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

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

FORM 10-Q

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

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ____ TO ____.

Commission file number 1-12431

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

New Jersey	22-3282551
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
64 Old Highway 22, Clinton, NJ	08809
(Address of Principal Executive Offices)	(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 x No o

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 o Accelerated filer o Nonaccelerated filer o Smaller reporting company x

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

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

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Part 1 - Consolidated Financial Information
Item 1 - Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.
Consolidated Balance Sheets
(Unaudited)

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

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

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

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Unity Bancorp
Consolidated Statements of Income
(unaudited)

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

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

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

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

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

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

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

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

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

FINANCING ACTIVITIES				
Net increase in deposits		24,646		70,613
Proceeds from new borrowings		10,000		15,000
Repayments of borrowings		(20,000)		(5,000)
Proceeds from the issuance of common stock		(48)		151
Cash dividends paid on preferred stock		(459)		-
Cash dividends paid on common stock		-		(674)
Net cash provided by financing activities		14,139		80,090
Increase in cash and cash equivalents		20,096		17,734
Cash and cash equivalents at beginning of period		34,431		36,312
Cash and cash equivalents at end of period	$	54,527	$	54,046
SUPPLEMENTAL DISCLOSURES				
Cash:				
Interest paid	$	11,447	$	11,285
Income taxes paid		814		851
Noncash investing activities:				
Transfer of loans to other real estate owned		577		470

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

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

NOTE 1. Significant Accounting Policies

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

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

Stock Transactions

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

Stock Option Plans

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

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

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

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

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

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

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

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

Restricted Stock Awards

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

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

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

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

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

Income Taxes

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

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

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

Derivative Instruments and Hedging Activities

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

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

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

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

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

Loans Held To Maturity and Loans Held For Sale

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

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

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

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

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

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

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

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

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

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

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

Allowance for Loan Losses

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

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

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

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

NOTE 2. Litigation

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

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NOTE 3. Earnings per share

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

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

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

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

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

NOTE 4. Income Taxes

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

NOTE 5. Other Comprehensive Income (Loss)
(In thousands)

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

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

Net unrealized security losses	Pre-tax	Tax	After-tax
Balance at December 31, 2007			$(476)
Unrealized holding loss on securities arising during the period	$ (1,881)	$ (720)	(1,161)
Less: Reclassification adjustment for gains included in net income	119	40	79
Net unrealized loss on securities arising during the period	(2,000)	(760)	(1,240)
Balance at June 30, 2008			$ (1,716)
Balance at December 31, 2008			$ (1,728)
Unrealized holding loss on securities arising during the period	$ 1,406	$ 490	916
Less: Reclassification adjustment for gains included in net income	517	173	344
Net unrealized loss on securities arising during the period	889	317	572
Balance at June 30, 2009			$ (1,156)

Net unrealized losses on cash flow hedges	Pre-tax	Tax	After-tax
Balance at December 31, 2007			$(14)
Unrealized holding loss arising during the period	$ (39)	$ 15	(24)
Balance at June 30, 2008			(38)
Balance at December 31, 2008			$ (628)
Unrealized holding gain arising during the period	$ 185	$ 70	115
Balance at June 30, 2009			$ (513)

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

NOTE 6. Fair Value

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

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

Fair Value Measurement

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

Level 1 Inputs

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

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

Level 2 Inputs

Quoted prices for similar assets or liabilities in active markets.

Quoted prices for identical or similar assets or liabilities.

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

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

Level 3 Inputs

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

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

Fair Value on a Recurring Basis

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

Available for Sale Securities Portfolio -

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

SBA Servicing Rights –

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

Interest rate swap agreements -

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

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

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

	As of December 31, 2008			
(In thousands)	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 June 30, 2009 and 2008 are summarized as follows:

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

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

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

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

Fair Value on a Nonrecurring Basis

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

As of June 30, 2009 (In thousands)	Level 1	Level 2	Level 3	Total	Total Fair Value Loss during 6 months ended June 30, 2009
Financial Assets:					
SBA loans held for sale	$ -	$ 23,823	$ -	$ 23,823	$ -
Other real estate owned ("OREO")	-	-	466	466	-
Impaired loans	$-	$ -	$ 19,713	$ 19,713	$ 324

As of December 31, 2008 (In thousands)	Level 1	Level 2	Level 3	Total	Total Fair Value Loss during 12 months ended December 31, 2008
Financial Assets:					
SBA loans held for sale	$ -	$ 22,733	$ -	$ 22,733	$ -
Other real estate owned ("OREO")	-	-	710	710	-
Impaired loans	$-	$ -	$ 13,118	$ 13,118	$ 585

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

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

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

Fair Value of Financial Instruments (SFAS 107 Disclosure)

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

Cash and Federal Funds Sold
For these short-term instruments, the carrying value is a reasonable estimate of fair value.

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

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

Federal Home Loan Bank Stock
Federal Home Loan Bank stock is carried at cost.

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

Borrowed Funds & Subordinated Debentures
The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Standby Letters of Credit

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

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

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

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Note 7. Securities

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

	June 30, 2009				December 31, 2008			
(In thousands)	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	$ 1,722	$ -	$ (38)	$ 1,684	$ 4,132	$ 27	$ (3)	$ 4,156
State and political subdivisions	2,946	6	(96)	2,856	2,946	-	(228)	2,718
Residential mortgage-backed securities	123,472	1,015	(1,909)	122,578	109,630	992	(1,043)	109,579
Commercial mortgage-backed securities	4,829	-	(230)	4,599	-	-	-	-
Collateralized debt obligations	975	-	(577)	398	975	-	(657)	318
Other equities	638	9	(43)	604	639	-	(62)	577
Total securities available for sale	$ 134,582	$ 1,030	$ (2,893)	$ 132,719	$ 118,322	$ 1,019	$ (1,993)	$ 117,348
Securities held to maturity:								
US Government sponsored entities	$ 2,000	$ 107	$ -	$ 2,107	$ 2,000	$ 119	$ -	$ 2,119
State and political subdivisions	3,157	-	(154)	3,003	3,157	-	(251)	2,906
Residential mortgage-backed securities	25,076	345	(891)	24,530	25,450	193	(880)	24,763
Commercial mortgage-backed securities	1,735	118	-	1,853	-	-	-	-
Collateralized debt obligations	107	43	(9)	141	1,554	-	(1,254)	300
Total securities held to maturity	$ 32,075	$ 613	$ (1,054)	$ 31,634	$ 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 June 30, 2009 is primarily distributed by contractual maturity. Mortgage-backed securities and other securities, which may have principal prepayment provisions, are distributed based on contractual maturity. Expected maturities will differ materially from contractual maturities as a result of early prepayments and calls. The total weighted average yield excludes equity securities.

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

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

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

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

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

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

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

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

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

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

Other-Than-Temporarily Impaired Debt Securities

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

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

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

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

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

- Moderate conditional repayment rates ("CRR") were used due to the lack of new trust preferred issuances and the poor conditions of the financial industry. CRR of 2 percent were used for performing issuers and 0 percent for nonperformers.

- Conditional deferral rates ("CDR") have been established based on the financial condition of the underlying trust preferred issuers in the pools. These ranged from 0.75 percent to 3.50 percent for performing issuers. Nonperforming issues were stated at 100 percent CDR.

- Expected loss severities of 95 percent were assumed (ie. recoveries occur only 5 percent of defaulted securities) for all performing issuers and ranged from 80.25 percent to 87.46 percent for nonperforming issues.

- Internal rates of return ("IRR") are the pre-tax yield used to discount the future cash flow stream expected from the collateral cash flows. The IRR used was 17 percent.

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

as follows for the period ended June 30, 2009.

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

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

Available-for-sale securities:	
Realized gains	$ 517
Realized (losses)	-
Other than temporary impairment	-
	$ 517
Held-to-maturity securities:	$ -
Realized gains	-
Realized (losses)	-
Other than temporary impairment	(1,749)
	$ (1,749)

Note 8. Allowance for Loan Losses

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

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

Allowance for Loan Loss Activity (In thousands)	Six months ended June 30, 2009	2008
Balance, beginning of period	$ 10,326	$ 8,383
Provision charged to expense	3,000	1,100
	13,326	9,483
Charge-offs	2,890	660
Recoveries	229	122
Net charge-offs	2,661	538
Balance, end of period	$ 10,665	$ 8,945

Note 9. New Accounting Pronouncements

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

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

- FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly - FSP FAS 157-4 provides additional guidance on: a) determining when the volume and level of activity for the asset or liability has significantly decreased; b) identifying circumstances in which a transaction is not orderly; and c) understanding the fair value measurement implications of both (a) and (b). This FSP requires several new disclosures, including the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, in both interim and annual periods.

- FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments - FSP FAS 115-2 and FAS 124-2 clarifies the interaction of factors that should be considered when determining whether a debt security is other-than-temporarily impaired ("OTTI"). For debt securities, management must assess whether (a) it has the intent to sell the security, or (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. If OTTI exists, but the entity does not intend to sell the security, then the OTTI adjustment is separated into the credit-related impairment portion which is charged to earnings and the other impairment portion which is recognized in other comprehensive income. This FSP also expands and increases the frequency of certain OTTI related disclosures.

- FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments - FSP FAS 107-1 and APB 28-1 require disclosures about the fair value of financial instruments for interim periods of publicly traded companies as well as in annual financial statements. Fair value information along with the significant assumptions used to estimate fair value must be disclosed.

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

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

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

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

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

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

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

- FAS No. 166, Accounting for Transfers of Financial Assets - an amendment of FASB Statement No. 140 - FAS No. 166 addresses concerns that have arisen since the implementation of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement eliminates the concept of "qualifying special-purpose entity" from Statement No. 140 and removes the exception from applying FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities, to qualifying special purpose entities. The Statement clarifies that the objective of paragraph 9 of Statement No. 140 is to determine whether a transferor has surrendered control over transferred financial assets; limits the circumstances in which a financial asset should be derecognized; defines the term participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale and removes the special provisions for guaranteed mortgage securitizations in Statement No. 140 and Statement No. 65 Accounting for Certain Mortgage Banking Activities. This statement also requires enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. This Statement is effective for fiscal years begining after November 15, 2009 and interim periods thereafter. Early application is prohibited. Management believes that adoption of FAS No. 166 will not have a material impact on the Company's financial position.

- FAS No. 167, Amendments to FASB No. 46(R) - FAS No. 167 amends FASB Interpretation (FIN) No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to require an enterprise to perform an analysis to determine whether the enterprises variable interest or interests give it a controlling financial interest in a variable interest entity (VIE). This analysis identifies the primary beneficiary of a VIE as the enterprise that has both (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Additionally, Statement No. 167 requires an enterprise to assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed when determining whether it has the power to direct the activities of the VIE that most significantly impact the entity's economic performance. Statement No. 167 is effective at the beginning of a company's first fiscal year that begins after November 15, 2009. Earlier application is prohibited. The Statement may be applied retrospectively in previously issued financial statements with a cumulative effect adjustment to retained earnings as of the beginning of the first year restated. Management believes that adoption of FAS No. 167 will not have a material impact on the Company's financial position.

- FAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162 -FAS No. 168 became the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. This Statement supersedes all non-SEC accounting and reporting standards. This Statement is effective for

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

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

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

Overview

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

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

Earnings Summary

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

concerns over employment, housing and stock market values.

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

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

Total assets exceeded $913 million,

Continued market share expansion as total loans increased 3.5 percent from one year ago,

Total deposits increased 8.9 percent from one year ago, and

The Company remained well-capitalized.

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

Our results reflect:

An increased provision for loan losses in response to increased credit risk due to continued weakness in the economy,

A lower level of noninterest income due to significantly reduced net gains on SBA loan sales and a $1.7 million other-than-temporary impairment charge on securities, and

Higher operating expenses due to the FDIC special assessment.

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

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

Net Interest Income

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) Yields related to securities and loans exempt from federal income taxes are stated on a fully tax-equivalent basis. They are reduced by the nondeductible portion of interest expense, assuming a federal tax rate of 34 percent.
(b) The loan averages are stated net of unearned income, and the averages include loans on which the accrual of interest has been discontinued.

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

	Six Months Ended					
	June 30, 2009			June 30, 2008		
	Average Balance	Interest	Rate/Yield	Average Balance	Interest	Rate/Yield
Assets						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits with banks	$ 12,249	$ 46	0.76%	$ 22,638	$ 291	2.59%
Federal Home Loan Bank stock	5,451	118	4.37	4,287	176	8.26
Securities:						
Available for sale	134,506	3,214	4.78	73,685	1,869	5.07
Held to maturity	34,221	813	4.75	32,847	871	5.30
Total securities (a)	168,727	4,027	4.77	106,532	2,740	5.14
Loans, net of unearned discount:						
SBA loans	103,641	3,171	6.12	99,810	4,356	8.73
SBA 504 loans	75,538	2,516	6.72	71,827	2,710	7.59
Commercial	304,365	10,067	6.67	303,539	10,692	7.08
Residential mortgages	126,623	3,646	5.76	77,163	2,288	5.93
Consumer	62,717	1,592	5.12	58,045	1,747	6.05
Total loans (a),(b)	672,884	20,992	6.27	610,384	21,793	