unrealized securities losses | | | | | | (68) | (68) |
| Net unrealized loss on cash flow hedge derivative | | | | | | (356) | (356) |
| Total comprehensive income | | | | | | | 820 |
| Dividends on Common Stock (\$0.05 per share) | | | | (337) | | | (337) |
| Issuance of common stock: | | | | | | | |
| Stock issued, including related tax benefits | | 9 | 84 | | | | 84 |
| Stock-based compensation | | 12 | 69 | | | | 69 |
| Balance, March 31, 2008 | \$ | 7,084 | \$ 49,600 | \$ 3,379 | \$ (4,169) | \$ (914) | \$ 47,896 |
| | | | | | | | |
| (In thousands) | Preferred Stock | Common Stock Shares | Common Stock Amount | Retained Earnings | Treasury Stock | Accumulated Comprehensive Other 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 Income | | | | 731 | | | | | 731 |
| Net unrealized securities losses: | | | | | | | | | |
| Available for sale securities | | | | | | | | (793) | (793) |
| Held to maturity securities | | | | | | | | 8 | 8 |
| Net unrealized gain on cash flow hedge derivative | | | | | | | | 25 | 25 |
| Total comprehensive income | | | | | | | | | (29) |
| Accretion of Discount on Preferred Stock | 130 | | | (130) | | | | | - |
| Dividends on Preferred Stock (5% annually) | | | | (249) | | | | | (249) |
| Issuance of common stock: | | | | | | | | | |
| Stock issued, including related tax benefits | | | | (48) | | | | | (48) |
| Stock-based compensation | | | | 48 | | | | | 48 |
| Balance, March 31, 2009 | \$ 18,194 | 7,119 | \$ 55,179 | \$ 1,437 | \$ (4,169) | \$ (3,116) | \$ | | 67,525 |

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 three months ended | |
|---|----------------------------|----------------|
| | March 31, 2009 | March 31, 2008 |
| OPERATING ACTIVITIES: | | |
| Net Income | \$ 731 | \$ 1,244 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 1,500 | 450 |
| Net amortization of purchase premiums and discounts on securities | 54 | 6 |
| Depreciation and amortization | 429 | 267 |
| Deferred income tax benefit | (219) | (347) |
| Net security gains | (515) | (70) |
| Stock compensation expense | 48 | 69 |
| Gain on sale of SBA loans held for sale, net | (29) | (576) |
| Gain on sale of mortgage loans | (64) | (21) |
| Origination of mortgage loans held for sale | (438) | (1,291) |
| Origination of SBA loans held for sale | (1,341) | (10,499) |
| Proceeds from the sale of mortgage loans held for sale, net | 5,246 | 1,312 |
| Proceeds from the sale of SBA loans held for sale, net | 867 | 12,083 |
| Net change in other assets and liabilities | 842 | 3,911 |
| Net cash provided by operating activities | 7,111 | 6,538 |
| INVESTING ACTIVITIES | | |
| Purchases of securities held to maturity | (4,036) | (2,780) |
| Purchases of securities available for sale | (37,412) | (21,460) |
| Purchases of Federal Home Loan Bank stock, at cost | (4,734) | (225) |
| Maturities and principal payments on securities held to maturity | 1,045 | 1,887 |
| Maturities and principal payments on securities available for sale | 11,262 | 5,857 |
| Proceeds from sales of securities available for sale | 19,809 | 790 |
| Proceeds from the redemption of Federal Home Loan Bank stock | 4,644 | 450 |
| Proceeds from the sale of other real estate owned | 67 | 309 |
| Net decrease (increase) in loans | 10,023 | (14,435) |
| Purchases of premises and equipment | (86) | (265) |
| Net cash provided by (used in) investing activities | 582 | (29,872) |
| FINANCING ACTIVITIES | | |
| Net (decrease) increase in deposits | (3,851) | 41,014 |
| Proceeds from new borrowings | 2,000 | 15,000 |
| Repayments of borrowings | (10,000) | (5,000) |

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

| | | |
|---|-----------|-----------|
| Proceeds from the issuance of common stock | (48) | 84 |
| Cash dividends paid on common stock | - | (336) |
| Net cash (used in) provided by financing activities | (11,899) | 50,762 |
| (Decrease) increase in cash and cash equivalents | (4,206) | 27,428 |
| Cash and cash equivalents at beginning of period | 34,431 | 36,312 |
| Cash and cash equivalents at end of period | \$ 30,225 | \$ 63,740 |

SUPPLEMENTAL DISCLOSURES

| | | | |
|--|----|-------|----------|
| Cash: | | | |
| Interest paid | \$ | 5,780 | \$ 5,841 |
| Income taxes paid | | 514 | 13 |
| Noncash investing activities: | | | |
| Transfer of loans to other real estate owned | | 121 | 470 |

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

Page 4 of 31

Table of Contents

Unity Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
March 31, 2009

NOTE 1. Summary of 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 in the market. 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 March 31, 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 March 31, 2009, 1,520,529 shares have been reserved for issuance upon the exercise of options, 872,274 option grants are outstanding, and 572,271 option grants have been exercised, forfeited or expired, leaving 75,984 shares available for grant.

The Company did not grant any options during the three months ended March 31, 2009. Comparatively, 39,113 options were granted during the three months ended March 31, 2008. The fair value of the options granted during the first quarter of 2008 was estimated on the date of grant using the Black-Scholes option-pricing model with the

following weighted average assumptions:

| | Three Months Ended March 31, | |
|--|---------------------------------|---------|
| | 2009 | 2008 |
| Number of shares granted | - | 39,113 |
| Weighted average exercise price | \$ - | \$ 7.61 |
| Weighted average fair value of options | \$ - | \$ 1.61 |
| Expected life (in years) | - | 3.78 |
| Expected volatility | -% | 30.92% |
| Risk-free interest rate | -% | 2.44% |
| Dividend yield | -% | 2.50% |

There were no options granted, exercised, forfeited or expired under the Company's stock option plans during the three months ended March 31, 2009. Options outstanding and options exercisable at March 31, 2009 are summarized as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value |
|-------------------------------|------------------|---------------------------------|--|---------------------------|
| Outstanding at March 31, 2009 | 872,274 | \$ 5.94 | 4.8 | \$ 41,187 |
| Exercisable at March 31, 2009 | 687,765 | \$ 5.89 | 3.6 | \$ 41,187 |

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 \$31 thousand and \$30 thousand for the three months ended March 31, 2009 and 2008, respectively. The related income tax benefit was approximately \$13 thousand for each of the three months ended March 31, 2009 and 2008. As of March 31, 2009, there was approximately \$269 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 2.0 years.

There were no options exercised during the three months ended March 31, 2009 and 2008; consequently, no intrinsic value was realized.

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 ended March 31, 2009, while 11,550 shares were granted during the three months ended March 31, 2008 with an average grant date fair value of \$7.60.

Compensation expense related to the restricted stock awards totaled \$17 thousand and \$39 thousand for the three months ended March 31, 2009 and 2008, respectively. As of March 31, 2009 there was approximately \$273 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 2.0 years.

As of March 31, 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 three months ended March 31, 2009:

| | Shares | Average Grant Date Fair Value |
|---|----------|---|
| Nonvested restricted stock at December 31, 2008 | 50,424 | \$ 9.76 |
| Granted | - | - |
| Vested | (14,368) | 11.43 |
| Forfeited | - | - |
| Nonvested restricted stock at March 31, 2009 | 36,056 | \$ 9.09 |

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 March 31, 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.

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

The following is a reconciliation of the calculation of basic and diluted earnings per share. Basic net income per common share is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding during the reporting period. Diluted net income per common share is computed similarly to that of basic net income 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).

| | Three Months ended March 31, | |
|--|------------------------------|----------|
| (In thousands, except per share data) | 2009 | 2008 |
| Net income | \$ 731 | \$ 1,244 |
| Less: Preferred stock dividends and discount accretion | 379 | - |
| Income available to common shareholders | 352 | 1,244 |
| Weighted-average common shares outstanding | 7,119 | 7,076 |
| Plus: Potential dilutive common stock | 29 | 195 |
| Diluted average common shares outstanding | 7,148 | 7,271 |
| Net income per common share: | | |
| Basic | \$ 0.05 | \$ 0.18 |
| Diluted | 0.05 | 0.17 |

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 periods ended March 31, 2009 and 2008. The Company does not have an accrual for uncertain tax positions as of March 31, 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)

| | Pre-tax | Tax | After-tax |
|---|---------|---------|-----------|
| Net unrealized security losses | | | |
| Balance at December 31, 2007 | | | \$ (476) |
| Unrealized holding loss on securities arising during the period | \$ (40) | \$ (18) | (22) |

| | | | |
|--|-------|------|-------|
| Less: Reclassification adjustment for gains included in net income | 70 | 24 | 46 |
| Net unrealized loss on securities arising during the period | (110) | (42) | (68) |
| Balance at March 31, 2008 | | \$ | (544) |

| | | | |
|--|----------|----------|---------|
| Balance at December 31, 2008 | | \$ | (1,728) |
| Unrealized holding loss on securities arising during the period | \$ (756) | \$ (313) | (443) |
| Less: Reclassification adjustment for gains included in net income | 515 | 173 | 342 |
| Net unrealized loss on securities arising during the period | (1,271) | (486) | (785) |
| Balance at March 31, 2009 | | \$ | (2,513) |

| 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 | \$ (574) | \$ (218) | (356) |
| Balance at March 31, 2008 | | | (370) |

| | | | |
|---|-------|-------|----------|
| Balance at December 31, 2008 | | | \$ (628) |
| Unrealized holding loss arising during the period | \$ 40 | \$ 15 | 25 |
| Balance at March 31, 2009 | | | \$ (603) |

Two securities with a market value of \$1.9 million were transferred from the available for sale category to held to maturity during the third quarter of 2008, consistent with the Company's intent and ability to hold these securities until maturity. Unrealized losses at the date of transfer amounted to \$1.1 million and continue to be reported in accumulated other comprehensive income, with amortization over the estimated remaining life of the securities. During the three months ended March 31, 2009, \$8 thousand of this unrealized loss was amortized.

NOTE 6. Fair Value

Effective January 1, 2008, the Company adopted 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.

Table of Contents

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. 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 March 31, 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 March 31, 2009 as compared to the quarters ended December 31, 2008 and March 31, 2008. The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2009 and December 31, 2008.

| (In thousands) | As of March 31, 2009 | | | |
|--|----------------------|----------|---------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | |
| Securities available for sale: | | | | |
| U.S. government sponsored entities | \$ - | \$ 4,759 | \$ - | \$ 4,759 |
| State and political subdivisions | - | 2,759 | - | 2,759 |
| Residential mortgage-backed securities | - | 114,429 | - | 114,429 |
| Commercial mortgage-backed securities | - | - | - | - |
| Collateralized debt obligations | - | 340 | - | 340 |
| Other equities | 8 | 578 | - | 586 |
| Total securities available for sale | 8 | 122,865 | - | 122,873 |
| SBA servicing assets | - | - | 1,320 | 1,320 |
| Total | 8 | 122,865 | 1,320 | 124,193 |
| Financial Liabilities: | | | | |
| Interest rate swap agreements | - | 974 | - | 974 |
| Total | \$ - | \$ 974 | \$ - | \$ 974 |

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

| (In thousands) | As of December 31, 2008 | | | |
|--|-------------------------|----------|---------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | |
| 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 |
| Financial Liabilities: | | | | |
| 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 March 31, 2009 and 2008 are summarized as follows:

| (In thousands) | As of March 31, 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 | (183) |
| Transfers in and/or out of Level 3 | - |
| Ending balance March 31, 2009 | \$ 1,320 |

| (In thousands) | As of March 31, 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 | (374) | - |

income

| | | |
|--|----------|----------|
| Purchases, sales, issuances and settlements, net | - | (66) |
| Transfers in and/or out of Level 3 | - | - |
| Ending balance March 31, 2008 | \$ 2,337 | \$ 1,990 |

There were no gains and losses (realized and unrealized) included in earnings for assets and liabilities held at March 31, 2009 or March 31, 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 March 31, 2009 and December 31, 2008.

| As of March 31, 2009 (In thousands) | Level 1 | Level 2 | Level 3 | Total | Total Fair Value Gain during 3 months ended March 31, 2009 |
|--|---------|-----------|-----------|-----------|--|
| Financial Assets: | | | | | |
| SBA loans held for sale | \$ - | \$ 23,213 | \$ - | \$ 23,213 | \$ - |
| Other real estate owned ("OREO") | - | - | 763 | 763 | - |
| Impaired loans | \$- | \$ - | \$ 19,241 | \$ 19,241 | \$ 370 |

Table of Contents

| 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 |
|---|---------|-----------|-----------|-----------|---|
| Financial Assets: | | | | | |
| SBA loans held for sale | \$ - | \$ 22,733 | \$ - | \$ 22,733 | \$ - |
| Other real estate owned ("OREO") | - | - | 710 | 710 | - |
| Impaired loans | \$- | \$ - | \$ 15,105 | \$ 15,105 | \$ 643 |

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 March 31, 2009 was \$645 thousand as compared to \$385 thousand at March 31, 2008. During the three months ended March 31, 2009, the valuation allowance for impaired loans decreased \$370 thousand from \$1.0 million at December 31, 2008. During the three months ended March 31, 2008, the valuation allowance for impaired loans increased \$13 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 March 31, 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 March 31, 2009 and December 31, 2008:

| (In thousands) | March 31, 2009 | | December 31, 2008 | |
|--|-----------------|----------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash and Federal funds sold | \$ 30,225 | \$ 30,225 | \$ 34,431 | \$ 34,431 |
| Securities available for sale | 122,873 | 122,873 | 117,348 | 117,348 |
| Securities held to maturity | 35,149 | 33,313 | 32,161 | 30,088 |
| Loans, net of allowance for possible loan losses | 659,595 | 670,048 | 675,620 | 696,966 |
| Federal Home Loan Bank stock | 4,947 | 4,947 | 4,857 | 4,857 |
| SBA servicing assets | 1,320 | 1,320 | 1,503 | 1,503 |
| Accrued interest receivable | 4,328 | 4,328 | 4,712 | 4,712 |
| Financial liabilities: | | | | |
| Deposits | 703,266 | 699,384 | 707,117 | 706,475 |
| Borrowed funds and subordinated debentures | 112,465 | 120,091 | 120,465 | 130,217 |
| Accrued interest payable | 841 | 841 | 805 | 805 |
| Interest rate swap agreements | 974 | 974 | 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 March 31, 2009 and December 31, 2008:

| (In thousands) | March 31, 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 |
| Securities available for sale: | | | | | | | | |
| US Government sponsored entities | \$ 4,729 | \$ 37 | \$ (7) | \$ 4,759 | \$ 4,132 | \$ 27 | \$ (3) | \$ 4,156 |
| State and political subdivisions | 2,946 | 5 | (192) | 2,759 | 2,946 | - | (228) | 2,718 |
| Residential mortgage-backed securities | 115,838 | 1,028 | (2,437) | 114,429 | 109,630 | 992 | (1,043) | 109,579 |
| Commercial mortgage-backed securities | - | - | - | - | - | - | - | - |
| Collateralized debt obligations | 975 | - | (635) | 340 | 975 | - | (657) | 318 |
| Other equities | 638 | 7 | (59) | 586 | 639 | - | (62) | 577 |
| Total securities available for sale | \$ 125,126 | \$ 1,077 | \$ (3,330) | \$ 122,873 | \$ 118,322 | \$ 1,019 | \$ (1,993) | \$ 117,348 |
| Securities held to maturity: | | | | | | | | |
| US Government sponsored entities | \$ 2,000 | \$ 114 | \$ - | \$ 2,114 | \$ 2,000 | \$ 119 | \$ - | \$ 2,119 |
| State and political subdivisions | 3,157 | - | (223) | 2,934 | 3,157 | - | (251) | 2,906 |
| Residential mortgage-backed securities | 26,640 | 318 | (747) | 26,211 | 25,450 | 193 | (880) | 24,763 |
| Commercial mortgage-backed securities | 1,798 | 14 | - | 1,812 | - | - | - | - |
| Collateralized debt obligations | 1,554 | - | (1,312) | 242 | 1,554 | - | (1,254) | 300 |
| Total securities held to maturity | \$ 35,149 | \$ 446 | \$ (2,282) | \$ 33,313 | \$ 32,161 | \$ 312 | \$ (2,385) | \$ 30,088 |

The table below provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at March 31, 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.

| (In thousands) | Within one year | | After one year through five years | | After five years through ten years | | After ten years | | Total carrying | |
|--|--------------------|-------|---|-------|---------------------------------------|-------|-----------------|-------|----------------|-------|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Available for sale at fair value: | | | | | | | | | | |
| US Government sponsored entities | \$ - | -% | \$ - | -% | \$ 2,712 | 2.74% | \$ 2,047 | 5.10% | \$ 4,759 | 3.74% |
| State and political subdivisions | - | - | - | - | - | - | 2,759 | 3.91 | 2,759 | 3.91 |
| Residential mortgage-backed securities | - | - | 2,376 | 3.67 | 19,077 | 4.31 | 92,976 | 4.80 | 114,429 | 4.71 |
| Commercial mortgage-backed securities | - | - | - | - | - | - | - | - | - | - |
| Collateralized debt obligations | - | - | - | - | - | - | 340 | 2.10 | 340 | 2.10 |
| Other equities | - | - | - | - | - | - | 586 | 0.57 | 586 | 0.57 |
| Total securities available for sale | \$ - | -% | \$ 2,376 | 3.67% | \$ 21,789 | 4.12% | \$ 98,708 | 4.74% | \$ 122,873 | 4.65% |
| Held to maturity at cost: | | | | | | | | | | |
| US Government sponsored entities | \$ - | -% | \$ 2,000 | 5.00% | \$ - | -% | \$ - | -% | \$ 2,000 | 5.00% |
| State and political subdivisions | - | - | - | - | - | - | 3,157 | 4.46 | 3,157 | 4.46 |
| Residential mortgage-backed securities | - | - | 1,664 | 4.48 | 6,720 | 4.81 | 18,256 | 5.31 | 26,640 | 5.14 |
| Commercial mortgage-backed securities | - | - | - | - | - | - | 1,798 | 5.59 | 1,798 | 5.59 |
| Collateralized debt obligations | - | - | - | - | - | - | 1,554 | 5.73 | 1,554 | 5.73 |
| Total securities held to maturity | \$ - | -% | \$ 3,664 | 4.76% | \$ 6,720 | 4.81% | \$ 24,765 | 4.84% | \$ 35,149 | 4.83% |

In the three months ended March 31, 2009 and 2008, gross realized gains on sales of securities amounted to \$515 thousand and \$70 thousand, respectively. There were no gross realized losses during either period. The net of these amounts is included in noninterest income in the Consolidated Statements of Income as securities gains. There were no other-than-temporary impairment (“OTTI”) charges included in either of these periods.

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 March 31, 2009 and December 31, 2008 are as follows:

| (In thousands) | Less than 12 months | | Greater than 12 months | | Total | |
|--|----------------------|-----------------|------------------------|-----------------|----------------------|-----------------|
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| March 31, 2009 | | | | | | |
| U.S. Government sponsored entities | \$ 709 | \$ (7) | \$ 11 | \$ - | \$ 720 | \$ (7) |
| State and political subdivisions | 4,275 | (374) | 635 | (40) | 4,910 | (415) |
| Residential mortgage-backed securities | 36,312 | (1,509) | 15,634 | (1,675) | 52,245 | (3,184) |
| Commercial mortgage-backed securities | - | - | - | - | - | - |
| Collateralized debt obligations | - | - | 590 | (1,947) | 590 | (1,947) |
| Other equities | - | - | 566 | (59) | 566 | (59) |
| Total temporarily impaired investments | \$ 41,596 | \$ (1,891) | \$ 17,435 | \$ (3,721) | \$ 59,031 | \$ (5,612) |
| December 31, 2008 | | | | | | |
| U.S. Government sponsored entities | \$ 2,110 | \$ (3) | \$ 11 | \$ - | \$ 2,121 | \$ (3) |
| State and political subdivisions | 5,624 | (479) | - | - | 5,624 | (479) |
| Residential mortgage-backed securities | 32,113 | (1,024) | 11,668 | (899) | 43,781 | (1,923) |
| Commercial mortgage-backed securities | - | - | - | - | - | - |
| Collateralized debt obligations | - | - | 618 | (1,911) | 618 | (1,911) |
| Other equities | 82 | (34) | 472 | (28) | 554 | (62) |
| Total temporarily impaired investments | \$ 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 and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. As of March 31, 2009, the number of securities in an unrealized loss position in each category was as follows: three securities of U.S. Government sponsored entities, eight state and political subdivision securities, thirty-seven mortgage-backed securities, one corporate debt security, and four other equity securities. 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 maturity, the Company does not consider these investments to be other-than-temporarily impaired.

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 maturity, the Company does not consider these investments to be other-than-temporarily impaired.

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.

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.

Note 8. 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 non-forfeitable 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 March 31, 2009 the Company had 36,056 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:

- FSP 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 115-2, Recognition and Presentation of Other-Than-Temporary Impairments
- FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments

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, Recognition and Presentation of Other-Than-Temporary Impairments -

FSP FAS 115-2 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.

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 Report 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.

Table of Contents

Earnings Summary

The last three months of 2008 were a period of 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 quarter of 2009 and will likely exist 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 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. In addition, during the quarter, the FDIC announced it would be assessing a special one-time fee on all FDIC insured institutions to help recapitalize its depleted reserve fund. Despite this challenging operating environment, the Company believes that it is well-positioned.

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

- Total assets exceeded \$887 million,
- Continued market share expansion as total loans increased 11.1 percent from one year ago,
- Total deposits increased 9.5 percent from one year ago,
- The Company remained well-capitalized, and
- The Company remained profitable, albeit at a reduced level of profitability.

For the three months ended March 31, 2009, the Company reported net income of \$731 thousand, a decrease of \$513 thousand from net income of \$1.2 million reported for the same period of 2008. Net income available to common shareholders, which includes the impact of dividends and accretion of discount on the Company's outstanding preferred stock, was \$352 thousand for the three months ended March 31, 2009. The Company had no outstanding preferred stock in the first quarter of 2008. The earnings per share and return on average common equity ratios shown below are calculated on net income available to common shareholders.

| (In thousands, except per share data) | Three Months ended March 30, | |
|---------------------------------------|------------------------------|---------|
| | 2009 | 2008 |
| Net Income per Common share: | | |
| Basic | \$ 0.05 | \$ 0.18 |
| Diluted | 0.05 | 0.17 |
| Return on average assets | 0.33 % | 0.65% |
| Return on average common equity | 2.90 % | 10.50% |
| Efficiency ratio | 73.02 % | 71.95% |

Our results reflect:

- Increased net interest income from growth in earning assets and a lower cost of funds,
- 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

Lower operating expenses related to the closure of our SBA loan production offices, partially offset by substantial hikes in FDIC insurance assessment rates.

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 March 31, 2008, the Federal Open Market Committee has lowered interest rates 200 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 March 31, 2009, tax-equivalent interest income decreased \$65 thousand or 0.5 percent to \$12.6 million. This decrease was driven by the lower average yield on these assets despite a higher volume of interest-earning assets:

- Of the \$65 thousand decrease in interest income on a tax-equivalent basis, \$2.0 million can be attributed to the reduced yields on the interest-earning assets, partially offset by a \$1.9 million increase due to a higher volume of earning assets.
- The yield on interest-earning assets decreased 106 basis points to 5.87 percent for the quarter-ended March 31, 2009 due to the lower overall interest rate environment compared to 2008. Yields on all loan products fell with the SBA, SBA 504, and consumer loan portfolios repricing 332, 135, and 112 basis points lower, respectively.
- The average volume of interest-earning assets increased \$132.0 million to \$866.8 million in the first three months of 2009 compared to \$734.8 million in 2008. This was due primarily to a \$75.5 million increase in average loans across all product lines and a \$67.4 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.

Total interest expense was \$5.8 million for the first three months of 2009, a decrease of \$184 thousand or 3.1 percent compared to the comparable period in 2008. This decrease was driven by the lower overall interest rate environment in 2009 despite the shift in deposit mix toward higher priced products:

- Of the \$184 thousand decrease in interest expense in the first quarter of 2009, \$1.4 million was attributed to a decrease in the rates paid on interest-bearing liabilities, partially offset by a \$1.2 million increase due to a higher volume of these liabilities.
- The average cost of interest-bearing liabilities decreased 63 basis points to 3.10 percent, primarily due to the repricing of deposits and borrowings in a lower interest rate environment. The cost of interest-bearing deposits decreased 61 basis points to 3.03 percent in 2009 as all product lines repriced lower. The cost of borrowed funds and subordinated debentures decreased 89 basis points to 3.36 percent due to the use of low cost overnight line of credit funding.
- Interest-bearing liabilities averaged \$762.0 million in the first quarter of 2009, an increase of \$115.1 million, or 17.8 percent, compared to the prior year's quarter. The increase in interest-bearing liabilities was a result of increases in time deposits, interest-bearing demand deposits and borrowed funds, offset in part by a decline in savings deposits. Average borrowed funds and subordinated debentures increased \$41.3 million to \$142.1 million in 2009 compared to \$100.9 million in 2008 as these funding sources provided favorable pricing compared to alternative sources of funds as market rates began to fall.

- The lower costs of funding were offset somewhat by the shift in the mix of deposits from lower cost savings deposits to higher cost time deposits. Our deposit concentration shifted from 35 percent savings and 51 percent time deposits at March 31, 2008 to 24 percent savings and 63 percent time at March 31, 2009.

During the quarter-ended March 31, 2009, tax-equivalent net interest income increased \$119 thousand or 1.8 percent to \$6.8 million. Net interest margin decreased 50 basis points to 3.14 percent for 2009 compared to 3.64 percent in 2008. The net interest spread was 2.77 percent, a 43 basis point decrease from 3.20 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.

Table of Contents

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

| | March 31, 2009 | | | Three Months Ended March 31, 2008 | | |
|---|--------------------|----------|------------|--------------------------------------|----------|------------|
| | Average Balance | Interest | Rate/Yield | Average Balance | Interest | Rate/Yield |
| ASSETS | | | | | | |
| Interest-earning assets: | | | | | | |
| Federal funds sold and interest-bearing deposits with banks | \$ 10,324 | \$ 13 | 0.51% | \$ 22,925 | \$ 180 | 3.16% |
| Federal Home Loan Bank stock | 5,936 | - | - | 4,174 | 100 | 9.64 |
| Securities: | | | | | | |
| Available for sale | 138,302 | 1,692 | 4.89 | 70,757 | 908 | 5.13 |
| Held to maturity | 33,984 | 404 | 4.76 | 34,147 | 455 | 5.33 |
| Total securities (a) | 172,286 | 2,096 | 4.87 | 104,904 | 1,363 | 5.20 |
| Loans, net of unearned discount: | | | | | | |
| SBA | 105,044 | 1,607 | 6.12 | 98,614 | 2,328 | 9.44 |
| SBA 504 | 76,882 | 1,231 | 6.49 | 74,345 | 1,450 | 7.84 |
| Commercial | 305,148 | 5,016 | 6.67 | 297,998 | 5,285 | 7.13 |
| Residential mortgage | 129,045 | 1,864 | 5.78 | 74,341 | 1,079 | 5.81 |
| Consumer | 62,148 | 794 | 5.18 | 57,482 | 901 | 6.30 |
| Total loans (a),(b) | 678,267 | 10,512 | 6.26 | 602,780 | 11,043 | 7.36 |
| Total interest-earning assets | 866,813 | 12,621 | 5.87 | 734,783 | 12,686 | 6.93 |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | 19,627 | | | 14,991 | | |
| Allowance for loan losses | (10,939) | | | (8,690) | | |
| Other assets | 33,179 | | | 30,304 | | |
| Total noninterest-earning assets | 41,867 | | | 36,605 | | |
| Total Assets | \$ 908,680 | | | \$ 771,388 | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing demand deposits | | | | | | |
| | \$ 85,064 | 270 | 1.29 | \$ 78,999 | 366 | 1.86 |
| Savings deposits | 147,260 | 644 | 1.77 | 190,574 | 1,349 | 2.85 |
| Time deposits | 387,554 | 3,723 | 3.90 | 276,426 | 3,220 | 4.69 |
| Total interest-bearing deposits | 619,878 | 4,637 | 3.03 | 545,999 | 4,935 | 3.64 |
| Borrowed funds and subordinated debentures | 142,109 | 1,179 | 3.36 | 100,850 | 1,065 | 4.25 |

| | | | | | | |
|--|------------|-------|-------|------------|-------|-------|
| Total interest-bearing liabilities | 761,987 | 5,816 | 3.10 | 646,849 | 6,000 | 3.73 |
| Noninterest-bearing liabilities: | | | | | | |
| Demand deposits | 75,546 | | | 74,709 | | |
| Other liabilities | 3,879 | | | 2,191 | | |
| Total noninterest-bearing liabilities | 79,425 | | | 76,900 | | |
| Shareholders' equity | 67,268 | | | 47,639 | | |
| Total Liabilities and Shareholders' Equity | \$ 908,680 | | | \$ 771,388 | | |
| Net interest spread | | 6,805 | 2.77% | | 6,686 | 3.20% |
| Tax-equivalent basis adjustment | | (31) | | | (51) | |
| Net interest income | \$ | 6,774 | | \$ | 6,635 | |
| Net interest margin | | | 3.14% | | | 3.64% |

(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

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 March 31, 2009 versus March 31, 2008 | | |
| | Due to change in: | | |
| | Volume | Rate | Total |
| Interest Income | | | |
| SBA | \$ 143 | \$ (864) | \$ (721) |
| SBA 504 | 47 | (266) | (219) |
| Commercial | 111 | (380) | (269) |
| Residential mortgage | 791 | (6) | 785 |
| Consumer | 66 | (173) | (107) |
| Total Loans | 1,158 | (1,689) | (531) |
| Available for sale securities | 828 | (44) | 784 |
| Held to maturity securities | (2) | (49) | (51) |
| Federal funds sold and interest-bearing deposits | (66) | (101) | (167) |
| Federal Home Loan Bank stock | 29 | (129) | (100) |
| Total interest-earning assets | \$ 1,947 | \$ (2,012) | \$ (65) |
| Interest Expense | | | |
| Interest-bearing checking | \$ 25 | \$ (121) | \$ (96) |
| Savings deposit | (263) | (442) | (705) |
| Time deposits | 1,113 | (610) | 503 |
| Total interest-bearing deposits | 875 | (1,173) | (298) |
| Borrowings | 372 | (258) | 114 |
| Total interest-bearing liabilities | 1,247 | (1,431) | (184) |
| Tax equivalent net interest income | \$ 700 | \$ (581) | \$ 119 |
| Tax equivalent adjustment | | | 20 |
| Increase in net interest income | | | \$ 139 |

Provision for Loan Losses

The provision for loan losses was \$1.5 million for the three months ended March 31, 2009, an increase of \$1.0 million, compared to a provision of \$450 thousand for the same period a year ago. This 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.

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. Consequently, as a result of the economic conditions, Unity elected to cease offering SBA loans as a line of business, and closed its SBA loan production offices outside of its New York, New Jersey and Pennsylvania primary trade areas. Unity will continue to offer these products in its trade area as an additional credit product for banking customers. This decision resulted in lower levels of noninterest income during the first quarter of 2009 and will likely reduce noninterest income for the foreseeable future.

Noninterest income was \$1.3 million for the three months ended March 31, 2009, a decrease of \$107 thousand or 7.4 percent compared with the same period in 2008. The components of noninterest income are as follows:

| (In thousands) | For the three months ended March 31, | | |
|--|--------------------------------------|----------|----------------|
| | 2009 | 2008 | Percent Change |
| Service charges on deposit accounts | \$ 330 | \$ 320 | 3.1 % |
| Service and loan fee income | 252 | 300 | (16.0) |
| Gain on sale of mortgage loans | 64 | 21 | 204.8 |
| Gain on sale of SBA loans held for sale, net | 29 | 576 | (95.0) |
| Bank owned life insurance | 55 | 51 | 7.8 |
| Net securities gains | 515 | 70 | NM |
| Other income | 103 | 117 | (12.0) |
| Total noninterest income | \$ 1,348 | \$ 1,455 | (7.4)% |

NM = Not meaningful

Table of Contents

Service charges on deposit accounts increased 3.1 percent for the three months ended March 31, 2009, when compared to the same period a year ago due to slight increases in overdraft fees and commercial analysis fees.

Service and loan fee income decreased \$48 thousand for the three month period ended March 31, 2009 when compared to the same period a year ago. The decrease in loan and servicing fees quarter over quarter was the result of lower levels of loan processing fee income and loan prepayment fees, partially offset by increased levels of letter of credit fees.

Net gains on mortgage loan sales increased \$43 thousand to \$64 thousand for the quarter-ended March 31, 2009 due to an increased volume of loans sold. Mortgage loan sales totaled \$5.2 million for the three months ended March 31, 2009 compared to \$1.3 million for the prior year's period.

Net gains on SBA loan sales decreased significantly to \$29 thousand for the quarter compared to \$576 thousand for the three months ended March 31, 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 three months ended March 31, 2009, compared to \$12.1 million for three months ended March 30, 2008. Management believes that net gains on SBA loans will remain at this lower level for the foreseeable future.

Bank owned life insurance income totaled \$55 thousand and \$51 thousand for the three months ended March 31, 2009 and 2008, respectively.

Net security gains of \$515 thousand were realized during the current quarter, compared to \$70 thousand during the prior period. The gains during the current quarter were the result of the sale of approximately \$20 million of fixed income securities.

Other noninterest income decreased \$14 thousand for the three months ended March 31, 2009 compared to the prior year, due to lower loan referral fees and annuity commissions.

Noninterest Expense

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 may be seen in the 18.5 percent decrease in compensation and benefits expense quarter over quarter. Unfortunately, this and other cost cutting strategies were partially offset by the large increase in FDIC insurance premiums during the quarter. Total noninterest expense decreased \$215 thousand or 3.7 percent to \$5.6 million for the three months ended March 31, 2009 compared to a year ago. The components of noninterest expense are detailed below:

| | For the three months ended March 31, | | |
|-------------------------------|--------------------------------------|----------|----------------|
| (In thousands) | 2009 | 2008 | Percent Change |
| Compensation and benefits | \$ 2,624 | \$ 3,220 | (18.5) % |
| Occupancy | 687 | 701 | (2.0) |
| Processing and communications | 541 | 570 | (5.1) |
| Furniture and equipment | 495 | 388 | 27.6 |
| Deposit insurance | 301 | 63 | 377.8 |
| Professional services | 246 | 198 | 24.2 |

| | | | |
|---------------------------|----------|----------|---------|
| Loan collection costs | 198 | 102 | 94.1 |
| Advertising | 75 | 62 | 21.0 |
| Other | 388 | 466 | (16.7) |
| Total noninterest expense | \$ 5,555 | \$ 5,770 | (3.7) % |

Compensation and benefits expense, the largest component of noninterest expense, decreased \$596 thousand for the three months ended March 31, 2009 compared to the same period 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. Full-time equivalent employees fell to 162 at March 31, 2009, compared to 188 at March 31, 2008.

Occupancy expense decreased \$14 thousand for the three months ended March 31, 2009 compared to the same period a year ago due to reduced lease and leasehold improvement related expenses due to the closure of our Bridgewater, NJ location during the second quarter 2008.

Processing and communications expense decreased \$29 thousand for the three months ended March 31, 2009 compared to the same period a year ago. This was the result of cost savings initiatives put in place over the last twelve months in telephone and data processing line costs, partially offset by increased data processing expenses.

Furniture and equipment expense increased \$107 thousand for the three months ended March 31, 2009, compared to the same period a year ago due to depreciation expenses on new equipment and software, and software maintenance expenses.

Deposit insurance expense increased \$238 thousand for the three months ended March 31, 2009 due to increased assessment rates. 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 announced a special one-time assessment during the quarter which is needed to recapitalize the reserve fund. The assessment rate has not been finalized but may range anywhere from an additional 6 to 20 basis points depending upon whether certain legislation is adopted. The special assessment may have a material impact on the Company's second or third quarter earnings.

Professional services increased \$48 thousand for the three months ended March 31, 2009, compared to the same period a year ago. Higher consulting, legal and audit fees attributed to the quarter over quarter increase.

Loan collection costs increased \$96 thousand for the three months ended March 31, 2009, compared to the same period a year ago. Quarter over quarter increases were due to higher collection expenses associated with delinquent loans.

Table of Contents

Advertising expense increased \$13 thousand for the three months ending March 31, 2009 due to deposit promotions being run during this period.

Other operating expenses decreased \$78 thousand for the quarter compared to the prior year due to lower employee travel and recruitment fees, office supply expense and loan commitment reserve funding expenses.

Income Tax Expense

For the quarter ended March 31, 2009, the Company recorded a \$336 thousand tax provision, compared to a tax provision of \$626 thousand for the same period a year ago. The current 2009 tax provision represents an effective tax rate of approximately 31.5 percent as compared to 33.5 percent for the prior year. Management anticipates an effective rate of approximately 31.5 percent for the remainder of 2009.

Financial Condition at March 31, 2009

Total assets at March 31, 2009 were \$886.7 million compared to \$898.3 million at year-end 2008 and \$807.8 million a year ago. Compared to year-end 2008, total assets decreased primarily due to loan sales and limited new loan volume. Compared to a March 31, 2008 total assets increased primarily due to increases in all loan categories during 2008 funded primarily by time deposits.

Securities

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

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 agencies, obligations of state and political subdivisions, mortgage-backed securities, corporate bonds and equity securities. AFS securities totaled \$122.9 million at March 31, 2009, an increase of \$5.5 million or 4.7 percent, compared to \$117.3 million at December 31, 2008. This net increase was the result of the following:

- \$37.4 million in purchases. During the first quarter of 2009, the Company took advantage of favorable credit spreads and purchased primarily mortgage-backed securities and collateralized mortgage obligations ("CMOs"),
- \$11.3 million of principal pay downs,
- \$19.3 million in sales. Sales consisted of fixed rate mortgage-backed securities and resulted in gains on sales of \$515 thousand.
- \$1.3 million depreciation in the market value of the portfolio. At March 31, 2009, the portfolio had a net unrealized loss of \$2.3 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 March 31, 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 March 31, 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 \$340 thousand. The Company monitors the credit worthiness of the issuer of this security quarterly. At March 31, 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 \$138.3 million for the three-months ended March 31, 2009, compared to \$70.8 million for the same period a year ago. The average yield earned on the available for sale portfolio decreased 24 basis points to 4.89 percent for the three-months ended March 31, 2009, compared to 5.13 percent for the same period a year ago. The weighted average life of the AFS portfolio was 4.03 years and the effective duration of the portfolio was 2.38 years at March 31, 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 of U.S. Government sponsored agencies, obligations of state and political subdivisions, mortgage-backed securities and corporate bonds. HTM securities were \$35.1 million at March 31, 2009, an increase of \$3.0 million or 9.3 percent, from year-end 2008. This net increase was the result of \$4.0 million in purchases, partially offset by \$1.0 million in principal pay downs.

As of March 31, 2009 and December 31, 2008, the market value of held to maturity securities was \$33.3 million and \$30.1 million, respectively. The average balance of securities held to maturity amounted to \$34.0 million for the three-months ended March 31, 2009, compared to \$34.1 million for the same period a year ago. The average yield earned on held to maturity securities decreased 57 basis points to 4.76 percent for the three-months ended March 31, 2009, compared to 5.33 percent for the same period a year ago. The weighted average life of the HTM portfolio was 5.35 years and the effective duration of the portfolio was 3.74 years at March 31, 2009, compared to 6.45 years and 3.71 years, respectively at December 31, 2008.

At March 31, 2009, the Company's held to maturity portfolio included two pooled bank trust preferred securities with an aggregate book value of \$1.6 million and a market value of \$250 thousand. The Company monitors the credit worthiness of the underlying issuers of these securities quarterly. 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 OTTI charges and realized losses in the future.

Approximately 81 percent of the total investment portfolio had a fixed rate of interest at March 31, 2009.

Securities with a carrying value of \$101.6 million and \$69.9 million at March 31, 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 \$2.8 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 \$16.0 million or 2.3 percent to \$669.9 million at March 31, 2009, compared to \$685.9 million at year-end 2008 due to declines in all loan product lines except for 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.

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

| | March 31, 2009 | December 31, 2008 |
|---------------------|----------------|----------------------|
| SBA Loans | 15.3 % | 15.3% |
| SBA 504 Loans | 11.3 | 11.2 |
| Commercial Loans | 45.4 | 44.9 |
| Mortgage Loans | 18.7 | 19.5 |
| Consumer Loans | 9.4 | 9.1 |

Average loans increased \$75.5 million or 12.5 percent from \$602.8 million for the three-months ended March 31, 2008, to \$678.3 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 \$54.7 million. The yield on the loan portfolio fell 110 basis points to 6.26 percent for the three-months ended March 31, 2009, compared to 7.36 percent for the same period in 2008. This reduced yield throughout the loan portfolio reflect 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 200 basis points since March 31, 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 premium resulting from 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 \$22.6 million at March 31, 2009, an increase of \$378 thousand from \$22.2 million at December 31, 2008. SBA 7(a) loans held to maturity amounted to \$80.0 million at March 31, 2009, a decrease of \$3.1 million 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 three-months ended March 31, 2009, compared to 9.44 percent for the same period a year ago.

At March 31, 2009, SBA 504 loans totaled \$75.6 million, a decrease of \$1.2 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 6.49 percent for the three months ended March 31, 2009, compared to 7.84 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 \$304.0 million at March 31, 2009, a decrease of \$4.2 million from \$308.2 million at year-end 2008. The yield on commercial loans was 6.67 percent for the three months ended March 31, 2009 compared to 7.13 percent for the same period a year ago. The commercial portfolio is expected to remain relatively flat in 2009.

Residential mortgage loans consist of loans secured by 1 to 4 family residential properties. These loans amounted to \$125.0 million at March 31, 2009, a decrease of \$8.1 million from \$133.1 million at December 31, 2008. This decrease is primarily due to mortgage loan sales during the first quarter of 2009 of \$5.2 million. The yield on residential mortgages was 5.78 percent for the three months ended March 31, 2009, compared to 5.81 percent for the same period a year ago. 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 \$62.8 million at March 31, 2009, remaining relatively flat from year-end 2008. The yield on consumer loans was 5.18 percent for the three months ended March 31, 2009, compared to 6.30 percent for the same period a year ago.

Table of Contents

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 and still accruing interest are not included in nonperforming loans. In addition, the Company had one loan totaling \$1.7 million which was classified as a troubled debt restructuring at March 31, 2009.

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) | March 31, 2009 | December 31, 2008 | March 31, 2008 |
|--|----------------|----------------------|----------------|
| Nonperforming loans | | | |
| SBA (1) | \$ 5,670 | \$ 4,228 | \$ 1,936 |
| SBA 504 | 4,400 | 4,600 | - |
| Commercial | 6,348 | 5,247 | 864 |
| Residential mortgage | 3,241 | 1,808 | 1,053 |
| Consumer | 227 | 237 | 289 |
| Total nonperforming loans | 19,886 | 16,120 | 4,142 |
| OREO | 763 | 710 | 266 |
| Total nonperforming assets | 20,649 | 16,830 | 4,408 |
| Past due 90 days or more and still accruing interest | | | |
| SBA | - | 332 | 290 |
| SBA 504 | - | - | - |
| Commercial | 289 | 146 | 81 |
| Residential mortgage | 564 | 2,058 | 169 |
| Consumer | - | - | 6 |
| Total | 853 | 2,536 | 546 |

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

| | | | | | | |
|---|----|-------|----|-------|----|-------|
| Nonperforming loans to total loans | | 2.97% | | 2.35% | | 0.69% |
| Nonperforming loans to total loans and OREO | | 3.08% | | 2.45% | | 0.73% |
| (1) SBA loans guaranteed | \$ | 2,426 | \$ | 1,983 | \$ | 591 |

Page 21 of 31

Table of Contents

Nonperforming loans amounted to \$19.9 million at March 31, 2009, an increase of \$3.8 million from year-end 2008. This increase was due primarily to the credit deterioration in the SBA 7(a) and SBA 504 portfolios, most of which is secured by real estate. In addition, the increase in nonperforming loans reflects the slow down in the economy generally and its impact on our customer base. There were \$853 thousand and \$2.5 million in loans past due 90 days or more and still accruing interest at March 31, 2009 and December 31, 2008, respectively. Included in nonperforming assets at March 31, 2009, are approximately \$2.4 million of loans guaranteed by the SBA, compared to \$2.0 million at December 31, 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 \$1.6 million at March 31, 2009, a decrease of \$1.1 million from December 31, 2008.

Allowance for Loan Losses

During the quarter, the Company significantly increased its loan loss provision in response to the inherent credit risk within its loan portfolio. This risk was evidenced by the increase in nonperforming loans during the quarter, 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 as the Company proactively addressed these issues.

The allowance for loan losses totaled \$10.3 million, \$10.3 million and \$8.7 million at March 31, 2009, December 31, 2008, and March 31, 2008, respectively, with a resulting allowance to total loan ratios of 1.54 percent, 1.51 percent and 1.43 percent, respectively. Net charge-offs amounted to \$1.5 million for the three months ended March 31, 2009, compared to \$183 thousand for the three months ended March 31, 2008. The increase in net charge-offs for the quarter was primarily related to credit deterioration in the SBA 7(a) and SBA 504 portfolios, most of which is secured by real estate.

The following is a reconciled summary of the allowance for loan losses for the three months ended March 31, 2009 and 2008:

| (In thousands) | For the three months ended | |
|-------------------------------|----------------------------|----------|
| | March 31, | |
| | 2009 | 2008 |
| Balance, beginning of quarter | \$ 10,326 | \$ 8,183 |
| Provision charged to expense | 1,500 | 450 |
| Charge-offs: | | |
| SBA | 1,106 | 264 |
| SBA 504 | 200 | - |
| Commercial | 249 | - |
| Residential mortgage | 58 | 25 |
| Consumer | - | 6 |
| Total charge-offs | 1,613 | 295 |
| Recoveries: | | |
| SBA | 33 | 60 |
| SBA 504 | 5 | - |
| Commercial | 53 | 2 |

| | | |
|--|-----------|----------|
| Residential mortgage | - | - |
| Consumer | 3 | 50 |
| Total recoveries | 94 | 112 |
| Total net charge-offs | 1,519 | 183 |
| Balance at end of quarter | \$ 10,307 | \$ 8,650 |
| Selected loan quality ratios: | | |
| Net charge-offs to average loans (annualized) | 0.91% | 0.12% |
| Allowance for loan losses to total loans at period end | 1.54% | 1.43% |
| Allowance for loan losses to nonperforming loans | 51.83% | 208.85% |

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 three months of 2009, total deposits decreased \$3.9 million to \$703.3 million at March 31, 2009, from \$707.1 million at December 31, 2008. The decrease in deposits was primarily the result of a \$32.7 million decrease in time deposits and a \$1.7 million decrease in interest-bearing demand deposits, partially offset by a \$28.7 million increase in savings deposits and a \$1.8 million increase in noninterest-bearing demand deposits. The savings deposit growth was due to the promotion of our new "Loyalty" savings account which had an initial yield of 2.75 percent.

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 23 percent savings and 54 percent time deposits at March 31, 2009. The concentration of demand deposits equaled 11 percent and interest-bearing demand deposits equaled 12 percent at March 31, 2009 and December 31, 2008, respectively. The Company anticipates a continued migration of deposits from time deposits to the Loyalty savings account product throughout 2009.

Table of Contents

Borrowed Funds and Subordinated Debentures

Borrowed funds and subordinated debentures totaled \$112.5 million at March 31, 2009, a decrease of \$8.0 million or 6.6 percent from December 31, 2008. This net decrease was due to the maturity of a repurchase agreement, offset in part by \$2.0 million increase in overnight borrowings. As of March 31, 2009, the Company was a party to the following borrowed funds and subordinated debenture transactions:

| (In thousands) | March 31, 2009 | December 31, 2008 |
|-----------------------------|----------------|----------------------|
| FHLB Borrowings: | | |
| Overnight line of credit | \$ 12,000 | \$ 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 March 31, 2009, is a decline of 0.88 percent in a rising-rate environment and an decrease of 1.68 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 \$30.2 million at March 31, 2009, a decrease of \$4.2 million from December 31, 2008. Net cash provided by operating activities for the three months ended March 31, 2009, amounted to \$7.1 million, primarily due to proceeds from the sale of mortgage loans and net income from operations, offset by originations of loans held for sale. Net cash provided by investing activities amounted to \$582 thousand for the three

months ended March 31, 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 \$11.9 million for the three months ended March 31, 2009, attributable to repayments of matured borrowings and decreased deposits, partially offset by proceeds from new borrowings.

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 March 31, 2009, the Parent Company had \$5.9 million in cash and \$85 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 March 31, 2009, \$91.2 million was available for additional borrowings from the FHLB of New York. Pledging additional collateral in the form of 1-4 family residential mortgages or investment securities can increase the line with the FHLB. Additional sources of liquidity are the securities available for sale and SBA loans held for sale portfolios, which were \$122.9 million and \$22.6 million at March 31, 2009, respectively.

As of March 31, 2009, deposits included \$17.6 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 \$11.8 million of deposits from three municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.

At March 31, 2009, the Bank had \$83.1 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 \$7.2 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 March 31, 2009 | | | | | | | | |
| Leverage Ratio | 84,172 | 9.28 % | ³ | 36,290 | 4.00% | ³ | N/A | N/A |
| Tier I risk-based ratio | 84,172 | 12.32 % | ³ | 27,330 | 4.00% | ³ | N/A | N/A |
| Total risk-based ratio | 92,735 | 13.57 % | ³ | 54,661 | 8.00% | ³ | N/A | N/A |
| As of December 31, 2008 | | | | | | | | |
| Leverage Ratio | 83,671 | 9.54% | ³ | 35,071 | 4.00% | ³ | N/A | N/A |
| Tier I risk-based ratio | 83,671 | 12.02% | ³ | 27,846 | 4.00% | ³ | N/A | N/A |
| Total risk-based ratio | 92,394 | 13.27% | ³ | 55,692 | 8.00% | ³ | N/A | 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 March 31, 2009 | | | | | | | | |
| Leverage Ratio | 69,824 | 7.70% | ³ | 36,251 | 4.00% | ³ | 45,314 | 5.00% |
| Tier I risk-based ratio | 69,824 | 10.23% | ³ | 27,290 | 4.00% | ³ | 40,935 | 6.00% |
| Total risk-based ratio | 86,875 | 12.73% | ³ | 54,580 | 8.00% | ³ | 68,225 | 10.00% |
| As of December 31, 2008 | | | | | | | | |
| Leverage Ratio | 69,049 | 7.88% | ³ | 35,043 | 4.00% | ³ | 43,804 | 5.00% |
| Tier I risk-based ratio | 69,049 | 9.93% | ³ | 27,806 | 4.00% | ³ | 41,709 | 6.00% |

| | | | | | | | | |
|------------------------|--------|--------|--------------|--------|-------|--------------|--------|--------|
| Total risk-based ratio | 86,259 | 12.41% | ³ | 55,612 | 8.00% | ³ | 69,514 | 10.00% |
|------------------------|--------|--------|--------------|--------|-------|--------------|--------|--------|

Shareholders' Equity

Shareholders' equity decreased \$278 thousand, or 0.4 percent, to \$67.5 million at March 31, 2009, compared to \$67.8 million at December 31, 2008. This decrease was primarily the result of \$731 thousand in net income, offset by \$249 thousand in preferred stock dividends accrued during the three months ended March 31, 2009 and a \$785 thousand depreciation in the market value of the securities available for sale portfolio.

In accordance with its revised dividend policy announced during the third quarter of 2008, the Company did not declare a dividend during the three months ended March 31, 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 three months ended March 31, 2009. As of March 31, 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.

Page 24 of 31

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 March 31, 2009 and 2008 the information pertaining to outstanding interest rate swap agreements used to hedge variable rate debt is 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 | 1.61 % | 4.60 % |
| Weighted average maturity in years | 2.7 | 3.3 |
| Unrealized loss relating to interest rate swaps | \$ (974) | \$ (597) |

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 March 31, 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 March 31, 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 March 31, 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 March 31, 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 - None

Item 5. Other Information - None

Item 6. Exhibits

(a) Exhibits

- | | |
|-----------------|--|
| 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: May 13, 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. |

