

UNITY BANCORP INC /NJ/  
Form 10-Q  
November 09, 2010

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 30, 2010

OR

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

Commission file number 1-12431

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

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

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

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

08809  
(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:  
Yes  No

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

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

The number of shares outstanding of each of the registrant's classes of common equity stock, as of November 1, 2010  
common stock, no par value: 7,206,748 shares outstanding

---

## Table of Contents

	Page #
<b>PART I</b>	
<b><u>CONSOLIDATED FINANCIAL INFORMATION</u></b>	
ITEM 1	
<u>Consolidated Financial Statements (Unaudited)</u>	
<u>Consolidated Balance Sheets at September 30, 2010, December 31, 2009, and September 30, 2009</u>	1
Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and 2009	2
<u>Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2010 and 2009</u>	3
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and 2009</u>	4
<u>Notes to the Consolidated Financial Statements</u>	5
ITEM 2	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
ITEM 3	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	35
ITEM 4T	
<u>Controls and Procedures</u>	35
<b>PART II</b>	
<b><u>OTHER INFORMATION</u></b>	35
ITEM 1	
<u>Legal Proceedings</u>	35
ITEM 1A	
<u>Risk Factors</u>	35
ITEM 2	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	35
ITEM 3	
<u>Defaults upon Senior Securities</u>	35
ITEM 4	
<u>Reserved</u>	35
ITEM 5	
<u>Other Information</u>	35
ITEM 6	
<u>Exhibits</u>	35
<b><u>SIGNATURES</u></b>	36
<b><u>EXHIBIT INDEX</u></b>	37

Exhibit 31.1	38
Exhibit 31.2	39
Exhibit 32.1	40

---

## PART I - CONSOLIDATED FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.  
Consolidated Balance Sheets  
(Unaudited)

(In thousands)	September 30, 2010	December 31, 2009	September 30, 2009
<b>ASSETS</b>			
Cash and due from banks	\$ 16,928	\$ 23,517	\$ 17,035
Federal funds sold and interest-bearing deposits	30,379	50,118	48,853
Cash and cash equivalents	47,307	73,635	65,888
Securities:			
Available for sale	111,777	140,770	140,906
Held to maturity (fair value of \$23,745, \$28,406 and \$30,396, respectively)	23,043	28,252	30,595
Total securities	134,820	169,022	171,501
Loans:			
SBA held for sale	19,021	21,406	21,364
SBA held to maturity	72,197	77,844	79,342
SBA 504	65,075	70,683	71,432
Commercial	284,875	293,739	298,019
Residential mortgage	131,479	133,059	124,313
Consumer	56,869	60,285	62,050
Total loans	629,516	657,016	656,520
Less: Allowance for loan losses	14,163	13,842	12,445
Net loans	615,353	643,174	644,075
Premises and equipment, net	11,137	11,773	11,911
Deferred tax assets	7,168	7,308	7,256
Bank owned life insurance	8,732	6,002	5,946
Prepaid FDIC insurance	3,545	4,739	-
Federal Home Loan Bank stock	4,656	4,677	4,677
Accrued interest receivable	3,750	4,225	4,230
Other real estate owned	5,773	1,530	2,774
Goodwill and other intangibles	1,548	1,559	1,563
SBA servicing assets	614	897	977
Other assets	1,982	1,816	1,891
Total Assets	\$ 846,385	\$ 930,357	\$ 922,689
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Liabilities:			
Deposits:			
Noninterest-bearing demand deposits	\$ 87,837	\$ 80,100	\$ 83,534
Interest-bearing demand deposits	100,350	100,046	92,401

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

Savings deposits	292,372	286,334	263,758
Time deposits, under \$100,000	124,851	183,377	209,050
Time deposits, \$100,000 and over	64,748	108,382	101,922
<b>Total deposits</b>	<b>670,158</b>	<b>758,239</b>	<b>750,665</b>
Borrowed funds	86,044	85,000	85,000
Subordinated debentures	15,465	15,465	15,465
Accrued interest payable	618	710	797
Accrued expenses and other liabilities	3,370	3,078	3,377
<b>Total Liabilities</b>	<b>775,655</b>	<b>862,492</b>	<b>855,304</b>
Commitments and contingencies	-	-	-
<b>Shareholders' equity:</b>			
Preferred stock, no par value, 500 shares authorized	18,894	18,533	18,418
Common stock, no par value, 12,500 shares authorized	55,798	55,454	55,351
Retained earnings (deficit)	(473)	(1,492)	(1,253)
Treasury stock at cost	(4,169)	(4,169)	(4,169)
Accumulated other comprehensive income (loss), net of tax	680	(461)	(962)
<b>Total Shareholders' Equity</b>	<b>70,730</b>	<b>67,865</b>	<b>67,385</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 846,385</b>	<b>\$ 930,357</b>	<b>\$ 922,689</b>
Preferred shares	21	21	21
Issued common shares	7,632	7,569	7,544
Outstanding common shares	7,207	7,144	7,119

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

Unity Bancorp  
Consolidated Statements of Operations  
(Unaudited)

(In thousands, except per share amounts)	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2010	2009	2010	2009
<b>INTEREST INCOME</b>				
Federal funds sold and interest-bearing deposits	\$ 21	\$ 32	\$76	\$ 78
Federal Home Loan Bank stock	65	101	148	219
Securities:				
Available for sale	1,071	1,482	3,405	4,670
Held to maturity	270	389	858	1,167
Total securities	1,341	1,871	4,263	5,837
Loans:				
SBA	1,225	1,498	3,977	4,668
SBA 504	1,093	1,147	3,270	3,663
Commercial	4,454	4,973	13,546	15,040
Residential mortgage	1,808	1,772	5,729	5,419
Consumer	719	791	2,174	2,383
Total loans	9,299	10,181	28,696	31,173
Total interest income	10,726	12,185	33,183	37,307
<b>INTEREST EXPENSE</b>				
Interest-bearing demand deposits	148	264	593	801
Savings deposits	639	1,032	2,268	2,588
Time deposits	1,450	2,950	4,952	10,084
Borrowed funds and subordinated debentures	1,077	1,081	3,232	3,344
Total interest expense	3,314	5,327	11,045	16,817
Net interest income	7,412	6,858	22,138	20,490
Provision for loan losses	1,500	3,000	4,500	6,000
Net interest income after provision for loan losses	5,912	3,858	17,638	14,490
<b>NONINTEREST INCOME</b>				
Branch fee income	359	373	1,051	1,038
Service and loan fee income	251	398	705	946
Gain on sale of SBA loans held for sale, net	269	-	416	29
Gain on sale of mortgage loans	247	71	504	184
Bank owned life insurance	79	56	230	166
Total other-than-temporary impairment charges on securities	-	-	-	(2,555)
Portion of loss recognized in other comprehensive income (before taxes)	-	-	-	806
Net other-than-temporary impairment charges recognized in earnings	-	-	-	(1,749)
Net security gains	35	158	42	675
Other income	220	106	592	316
Total noninterest income	1,460	1,162	3,540	1,605

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

NONINTEREST EXPENSE				
Compensation and benefits	2,960	2,909	8,781	8,386
Occupancy	624	595	1,910	1,929
Processing and communications	529	531	1,609	1,554
Furniture and equipment	440	414	1,311	1,381
Professional services	229	274	657	780
Loan collection costs	272	315	698	694
OREO expenses	482	176	669	193
Deposit insurance	333	351	983	1,361
Advertising	130	147	478	373
Other expenses	405	398	1,288	1,218
Total noninterest expense	6,404	6,110	18,384	17,869
Income (loss) before provision (benefit) for income taxes	968	(1,090 )	2,794	(1,774)
Provision (benefit) for income taxes	242	(343 )	639	(559)
Net income (loss)	726	(747 )	2,155	(1,215)
Preferred stock dividends and discount accretion	385	372	1,136	1,123
Income available (loss attributable) to common shareholders	\$ 341	\$ (1,119 )	\$ 1,019	\$ (2,338)
Net income (loss) per common share - Basic	\$ 0.05	\$ (0.16 )	\$ 0.14	\$ (0.33)
Diluted	0.05	(0.16 )	0.14	(0.33)
Weighted average common shares outstanding - Basic	7,176	7,119	7,161	7,119
- Diluted	7,467	7,119	7,417	7,119

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 nine months ended September 30, 2010 and 2009

(In thousands)	Preferred Stock	Common 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				(1,215 )			(1,215 )
Net noncredit unrealized losses on held to maturity debt securities						(532 )	(532 )
Net unrealized gains on securities						1,841	1,841
Net unrealized gains on cash flow hedge derivatives						85	85
Total comprehensive income							179
Accretion of discount on preferred stock	354			(354 )			-
Dividends on preferred stock (5% annually)				(769 )			(769 )
Common stock issued and related tax effects (a)			172				172
Balance, September 30, 2009	\$ 18,418	7,119	\$ 55,351	\$ (1,253 )	\$ (4,169 )	\$ (962 )	\$ 67,385

(In thousands)	Preferred Stock	Common Shares	Common Stock Amount	Retained Earnings (Deficit)	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2009	\$ 18,533	7,144	\$ 55,454	\$ (1,492 )	\$ (4,169 )	\$ (461 )	\$ 67,865
Comprehensive income:							
Net income				2,155			2,155
Net unrealized gains on securities						1,049	1,049
Net unrealized gains on cash flow hedge derivatives						92	92
Total comprehensive income							3,296
Accretion of discount on preferred stock	361			(361 )			-

Dividends on preferred stock (5% annually)				(775 )				(775 )
Common stock issued and related tax effects (a)	63		344					344
Balance, September 30, 2010	\$ 18,894	7,207	\$ 55,798	\$ (473 )	\$ (4,169 )	\$ 680		\$ 70,730

(a) Includes the issuance of common stock under employee benefit plans, which includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

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

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

(In thousands)	For the nine months ended September 30,	
	2010	2009
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ 2,155	\$ (1,215 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	4,500	6,000
Net amortization of purchase premiums and discounts on securities	644	327
Depreciation and amortization	941	1,115
Deferred income tax benefit	(630 )	(2,091 )
Other-than-temporary impairment charges on securities	-	1,749
Net security gains	(42 )	(675 )
Stock compensation expense	219	223
Loss on sale of other real estate owned	(368 )	(157 )
Gain on sale of SBA loans held for sale, net	(416 )	(29 )
Gain on sale of mortgage loans	(504 )	(184 )
Origination of mortgage loans held for sale	(26,182 )	(15,700 )
Origination of SBA loans held for sale	(2,679 )	(1,910 )
Proceeds from the sale of mortgage loans held for sale, net	26,686	15,884
Proceeds from the sale of SBA loans held for sale, net	4,250	867
Loss on the sale of premises and equipment	(9 )	-
Net change in other assets and liabilities	1,899	1,953
Net cash provided by operating activities	10,464	6,157
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities held to maturity	(2,330 )	(4,036 )
Purchases of securities available for sale	(27,704 )	(87,708 )
Purchases of Federal Home Loan Bank stock, at cost	-	(8,469 )
Maturities and principal payments on securities held to maturity	5,517	4,096
Maturities and principal payments on securities available for sale	46,475	39,665
Proceeds from sale of securities held to maturity	1,893	-
Proceeds from sale of securities available for sale	11,507	26,048
Proceeds from redemption of Federal Home Loan Bank stock	21	8,649
Proceeds from the sale of other real estate owned	3,034	1,335
Net decrease in loans	15,202	23,245
Purchase of bank owned life insurance	(2,500 )	-
Proceeds from the sale of premises and equipment	53	-
Purchases of premises and equipment	(283 )	(305 )
Net cash provided by investing activities	50,885	2,520

## FINANCING ACTIVITIES:

Net (decrease) increase in deposits	(88,081 )	43,548
Proceeds from new borrowings	1,044	22,000
Repayments of borrowings	-	(42,000 )
Proceeds from the exercise of stock options, including related tax benefits	134	(51 )
Cash dividends paid on preferred stock	(774 )	(717 )
Net cash (used in) provided by financing activities	(87,677 )	22,780
(Decrease) increase in cash and cash equivalents	(26,328 )	31,457
Cash and cash equivalents, beginning of period	73,635	34,431
Cash and cash equivalents, end of period	\$ 47,307	\$ 65,888

## SUPPLEMENTAL DISCLOSURES:

## Cash:

Interest paid	\$ 11,137	\$ 16,825
Income taxes paid	1,204	1,035

## Noncash investing activities:

Transfer of AFS SBA loans to HTM SBA loans	1,230	1,890
Transfer of loans to other real estate owned	6,909	3,242

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)  
September 30, 2010

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. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings. 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 and revenues and expenses during the reporting periods. Actual results could differ from those estimates. The Company has evaluated subsequent events for potential recognition and/or disclosure through the date the consolidated financial statements included in this Quarterly Report on Form 10-Q were issued.

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 and nine months ended September 30, 2010 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 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Accounting Standards Codification

The Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") became effective on July 1, 2009. At that date, the ASC became FASB's officially recognized source of authoritative U.S. generally accepted accounting principles ("GAAP") applicable to all public and nonpublic nongovernmental entities, superseding existing FASB, American Institute of Certified Public Accountants ("AICPA"), Emerging Issues Task Force ("EITF") and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered nonauthoritative. The switch to the ASC affects the way companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

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

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of September 30, 2010, 1,520,529 shares have been reserved for issuance upon the exercise of options, 781,019 option grants are outstanding, and 713,250 option grants have been exercised, forfeited or expired, leaving 26,260 shares available for grant.

No options were granted during the three or nine months ended September 30, 2010 or 2009.

FASB ASC Topic 718, "Compensation - Stock Compensation," requires an entity to recognize the fair value of equity awards 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 \$52 thousand and \$43 thousand for the three months ended September 30, 2010 and 2009, respectively. The related income tax benefit was approximately \$34 thousand and \$18 thousand for the three months ended September 30, 2010 and 2009, respectively. Compensation expense related to stock options totaled \$135 thousand and \$115 thousand for the nine months ended September 30, 2010 and 2009, respectively. The related income tax benefit was approximately \$67 thousand and \$54 thousand for the nine months ended September 30, 2010 and 2009, respectively. As of September 30, 2010, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company's stock option plans totaled approximately \$148 thousand. That cost is expected to be recognized over a weighted average period of 1.6 years.

Transactions under the Company's stock option plans for the nine months ended September 30, 2010 are summarized in the following table:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2009	886,286	\$ 5.73	4.6	\$ 293,911
Options granted	-	-		
Options exercised	(76,671 )	2.74		
Options forfeited	(5,524 )	4.44		
Options expired	(23,072 )	10.47		
Outstanding at September 30, 2010	781,019	\$ 5.90	4.1	\$ 657,401
Exercisable at September 30, 2010	631,875	\$ 6.21	3.1	\$ 501,291

The following table summarizes information about stock options outstanding at September 30, 2010:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
0.00					
\$- 4.00	335,100	3.8	\$3.44	230,853	\$3.24
4.01					
- 8.00	249,839	4.4	5.72	204,942	5.63
8.01 -					
12.00	130,618	3.4	9.19	130,618	9.19
12.01 -					
16.00	65,462	6.2	12.55	65,462	12.55
Total	781,019	4.1	\$5.90	631,875	\$6.21

The following table presents information about options exercised during the three and nine months ended September 30, 2010 and 2009:

	Three months ended		Nine months ended	
	September 30, 2010	2009	September 30, 2010	2009
Number of options exercised	50,929	-	76,671	-
Total intrinsic value of options exercised	\$ 115,156	\$ -	\$ 130,972	\$ -
Cash received from options exercised	47,048	-	78,743	-
Tax deduction realized from options exercised	45,977	-	52,276	-

Upon exercise, the Company issues shares from its authorized but unissued common stock to satisfy the options.

#### 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. As of September 30, 2010, 121,551 shares of restricted stock were reserved for issuance, of which 12,335 shares are available for grant.

There were 13,200 shares of restricted stock granted during the third quarter of 2010 with a average grant date fair value of \$5.30.

Compensation expense related to the restricted stock awards totaled \$27 thousand and \$46 thousand for the three months ended September 30, 2010 and 2009, respectively. Compensation expense related to the restricted stock awards totaled \$84 thousand and \$108 thousand for the nine months ended September 30, 2010 and 2009, respectively. As of September 30, 2010, there was approximately \$196 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.9 years.

The following table summarizes nonvested restricted stock activity for the nine months ended September 30, 2010:

	Shares	Average Grant Date Fair Value
Nonvested restricted stock at December 31, 2009	54,281	\$ 7.25
Granted	13,200	5.30
Vested	(15,012 )	11.23
Forfeited	(2,427 )	6.18
Nonvested restricted stock at September 30, 2010	50,042	\$ 5.60

#### Income Taxes

The Company follows FASB ASC Topic 740, "Income Taxes," which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes. 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 September 30, 2010, 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 ability to collect interest on a 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 the ability to collect 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 Company 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 flows, 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 ability to collect 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 restructurings and nonperforming loans. Troubled debt restructurings occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate. Impairment is 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 net amount of loan origination fees on loans sold is included in the carrying value and in the gain or loss on the sale.

The Company originates loans to customers under an SBA program that generally provides for SBA guarantees of up to 90 percent of each loan. In the past, the Company generally sold the guaranteed portion of its SBA loans to a third party and retained the servicing, holding the nonguaranteed portion in its portfolio. During late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area. If sales of SBA loans do occur, the premium received on the sale and the present value of future cash flows of the servicing assets are recognized in income. However, new authoritative accounting guidance under FASB ASC Topic 860, "Transfers and Servicing," requires that the gains on sales of SBA 7(a) loans be deferred for a 90-day period after the sale, which coincides with the buyback or warranty period required by the SBA for all secondary market sales.

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

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

#### Allowance for Loan Losses and Unfunded Loan Commitments

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.

The Company maintains an allowance for unfunded loan commitments that is maintained at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the allowance are made through other expenses and applied to the allowance which is maintained in other liabilities.

For additional information, see the sections titled "Asset Quality" and "Allowance for Loan Losses and Unfunded Loan Commitments" under Item 2. Management's Discussion and Analysis.

#### Other-Than-Temporary Impairment

The Company has a process in place to identify debt securities that could potentially incur 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. 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. This evaluation considers 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 forecasted period of time that allows for the recovery in value.

Management assesses its intent to sell or whether it is more likely than not that it 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 with no intent to sell and no requirement to sell prior to recovery of its amortized cost basis, the amount of the impairment is separated 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.

#### 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 operations of the Company.

## NOTE 3. Net Income per Share

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

Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally stock options, were issued during the reporting period utilizing the Treasury stock method. However, when a net loss rather than net income is recognized, diluted earnings per share equals basic earnings per share.

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
(In thousands, except per share amounts)				
Net income (loss)	\$ 726	\$ (747)	\$ 2,155	\$ (1,215 )
Less: Preferred stock dividends and discount accretion	385	372	1,136	1,123
Income available (loss attributable) to common shareholders	\$ 341	\$ (1,119)	\$ 1,019	\$ (2,338 )
Weighted average common shares outstanding - Basic	7,176	7,119	7,161	7,119
Plus: Potential dilutive common stock equivalents	291	-	256	-
Weighted average common shares outstanding - Diluted	7,467	7,119	7,417	7,119
Net income (loss) per common share -				
Basic	\$ 0.05	\$ (0.16)	\$ 0.14	\$ (0.33 )
Diluted	0.05	(0.16)	0.14	(0.33 )
Stock options and common stock excluded from the income per share computation as their effect would have been anti-dilutive	432	1,385	609	1,405

The number of anti-dilutive stock options and common stock warrants for the three and nine months ended September 30, 2010 and 2009 include 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 follows FASB ASC Topic 740, "Income Taxes," which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes.

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

The Company did not recognize or accrue any interest or penalties related to income taxes during the three or nine months ended September 30, 2010 and 2009. The Company does not have an accrual for uncertain tax positions as of September 30, 2010 or December 31, 2009, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2007 and thereafter are subject to future examination by tax authorities.

NOTE 5. Other Comprehensive Income (Loss)

Changes in Other Comprehensive Income (Loss) for the nine months ended September 30, 2010 and 2009:

(In thousands)	Pre-tax	Tax	After-tax
Net noncredit unrealized losses on held to maturity debt securities with other-than-temporary impairment:			
Balance at December 31, 2008			\$-
Noncredit unrealized holding loss on securities arising during the period	(806 )	(274 )	(532 )
Balance at September 30, 2009			\$(532 )
Net unrealized gains (losses) on securities:			
Balance at December 31, 2008			\$(1,728 )
Unrealized holding gain on securities arising during the period	\$2,956	\$666	2,290
Less: Reclassification adjustment for gains included in net income	675	226	449
Net unrealized gain on securities arising during the period	2,281	440	1,841
Balance at September 30, 2009			113
Balance at December 31, 2009			5
Unrealized holding gain on securities arising during the period	1,798	721	1,077
Less: Reclassification adjustment for gains included in net income	42	14	28
Net unrealized gain on securities arising during the period	1,756	707	1,049
Balance at September 30, 2010			\$1,054
Net unrealized gains (losses) on cash flow hedges:			
Balance at December 31, 2008			\$(628 )
Unrealized holding gain on cash flow hedges arising during the period	\$137	\$52	85
Balance at September 30, 2009			(543 )
Balance at December 31, 2009			(466 )
Unrealized holding gain on cash flow hedges arising during the period	153	61	92
Balance at September 30, 2010			(374 )
Total Accumulated Other Comprehensive Income at September 30, 2010			\$680

## Changes in Other Comprehensive Income (Loss) for the three months ended September 30, 2010 and 2009:

(In thousands)	Pre-tax	Tax	After-tax
Net unrealized gains (losses) on securities:			
Balance at June 30, 2009			(1,156 )
Unrealized holding gain on securities arising during the period	2,205	831	1,374
Less: Reclassification adjustment for gains included in net income	158	53	105
Net unrealized gain on securities arising during the period	2,047	778	1,269
Balance at September 30, 2009			113
Balance at June 30, 2010			
Unrealized holding gain on securities arising during the period	672	266	406
Less: Reclassification adjustment for gains included in net income	34	11	23
Net unrealized gain on securities arising during the period	638	255	383
Balance at September 30, 2010			1,054
Net unrealized gains (losses) on cash flow hedges:			
Balance at June 30, 2009			(513 )
Unrealized holding loss on cash flow hedges arising during the period	(48 )	(18 )	(30 )
Balance at September 30, 2009			(543 )
Balance at June 30, 2010			
Unrealized holding gain on cash flow hedges arising during the period	70	28	42
Balance at September 30, 2010			(374 )
Total Accumulated Other Comprehensive Income at September 30, 2010			680

## NOTE 6. Fair Value

### Fair Value Measurement

The Company follows FASB ASC Topic 820, "Fair Value Measurement and Disclosures," which requires additional disclosures about the Company's assets and liabilities that are measured at fair value. Fair value is 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 U.S. Treasury, U.S. 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 in inactive markets.
- Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (i.e., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes U.S. 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 on a recurring basis:

#### Securities Available for Sale

The fair value of available for sale ("AFS") 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).

As of September 30, 2010, the fair value of the Company's AFS securities portfolio was \$111.8 million. Approximately 81 percent of the portfolio was made up of residential mortgage-backed securities, which had a fair value of \$90.7 million at September 30, 2010. Approximately \$78.2 million of the residential mortgage-backed securities are guaranteed by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC"). The underlying loans for these securities are residential mortgages that are geographically dispersed throughout the United States. All AFS securities were classified as Level 2 assets at September 30, 2010. The valuation of AFS securities using Level 2 inputs was primarily determined using the market approach, which uses quoted prices for similar assets or liabilities in active markets and all other relevant information. It includes model pricing, defined as valuing securities based upon their relationship with other benchmark securities.

#### SBA Servicing Assets

SBA servicing assets do not trade in an active, open market with readily observable prices. The Company estimates the fair value of SBA servicing assets 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 assets as of September 30, 2010 was determined using a discount rate of 15 percent, conditional prepayment rates of 15 to 18, 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 assets 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 periods ended September 30, 2010 as compared to the periods ended December 31, 2009 and September 30, 2009. The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009.

(In thousands)	As of September 30, 2010			Total
	Level 1	Level 2	Level 3	
<b>Financial Assets:</b>				
Securities available for sale:				
U.S. government sponsored entities	\$-	\$13,557	\$-	\$13,557
State and political subdivisions	-	3,036	-	3,036
Residential mortgage-backed securities	-	90,741	-	90,741
Commercial mortgage-backed securities	-	2,297	-	2,297
Trust preferred securities	-	561	-	561
Other equities	-	1,585	-	1,585
Total securities available for sale	-	111,777	-	111,777
SBA servicing assets	-	-	614	614
<b>Financial Liabilities:</b>				
Interest rate swap agreements	-	623	-	623

(In thousands)	As of December 31, 2009			Total
	Level 1	Level 2	Level 3	
<b>Financial Assets:</b>				
Securities available for sale:				
U.S. government sponsored entities	\$500	\$15,507	\$-	\$16,007
State and political subdivisions	-	2,942	-	2,942
Residential mortgage-backed securities	8,756	107,469	-	116,225
Commercial mortgage-backed securities	-	4,627	-	4,627
Trust preferred securities	-	390	-	390
Other equities	-	579	-	579
Total securities available for sale	9,256	131,514	-	140,770
SBA servicing assets	-	-	897	897
<b>Financial Liabilities:</b>				
Interest rate swap agreements	-	777	-	777

The changes in Level 1 assets and liabilities measured at fair value on a recurring basis as of September 30, 2010 are summarized as follows:

(In thousands)	As of September 30, 2010
<b>Securities Available for Sale</b>	
Beginning balance December 31, 2009	\$ 9,256
Total net gains (losses) included in:	
Net income	-
Other comprehensive income	-
Purchases, sales, issuances and settlements, net	(500)
Transfers in and/or out of Level 1 (a)	(8,756)
Ending balance September 30, 2010	\$ -

(a) Transferred from Level 1 to Level 2 because of lack of observable market data due to decreased market activity for these securities. The transferred available for sale securities consisted entirely of residential mortgage-backed securities.

The changes in Level 2 assets and liabilities measured at fair value on a recurring basis as of September 30, 2010 are summarized as follows:

(In thousands)	As of September 30, 2010	
	Securities Available for Sale	Interest Rate Swap Agreements
Beginning balance December 31, 2009	\$ 131,514	\$ 777
Total net gains (losses) included in:		
Net income	128	-
Other comprehensive income	1,756	(154 )
Purchases, sales, issuances and settlements, net	(30,377 )	-
Transfers in and/or out of Level 2 (a)	8,756	-
Ending balance September 30, 2010	\$ 111,777	\$ 623

(a) Transferred from Level 1 to Level 2 because of lack of observable market data due to decreased market activity for these securities. The transferred available for sale securities consisted entirely of residential mortgage-backed securities.

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis as of September 30, 2010 and 2009 are summarized as follows:

(In thousands)	As of September 30, 2010	
	SBA Servicing Assets	
Beginning balance December 31, 2009	\$ 897	
Total net gains (losses) included in:		
Net income	-	
Other comprehensive income	-	
Purchases, sales, issuances and settlements, net	(283 )	
Transfers in and/or out of Level 3	-	
Ending balance September 30, 2010	\$ 614	

(In thousands)	As of September 30, 2009	
	SBA Servicing Assets	
Beginning balance December 31, 2008	\$ 1,503	
Total net gains (losses) included in:		
Net income	-	
Other comprehensive income	-	
Purchases, sales, issuances and settlements, net	(526 )	
Transfers in and/or out of Level 3	-	
Ending balance September 30, 2009	\$ 977	

There were no gains or losses (realized or unrealized) included in earnings for assets and liabilities held at September 30, 2010 or 2009.

## 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 is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis:

## Other Real Estate Owned ("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 Collateral-Dependent Loans

The fair value of impaired collateral-dependent loans is derived in accordance with FASB ASC Topic 310, "Receivables." Fair value is determined based on the loan's observable market price or the fair value of the collateral. The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. During the nine months ended September 30, 2010, the valuation allowance for impaired loans decreased \$127 thousand from \$2.5 million at December 31, 2009 to \$2.3 million at September 30, 2010. During the twelve months ended December 31, 2009, the valuation allowance for impaired loans increased \$1.5 million from \$957 thousand at December 31, 2008 to \$2.5 million at December 31, 2009.

The following tables present the assets and liabilities carried on the balance sheet by caption and by level within the hierarchy (as described above) as of September 30, 2010 and December 31, 2009:

As of September 30, 2010					Total fair value gain (loss) during nine months ended September 30, 2010
(In thousands)	Level 1	Level 2	Level 3	Total	
<b>Financial Assets:</b>					
Other real estate owned ("OREO")	\$ -	\$ -	\$ 5,773	\$ 5,773	\$ -
Impaired collateral-dependent loans	-	-	24,998	24,998	127

As of December 31, 2009					Total fair value gain (loss) during twelve months ended December 31, 2009
(In thousands)	Level 1	Level 2	Level 3	Total	
<b>Financial Assets:</b>					
Other real estate owned ("OREO")	\$ -	\$ -	\$ 1,530	\$ 1,530	\$ (150 )
Impaired collateral-dependent loans	-	-	21,713	21,713	(1,507 )



## Fair Value of Financial Instruments

FASB ASC Topic 825, "Financial Instruments," requires the disclosure of the estimated fair value of certain financial instruments, including those financial instruments for which the Company did not elect the fair value option. These estimated fair values as of September 30, 2010 and December 31, 2009 have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop estimates of fair value. The estimates presented are not necessarily indicative of amounts the Company could realize in a current market exchange. The use of alternative market assumptions and estimation methodologies could have had a material effect on these estimates of fair value. 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 Cash Equivalents

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

### Loans

The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the 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. Carrying value approximates fair value based on the redemption provisions of the issues.

### 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 September 30, 2010, the Bank had standby letters of credit outstanding of \$3.5 million, as compared to \$6.4 million at December 31, 2009. The fair value of these commitments is nominal.

The table below presents the estimated fair values of the Company's financial instruments as of September 30, 2010 and December 31, 2009:

(In thousands)	September 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$47,307	\$47,307	\$73,635	\$73,635
Securities available for sale	111,777	111,777	140,770	140,770
Securities held to maturity	23,043	23,745	28,252	28,406

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

Loans, net of allowance for loan losses	615,353	615,374	643,174	640,246
Federal Home Loan Bank stock	4,656	4,656	4,677	4,677
SBA servicing assets	614	614	897	897
Accrued interest receivable	3,750	3,750	4,225	4,225
Financial liabilities:				
Deposits	670,158	657,834	758,239	739,909
Borrowed funds and subordinated debentures	101,509	115,408	100,465	113,227
Accrued interest payable	618	618	710	710
Interest rate swap agreements	623	623	777	777



## Note 7. Securities

This table provides the major components of securities available for sale (“AFS”) and held to maturity (“HTM”) at amortized cost and estimated fair value at September 30, 2010 and December 31, 2009 :

(In thousands)	September 30, 2010				December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:								
US Government sponsored entities	\$ 13,417	\$ 140	\$ -	\$ 13,557	\$ 16,198	\$ 20	\$ (211)	\$ 16,007
State and political subdivisions	2,946	90	-	3,036	2,946	9	(13 )	2,942
Residential mortgage-backed securities	88,773	2,306	(338 )	90,741	115,397	1,849	(1,021 )	116,225
Commercial mortgage-backed securities	2,306	-	(9 )	2,297	4,651	-	(24 )	4,627
Trust preferred securities	977	-	(416 )	561	976	-	(586 )	390
Other equities	1,610	1	(26 )	1,585	610	-	(31 )	579
Total securities available for sale	\$ 110,029	\$ 2,537	\$ (789 )	\$ 111,777	\$ 140,778	\$ 1,878	\$ (1,886 )	\$ 140,770
Held to maturity:								
US Government sponsored entities	\$ 2,000	\$ 7	\$ -	\$ 2,007	\$ 2,000	\$ 76	\$ -	\$ 2,076
State and political subdivisions	862	15	-	877	3,156	4	(92 )	3,068
Residential mortgage-backed securities	15,982	461	(283 )	16,160	18,700	545	(527 )	18,718
Commercial mortgage-backed securities	4,149	539	-	4,688	4,346	185	-	4,531
Trust preferred securities	50	-	(37 )	13	50	-	(37 )	13
Total securities held to maturity	\$ 23,043	\$ 1,022	\$ (320 )	\$ 23,745	\$ 28,252	\$ 810	\$ (656 )	\$ 28,406

The table below provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at September 30, 2010 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.

	After one year	After five years	After ten years
--	----------------	------------------	-----------------

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

(In thousands)	Within one year		through five years		through ten years				Total carrying value	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale at fair value:										
US Government sponsored entities	\$ -	- %	\$ 3,398	1.54 %	\$ 7,123	2.88 %	\$ 3,036	3.73 %	\$ 13,557	2.84 %
State and political subdivisions	-	-	-	-	1,187	3.83	1,849	3.91	3,036	3.91
Residential mortgage-backed securities	66	2.07	1,259	3.41	6,780	4.66	82,636	3.75	90,741	3.81
Commercial mortgage-backed securities	-	-	-	-	-	-	2,297	6.10	2,297	6.10
Trust preferred securities	-	-	-	-	-	-	561	1.06	561	1.06
Other equities	-	-	-	-	-	-	1,585	3.20	1,585	3.20
Total securities available for sale	\$ 66	2.07 %	\$ 4,657	2.05 %	\$ 15,090	3.45 %	\$ 91,964	3.78 %	\$ 111,777	3.72 %
Held to maturity at cost:										
US Government sponsored entities	\$ 2,000	4.94 %	\$ -	- %	\$ -	- %	\$ -	- %	\$ 2,000	4.94 %
State and political subdivisions	-	-	-	-	-	-	862	4.34	862	4.34
Residential mortgage-backed securities	-	-	566	4.29	4,288	4.78	11,128	4.63	15,982	4.66
Commercial mortgage-backed securities	-	-	-	-	-	-	4,149	5.30	4,149	5.30
Trust preferred securities	-	-	-	-	-	-	50	-	50	-
Total securities held to maturity	\$ 2,000	4.94 %	\$ 566	4.29 %	\$ 4,288	4.78 %	\$ 16,189	4.78 %	\$ 23,043	4.78 %

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

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 September 30, 2010 and December 31, 2009 are as follows:

(In thousands)	Total Number in a Loss Position	September 30, 2010				Total	
		Less than 12 months		12 months and greater		Estimated Fair Value	Unrealized Loss
		Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss		
Available for sale:							
U.S. Government sponsored entities	2	\$ -	\$ -	\$ 75	\$ -	\$ 75	\$ -
Residential mortgage-backed securities	13	6,816	(49 )	3,801	(289 )	10,617	(338 )
Commercial mortgage-backed securities	2	306	(4 )	1,991	(5 )	2,297	(9 )
Trust preferred securities	1	-	-	561	(416 )	561	(416 )
Other equities	3	-	-	584	(26 )	584	(26 )
Total temporarily impaired investments	21	\$ 7,122	\$ (53 )	\$ 7,012	\$ (736 )	\$ 14,134	\$ (789 )
Held to maturity:							
Residential mortgage-backed securities	5	\$ 1,143	\$ (5 )	\$ 3,244	\$ (278 )	\$ 4,387	\$ (283 )
Trust preferred securities	2	-	-	13	(37 )	13	(37 )
Total temporarily impaired investments	7	\$ 1,143	\$ (5 )	\$ 3,257	\$ (315 )	\$ 4,400	\$ (320 )

(In thousands)	Total Number in a Loss Position	December 31, 2009				Total	
		Less than 12 months		12 months and greater		Estimated Fair Value	Unrealized Loss
		Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss		
Available for sale:							
U.S. Government sponsored entities	10	\$ 12,807	\$ (210 )	\$ 96	\$ (1 )	\$ 12,903	\$ (211 )
State and political subdivisions	7	1,820	(13 )	-	-	1,820	(13 )
Residential mortgage-backed securities	24	17,372	(207 )	7,735	(814 )	25,107	(1,021 )
Commercial mortgage-backed	4	4,627	(24 )	-	-	4,627	(24 )

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

securities

Trust preferred securities	1	-	-	390	(586 )	390	(586 )
Other equities	3	-	-	579	(31 )	579	(31 )
Total temporarily impaired investments	49	\$ 36,626	\$ (454 )	\$ 8,800	\$ (1,432 )	\$ 45,426	\$ (1,886 )
Held to maturity:							
State and political subdivisions	6	\$ 1,753	\$ (32 )	\$ 999	\$ (60 )	\$ 2,752	\$ (92 )
Residential mortgage-backed securities							
Trust preferred securities	5	124	(10 )	3,844	(517 )	3,968	(527 )
Trust preferred securities	2	5	(6 )	26	(31 )	31	(37 )
Total temporarily impaired investments	13	\$ 1,882	\$ (48 )	\$ 4,869	\$ (608 )	\$ 6,751	\$ (656 )

Unrealized Losses

The unrealized losses in each of the categories presented in the tables above are discussed in the paragraphs that follow:

U.S. Government sponsored entities and state and political subdivision securities: The unrealized losses on investments in this type of security 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 September 30, 2010.

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 September 30, 2010.

Trust preferred securities: The unrealized losses on trust preferred securities were caused by an inactive trading market and changes in market credit spreads. At September 30, 2010, this category consisted primarily of one single-issuer trust preferred security. The company that issued the trust preferred security is considered a well-capitalized institution per regulatory standards and significantly strengthened its capital position. In addition, the company has ample liquidity, bolstered its allowance for loan losses and is projected to be profitable for 2010. The contractual terms do not allow the security to be settled at a price less than the par value. Because the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, which may be at maturity, the Company does not consider this security to be other-than-temporarily impaired as of September 30, 2010.

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 evaluated the prospects of the issuer and has forecasted a recovery period; therefore these investments are not considered other-than-temporarily impaired as of September 30, 2010.



## Realized Gains and Losses and Other-than-temporary Impairment

The net realized gains and losses are included in noninterest income in the Consolidated Statements of Operations as net securities gains (losses). For the three months ended September 30, 2010 and 2009, gross realized gains on sales of securities amounted to \$35 thousand and \$158 thousand, respectively, while there were no gross realized losses during those periods. For the nine months ended September 30, 2010 and 2009, gross realized gains on sales of securities amounted to \$282 thousand and \$675 thousand, respectively, while gross realized losses amounted to \$240 thousand and \$0, respectively. The gross gains during the nine months ended September 30, 2010 are primarily attributed to the Company selling approximately \$9.0 million in book value of mortgage-backed securities, resulting in pretax gains of approximately \$272 thousand on the sales, two called structured agency securities with resulting gains of \$6 thousand, and one called municipal security with a resulting gain of \$4 thousand. These gains were partially offset by losses of \$150 thousand on the sale of two mortgage-backed securities and losses of \$90 thousand on the sale of five held to maturity tax-exempt municipal securities with a total book value of approximately \$2.0 million. Although designated as held to maturity, these municipal securities were sold due to deterioration in the issuer's creditworthiness, as evidenced by downgrades in their credit ratings. The gross gains of \$675 thousand for the same period in 2009 are attributed to the Company selling approximately \$25.2 million in book value of mortgage-backed securities. There were no realized losses during the nine months ended September 30, 2009.

Also included in noninterest income for the nine months ended September 30, 2009 are other-than-temporary-impairment charges of \$1.7 million. During the second quarter of 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. In estimating the present value of the expected cash flows on the two collateralized debt obligations which were other-than-temporarily impaired as of September 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. A CRR of 2 percent was 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 (i.e. recoveries occur on 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.

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 and again by \$862 thousand in December 2009. For the assumptions used in estimating the present value of the expected cash flows on these two securities as of December 31, 2008 and December 31, 2009, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2009. After the above charges, the two pooled trust preferred securities have a remaining book value of approximately \$50 thousand as of September 30, 2010.

Gross realized gains (losses) on securities and other-than-temporary impairment charges for the three and nine months ended September 30, 2010 and 2009 are detailed in the table below:

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

(In thousands)	For the three months ended		For the nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2010	2009	2010	2009
<b>Available for sale:</b>				
Realized gains	\$ 35	\$ 158	\$ 278	\$ 675
Realized losses	-	-	(150 )	-
Total securities available for sale	\$ 35	\$ 158	\$ 128	\$ 675
<b>Held to maturity:</b>				
Realized gains	\$ -	\$ -	\$ 4	\$ -
Realized losses	-	-	(90 )	-
Other than temporary impairment charges	-	-	-	(1,749 )
Total securities held to maturity	\$ -	\$ -	\$ (86 )	\$ (1,749 )
Net realized gains on sales of securities and other-than-temporary impairment charges	\$ 35	\$ 158	\$ 42	\$ (1,074 )

Pledged Securities

Securities with a carrying value of \$67.5 million and \$71.4 million at September 30, 2010 and December 31, 2009, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law. Included in these figures was \$3.0 million and \$2.9 million pledged to secure Government deposits at September 30, 2010 and December 31, 2009, respectively, per the requirements of the New Jersey Department of Banking and Insurance.

## Note 8. Allowance for Loan Losses and Unfunded Loan Commitments

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.

An analysis of the change in the allowance for loan losses for the three and nine months ended September 30, 2010 and 2009:

(In thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
Balance, beginning of period	\$ 13,946	\$ 10,665	\$ 13,842	\$ 10,326
Provision charged to expense	1,500	3,000	4,500	6,000
Charge-offs	1,482	1,258	4,489	4,147
Recoveries	199	38	310	266
Net charge-offs	1,283	1,220	4,179	3,881
Balance, end of period	\$ 14,163	\$ 12,445	\$ 14,163	\$ 12,445

The Company maintains an allowance for unfunded loan commitments that is maintained at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the allowance are made through other expense and applied to the allowance which is maintained in other liabilities. The commitment reserve was \$69 thousand and \$76 thousand at September 30, 2010 and December 31, 2009, respectively.

The following table provides detail on the Company's impaired loans as of September 30, 2010 and December 31, 2009:

(In thousands)	September 30, 2010	December 31, 2009
Nonperforming loans	\$ 27,304	\$ 25,496
Troubled debt restructurings	7,909	6,576
Total impaired loans	35,213	32,072
Year-to-date average impaired loans	\$ 32,047	\$ 26,775

## Note 9. New Accounting Pronouncements

FASB ASC Topic 310, "Receivables." New authoritative accounting guidance (Accounting Standards Update No. 2010-20) under ASC Topic 310, "Receivables", amends the current disclosures required by ASC Topic 310. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company is currently evaluating this new disclosure guidance, but does not expect it to have any effect on the Company's reported financial condition or results of operations.

FASB ASC Topic 820, "Fair Value Measurements and Disclosures." New authoritative accounting guidance (Accounting Standards Update No. 2010-6) provides amendments to ASC Topic 820 that require new disclosures as



follows: 1) A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and 2) In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). The new authoritative guidance also clarifies existing disclosures as follows: 1) A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3. These new disclosures and clarifications of existing disclosures were effective for the Company's financial statements beginning after December 15, 2009 (except for the disclosures about the purchases, sales, issuances, and settlements in the roll forward activity of Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010) and did not have a significant impact on the Company's financial statements.

FASB ASC Topic 860, "Transfers and Servicing." New authoritative accounting guidance under ASC Topic 860, "Transfers and Servicing," amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC Topic 860 was effective January 1, 2010 and did not have a significant impact on the Company's financial statements; however the guidance defers the gains of SBA 7(a) loans for a 90-day period after the sale of the loan. Pre-tax gains of \$92 thousand, or \$0.01 per diluted share, for the three months ended September 30, 2010 were deferred to the fourth quarter as a result of this guidance. Pre-tax gains of \$269 thousand, or \$0.02 per diluted share, for sales during the three months ended June 30, 2010 were recognized during the third quarter.

## 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 2009 consolidated audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009. 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 (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. The Company does not consolidate the accounts and related activity of any of its business trust subsidiaries.

### Earnings Summary

Over the past nine months, we have seen signs of economic recovery, albeit at a moderate rate. Household spending has expanded but remains constrained by other factors, such as high unemployment, modest income growth, lower housing wealth, and tighter credit standards. Consumer spending continues to be concentrated in necessities, as opposed to discretionary big-ticket items, while business spending patterns are tempered due to uncertainties in the economic and political environment. Economists expect that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations are likely to warrant the continued low levels of the federal funds rate for an extended period.

There continues to be stress on the financial industry in terms of asset quality and loan demand. Credit quality continues to remain a primary focus as delinquencies are inflated throughout the industry. Commercial, industrial and consumer lending remains weak throughout the national banking industry. Real estate lending, however, has

increased. Despite these economic conditions and the impact the recession has had on our borrowers, we are pleased to report improvements in our financial performance as noted below.

Our performance during the third quarter of 2010 included the following accomplishments when compared to the third quarter of 2009 :

- Net income increased \$1.5 million.
- Net interest margin expanded due to reduced funding costs as higher-priced time deposits rolled off.
- The provision for loan losses declined.
- Noninterest income increased primarily due to increased gains on the sale of SBA and residential mortgage loans.
- The Company remained well-capitalized.

Our performance during the nine months ended September 30, 2010 included the following accomplishments when compared to the same period in the prior year:

- Net income increased \$3.4 million.
- Net interest margin widened due to reduced funding costs as higher-priced time deposits rolled off.
- The provision for loan losses declined.
- Noninterest income increased primarily due to OTTI charges recorded during the nine months ended September 30, 2009, compared to no OTTI charges recorded in 2010.
- The Company remained well-capitalized.

For the three months ended September 30, 2010 and 2009, the Company reported income available to common shareholders of \$341 thousand and a loss attributable to common shareholders of \$1.1 million, respectively. For the nine months ended September 30, 2010 and 2009, the Company reported income available to common shareholders of \$1.0 million and a loss attributable to common shareholders of \$2.3 million, respectively. Performance ratios included:

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
Net income (loss) per common share - Basic (1)	\$ 0.05	\$ (0.16)	\$ 0.14	\$ (0.33 )
Net income (loss) per common share - Diluted (1)	\$ 0.05	\$ (0.16)	\$ 0.14	\$ (0.33 )
Return (loss) on average assets	0.34%	(0.33)%	0.33 %	(0.18 )%
Return (loss) on average equity (2)	2.66%	(9.14)%	2.72 %	(6.38 )%
Efficiency ratio	72.47%	77.72%	71.72 %	77.12 %

(1) Defined as net income adjusted for dividends accrued and accretion of discount on perpetual preferred stock divided by weighted average shares outstanding.

(2) Defined as net income adjusted for dividends accrued and accretion of discount on perpetual preferred stock divided by average shareholders' equity (excluding preferred stock).

## 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 marketplace.

In 2008, the Federal Open Market Committee lowered interest rates 400 basis points in an attempt to stimulate economic activity. By year-end 2008, the Fed Funds target rate had fallen to 0.25 percent and the Prime rate to 3.25 percent. Interest rates continue to remain stable at this low level. Consequently, the Company has realized lower yields on earning assets and lower funding costs.

Tax-equivalent interest income was \$10.7 million for the three months ended September 30, 2010, a decrease of \$1.5 million or 12.0 percent when compared to the same period in the prior year. This decrease was driven by the lower average yield on earning assets and a decrease in the average volume of earning assets:

- Of the \$1.5 million decrease in interest income on a tax-equivalent basis, \$736 thousand was attributed to reduced yields on average interest-earning assets and \$735 thousand was attributable to the decrease in volume of average interest-earning assets.
- The average volume of interest-earning assets decreased \$55.6 million to \$806.5 million for the third quarter of 2010 compared to \$862.1 million for the same period in 2009. This was due primarily to a \$28.9 million decrease in average loans and a \$24.8 million decrease in average investment securities.
- The yield on interest-earning assets decreased 34 basis points to 5.30 percent for the third quarter of 2010 when compared to the third quarter of 2009, due to continued re-pricing in a lower overall interest rate environment. Yields on most earning assets, particularly those with variable rates, fell due to these lower market rates. There was a slight increase in the yield on SBA 504 loans.

Total interest expense was \$3.3 million for the three months ended September 30, 2010, a decrease of \$2.0 million or 37.8 percent compared to the same period in 2009. This decrease was driven by the lower overall interest rate environment combined with the shift in deposit mix away from higher priced products and a decrease in the average volume of interest-bearing liabilities:

- Of the \$2.0 million decrease in interest expense, \$1.3 million was attributed to a decrease in the rates paid on interest-bearing liabilities and \$708 thousand was due to the decrease in the volume of average interest-bearing liabilities.
- Interest-bearing liabilities averaged \$692.0 million for the third quarter of 2010, a decrease of \$59.7 million or 7.9 percent, compared to the third quarter of 2009. The decrease in interest-bearing liabilities was a result of a decrease in average time deposits, partially offset by increases in all other deposit categories and borrowed funds.
- The average cost of interest-bearing liabilities decreased 91 basis points to 1.89 percent, primarily due to the repricing of deposits in a lower interest rate environment. The cost of interest-bearing deposits decreased 108 basis points to 1.51 percent for the third quarter of 2010 and the cost of borrowed funds and subordinated debentures decreased 13 basis points to 4.08 percent.
- The lower cost of funding was also attributed to a shift in the mix of deposits from higher cost time deposits to lower cost savings deposits and interest-bearing demand deposits.

During the quarter ended September 30, 2010, tax-equivalent net interest income amounted to \$7.4 million, an increase of \$542 thousand or 7.9 percent, compared to the same period in 2009. Net interest margin increased 49 basis points to 3.66 percent for the quarter ended September 30, 2010, compared to 3.17 percent for the same period in 2009. The net interest spread was 3.41 percent for the third quarter of 2010, a 57 basis point increase from 2.84 percent for the same period in 2009.

Tax-equivalent interest income was \$33.3 million for the nine months ended September 30, 2010, a decrease of \$4.2 million or 11.1 percent when compared to the same period in the prior year. This decrease was driven by the lower average yield on earning assets and a decrease in the average volume of earning assets:

- Of the \$4.2 million decrease in interest income on a tax-equivalent basis, \$2.3 million was attributed to reduced yields on average interest-earning assets and \$1.9 million was attributable to the decrease in volume of average interest-earning assets.
- The average volume of interest-earning assets decreased \$30.5 million to \$829.7 million for the nine months ended September 30, 2010, compared to \$860.3 million for the same period in 2009. This was due primarily to a \$25.8 million decrease in average loans and a \$20.0 million decrease in average investment securities, partially offset by a \$15.8 million increase in federal funds sold and interest-bearing deposits.
- The yield on interest-earning assets decreased 46 basis points to 5.35 percent for the nine months ended September 30, 2010 when compared to the same period in 2009, due to continued re-pricing in a lower overall interest rate environment. Yields on most earning assets, particularly those with variable rates, fell due to these lower market rates.

Total interest expense was \$11.0 million for the nine months ended September 30, 2010, a decrease of \$5.8 million or 34.3 percent compared to the same period in 2009. This decrease was driven by the lower overall interest rate environment combined with the shift in deposit mix away from higher priced products and a decrease in the average volume of interest-bearing liabilities:

- Of the \$5.8 million decrease in interest expense, \$3.3 million was attributed to a decrease in the rates paid on interest-bearing liabilities and \$2.4 million was due to a lower volume of average interest-bearing liabilities.
- Interest-bearing liabilities averaged \$719.3 million for the nine months ended September 30, 2010, a decrease of \$33.0 million or 4.4 percent, compared to the same period in 2009. The decrease in interest-bearing liabilities was a result of a decrease in average time deposits and borrowed funds, partially offset by increases in all other deposit categories.
- The average cost of interest-bearing liabilities decreased 94 basis points to 2.04 percent, primarily due to the repricing of deposits in a lower interest rate environment. This was partially offset by an increase in the cost of borrowings due to the use of low cost overnight lines of credit and a low rate repurchase agreement during the nine months ended 2009 and not in 2010. The cost of interest-bearing deposits decreased 114 basis points to 1.69 percent for the nine months ended September 30, 2010 and the cost of borrowed funds and subordinated debentures increased 39 basis points to 4.18 percent.
- The lower cost of funding was also attributed to a shift in the mix of deposits from higher cost time deposits to lower cost savings deposits.

During the nine months ended September 30, 2010, tax-equivalent net interest income amounted to \$22.2 million, an increase of \$1.6 million or 7.9 percent, compared to the same period in 2009. Net interest margin increased 38 basis points to 3.58 percent for the nine months ended September 30, 2010, compared to 3.20 percent for the same period in 2009. The net interest spread was 3.31 percent for the nine months ended September 30, 2010, a 48 basis point

increase from 2.83 percent for the same period in 2009.

The following table reflects the components of net interest income, setting forth for the periods presented herein: (1) average assets, liabilities and shareholders' equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) net interest spread (which is the average yield on interest-earning assets less the average rate on interest-bearing liabilities), and (5) net interest income/margin on average earning assets. Rates/Yields are computed on a fully tax-equivalent basis, assuming a federal income tax rate of 34 percent.

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

Unity Bancorp, Inc.  
Consolidated Average Balance Sheets with Resultant Interest and Rates  
(Unaudited)

(Dollar amounts in thousands - interest amounts and interest rates/yields on a fully tax-equivalent basis.)

	For the three months ended September 30,					
	2010			2009		
	Average Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield
<b>ASSETS</b>						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits	\$ 30,939	\$ 21	0.27 %	\$ 32,940	\$ 32	0.39 %
Federal Home Loan Bank stock	4,656	65	5.54	4,677	101	8.57
Securities:						
Available for sale	115,876	1,085	3.75	131,360	1,495	4.55
Held to maturity	22,148	275	4.97	31,418	407	5.18
Total securities (A)	138,024	1,360	3.94	162,778	1,902	4.67
Loans, net of unearned discount:						
SBA	94,723	1,225	5.17	102,691	1,498	5.83
SBA 504	65,506	1,093	6.62	71,764	1,147	6.34
Commercial	283,267	4,454	6.24	301,010	4,973	6.55
Residential mortgage	132,031	1,808	5.48	123,786	1,772	5.73
Consumer	57,315	719	4.98	62,459	791	5.02
Total loans (A),(B)	632,842	9,299	5.85	661,710	10,181	6.12
Total interest-earning assets	806,461	\$ 10,745	5.30 %	862,105	\$ 12,216	5.64 %
Noninterest-earning assets:						
Cash and due from banks	20,469			18,502		
Allowance for loan losses	(14,725 )			(11,478 )		
Other assets	41,374			34,355		
Total noninterest-earning assets	47,118			41,379		
Total Assets	\$ 853,579			\$ 903,484		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
	\$ 95,348	\$ 148	0.62 %	\$ 88,284	\$ 264	1.19 %

Interest-bearing demand deposits						
Savings deposits	290,017	639	0.87	239,427	1,032	1.71
Time deposits	203,346	1,450	2.83	323,484	2,950	3.62
Total interest-bearing deposits	588,711	2,237	1.51	651,195	4,246	2.59
Borrowed funds and subordinated debentures						
	103,296	1,077	4.08	100,465	1,081	4.21
Total interest-bearing liabilities	692,007	3,314	1.89	751,660	5,327	2.80
Noninterest-bearing liabilities:						
Demand deposits	87,644			79,965		
Other liabilities	4,115			4,945		
Total noninterest-bearing liabilities						
	91,759			84,910		
Shareholders' equity	69,813			66,914		
Total Liabilities and Shareholders' Equity	\$ 853,579			\$ 903,484		
Net interest spread		7,431	3.41 %		6,889	2.84 %
Tax-equivalent basis adjustment		(19 )			(31 )	
Net interest income		\$ 7,412			\$ 6,858	
Net interest margin			3.66 %			3.17 %

(A) Yields related to securities and loans exempt from federal and state 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 and applicable state tax rates.

(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)

(Dollar amounts in thousands - interest amounts and interest rates/yields on a fully tax-equivalent basis.)

	For the nine months ended September 30,					
	2010			2009		
	Average Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield
<b>ASSETS</b>						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits	\$ 35,037	\$ 76	0.29 %	\$ 19,222	\$ 78	0.54 %
Federal Home Loan Bank stock	4,663	148	4.24	5,190	219	5.64
Securities:						
Available for sale	122,445	3,446	3.75	133,446	4,709	4.71
Held to maturity	24,238	885	4.87	33,277	1,222	4.90
Total securities (A)	146,683	4,331	3.94	166,723	5,931	4.74
Loans, net of unearned discount:						
SBA	97,013	3,977	5.47	103,321	4,668	6.02
SBA 504	67,405	3,270	6.49	74,266	3,663	6.59
Commercial	286,978	13,546	6.31	303,234	15,040	6.63
Residential mortgage	133,331	5,729	5.73	125,667	5,419	5.75
Consumer	58,595	2,174	4.96	62,630	2,383	5.09
Total loans (A),(B)	643,322	28,696	5.96	669,118	31,173	6.22
Total interest-earning assets	829,705	\$ 33,251	5.35 %	860,253	\$ 37,401	5.81 %
Noninterest-earning assets:						
Cash and due from banks	21,458			18,838		
Allowance for loan losses	(14,662 )			(11,173 )		
Other assets	41,521			33,409		
Total noninterest-earning assets	48,317			41,074		
Total Assets	\$ 878,022			\$ 901,327		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
	\$ 99,323	\$ 593	0.80 %	\$ 86,232	\$ 801	1.24 %

Interest-bearing demand deposits						
Savings deposits	290,606	2,268	1.04	192,559	2,588	1.80
Time deposits	227,438	4,952	2.91	357,073	10,084	3.78
Total interest-bearing deposits	617,367	7,813	1.69	635,864	13,473	2.83
Borrowed funds and subordinated debentures						
	101,911	3,232	4.18	116,427	3,344	3.79
Total interest-bearing liabilities	719,278	11,045	2.04	752,291	16,817	2.98
Noninterest-bearing liabilities:						
Demand deposits	85,876			77,730		
Other liabilities	4,166			4,297		
Total noninterest-bearing liabilities						
	90,042			82,027		
Shareholders' equity	68,702			67,009		
Total Liabilities and Shareholders' Equity	\$ 878,022			\$ 901,327		
Net interest spread		22,206	3.31 %		20,584	2.83 %
Tax-equivalent basis adjustment		(68 )			(94 )	
Net interest income		\$ 22,138			\$ 20,490	
Net interest margin			3.58 %			3.20 %

(A) Yields related to securities and loans exempt from federal and state 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 and applicable state tax rates.

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

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

The rate volume table below presents an analysis of the impact on interest income and expense resulting from changes in average volume and rates over the periods presented. Changes that are not due to volume or rate variances have been allocated proportionally to both, based on their relative absolute values. Amounts have been computed on a tax-equivalent basis, assuming a federal income tax rate of 34 percent.

	Three months ended September 30, 2010 versus September 30, 2009			Nine months ended September 30, 2010 versus September 30, 2009		
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in		
(In thousands on a tax-equivalent basis)	Volume	Rate	Net	Volume	Rate	Net
<b>Interest Income:</b>						
Federal funds sold and interest-bearing deposits	\$ (2)	\$ (9)	\$ (11)	\$ 45	\$ (47 )	\$ (2 )
Federal Home Loan Bank stock	-	(36)	(36)	(21 )	(50 )	(71 )
Investment securities	(280)	(262)	(542)	(694 )	(906 )	(1,600 )
Net loans	(453)	(429)	(882)	(1,221 )	(1,256 )	(2,477 )
<b>Total interest income</b>	<b>\$ (735)</b>	<b>\$ (736)</b>	<b>\$ (1,471)</b>	<b>\$ (1,891 )</b>	<b>\$ (2,259 )</b>	<b>\$ (4,150 )</b>
<b>Interest Expense:</b>						
Interest-bearing demand deposits	\$ 20	\$ (136)	\$ (116)	\$ 108	\$ (316 )	\$ (208 )
Savings deposits	187	(580)	(393)	1,022	(1,342 )	(320 )
Time deposits	(945)	(555)	(1,500)	(3,141 )	(1,991 )	(5,132 )
<b>Total deposits</b>	<b>(738)</b>	<b>(1,271)</b>	<b>(2,009)</b>	<b>(2,011 )</b>	<b>(3,649 )</b>	<b>(5,660 )</b>
Borrowed funds and subordinated debentures	30	(34)	(4)	(438 )	326	(112 )
<b>Total interest expense</b>	<b>(708)</b>	<b>(1,305)</b>	<b>(2,013)</b>	<b>(2,449 )</b>	<b>(3,323 )</b>	<b>(5,772 )</b>
<b>Net interest income – fully tax-equivalent</b>	<b>\$ (27)</b>	<b>\$ 569</b>	<b>542</b>	<b>\$ 558</b>	<b>\$ 1,064</b>	<b>1,622</b>
Decrease in tax-equivalent adjustment			12			26
<b>Net interest income</b>			<b>\$ 554</b>			<b>\$ 1,648</b>

#### Provision for Loan Losses

The provision for loan losses totaled \$1.5 million for the three months ended September 30, 2010, compared to \$3.0 million for the three months ended September 30, 2009. For the nine months ended September 30, 2010, the provision for loan losses totaled \$4.5 million, compared to \$6.0 million for the same period in 2009. Each period's loan loss provision is the result of management's analysis of the loan portfolio and reflects changes in the size and composition of the portfolio, the level of net charge-offs, delinquencies, current economic conditions and other internal and external factors impacting the risk within the loan portfolio. Additional information may be found under the captions "Financial Condition-Asset Quality" and "Financial Condition - Allowance for Loan Losses and Unfunded Loan Commitments." The current provision is considered appropriate under management's assessment of the adequacy of the allowance for loan losses.

#### Noninterest Income

Noninterest income was \$1.5 million for the three months ended September 30, 2010, an increase of \$298 thousand compared with the same period in 2009. The increase is primarily due to higher gains on the sale of SBA and residential mortgage loans.

Noninterest income was \$3.5 million for the nine months ended September 30, 2010, an increase of \$1.9 million compared with the same period in 2009. The increase is primarily due to other-than-temporary impairment ("OTTI") charges recorded during the nine months ended September 30, 2009, compared to no OTTI charges during the same period in 2010. Excluding OTTI, noninterest income would have increased \$186 thousand.

The following table shows the components of noninterest income for the three and nine months ended September 30, 2010 and 2009:

(In thousands)	For the three months ended		For the nine months ended September	
	September 30,	September 30,	30,	2009
	2010	2009	2010	2009
Branch fee income	\$ 359	\$ 373	\$ 1,051	\$ 1,038
Service and loan fee income	251	398	705	946
Gain on sale of SBA loans held for sale, net	269	-	416	29
Gain on sale of mortgage loans	247	71	504	184
Bank owned life insurance	79	56	230	166
Net other-than-temporary impairment charges on securities	-	-	-	(1,749)
Net security gains	35	158	42	675
Other income	220	106	592	316
<b>Total noninterest income</b>	<b>\$ 1,460</b>	<b>\$ 1,162</b>	<b>\$ 3,540</b>	<b>\$ 1,605</b>

Changes in our noninterest income for the three and nine months ended September 30, 2010 versus the three and nine months ended September 30, 2009 reflect:

- Branch fee income was relatively flat for the three and nine months ended September 30, 2010, when compared to the same periods a year ago.
- For the three and nine months ended September 30, 2010, service and loan fee income decreased \$147 thousand and \$241 thousand, respectively, when compared to the same periods in the prior year. The decreases were primarily the result of lower levels of prepayment fees.
- Net gains on SBA loan sales amounted to \$269 thousand and \$416 thousand for the three and nine months ended September 30, 2010, respectively. Due to new authoritative accounting guidance under FASB ASC Topic 860, "Transfers and Servicing," the gains on sales of SBA 7(a) loans must be deferred for a 90-day period after the sale. Consequently, net gains of \$269 thousand on \$2.5 million of SBA loans sold during the second quarter of 2010 were recorded during the third quarter of 2010. For the nine months ended September 30, 2010, \$416 thousand in net gains were recognized on SBA loan sales of \$3.8 million. Net gains on SBA loan sales amounted to zero and \$29 thousand for the three and nine months ended September 30, 2009, respectively, due to little or no sales volume as a result of market conditions.
- For the three and nine months ended September 30, 2010, gains on the sale of mortgage loans increased \$176 thousand and \$320 thousand, respectively, when compared to the same periods in the prior year. The increases are directly related to a higher volume of loan sales in 2010. Sales of mortgage loans totaled \$11.9 million and \$7.0 million for

the three months ended September 30, 2010 and 2009, respectively, and \$26.2 million and \$15.7 million for the nine months ended September 30, 2010 and 2009, respectively. In December 2004, the Company purchased \$5.0 million of bank owned life insurance (“BOLI”). An additional \$2.5 million was purchased in January 2010 to offset the rising costs of employee benefits. The increase in the cash surrender value of the BOLI was \$79 thousand for the three months ended September 30, 2010, compared to \$56 thousand for the same period in the prior year. For the nine months ended September 30, 2010, the increase in the cash surrender value of the BOLI was \$230 thousand compared to \$166 thousand for the same period in 2009.

- No OTTI charges on securities have been recorded in 2010, compared to OTTI charges of \$1.7 million recorded during the second quarter of 2009. At June 30, 2009, the Company's held to maturity portfolio included two pooled bank trust preferred securities. Due to the declines in their market value and the uncertainty that they would recover their book value, the Company took an impairment charge of \$1.7 million on these securities at June 30, 2009. The securities, which had a cost basis of \$3.0 million, had been previously written down by approximately \$306 thousand in December of 2008 and were written down again by \$862 thousand in December 2009. After the above charges, the two issues of pooled trust preferred securities have a remaining book value of approximately \$50 thousand as of September 30, 2010.
- For the three months ended September 30, 2010 and 2009, net realized gains on sales of securities amounted to \$35 thousand and \$158 thousand, respectively. For the nine months ended September 30, 2010 and 2009, net realized gains amounted to \$42 thousand and \$675 thousand, respectively. The net gains during the nine months ended September 30, 2010 are primarily attributed to the Company selling approximately \$9.0 million in book value of mortgage-backed securities, resulting in pretax gains of approximately \$272 thousand on the sales, two called structured agency security with resulting gains of \$6 thousand, and one called municipal security with a resulting gain of \$4 thousand, partially offset by losses of \$150 thousand on the sale of two mortgage-backed securities and losses of \$90 thousand on the sale of five held to maturity tax-exempt municipal securities with a total book value of approximately \$2.0 million. Although designated as held to maturity, these municipal securities were sold due to deterioration in the issuers' creditworthiness, as evidenced by downgrades in their credit ratings. The net gains of \$675 thousand for the same period in 2009 are attributed to the Company selling approximately \$19.6 million in book value of mortgage-backed securities.
- For the three and nine months ended September 30, 2010, other income increased \$114 thousand and \$276 thousand, respectively, when compared to the same periods in the prior year. The increases are primarily due to a refund of NJ state sales tax for overpayment in previous years received during the second quarter of 2010.

#### Noninterest Expense

Total noninterest expense was \$6.4 million for the third quarter of 2010, an increase of \$294 thousand or 4.8 percent over the third quarter of 2009. The majority of this increase is due to increased expenses related to other real estate owned ("OREO").

Total noninterest expense was \$18.3 million for the nine months ended September 30, 2010, an increase of \$515 thousand or 2.9 percent over the same period in 2009. The majority of this increase is due to increased compensation and benefits expense and increased OREO related expenses, partially offset by lower FDIC deposit insurance premiums due to the special assessment paid during the second quarter of 2009.

The following table presents a breakdown of noninterest expense for the three and nine months ended September 30, 2010 and 2009:

(In thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
Compensation and benefits	\$ 2,960	\$ 2,909	\$ 8,781	\$ 8,386

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

Occupancy	624	595	1,910	1,929
Processing and communications	529	531	1,609	1,554
Furniture and equipment	440	414	1,311	1,381
Professional services	229	274	657	780
Loan collection costs	272	315	698	694
OREO expenses	482	176	669	193
Deposit insurance	333	351	983	1,361
Advertising	130	147	478	373
Other expenses	405	398	1,288	1,218
Total noninterest expense	\$ 6,404	\$ 6,110	\$ 18,384	\$ 17,869

Changes in noninterest expense for the three and nine months ended September 30, 2010 versus the three and nine months ended September 30, 2009 reflect:

- Compensation and benefits expense, the largest component of noninterest expense, increased \$51 thousand and \$395 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. These increases are attributed to an increase in compensation, higher employee medical benefits costs and increased residential mortgage commissions due to a higher sales volume, partially offset by lower incentive bonus payments.
- Occupancy expense increased \$29 thousand and decreased \$19 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. The quarter over quarter increase is primarily due to an increase in janitorial expenses, partially offset by a decline in depreciation expense on capital expenditures. The year over year decline is primarily due to the renegotiation of the lease on the Company's corporate headquarters and a decline in depreciation expense on capital expenditures, partially offset by an increase in seasonal snow removal costs, property taxes, and janitorial expenses.
- Processing and communications expenses remained relatively flat for the three months ended September 30, 2010 when compared to the same period in 2009 and increased \$55 thousand for the nine months ended September 30, 2010 when compared to the same period in 2009. This increase was primarily the result of increased data processing line costs and cell phone expenses.
- Furniture and equipment expense increased \$26 thousand and decreased \$70 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. Quarter over quarter, the increase was primarily due to increased software and network maintenance costs, partially offset by decreased equipment maintenance costs. Year over year, the decrease was primarily due to lower depreciation expense as capital expenditures declined, as well as lower maintenance costs on software and security.
- Professional service fees decreased \$45 thousand and \$123 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009, due to lower consulting, audit, tax and loan review fees.
- Loan collection costs decreased \$43 thousand and increased \$4 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. The quarter over quarter decrease is primarily due to decreased collections costs on past due loans.
- OREO expenses increased \$306 thousand and \$476 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009, due to increased maintenance and valuation related expenses on OREO properties.

Deposit insurance expense decreased \$18 thousand and \$378 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. The quarter over quarter decrease is primarily due to a lower deposit base at September 30, 2010 compared to September 30, 2009. The year over year decrease is due primarily to the \$408 thousand special assessment in the second quarter of 2009.

- Advertising expense decreased \$17 thousand and increased \$105 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. The quarter over quarter decrease is due to fewer newspaper and billboard advertisements during the third quarter of 2010. The year over year increase reflects the Company's sales initiatives and brand recognition efforts.
- Other expenses increased \$7 thousand and \$70 thousand for the three and nine months ended September 30, 2010, respectively, when compared to the same periods in 2009. The year over year increase is primarily due to uninsured losses and a higher reserve for outstanding loan commitments.

#### Income Tax Expense

For the quarter ended September 30, 2010, the Company recorded an income tax expense of \$242 thousand, compared to an income tax benefit of \$343 thousand for the same period a year ago. For the nine months ended September 30, 2010, the Company recorded an income tax expense of \$639 thousand, compared to an income tax benefit of \$559 thousand for the same period a year ago. The current 2010 tax provision represents an effective tax rate of approximately 22.9 percent as compared to 31.5 percent for the prior year. Management anticipates an effective tax rate of approximately 23.0 percent for the remainder of 2010.



## Financial Condition at September 30, 2010

Total assets decreased \$84.0 million or 9.0 percent, to \$846.4 million at September 30, 2010, compared to \$930.4 million at December 31, 2009. This decrease was primarily due to a \$34.2 million decrease in total securities, a \$27.5 million decrease in total loans and a \$26.3 million decrease in cash and cash equivalents. Total deposits decreased \$88.1 million and borrowed funds increased \$1.0 million. Total shareholders' equity increased \$2.9 million over year-end 2009. These fluctuations are discussed in further detail in the paragraphs that follow.

### Investment Securities Portfolio

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

AFS securities are investments carried at fair value that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk, to take advantage of market conditions that create economically attractive returns and as an additional source of earnings. AFS securities consist primarily of obligations of U.S. Government sponsored entities, obligations of state and political subdivisions, mortgage-backed securities, trust preferred securities and equity securities.

HTM securities, which are carried at amortized cost, are investments for which there is the positive intent and ability to hold to maturity. The portfolio is comprised of obligations of U.S. Government sponsored entities, obligations of state and political subdivisions, mortgage-backed securities and trust preferred securities.

AFS securities totaled \$111.8 million at September 30, 2010, a decrease of \$29.0 million or 20.6 percent, compared to \$140.8 million at December 31, 2009. This net decrease was the result of the following:

- \$46.5 million in principal payments, maturities and called bonds,
- \$27.7 million in purchases of collateralized mortgage obligations ("CMOs"), structured agencies, and Community Reinvestment Act ("CRA") investments,
- \$11.4 million in sales net of realized gains, which consisted primarily of mortgage-backed securities and CMOs,
- \$600 thousand in net amortization of premiums, partially offset by
- \$1.8 million of appreciation in the market value of the portfolio. At September 30, 2010, the portfolio had a net unrealized gain of \$1.8 million compared to a net unrealized loss of \$8 thousand at December 31, 2009. These unrealized gains (losses) are reflected net of tax in shareholders' equity as accumulated other comprehensive income (loss).

The average balance of AFS securities amounted to \$122.4 million for the nine months ended September, 30, 2010, compared to \$133.4 million for the same period in 2009. The average yield earned on the AFS portfolio decreased 96 basis points, to 3.75 percent for the nine months ended September, 30, 2010, from 4.71 percent for the same period in the prior year. The weighted average repricing of AFS securities, adjusted for prepayments, amounted to 1.4 years at September 30, 2010, compared to 2.5 years at December 31, 2009.

At September 30, 2010, the Company's AFS portfolio included one bank trust preferred security with a book value of \$977 thousand and a fair value of \$561 thousand. The Company monitors the credit worthiness of the issuer of this security quarterly. At September 30, 2010, the Company had not taken any OTTI credit loss adjustments on this security. Management will continue to monitor the performance of the security and the underlying institution for

impairment.

HTM securities were \$23.0 million at September 30, 2010, a decrease of \$5.2 million or 18.4 percent, from year-end 2009. This net decrease was the result of:

- \$2.3 million in purchases of mortgage-backed securities,
- \$2.0 million in sales net of realized losses, which consisted primarily of tax-exempt municipal securities due to declines in their ratings,
- \$5.5 million in principal payments, maturities and called bonds, and
- \$44 thousand in net amortization of premiums.

As of September 30, 2010 and December 31, 2009, the fair value of HTM securities was \$23.7 million and \$28.4 million, respectively. The average balance of HTM securities amounted to \$24.2 million for the nine months ended September 30, 2010, compared to \$33.3 million for the same period in 2009. The average yield earned on HTM securities decreased 3 basis points, from 4.90 percent for the nine months ended September 30 2009, to 4.87 percent for the same period in 2010. The weighted average repricing of HTM securities, adjusted for prepayments, amounted to 2.2 years and 2.7 years at September 30, 2010 and December 31, 2009, respectively.

Securities with a carrying value of \$67.5 million and \$71.4 million at September 30, 2010 and December 31, 2009, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law.

Approximately 82 percent of the total investment portfolio had a fixed rate of interest at September 30, 2010.

## Loan Portfolio

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

Total loans decreased \$27.5 million or 4.2 percent to \$629.5 million at September 30, 2010, compared to \$657.0 million at year-end 2009. The declines occurred in all loan types and are a direct result of the economic downturn, low consumer and business confidence levels, and reduced loan demand. Creditworthy borrowers are cutting back on capital expenditures or postponing their purchases in hopes that the economy will improve. In general, banks are lending less because consumers and businesses are demanding less credit.

The following table sets forth the classification of loans by major category, including unearned fees, deferred costs and excluding the allowance for loan losses as of September 30, 2010 and December 31, 2009:

(In thousands)	September 30, 2010		December 31, 2009		
	Amount	% of Total	Amount	% of Total	
SBA held for sale	\$ 19,021	3.0	% \$ 21,406	3.3	%
SBA held to maturity	72,197	11.5	77,844	11.8	
SBA 504	65,075	10.3	70,683	10.8	
Commercial	284,875	45.3	293,739	44.6	
Residential mortgage	131,479	20.9	133,059	20.3	
Consumer	56,869	9.0	60,285	9.2	
Total loans	\$ 629,516	100.0	% \$ 657,016	100.0	%

Average loans decreased \$25.8 million or 3.9 percent from \$669.1 million for the nine months ended September 30, 2009, to \$643.3 million for the same period in 2010. The decrease in average loans was due to declines in all portfolio types, except residential mortgage loans which increased \$7.7 million. The yield on the overall loan portfolio fell 26 basis points to 5.96 percent for the nine months ended September 30, 2010, compared to 6.22 percent for the same period in the prior year. This decrease was the result of variable rate, prime-based loan products such as SBA loans repricing lower as rates remained low throughout 2009 and 2010. The prime rate has remained at 3.25 percent since December 2008.

SBA loans, on which the SBA provides guarantees of up to 90 percent of the principal balance, are considered a higher risk loan product for the Company than its other loan products. The Company's SBA loans were historically sold in the secondary market with the nonguaranteed portion held in the portfolio as a loan held for investment. During the third and fourth quarters of 2008, as a result of the significantly reduced premiums on sale and the ongoing credit crisis, the Company closed all SBA production offices outside of its New Jersey, Pennsylvania and New York primary trade area. Consequently, the volume of new SBA loans and gains on SBA loans has declined. In addition, new authoritative accounting guidance under FASB ASC Topic 860, "Transfers and Servicing," requires that the gains on sales of SBA 7(a) loans be deferred for a 90-day period after the sale.

SBA 7(a) loans held for sale, carried at the lower of cost or market, amounted to \$19.0 million at September 30, 2010, a decrease of \$2.4 million from \$21.4 million at December 31, 2009. SBA 7(a) loans held to maturity amounted to \$72.2 million at September 30, 2010, a decrease of \$5.6 million from \$77.8 million at December 31, 2009. The yield on SBA loans, which are generally floating and adjust quarterly to the Prime rate, was 5.47 percent for the nine months ended September 30, 2010, compared to 6.02 percent for the same period in the prior year due to the continued low interest rate environment.

At September 30, 2010, SBA 504 loans totaled \$65.1 million, a decrease of \$5.6 million from \$70.7 million at December 31, 2009. The SBA 504 program consists of real estate backed commercial mortgages where the Company has the first mortgage and the SBA has the second mortgage on the property. Generally, the Company has a 50 percent loan to value ratio on SBA 504 program loans. The yield on SBA 504 loans dropped 10 basis points to 6.49 percent for the nine months ended September 30, 2010, compared to 6.59 percent for the nine months ended September 30, 2009.

Commercial loans are generally made in the Company's market place for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. These loans amounted to \$284.9 million at September 30, 2010, a decrease of \$8.9 million from year-end 2009. This decrease can be attributed to principal paydowns on these loans with minimal new loan volume. The yield on commercial loans was 6.31 percent for the nine months ended September 30, 2010, compared to 6.63 percent for the nine months ended September 30, 2009.

Residential mortgage loans consist of loans secured by 1 to 4 family residential properties. These loans amounted to \$131.5 million at September 30, 2010, a decrease of \$1.6 million from year-end 2009. New loan volume during the nine months ended September 30, 2010 was partially offset by the sale of mortgage loans totaling \$26.2 million. The yield on residential mortgages was 5.73 percent for the nine months ended September 30, 2010, compared to 5.75 percent for the same period in 2009.

Consumer loans consist of home equity loans and loans for the purpose of financing the purchase of consumer goods, home improvements, and other personal needs, and are generally secured by the personal property being purchased. These loans amounted to \$56.9 million at September 30, 2010, a decrease of \$3.4 million from December 31, 2009. The yield on consumer loans was 4.96 percent for the nine months ended September 30, 2010, compared to 5.09 percent for the same period in 2009.

As of September 30, 2010, approximately 11 percent of the Company's total loan portfolio consists of loans to various unrelated and unaffiliated borrowers in the Hotel/Motel industry. Such loans are collateralized by the underlying real property financed and/or partially guaranteed by the SBA. There are no other concentrations of loans to any borrowers or group of borrowers exceeding 10 percent of the total loan portfolio. There are no foreign loans in the portfolio. As a preferred SBA lender, a portion of the SBA portfolio is to borrowers outside the Company's lending area. However, during late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area.

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

The majority of the Company's loans are secured by real estate. The declines in the market values of real estate in the Company's trade area impact the value of the collateral securing its loans. This could lead to greater losses in the event of defaults on loans secured by real estate. Specifically, as of September 30, 2010, 89 percent of SBA 7(a) loans are secured by commercial or residential real estate and 11 percent by other non-real estate collateral. Commercial real estate secures all SBA 504 loans. Approximately 97 percent of consumer loans are secured by owner-occupied residential real estate, with the other 3 percent secured by automobiles or other. The detailed allocation of the Company's commercial loan portfolio collateral as of September 30, 2010 is shown in the table below:

(In thousands)	Balance	Concentration	
		Percent	
Commercial real estate – owner occupied	\$ 139,516	49.0	%
Commercial real estate – investment property	118,423	41.3	
Undeveloped land	16,897	5.9	
Other non-real estate collateral	10,039	3.8	
Total commercial loans	\$ 284,875	100.0	%

## Asset Quality

Inherent in the lending function is credit risk, which is the possibility a borrower may not perform in accordance with the contractual terms of their loan. A borrower's inability to pay their obligations according to the contractual terms can create the risk of past due loans and, ultimately, credit losses, especially on collateral deficient loans. The Company minimizes its credit risk by loan diversification and adhering to credit administration policies and procedures. Due diligence on loans begins when we initiate contact regarding a loan with a borrower. Documentation, including a borrower's credit history, materials establishing the value and liquidity of potential collateral, the purpose of the loan, the source of funds for repayment of the loan, and other factors, are analyzed before a loan is submitted for approval. The loan portfolio is then subject to on-going internal reviews for credit quality, as well as independent credit reviews by an outside firm.

The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. The current state of the economy and the downturn in the real estate market have resulted in increased loan delinquencies and defaults. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market. In response to the credit risk in its portfolio, the Company has increased staffing in its credit monitoring department and increased efforts in the collection and analysis of borrower's financial statements and tax returns. The recession that began in 2008 continues to put a strain on the Company's borrowers and their ability to pay their loan obligations. Unemployment rates are at the highest level in 25 years and businesses are reluctant to hire. Unemployment and flat wages have caused consumer spending and demand for goods to decline, impacting the profitability of small businesses. Consequently, the Company's nonperforming loans increased compared to the prior year.

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 ability to collect principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal, until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income. Loans past due 90 days or more and still accruing interest are not included in nonperforming loans. Loans past due 90 days or more generally represent loans that are well collateralized and in a continuing process that is expected to result in repayment or restoration to current status.

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

(In thousands)	September 30, 2010	December 31, 2009	September 30, 2009
Nonperforming by category:			
SBA (1)	\$ 6,331	\$ 6,559	\$ 5,761
SBA 504	5,212	5,575	6,026
Commercial	9,461	7,397	6,548
Residential mortgage	6,065	5,578	6,105
Consumer	235	387	247
Total nonperforming loans	27,304	\$ 25,496	\$ 24,687
OREO	5,773	1,530	2,774
Total nonperforming assets	\$ 33,077	\$ 27,026	\$ 27,461

Past due 90 days or more and still accruing interest:

SBA	\$	995		\$	592		\$	-
SBA 504		-			-			174
Commercial		456			469			1,180
Residential mortgage		992			1,196			255
Consumer		24			29			-
Total	\$	2,467		\$	2,286		\$	1,609
Nonperforming loans to total loans		4.34	%		3.88	%		3.76 %
Nonperforming assets to total loans and OREO		5.21	%		4.10	%		4.17 %
Nonperforming assets to total assets		3.91	%		2.90	%		2.98 %
(1) SBA loans guaranteed	\$	2,094		\$	1,931		\$	1,759

Nonperforming loans were \$27.3 million at September 30, 2010, a \$1.8 million increase from \$25.5 million at year-end 2009 and a \$2.6 million increase from \$24.7 million at September 30, 2009. Since year-end 2009, the biggest increase in nonperforming loans was a \$2.1 million increase in the commercial loan portfolio. Included in nonperforming loans at September 30, 2010, are approximately \$2.1 million of loans guaranteed by the SBA, compared to \$1.9 million at December 31, 2009. In addition, there were \$2.5 million and \$2.3 million in loans past due 90 days or more and still accruing interest at September 30, 2010 and December 31, 2009, respectively.

Other real estate owned (“OREO”) properties totaled \$5.8 million at September 30, 2010, an increase of \$4.2 million from \$1.5 million at year-end 2009. During the nine months ended September 30, 2010, the Company took title to eight commercial properties totaling \$5.3 million and four residential properties totaling \$1.3 million. These increases were partially offset by the sale of four commercial properties and three residential properties.

Potential problem loans are those loans where information about possible credit problems of borrowers causes management to have doubts as to the ability of such borrowers to comply with loan repayment terms. These loans are not included in nonperforming loans as they continue to perform. Potential problem loans totaled \$10.4 million at September 30, 2010, an increase of \$8.8 million from \$1.6 million at December 31, 2009. The increase is due to the addition of eight commercial loans totaling \$5.2 million, eleven SBA loans totaling \$3.2 million, one \$572 thousand residential mortgage loan, and one \$234 thousand consumer loan, partially offset by the removal of two SBA loans that were paid off during the period.

The Company has defined impaired loans to be all troubled debt restructurings and nonperforming loans. Troubled debt restructurings (“TDRs”) occur when a creditor, for economic or legal reasons related to a debtor’s financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate, extending the maturity of a loan, or a combination of both. At September 30, 2010, there were eleven loans totaling \$7.9 million that were classified as TDRs by the Company and are deemed impaired, compared to four loans totaling \$6.6 million at December 31, 2009. During the nine months ended September 30, 2010, nine loans totaling \$4.2 million were classified as TDRs, while two loans totaling \$2.8 million previously classified as TDRs were transferred to nonaccrual status. TDRs are not included in the nonperforming or potential problem loan figures listed above, as they continue to perform under their modified terms.

In addition, the Company modified loans during the first nine months of 2010 that were not considered troubled debt restructurings. These loan modifications were predominantly done in the Company’s higher risk SBA portfolio. The types of modifications include changing from a fixed rate of interest to a floating market rate, extending the term of the loan, or allowing interest only payments for a specified period of time. The majority of loans modified year to date are performing according to their new terms.





## Allowance for Loan Losses and Unfunded Loan Commitments

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

Beginning in the third quarter of 2009, when calculating the five-year historical net charge-off rate, the Company weights the past three years more heavily due to the higher amount of charge-offs experienced during those years. All of the environmental factors are ranked and assigned a basis points value based on the following scale: low, low moderate, moderate, high moderate, and high risk. The factors are evaluated separately for each type of loan. For example, commercial loans are broken down further into commercial and industrial loans, commercial mortgages, construction loans, etc. Each type of loan is risk weighted for each environmental factor based on its individual characteristics.

According to the Company's policy, a loss ("charge-off") is to be recognized and charged to the allowance for loan losses as soon as a loan is recognized as uncollectable. All credits which are 90 days past due must be analyzed for the Company's ability to collect on the credit. Once a loss is known to exist, the charge-off approval process is immediately expedited.

Beginning in 2009, the Company significantly increased its loan loss provision in response to the inherent credit risk within its loan portfolio and changes to some of the environmental factors noted above. The inherent credit risk was evidenced by the increase in delinquent and nonperforming loans in recent quarters, as the downturn in the economy impacted borrowers' ability to pay and factors, such as a weakened housing market, eroded the value of underlying collateral. In addition, net charge-offs are higher than normal, as the Company is proactively addressing these issues.

The allowance for loan losses totaled \$14.2 million, \$13.8 million, and \$12.4 million at September 30, 2010, December 31, 2009, and September 30, 2009, respectively, with resulting allowance to total loan ratios of 2.25 percent, 2.11 percent, and 1.90 percent, respectively. Net charge-offs amounted to \$1.3 million for the three months ended September 30, 2010, compared to \$1.2 million for the same period in 2009. Net charge-offs amounted to \$4.2 million for the nine months ended September 30, 2010, compared to \$3.9 million for the same period in 2009. Net charge-offs to average loan ratios are shown in the table below for each major loan category. For the nine months ended September 30, 2010, the highest net charge-off ratios can be seen in the Company's SBA 504, SBA and commercial loan portfolios, most of which are secured by real estate. For the nine months ended September 30, 2009, the highest net charge-off ratio can be seen in the Company's higher risk SBA portfolio.

The following is a summary of the allowance for loan losses for the three and nine months ended September 30, 2010 and 2009:

	For the three months ended		For the nine months ended September	
	September 30,		30,	
(In thousands)	2010	2009	2010	2009
Balance, beginning of period	\$ 13,946	\$ 10,665	\$ 13,842	\$ 10,326
Provision charged to expense	1,500	3,000	4,500	6,000
Charge-offs:				
SBA	389	448	906	1,877

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

SBA 504	-	-	750	312			
Commercial	989	674	2,512	1,720			
Residential mortgage	95	125	310	216			
Consumer	9	11	11	22			
Total charge-offs	1,482	1,258	4,489	4,147			
Recoveries:							
SBA	17	14	115	103			
SBA 504	-	22	-	27			
Commercial	178	-	191	131			
Residential mortgage	-	-	-	-			
Consumer	4	2	4	5			
Total recoveries	199	38	310	266			
Total net charge-offs	\$ 1,283	\$ 1,220	\$ 4,179	\$ 3,881			
Balance, end of period	\$ 14,163	\$ 12,445	\$ 14,163	\$ 12,445			
Selected loan quality ratios:							
Net charge-offs to average loans:							
SBA	1.56%	1.68	%	1.09	%	2.30	%
SBA 504	-	(0.12)		1.49		0.51	
Commercial	1.14	0.89		1.08		0.70	
Residential mortgage	0.29	0.40		0.31		0.23	
Consumer	0.03	0.06		0.02		0.04	
Total loans	0.80	0.73		0.87		0.78	
Allowance to total loans	2.25	1.90		2.25		1.90	
Allowance to nonperforming loans	51.87	50.41		51.87		50.41	

In addition to the allowance for loan losses, the Company maintains an allowance for unfunded loan commitments. Commitments to extend credit represent arrangements to lend funds or provide liquidity subject to specified contractual conditions. At September 30, 2010, a \$69 thousand commitment reserve was reported on the balance sheet as an "other liability" compared to a \$76 thousand commitment reserve at December 31, 2009. Management determines this amount using estimates of future loan funding and losses related to those credit exposures.

## Deposits

Deposits, which include noninterest-bearing demand deposits, interest-bearing demand deposits, savings deposits and time deposits, are the primary source of the Company's funds. The Company offers a variety of products designed to attract and retain customers, with primary focus on building and expanding relationships. The Company continues to focus on establishing a comprehensive relationship with business borrowers, seeking deposits as well as lending relationships.

Total deposits decreased \$88.1 million to \$670.2 million at September 30, 2010, from \$758.2 million at December 31, 2009. The decrease in deposits was the result of a \$102.2 million decrease in time deposits, partially offset by increases of \$7.7 million, \$6.0 million, and \$304 thousand in noninterest-bearing demand deposits, savings deposits, and interest-bearing demand deposits, respectively. The decline in time deposits was due to the planned run off of a maturing high rate promotion done at the end of 2008 to bolster liquidity. In addition, the Company's new sales initiatives and efforts by branch personnel and administration to bring in deposit relationships resulted in increased noninterest-bearing demand deposits during the year.

The mix of deposits shifted during the quarter as the concentration of time deposits fell from 38.5 percent of total deposits at December 31, 2009 to 28.3 percent of total deposits at September 30, 2010, in turn causing the concentration of all other deposits to increase.

## Borrowed Funds and Subordinated Debentures

Borrowed funds consist primarily of fixed rate advances from the Federal Home Loan Bank ("FHLB") of New York and repurchase agreements. These borrowings are used as a source of liquidity or to fund asset growth not supported by deposit generation. Residential mortgages and investment securities collateralize the borrowings from the FHLB, while investment securities are pledged against the repurchase agreements.

Borrowed funds and subordinated debentures totaled \$101.5 million at September 30, 2010 and \$100.5 million at December 31, 2009 and are broken down in the following table:

(In thousands)	September 30, 2010	December 31, 2009
FHLB borrowings:		
Fixed rate advances	\$ 40,000	\$ 40,000
Repurchase agreements	30,000	30,000
Other repurchase agreements	15,000	15,000
SBA loan sales	1,044	-
Subordinated debentures	15,465	15,465

Borrowed funds at September 30, 2010 include \$1.0 million for SBA 7(a) loan sales that occurred during the third quarter of 2010. According to FASB ASC Topic 860, "Transfers and Servicing," as discussed in Note 9 above, the sales credit and gains on the sale of SBA 7(a) loans must be deferred for a 90-day period after the sale and the transaction is reported as a secured borrowing. At September 30, 2010, the Company had \$66.9 million of additional credit available at the FHLB. Pledging additional collateral in the form of 1 to 4 family residential mortgages or investment securities can increase the line with the FHLB.

## Interest Rate Sensitivity

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

The Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity (“EVPE”) models to measure the impact of longer-term asset and liability mismatches beyond two years. The modified duration of equity measures the potential price risk of equity to changes in interest rates. A longer modified duration of equity indicates a greater degree of risk to rising interest rates. Because of balance sheet optionality, an EVPE analysis is also used to dynamically model the present value of asset and liability cash flows with rate shocks of 200 basis points. The economic value of equity is likely to be different as interest rates change. Like the simulation model, results falling outside prescribed ranges require action by the ALCO. The Company’s variance in the economic value of equity, as a percentage of assets with rate shocks of 200 basis points at September 30, 2010, is a decline of 0.01 percent in a rising-rate environment and a decline of 1.67 percent in a falling-rate environment. The variances in the EVPE at September 30, 2010 are within the Board-approved guidelines of +/- 3.00 percent. At December 31, 2009, the economic value of equity as a percentage of assets with rate shocks of 200 basis points was a decline of 0.90 percent in a rising-rate environment and a decline of 0.89 percent in a falling-rate environment.

## Operating, Investing and Financing

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At September 30, 2010, the balance of cash and cash equivalents was \$47.3 million, a decrease of \$26.3 million from December 31, 2009.

Net cash provided by operating activities totaled \$10.5 million and \$6.2 million for the nine months ended September 30, 2010 and 2009, respectively. The primary sources of funds were net income from operations and adjustments to net income, such as the provision for loan losses, depreciation and amortization, and proceeds from the sale of loans held for sale, partially offset by originations of SBA and mortgage loans held for sale and deferred taxes.

Net cash provided by investing activities amounted to \$50.9 million and \$2.5 million for the nine months ended September 30, 2010 and 2009, respectively. The cash provided by investing activities was primarily a result of sales, maturities and paydowns on securities, loan paydowns and proceeds from the sale of other real estate owned, partially offset by the purchase of securities and additional bank owned life insurance.

Net cash used in financing activities amounted to \$87.7 million for the nine months ended September 30, 2010, while financing activities provided \$22.8 million in net cash during the nine months ended September 30, 2009. The cash used in financing activities was primarily due to the decline in the Company's deposit base and dividends paid on preferred stock, partially offset by an increase in the Company's borrowings.

## Liquidity

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

## Parent Company

Generally, the Parent Company's cash is used for the payment of operating expenses and cash dividends on the preferred stock issued to the U.S. Treasury. The principal sources of funds for the Parent Company are dividends paid by the Bank. The Parent Company only pays expenses that are specifically for the benefit of the Parent Company. Other than its investment in the Bank, Unity Statutory Trust II and Unity Statutory Trust III, the Parent Company does not actively engage in other transactions or business. The majority of expenses paid by the Parent Company are related to Unity Statutory Trust II and Unity Statutory Trust III.

At September 30, 2010, the Parent Company had \$4.3 million in cash and \$92 thousand in marketable securities valued at fair value compared to \$5.1 million in cash and \$90 thousand in marketable securities at December 31, 2009. The decrease in cash at the Parent Company was primarily due to the payment of cash dividends on preferred stock.

## Consolidated Bank

The principal sources of funds at the Bank are deposits, scheduled amortization and prepayments of loan and investment principal, sales and maturities of investment securities and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

Total FHLB borrowings amounted to \$70.0 million and third party repurchase agreements totaled \$15.0 million as of September 30, 2010. At September 30, 2010, \$66.9 million was available for additional borrowings from the

FHLB. Pledging additional collateral in the form of 1 to 4 family residential mortgages or investment securities can increase the line with the FHLB. An additional source of liquidity is the securities available for sale portfolio and SBA loans held for sale portfolio, which amounted to \$111.7 million and \$19.0 million, respectively, at September 30, 2010.

As of September 30, 2010, deposits included \$32.1 million of Government deposits, as compared to \$29.2 million at year-end 2009. These deposits are generally short in duration and are very sensitive to price competition. The Company believes that the current level of these types of deposits is appropriate. Included in the portfolio were \$27.5 million of deposits from five municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.

The Company was committed to advance approximately \$69.1 million to its borrowers as of September 30, 2010, compared to \$76.2 million at December 31, 2009. At September 30, 2010, \$20.7 million of these commitments expire after one year, compared to \$32.7 million at December 31, 2009. At September 30, 2010, the Company had \$3.5 million in standby letters of credit compared to \$6.4 million at December 31, 2009, which are included in the commitments amount noted above. The estimated fair value of these guarantees is not significant. The Company believes it has the necessary liquidity to honor all commitments. Many of these commitments will expire and never be funded. In addition, at September 30, 2010 and December 31, 2009, approximately 5 percent of these commitments were for SBA loans, which may be sold in the secondary market.

## Regulatory Capital

A significant measure of the strength of a financial institution is its capital base. Federal regulators have classified and defined capital into the following components: (1) tier 1 capital, which includes tangible shareholders' equity for common stock, qualifying preferred stock and certain qualifying hybrid instruments, and (2) tier 2 capital, which includes a portion of the allowance for loan losses, subject to limitations, certain qualifying long-term debt, preferred stock and hybrid instruments, which do not qualify for tier 1 capital. The parent company and its subsidiary bank are subject to various regulatory capital requirements administered by banking regulators. Quantitative measures of capital adequacy include the leverage ratio (tier 1 capital as a percentage of tangible assets), tier 1 risk-based capital ratio (tier 1 capital as a percent of risk-weighted assets) and total risk-based capital ratio (total risk-based capital as a percent of total risk-weighted assets).

Minimum capital levels are regulated by risk-based capital adequacy guidelines, which require the Company and the bank to maintain certain capital as a percentage of assets and certain off-balance sheet items adjusted for predefined credit risk factors (risk-weighted assets). Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines. However, prompt corrective action provisions are not applicable to bank holding companies. At a minimum, tier 1 capital as a percentage of risk-weighted assets of 4 percent and combined tier 1 and tier 2 capital as a percentage of risk-weighted assets of 8 percent must be maintained.

In addition to the risk-based guidelines, regulators require that a bank, which meets the regulator's highest performance and operation standards, maintain a minimum leverage ratio of 3 percent. For those banks with higher levels of risk or that are experiencing or anticipating significant growth, the minimum leverage ratio will be proportionately increased. Minimum leverage ratios for each institution are evaluated through the ongoing regulatory examination process.

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

(In thousands)	Actual		For Capital Adequacy Purposes				To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
As of September 30, 2010								
Leverage ratio	\$83,621	9.83 %	≥ \$ 34,026	4.00 %	≥ \$ 42,533	N/A		
Tier I risk-based capital ratio	83,621	12.67	26,399	4.00	39,598	N/A		
Total risk-based capital ratio	91,944	13.93	52,798	8.00	65,997	N/A		
As of December 31, 2009								
Leverage ratio	\$81,824	8.83 %	≥ \$ 37,058	4.00 %	≥ \$ 46,323	N/A		
Tier I risk-based capital ratio	81,824	11.75	27,852	4.00	41,778	N/A		
Total risk-based capital ratio	90,592	13.01	55,704	8.00	69,630	N/A		

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

(In thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2010						

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

Leverage ratio	\$70,855	8.34	%	≥ \$ 33,991	4.00	%	≥ \$ 42,489	5.00	%
Tier I risk-based capital ratio	70,855	10.75		26,364	4.00		39,546	6.00	
Total risk-based capital ratio	87,668	13.30		52,728	8.00		65,910	10.00	
As of December 31, 2009									
Leverage ratio	\$68,299	7.38	%	≥ \$ 37,020	4.00	%	≥ \$ 46,275	5.00	%
Tier I risk-based capital ratio	68,299	9.82		27,815	4.00		41,722	6.00	
Total risk-based capital ratio	85,555	12.30		55,630	8.00		69,537	10.00	

### Shareholders' Equity

Shareholders' equity increased \$2.9 million to \$70.7 million at September 30, 2010 compared to \$67.9 million at December 31, 2009, due to net income of \$2.2 million, \$1.0 million in net unrealized gains on the available for sale securities portfolio, \$92 thousand in net unrealized gains on cash flow hedge derivatives, and \$344 thousand from the issuance of common stock under employee benefit plans, partially offset by \$775 thousand in dividends accrued on preferred stock. The issuance of common stock under employee benefit plans includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act of 2008 ("EESA"), which provided the U.S. Secretary of the Treasury with broad authority to implement certain actions to help restore stability and liquidity to the U.S. markets. One of the programs resulting from the EESA was the Treasury's Capital Purchase Program ("CPP") which provided direct equity investment of perpetual preferred stock by the U.S. Treasury in qualified financial institutions. This program was voluntary and requires an institution to comply with several restrictions and provisions, including limits on executive compensation, stock redemptions, and declaration of dividends. The perpetual preferred stock has a dividend rate of 5 percent per year until the fifth anniversary of the Treasury investment and a dividend of 9 percent thereafter. The Company received an investment in perpetual preferred stock of \$20.6 million on December 5, 2008.

As part of the CPP, the Company's future ability to pay cash dividends is limited for so long as the Treasury holds the preferred stock. As so limited the Company may not increase its quarterly cash dividend above \$0.05 per share, the quarterly rate in effect at the time the CPP program was announced, without the prior approval of the Treasury. In accordance with its revised dividend policy announced during the third quarter of 2008, the Company did not declare any dividends during the three and nine month periods ended September 30, 2010. The revised dividend policy establishes a targeted dividend payout ratio of 20 percent of the Company's earnings, subject to adjustment based upon factors existing at the time of the dividend and the Company's projected capital needs. The dividend is to be paid once annually. No dividends were paid in 2009 due to the Company's net loss.

The Company has suspended its share repurchase program, as required by the CPP. On October 21, 2002, the Company authorized the repurchase of up to 10% of its outstanding common stock. The amount and timing of purchases would be dependent upon a number of factors, including the price and availability of the Company's shares, general market conditions and competing alternate uses of funds. There were no shares repurchased during the three and nine month periods ended September 30, 2010. As of September 30, 2010, the Company had repurchased a total of 556 thousand shares, of which 131 thousand shares have been retired, leaving 153 thousand shares remaining to be repurchased under the plan when it is reinstated.



## Derivative Financial Instruments

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

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

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

## Risk Management Policies – Hedging Instruments

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

## Interest Rate Risk Management – Cash Flow Hedging Instruments

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

At September 30, 2010 and December 31, 2009, the information pertaining to outstanding interest rate swap agreements used to hedge variable rate debt was as follows:

(In thousands, except percentages and years)	September 30, 2010		December 31, 2009	
Notional amount	\$ 15,000		\$ 15,000	
Weighted average pay rate	4.05	%	4.05	%
Weighted average receive rate (three-month LIBOR)	0.36	%	0.90	%
Weighted average maturity in years	1.16		1.90	
Unrealized loss relating to interest rate swaps	\$ (623	)	\$ (777	)

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

At September 30, 2010, the net unrealized loss relating to interest rate swaps was recorded as a derivative liability. Changes in the fair value of interest rate swaps designated as hedging instruments of the variability of cash flows associated with long-term debt are reported in other comprehensive income. The net spread between the fixed rate of interest which is paid and the variable interest received is classified in interest expense as a yield adjustment in the same period in which the related interest on the long-term debt affects earnings.

#### Impact of Inflation and Changing Prices

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

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

During 2010, there have been no significant changes in the Company's assessment of market risk as reported in Item 6 of the Company's Annual Report on Form 10-K for the year ended December 31, 2009. (See Interest Rate Sensitivity in Management's Discussion and Analysis Herein.)

ITEM 4.T. Controls and Procedures

- (a) The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2010. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for recording, processing, summarizing and reporting the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms.
- (b) Changes in internal controls over financial reporting – No significant change in the Company's internal control over financial reporting has occurred during the quarterly period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1.A. Risk Factors

Information regarding this item as of September 30, 2010 appears under the heading, "Risk Factors" within the Company's Form 10-K for the year ended December 31, 2009.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds - None

Item 3. Defaults Upon Senior Securities - None

Item 4. Reserved

Item 5. Other Information - None

Item 6. Exhibits

- | (a) | Exhibits     | Description   |
|-----|--------------|---|
|     | Exhibit 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002 |
|     | Exhibit 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002 |

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

Page 35 of 40

---

SIGNATURES

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

UNITY BANCORP, INC.

Dated: November 9, 2010

ALAN J. BEDNER, JR.  
Executive Vice President and Chief Financial Officer

Page 36 of 40

---

EXHIBIT INDEX

QUARTERLY REPORT ON FORM 10-Q

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

