

UNITY BANCORP INC /NJ/  
Form 10-Q  
November 13, 2008

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, 2008

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, 2008  
common stock, no par value: 7,110,938 shares outstanding

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## Part 1.-Consolidated Financial Information

## Item 1.-Consolidated Financial Statements (unaudited)

Unity Bancorp, Inc.  
Consolidated Balance Sheets  
(unaudited)

| (In thousands)   | 09/30/08   | 12/31/07   | 09/30/07   |
|--|------------|------------|------------|
| Assets   |            |            |            |
| Cash and due from banks  | \$ 21,987  | \$ 14,336  | \$ 12,826  |
| Federal funds sold and interest-bearing deposits                                 | 29,356     | 21,976     | 32,495     |
| Securities:  |            |            |            |
| Available for sale   | 70,144     | 64,855     | 72,980     |
| Held to maturity (market value of \$27,063, \$33,639 and \$34,955, respectively) | 29,266     | 33,736     | 35,496     |
| Total securities   | 99,410     | 98,591     | 108,476    |
| Loans:   |            |            |            |
| SBA held for sale  | 19,863     | 24,640     | 17,014     |
| SBA held to maturity   | 82,551     | 68,875     | 66,255     |
| Commercial   | 394,215    | 365,786    | 356,964    |
| Residential mortgage   | 128,216    | 73,697     | 72,177     |
| Consumer   | 60,178     | 57,134     | 55,187     |
| Total loans  | 685,023    | 590,132    | 567,597    |
| Less: Allowance for loan losses  | 9,913      | 8,383      | 8,183      |
| Net loans  | 675,110    | 581,749    | 559,414    |
| Premises and equipment, net  | 12,475     | 12,102     | 11,729     |
| Bank-owned life insurance  | 5,727      | 5,570      | 5,520      |
| Accrued interest receivable  | 4,364      | 3,994      | 4,073      |
| Loan servicing asset   | 1,721      | 2,056      | 2,139      |
| Goodwill and other intangibles   | 1,577      | 1,588      | 1,592      |
| Other assets   | 12,356     | 10,234     | 8,557      |
| Total assets   | \$ 864,083 | \$ 752,196 | \$ 746,821 |
| Liabilities and Shareholders' Equity   |            |            |            |
| Liabilities:   |            |            |            |
| Deposits   |            |            |            |
| Noninterest-bearing demand deposits  | \$ 82,167  | \$ 70,600  | \$ 73,355  |
| Interest-bearing checking  | 87,587     | 78,019     | 81,985     |
| Savings deposits   | 148,026    | 196,390    | 193,387    |
| Time deposits, under \$100,000   | 274,845    | 168,244    | 181,776    |
| Time deposits, \$100,000 and over  | 92,055     | 88,015     | 81,712     |
| Total deposits   | 684,680    | 601,268    | 612,215    |
| Borrowed funds   | 115,000    | 85,000     | 70,000     |
| Subordinated debentures  | 15,465     | 15,465     | 15,465     |
| Accrued interest payable   | 869        | 635        | 757        |
| Accrued expense and other liabilities  | 1,530      | 2,568      | 1,123      |
| Total liabilities  | 817,544    | 704,936    | 699,560    |
| Commitments and contingencies  | -          | -          | -          |
| Shareholders' equity:  |            |            |            |

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|  |            |            |            |
|--|------------|------------|------------|
| Common stock, no par value: 12,500 shares authorized   | 52,453     | 49,447     | 49,282     |
| Retained earnings  | 591        | 2,472      | 2,128      |
| Treasury stock (425 shares at September 30, 2008 and December 31, 2007 and 324 shares at September 30, 2007) | (4,169)    | (4,169)    | (3,218)    |
| Accumulated other comprehensive loss   | (2,336)    | (490)      | (931)      |
| Total Shareholders' Equity   | 46,539     | 47,260     | 47,261     |
| Total Liabilities and Shareholders' Equity   | \$ 864,083 | \$ 752,196 | \$ 746,821 |
| Issued common shares   | 7,535      | 7,488      | 7,478      |
| Outstanding common shares  | 7,110      | 7,063      | 7,154      |

See Accompanying Notes to the Consolidated Financial Statements

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Unity Bancorp  
Consolidated Statements of Income  
(unaudited)

| (In thousands, except per share amounts)                  | For the three months<br>ended September 30, |        | For the nine months<br>ended September 30, |        |
|---|---|--------|--|--------|
|   | 2008  | 2007   | 2008                                       | 2007   |
| Interest and dividend income:                             |   |        |  |        |
| Fed funds sold and interest on deposits                   | \$ 113                                      | \$ 390 | \$ 404                                     | \$ 873 |
| Bankers bank stock  | 58  | 66     | 234  | 180    |
| Securities:   |   |        |  |        |
| Available for sale  | 907   | 888    | 2,714                                      | 2,332  |
| Held to maturity  | 381   | 452    | 1,216                                      | 1,470  |
| Total securities  | 1,288                                       | 1,340  | 3,930                                      | 3,802  |
| Loans:  |   |        |  |        |
| SBA loans   | 2,043                                       | 2,190  | 6,399                                      | 6,732  |
| Commercial loans  | 6,877                                       | 6,600  | 20,279                                     | 18,966 |
| Residential mortgage loans                                | 1,720                                       | 1,047  | 4,008                                      | 2,902  |
| Consumer loans  | 866   | 933    | 2,613                                      | 2,788  |
| Total loan interest income                                | 11,506                                      | 10,770 | 33,299                                     | 31,388 |
| Total interest and dividend income                        | 12,965                                      | 12,566 | 37,867                                     | 36,243 |
| Interest expense:   |   |        |  |        |
| Interest-bearing demand deposits                          | 404   | 451    | 1,120                                      | 1,480  |
| Savings deposits  | 774   | 1,995  | 3,041                                      | 6,288  |
| Time deposits   | 3,553                                       | 2,994  | 9,779                                      | 7,117  |
| Borrowed funds and subordinated debentures                | 1,152                                       | 1,153  | 3,372                                      | 3,279  |
| Total interest expense                                    | 5,883                                       | 6,593  | 17,312                                     | 18,164 |
| Net interest income                                       | 7,082                                       | 5,973  | 20,555                                     | 18,079 |
| Provision for loan losses                                 | 2,100                                       | 450    | 3,200                                      | 1,000  |
| Net interest income after provision for loan losses       | 4,982                                       | 5,523  | 17,355                                     | 17,079 |
| Noninterest income:                                       |   |        |  |        |
| Service charges on deposit accounts                       | 381   | 338    | 1,042                                      | 1,026  |
| Service and loan fee income                               | 334   | 428    | 936  | 1,174  |
| Gain on sales of SBA loans, net                           | 215   | 316    | 1,208                                      | 1,819  |
| Other-than-temporary impairment charges on AFS securities | (946)                                       | -      | (1,201)                                    | -      |
| Net security (losses) gains                               | (512)                                       | 22     | (393)                                      | 32     |
| Bank-owned life insurance                                 | 53  | 53     | 157  | 148    |
| Other income  | 131   | 303    | 390  | 688    |
| Total noninterest income                                  | (344)                                       | 1,460  | 2,139                                      | 4,887  |
| Noninterest expense:                                      |   |        |  |        |
| Compensation and benefits                                 | 2,948                                       | 2,816  | 9,148                                      | 8,494  |
| Occupancy   | 688   | 699    | 2,102                                      | 2,016  |
| Processing and communications                             | 554   | 645    | 1,668                                      | 1,758  |
| Furniture and equipment                                   | 423   | 419    | 1,224                                      | 1,213  |
| Professional services                                     | 285   | 116    | 626  | 414    |
| Loan servicing costs                                      | 206   | 184    | 446  | 443    |
| Advertising   | 158   | 113    | 299  | 312    |
| Deposit Insurance   | 117   | 16     | 291  | 50     |

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|   |            |          |          |          |
|---|------------|----------|----------|----------|
| Other expenses                                | 400        | 493      | 1,362    | 1,485    |
| Total noninterest expense                     | 5,779      | 5,501    | 17,166   | 16,185   |
| Net income before provision for income taxes  | (1,141)    | 1,482    | 2,328    | 5,781    |
| Provision for income taxes                    | (139)      | 430      | 982      | 1,736    |
| Net income                                    | \$ (1,002) | \$ 1,052 | \$ 1,346 | \$ 4,045 |
| Net income per common share - Basic           | \$ (0.14)  | \$ 0.15  | \$ 0.19  | \$ 0.55  |
| Net income per common share - Diluted         | (0.14)     | 0.14     | 0.19     | 0.53     |
| Weighted average shares outstanding – Basic   | 7,107      | 7,215    | 7,091    | 7,291    |
| Weighted average shares outstanding – Diluted | 7,259      | 7,462    | 7,268    | 7,596    |



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Unity Bancorp, Inc.  
Consolidated Statements of Changes in Shareholders' Equity  
For the nine months ended September 30, 2008 and 2007  
(unaudited)

| (In thousands)  | Outstanding<br>Shares | Common<br>Stock | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Shareholders'<br>Equity |
|---|-----------------------|-----------------|----------------------|-------------------|---|----------------------------------|
| Balance, December 31, 2006                                  | 7,296                 | \$ 44,343       | \$ 2,951             | \$ (242)          | \$ (824)                                      | \$ 46,228                        |
| Comprehensive income (loss):                                |                       |                 |                      |                   |   |                                  |
| Net Income  |                       |                 | 4,045                |                   |   | 4,045                            |
| Net unrealized loss on securities                           |                       |                 |                      |                   | (107)   | (107)                            |
| Total comprehensive income                                  |                       |                 |                      |                   |   | 3,938                            |
| Cash dividends declared on common stock of \$ .15 per share |                       |                 | (1,045)              |                   |   | (1,045)                          |
| Common stock purchased                                      | (299)                 |                 |                      | (2,976)           |   | (2,976)                          |
| 5% stock dividend, including cash-in-lieu                   |                       | 3,820           | (3,823)              |                   |   | (3)                              |
| Stock issued, including related tax benefits                | 137                   | 897             |                      |                   |   | 897                              |
| Stock-based compensation                                    | 20                    | 222             |                      |                   |   | 222                              |
| Balance, September 30, 2007                                 | 7,154                 | \$ 49,282       | \$ 2,128             | \$ (3,218)        | \$ (931)                                      | \$ 47,261                        |

| (In thousands)  | Outstanding<br>Shares | Common<br>Stock | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Shareholders'<br>Equity |
|---|-----------------------|-----------------|----------------------|-------------------|---|----------------------------------|
| Balance, December 31, 2007                                  | 7,063                 | \$ 49,447       | \$ 2,472             | \$ (4,169)        | \$ (490)                                      | \$ 47,260                        |
| Comprehensive income (loss):                                |                       |                 |                      |                   |   |                                  |
| Net Income  |                       |                 | 1,346                |                   |   | 1,346                            |
| Net unrealized loss on securities                           |                       |                 |                      |                   | (1,727)                                       | (1,727)                          |
| Net unrealized loss on cash flow hedge derivatives          |                       |                 |                      |                   | (119)   | (119)                            |
| Total comprehensive loss                                    |                       |                 |                      |                   |   | (500)                            |
| Cash dividends declared on common stock of \$ .10 per share |                       |                 | (692)                |                   |   | (692)                            |

|   |       |           |         |            |            |           |     |
|---|-------|-----------|---------|------------|------------|-----------|-----|
| 5% stock dividend,<br>including cash-in-lieu    |       | 2,532     | (2,535) |            |            |           | (3) |
| Stock issued, including<br>related tax benefits | 34    | 259       |         |            |            |           | 259 |
| Stock-based<br>compensation                     | 13    | 215       |         |            |            |           | 215 |
| Balance, September 30,<br>2008                  | 7,110 | \$ 52,453 | \$ 591  | \$ (4,169) | \$ (2,336) | \$ 46,539 |     |

See Accompanying Notes to the Unaudited Consolidated Financial Statements.

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

|   | For the nine months ended September 30, |          |
|---|---|----------|
| (In thousands)  | 2008                                    | 2007     |
| Operating activities:   |   |          |
| Net income  | \$ 1,346                                | \$ 4,045 |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |          |
| Provision for loan losses   | 3,200                                   | 1,000    |
| Net amortization of purchase premium (discount) on securities                     | 55                                      | 56       |
| Depreciation and amortization   | 626                                     | 651      |
| Increase in deferred income taxes   | (1,515)                                 | (337)    |
| Net loss (gain) on sale of securities   | 426                                     | (32)     |
| Stock compensation expense  | 234                                     | 222      |
| Gain on sale of SBA loans held for sale   | (1,208)                                 | (1,819)  |
| Gain on sale of mortgage loans  | (21)                                    | (61)     |
| Loss on disposal of fixed assets  | 28                                      | -        |
| Origination of mortgage loans held for sale                                       | (1,739)                                 | (2,058)  |
| Origination of SBA loans held for sale  | (25,846)                                | (36,069) |
| Proceeds from the sale of mortgage loans held for sale                            | 1,760                                   | 2,119    |
| Proceeds from the sale of SBA loans   | 26,041                                  | 33,147   |
| Net change in other assets and liabilities  | 1,278                                   | 644      |
| Net cash provided by operating activities   | 4,665                                   | 1,507    |
| Investing activities:   |   |          |
| Purchases of securities held to maturity  | (2,782)                                 | -        |
| Purchases of securities available for sale  | (30,337)                                | (15,552) |
| Purchases of banker's bank stock  | (1,362)                                 | (3,595)  |
| Maturities and principal payments on securities held to maturity                  | 9,098                                   | 7,286    |
| Maturities and principal payments on securities available for sale                | 15,757                                  | 4,922    |
| Proceeds from the sale of securities available for sale                           | 3,696                                   | 130      |
| Proceeds from the redemption of banker's bank stock                               | 450                                     | 2,828    |
| Proceeds from the sale of other real estate owned                                 | 353                                     | 583      |
| Net increase in loans   | (96,066)                                | (55,952) |
| Proceeds from the sale of premises and equipment                                  | 263                                     | -        |
| Purchases of premises and equipment   | (1,326)                                 | (921)    |
| Net cash used in investing activities   | (102,257)                               | (60,271) |
| Financing activities:   |   |          |
| Net increase in deposits  | 83,412                                  | 45,750   |
| Proceeds from new borrowings  | 35,000                                  | 25,000   |
| Repayments of borrowings  | (5,000)                                 | (10,000) |
| Redemption of subordinated debentures   | -                                       | (9,000)  |
| Proceeds from the issuance of common stock  | 240                                     | 897      |
| Purchase of common stock  | -                                       | (2,976)  |

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|  |           |           |
|--|-----------|-----------|
| Dividends paid                                   | (1,028)   | (1,022)   |
| Net cash provided by financing activities        | 112,623   | 48,649    |
| Increase (decrease) in cash and cash equivalents | 15,031    | (10,115)  |
| Cash and cash equivalents at beginning of year   | 36,312    | 55,436    |
| Cash and cash equivalents at end of period       | \$ 51,343 | \$ 45,321 |

Supplemental disclosures:

Cash:

|                   |           |           |
|-------------------|-----------|-----------|
| Interest paid     | \$ 17,078 | \$ 17,882 |
| Income taxes paid | 1,391     | 2,713     |

Noncash investing activities:

|  |        |        |
|--|--------|--------|
| Transfer of AFS securities to HTM securities | 1,860  | -      |
| Transfer of loans to Other Real Estate Owned | \$ 565 | \$ 507 |

See Accompanying Notes to the Consolidated Financial Statements.

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Unity Bancorp, Inc.  
Notes to the Consolidated Financial Statements (Unaudited)  
September 30, 2008

NOTE 1. Summary of Significant Accounting Policies

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

Estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions in the market. The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission ("SEC"). The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, "we" and "us" and "our" refer to Unity Bancorp, Inc., and its consolidated subsidiary, Unity Bank, depending on the context. Interim financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2007, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

Stock Transactions

On April 24, 2008, the Company announced a 5 percent stock dividend which was paid on June 27, 2008 to all shareholders of record as of June 13, 2008 and accordingly, all share amounts presented have been restated to include the effect of the distribution. On April 24, 2008, \$2.5 million was transferred from retained earnings to common stock to account for this transaction based on a per share price of \$7.85.

The Company adopted EITF Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards, effective January 1, 2007. Accordingly, the realized income tax benefits from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity-classified nonvested equity shares, nonvested equity share units, and outstanding equity share options are recognized as an increase in additional paid-in capital. This Issue is being applied prospectively to the income tax benefits that result from dividends on equity-classified employee share-based payment awards that are declared in fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. There was no change in accounting policy for income tax benefits of dividends on share-based payment awards resulting from adoption.

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

#### Stock Option Plans

The Company's incentive and nonqualified option plans permit the Board to set vesting requirements. Grants issued to date generally vest over 3 years and must be exercised within 10 years of the date of the grant. The exercise price of each option is the market price on the date of grant. As of September 30, 2008, 1,520,529 shares have been reserved for issuance upon the exercise of options, 783,627 option grants are outstanding, and 572,271 option grants have been exercised, forfeited or expired leaving 164,631 shares available for grant.

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During the three and nine month periods ended September 30, 2008 and 2007, the fair value of the options granted during each period was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                                 | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |          |
|---------------------------------|-------------------------------------|------|------------------------------------|----------|
|                                 | 2008                                | 2007 | 2008                               | 2007     |
| Number of shares granted        | 5,000                               | -    | 47,263                             | 66,978   |
| Weighted average exercise price | \$ 6.12                             | -    | \$ 7.44                            | \$ 12.56 |
| Weighted average fair value     | \$ 1.42                             | -    | \$ 1.58                            | \$ 3.45  |
| Expected life                   | 3.99                                | -    | 3.82                               | 4.01     |
| Expected volatility             | 34.14%                              | -    | 31.33 %                            | 29.72%   |
| Risk-free interest rate         | 3.15%                               | -    | 2.51 %                             | 4.86%    |
| Dividend yield                  | 3.27%                               | -    | 2.59 %                             | 1.45%    |

Transactions under the Company's stock option plans during the nine months ended September 30, 2008 are summarized as follows:

|                                      | Number<br>of Shares | Exercise Price<br>per Share | Weighted<br>Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual<br>Life (in years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------------|---------------------|-----------------------------|---------------------------------------|---|---------------------------------|
| Outstanding at December<br>31, 2007  | 766,054             | \$ 2.70 –<br>14.01          | \$ 6.28                               |   |                                 |
| Options granted                      | 47,263              | 6.12 –<br>7.70              | 7.44                                  |   |                                 |
| Options exercised                    | (536)               | 5.04<br>– 5.04              | 5.04                                  |   |                                 |
| Options expired                      | (29,154)            | 5.04 –<br>12.62             | 9.21                                  |   |                                 |
| Outstanding at<br>September 30, 2008 | 783,627             | \$ 2.70 –<br>14.01          | \$ 6.24                               | 4.53  | \$ 275,096                      |
| Exercisable at September<br>30, 2008 | 653,020             | \$ 2.70 –<br>14.01          | \$ 5.65                               | 3.65  | \$ 275,096                      |

Compensation expense related to stock options totaled \$38 thousand and \$27 thousand for the three months ended September 30, 2008 and 2007, respectively and \$105 thousand and \$84 thousand for the nine months ended September 30, 2008 and 2007, respectively. As of September 30, 2008, there was approximately \$230 thousand of unrecognized compensation cost related to nonvested, share-based compensation arrangements granted under the Company's stock incentive plans. This cost is expected to be recognized over a weighted-average period of 1 year.

The total intrinsic value (spread between the market value and exercise price) of the stock options exercised during the three months ended September 30, 2008 and 2007 was \$0 thousand and \$61 thousand, respectively. The total intrinsic value of the stock options exercised during the nine months ended September 30, 2008 and 2007 was \$1 thousand and \$833 thousand, respectively.

## 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. Restricted stock awards granted during the three and nine months ended September 30, 2008 and 2007 were as follows:

|                                    | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|------------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                                    | 2008                                | 2007   | 2008                               | 2007     |
| Number of Shares Granted           | 1,500                               | 0      | 14,100                             | 19,549   |
| Weighted Average Fair Market Value | \$ 6.12                             | \$ n/a | \$ 7.43                            | \$ 12.55 |
| Vested as of Period End            | 23,054                              | 9,382  | 23,054                             | 9,382    |

Compensation expense related to the restricted stock awards totaled \$45 thousand and \$51 thousand for the three months ended September 30, 2008 and 2007, respectively. Compensation expense related to the restricted stock awards totaled \$129 thousand and \$139 thousand for the nine months ended September 30, 2008 and 2007, respectively. As of September 30, 2008, 121,551 shares of restricted stock were reserved for issuance, of which 66,498 shares are outstanding, 641 shares have been issued and 54,412 shares are available for grant.



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The following table summarizes nonvested restricted stock award activity for the nine months ended September 30, 2008:

|   | Shares   | Average<br>Grant Date<br>Fair Value |
|---|----------|-------------------------------------|
| Nonvested restricted stock at<br>December 31, 2007  | 44,611   | \$ 12.30                            |
| Granted   | 14,100   | 7.43                                |
| Vested  | (12,377) | 12.31                               |
| Forfeited   | (2,890)  | 10.46                               |
| Nonvested restricted stock at<br>September 30, 2008 | 43,444   | \$ 10.84                            |

## Income Taxes

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

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

## Derivative Instruments and Hedging Activities

The Company uses derivative instruments, such as interest rate swaps, to manage interest rate risk. The Company recognizes all derivative instruments at fair value as either assets or liabilities in other assets or other liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as an accounting hedge, the gain or loss is recognized in trading noninterest income. As of September 30, 2008, 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 of outstanding. When management believes there is sufficient doubt as to the ultimate collectibility of interest on any loan interest accruals are discontinued and all past due interest, previously recognized as income, is reversed and charged against current period earnings. Payments received on nonaccrual loans are applied as principal. Loans are returned to an accrual status when collectibility is reasonably assured and when the loan is brought current as to principal and interest.

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

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

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

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

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

The Company originates loans to customers under an SBA program that generally provides for SBA guarantees up to 85 percent of each loan. The Company generally sells the guaranteed portion of each loan to a third party and retains the servicing. The premium received on the sale of the guaranteed portion of SBA loans and the present value of future cash flows of the servicing asset are recognized in income. The nonguaranteed portion is generally held in the portfolio.

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

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

#### Allowance for Loan Losses

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

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

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

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

#### NOTE 2. Litigation

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

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## NOTE 3. Earnings per share

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

|  | Three Months ended September<br>30, |          | Nine months ended September<br>30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
| (In thousands, except per share data)              | 2008                                | 2007     | 2008                               | 2007     |
| Net Income (loss) to common shareholders           | \$ (1,002)                          | \$ 1,052 | \$ 1,346                           | \$ 4,045 |
| Basic weighted-average common shares outstanding   | 7,107                               | 7,215    | 7,091                              | 7,291    |
| Plus: Common stock equivalents                     | 152                                 | 247      | 177                                | 305      |
| Diluted weighted-average common shares outstanding | 7,259                               | 7,462    | 7,268                              | 7,596    |
| Net Income (loss) per common share:                |                                     |          |                                    |          |
| Basic  | \$ (0.14)                           | \$ 0.15  | \$ 0.19                            | \$ 0.55  |
| Diluted  | (0.14)                              | 0.14     | 0.19                               | 0.53     |

## NOTE 4. Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. There were no unrecognized tax benefits recognized as a result of the implementation of FIN 48. The tax years 2004-2007 remain open to examination by the major taxing jurisdictions to which the Company is subject.

## NOTE 5. Other Comprehensive Income (Loss)

| (In thousands)   | Pre-tax    | Tax      | After-tax |
|--|------------|----------|-----------|
| Net unrealized security losses                                     |            |          |           |
| Balance at December 31, 2006                                       |            |          | \$ (824)  |
| Unrealized holding loss on securities arising during the period    | \$ (140)   | \$ (54)  | (86)      |
| Less: Reclassification adjustment for gains included in net income | 32         | 11       | 21        |
| Net unrealized loss on securities arising during the period        | \$ (172)   | \$ (65)  | \$ (107)  |
| Balance at September 30, 2007                                      |            |          | (931)     |
| Balance at December 31, 2007                                       |            |          | \$ (476)  |
| Unrealized holding loss on securities arising during the period    | \$ (3,686) | \$ (899) | (2,787)   |
| Less: Reclassification adjustment for loss included in net income  | (1,594)    | (534)    | (1,060)   |

|   |    |         |    |       |    |         |
|---|----|---------|----|-------|----|---------|
| Net unrealized loss on securities arising during the period | \$ | (2,092) | \$ | (365) | \$ | (1,727) |
| Balance at September 30, 2008                               |    |         |    |       |    | (2,203) |

Net unrealized losses on cash flow hedges

|                              |  |  |  |  |    |      |
|------------------------------|--|--|--|--|----|------|
| Balance at December 31, 2007 |  |  |  |  | \$ | (14) |
|------------------------------|--|--|--|--|----|------|

|   |    |       |    |    |  |       |
|---|----|-------|----|----|--|-------|
| Unrealized holding loss arising during the period | \$ | (192) | \$ | 73 |  | (119) |
|---|----|-------|----|----|--|-------|

|                               |  |  |  |  |    |       |
|-------------------------------|--|--|--|--|----|-------|
| Balance at September 30, 2008 |  |  |  |  | \$ | (133) |
|-------------------------------|--|--|--|--|----|-------|

#### NOTE 6. Fair Value

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

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

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Fair Value Measurement

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

Level 1 Inputs

- Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain US Treasury and US Government and agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities.
- Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (e.g., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes US Government and agency mortgage-backed securities, corporate debt securities, derivative contracts and loans held for sale.

Level 3 Inputs

- Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
- These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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

Available for Sale Securities Portfolio -

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

SBA Servicing Rights –

SBA servicing rights do not trade in an active, open market with readily observable prices. The Company estimates the fair value of SBA servicing rights using discounted cash flow models incorporating numerous assumptions from the perspective of a market participant including market discount rates and prepayment speeds. The fair value of SBA

servicing rights as of September 30, 2008 was determined using a discount rate of 15 percent, constant prepayment rates of 15 to 18 CPR, and interest strip multiples ranging from 2.08 to 3.80, depending on each individual credit. Due to the nature of the valuation inputs, SBA servicing rights are classified as Level 3 assets.

#### Interest rate swap agreements -

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

#### Fair Value on a Recurring Basis

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

| (In thousands)                | Level 1   | Level 2       | Level 3      | Total         |
|-------------------------------|-----------|---------------|--------------|---------------|
| <b>Financial Assets:</b>      |           |               |              |               |
| Securities available for sale | \$ 40     | \$ 70,104     | \$ -         | \$ 70,144     |
| SBA servicing assets          | -         | -             | 1,721        | 1,721         |
| <b>Total</b>                  | <b>40</b> | <b>70,104</b> | <b>1,721</b> | <b>71,865</b> |
| <b>Financial Liabilities:</b> |           |               |              |               |
| Interest rate swap agreements | -         | 214           | -            | 214           |
| <b>Total</b>                  | <b>-</b>  | <b>214</b>    | <b>-</b>     | <b>214</b>    |



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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

| (In thousands)                                   | Securities<br>Available<br>for Sale | SBA<br>Servicing<br>Asset |
|--|-------------------------------------|---------------------------|
| Beginning balance December 31, 2007              | \$ 2,711                            | \$ 2,056                  |
| Total net gains (losses) included in:            |                                     |                           |
| Net income                                       | -                                   | -                         |
| Other comprehensive income                       | (851)                               | -                         |
| Purchases, sales, issuances and settlements, net | -                                   | (335)                     |
| Transfers in and/or out of Level 3               | (1,860)                             | -                         |
| Ending balance September 30, 2008                | \$ -                                | \$ 1,721                  |

There were no gains and losses (realized and unrealized) included in earnings for assets and liabilities held at September 30, 2008.

#### Fair Value on a Nonrecurring Basis

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the FAS 157 hierarchy (as described above) as of September 30, 2008, for which a nonrecurring change in fair value has been recorded during the nine months ended September 30, 2008.

| (In thousands)           | Level 1 | Level 2   | Level 3  | Total     | Total Fair Value<br>Gain during 9<br>months ended<br>September 30,<br>2008 |
|--------------------------|---------|-----------|----------|-----------|--|
| <b>Financial Assets:</b> |         |           |          |           |  |
| SBA loans held for sale  |         | \$ 20,793 |          | \$ 20,793 | \$ -   |
| Impaired loans           |         |           | \$ 9,913 | \$ 9,913  | \$ 354   |

#### SBA Loans – Held for Sale -

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

#### Impaired Loans -

The fair value of impaired collateral dependent loans is derived in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Fair value is determined based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. The valuation allowance for impaired loans at September 30, 2008 was \$726 thousand. During the nine months ended September 30, 2008, the valuation allowance for impaired loans increased \$354 thousand from \$372 thousand at December 31, 2007.



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Note 7. New Accounting Pronouncements

SFAS No. 141R, Business Combinations (Revised 2007). In December 2007, the FASB issued SFAS No. 141R (Revised 2007), which replaces SFAS No. 141, Business Combinations, and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS No. 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any noncontrolling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS No. 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS No. 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS No. 141. Under SFAS No. 141R, the requirements of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a noncontractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, Accounting for Contingencies. SFAS No. 141R is effective for all business combinations closing on or after January 1, 2009 and could have a significant impact on our accounting for business combinations on or after such date.

SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. This Statement requires all entities to report noncontrolling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. Moreover, Statement 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. This Statement shall be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. The Company does not expect that adoption of this Statement will have a material impact on its statements of financial position, operations or shareholders' equity.

SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an Amendment of SFAS No. 133. This Statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance and cash flows. It amends the current qualitative and quantitative disclosure requirements for derivative instruments and hedging activities set forth in SFAS 133 and generally increases the level of disaggregation that will be required in an entity's financial statements. SFAS 161 also requires cross-referencing within the footnotes within an entity's financial statements, which may help users of financial statements locate important information about derivative instruments. The Statement is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect that adoption of this Statement will have a material impact on its statements of financial position, operations or shareholders' equity.

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 2007 consolidated audited financial statements and notes thereto included in our Annual Report on Form

10-K for the year ended December 31, 2007. 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 1A-Risk Factors, as updated by our subsequent Quarterly Report on Form 10-Q, the following: changes in general, economic, and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects Unity Bancorp, Inc.’s interest-rate spread or other income anticipated from operations and investments.

## Overview

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

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

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Earnings Summary

The past nine months have been a period of unprecedented financial, credit and capital market stress. Factors such as lack of liquidity in the credit markets, financial institution failures, continued fall-out from the subprime mortgage crisis, asset "fair market" value write-downs, capital adequacy and credit quality concerns have resulted in a lack of confidence by the markets in the financial industry. Consumer sentiment remained low and consumer spending contracted due to concerns over employment, housing and stock market values.

As a result of these stresses, secondary markets for many types of financial assets, including the guaranteed portion of SBA loans, have closed down or become very restrictive. Consequently, late in the third quarter we closed our SBA origination offices outside of our New Jersey, New York and Pennsylvania primary trade areas. Although we believe this will lead to reduced SBA loan origination volume and premiums on sale for the foreseeable future, we believe these cost savings are prudent given the current market environment.

During the third quarter, this lack of confidence became so strained that Congress intervened with its Emergency Economic Stabilization Act (the "Act") to address the dysfunctional markets. This Act authorized the Troubled Asset Relief Program which will provide capital to financial institutions and purchase troubled mortgages from institutions. Institutions may apply to participate in the Treasury's Capital Purchase Program ("CPP"), under which the Treasury will purchase newly issued preferred stock and common stock purchase warrants from financial institutions or their holding companies. Although we are continuing to analyzing the terms of the CPP program, which have undergone numerous revisions, we have applied to participate in the CPP to ensure that we will remain eligible for the CPP if we determine it is in our shareholders best interests to participate.

In addition, the Act authorized the temporary increase in the FDIC insurance limit to \$250 thousand from \$100 thousand per account. Finally, the FDIC implemented a program to insure all deposits held in non-interest bearing transactional accounts, regardless of amount, at institutions which do not opt out of the program and which pay an additional assessment to the FDIC. These governmental actions were designed to rebuild confidence in the financial markets, increase liquidity and strengthen the financial sector.

The Federal Reserve Board lowered rates three times for a total of 200 basis points during the first quarter of 2008 and 25 basis points in the beginning of the second quarter of 2008 in an attempt to stimulate economic growth. These rate reductions brought the Fed Funds target rate down to 2.00 percent by the end of the second quarter and the Prime lending rate to 5.00 percent. The decrease in short-term rates normalized the Treasury yield curve as opposed to the flat and at times inverted Treasury yield curve which existed during 2006 and 2007. There were no rate reductions during the third quarter; however, a 50 basis point cut was announced October 9th in a coordinated move with other central banks worldwide in an attempt to calm the markets and stimulate economic activity. Finally, on October 29th, the Federal Reserve cut rates another 50 basis points, reducing the Fed Funds target rate to an historical low of 1.00 percent.

Despite this challenging operating environment, our performance included the following accomplishments:

- Total assets exceeded \$864 million,
- Continued market share expansion as total loans increased 20.7 percent from one year ago,
- Total deposits increased 11.8 percent from one year ago,
- The Company remained well capitalized.

For the three months ended September 30, 2008, the Company reported a net loss of \$1.0 million, a decrease from net income of \$1.1 million for the same period in 2007. For the nine months ended September 30, 2008, net income was \$1.3 million, or \$0.19 per diluted share, compared to \$4.0 million, or \$0.53 per diluted share for the same period a year ago.

Earnings for the quarter and nine months ended were impacted by the sale and other-than-temporary impairment charges ("OTTI") on Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") perpetual callable preferred securities. Unity sold approximately \$909 thousand in book value of these securities in August 2008 and recorded a pretax loss of approximately \$518 thousand on this sale. In addition, the market value of the remaining securities was written down as of September 30, 2008, due to actions by the U.S. Treasury and the OFHEO (now FHFA) placing Freddie Mac under conservatorship. The aggregate amount of security losses and OTTI charges related to Freddie Mac perpetual preferred stock for the third quarter of 2008 were \$1.5 million, pre-tax, or \$950 thousand, \$0.13 per diluted share after tax. Over the nine month period, security losses and OTTI charges of \$1.6 million were realized on the FHLMC perpetual preferred stock. In addition to the FHLMC charges described above, the Company recorded a quarterly provision for loan losses of \$2.1 million, an increase of \$1.7 million compared to \$450 thousand recorded a year ago.

While the reported results for the three and nine month periods reflect the effects of the OTTI charge, they do not reflect the change in tax treatment enacted as part of the Act, which was adopted on October 3, 2008. Under the Act, the Company is permitted to deduct the loss related to FHLMC perpetual preferred stock as an ordinary loss for tax purposes, thereby offsetting a portion of the Company's ordinary income. However, since the Act was not enacted until the fourth quarter 2008, the Company cannot recognize this tax benefit as part of its third quarter results. The tax benefit will be recognized in the fourth quarter, and it is expected to amount to approximately \$239 thousand or \$.03 per diluted share, based on the average shares outstanding for the quarter ended September 30, 2008.

| (In thousands, except per share data) | Three Months ended September 30, |          | Nine months ended September 30, |         |
|---------------------------------------|----------------------------------|----------|---------------------------------|---------|
|                                       | 2008                             | 2007     | 2008                            | 2007    |
| Net Income per Common share:          |                                  |          |                                 |         |
| Basic                                 | \$ (0.14)                        | \$ 0.15  | \$ 0.19                         | \$ 0.55 |
| Diluted                               | (0.14)                           | 0.14     | 0.19                            | 0.53    |
| Return on average assets              | (0.47)                           | % 0.57%  | 0.22%                           | 0.77%   |
| Return on average common equity       | (8.45)                           | % 8.89%  | 3.77%                           | 11.57%  |
| Efficiency ratio                      | 70.51                            | % 74.23% | 70.68%                          | 70.57%  |

In addition to the impairment charge and loan loss provision noted above, our results reflect:

- Increased net interest income on strong earning asset growth,
- A lower level of net gains on SBA loan sales as a result of a lower volume of loans sold and reduced premiums on sales, and
- Higher operating expenses related to the expansion of our retail and lending networks.

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## Net Interest Income

Tax-equivalent interest income totaled \$13.0 million for the three months ended September 30, 2008, an increase of \$389 thousand or 3.1 percent, compared to a year ago. Of the \$389 thousand increase in interest income, \$1.9 million was due to an increase in the volume of interest-earning assets, partially offset by a \$1.5 million decrease due to lower yields on interest-earning assets. The average volume of interest-earning assets increased \$102.2 million to \$802.4 million for the three months ended September 30, 2008 due to a \$112.3 million increase in average total loans as loans increased in all categories. The tax-equivalent yield on interest-earning assets decreased 71 basis points to 6.45 percent during the period as variable rate assets such as SBA loans, commercial loans, consumer home equity loans and federal funds sold and interest-bearing deposits with banks repriced lower. The mix of earning assets is illustrated below:

|  | 9/30/2008 | 9/30/2007 |
|--|-----------|-----------|
| Federal funds sold and interest-bearing deposits | 3%        | 4%        |
| Securities (includes ACBB and FHLB stock)        | 13        | 16        |
| Loans  | 84        | 80        |

Total interest expense was \$5.9 million for the three months ended September 30, 2008, a decrease of \$711 thousand or 10.8 percent, compared to \$6.6 million for the same period a year ago. The \$711 thousand decrease in interest expense, was primarily due to a \$1.8 million decrease due to a reduction in the cost of funds, partially offset by \$1.1 million increase which was related to an increase in average interest-bearing liabilities. Quarter over quarter, average interest-bearing liabilities increased \$102.1 million as average interest-bearing deposits increased \$81.3 million and borrowed funds and subordinated debentures increased \$20.8 million. The increase in average interest-bearing deposits was a result of increases in the time deposit and interest-bearing demand deposits categories, partially offset by a decline in savings accounts. The increase in average borrowed funds and subordinated debentures was a result of favorable pricing compared to alternative sources of funds as rates began to fall. The rate paid on interest-bearing liabilities decreased 99 basis points to 3.28 percent for the three months ended September 30, 2008, from 4.27 percent in the same period in 2007. The cost of interest-bearing deposits decreased 101 basis points to 3.12 percent as the rates paid on all deposit products decreased, while the cost of borrowed funds and subordinated debentures decreased 95 basis points to 4.14 percent. These rates fell as our variable rate instruments tied to Prime and LIBOR repriced lower and other fixed rate products were repriced lower. At the same time, the interest-bearing deposit base shifted to a higher cost of funding as illustrated below:

|                                  | 9/30/2008 | 9/30/2007 |
|----------------------------------|-----------|-----------|
| Interest-bearing demand deposits | 15%       | 15%       |
| Savings deposits                 | 27        | 38        |
| Time deposits                    | 58        | 47        |

Tax-equivalent net interest income increased \$1.1 million to \$7.1 million for the quarter ended September 30, 2008, compared to \$6.0 million for the same period a year ago. Net interest margin increased 11 basis points to 3.55 percent, compared to 3.44 percent for the same period a year ago. The net interest spread was 3.17 percent for the three months ended September 30, 2008, compared to 2.89 percent for the same period a year ago.

Tax-equivalent interest income totaled \$38.0 million for the nine months ended September 30, 2008, an increase of \$1.7 million or 4.5 percent, compared to a year ago. Of the \$1.7 million increase in interest income, \$5.1 million was due to an increase in the volume of interest-earning assets, partially offset by a \$3.4 million decrease due to lower yields on interest-earning assets. The average volume of interest-earning assets increased \$91.7 million to \$763.5

million for the nine months ended September 30, 2008 due to a \$92.6 million increase in average total loans as loans increased in all categories. The tax-equivalent yield on interest-earning assets decreased 58 basis points to 6.64 percent during the period as variable rate assets such as SBA loans, commercial loans, consumer home equity loans and federal funds sold and interest-bearing deposits with banks repriced lower. The mix of earning assets remained as follows:

|  | 9/30/2008 | 9/30/2007 |
|--|-----------|-----------|
| Federal funds sold and interest-bearing deposits | 3%        | 4%        |
| Securities (includes ACBB and FHLB stock)        | 14        | 16        |
| Loans  | 83        | 80        |

Total interest expense was \$17.3 million for the nine months ended September 30, 2008, a decrease of \$853 thousand or 4.7 percent, compared to \$18.2 million for the same period a year ago. The \$853 thousand decrease in interest expense reflects a \$4.2 million decrease due to a reduction in the cost of funds, partially offset by a \$3.4 million increase which was related to an increase in average interest-bearing liabilities. Average interest-bearing liabilities increased \$95.5 million as average interest-bearing deposits increased \$72.5 million and borrowed funds and subordinated debentures increased \$23.0 million. The increase in average interest-bearing deposits was a result of increases in the time deposit category, partially offset by a decline in interest-bearing checking and savings accounts. The increase in average borrowed funds and subordinated debentures was a result of favorable pricing compared to alternative sources of funds as rates began to fall. The rate paid on interest-bearing liabilities decreased 77 basis points to 3.43 percent for the nine months ended September 30, 2008, from 4.20 percent in the same period in 2007. The cost of interest-bearing deposits decreased 74 basis points to 3.29 percent as the rates paid on all deposit products decreased, while the cost of borrowed funds and subordinated debentures decreased 100 basis points to 4.20 percent. These rates fell as our variable rate instruments tied to Prime and Libor repriced lower and other fixed rate products were repriced lower. At the same time, the deposit concentration fluctuation illustrated below partially offset the benefit of lower rates as customers shifted into higher costing time deposits.

|                                  | 9/30/2008 | 9/30/2007 |
|----------------------------------|-----------|-----------|
| Interest-bearing demand deposits | 15%       | 18%       |
| Savings deposits                 | 32        | 42        |
| Time deposits                    | 53        | 40        |

Tax-equivalent net interest income increased \$2.5 million to \$20.7 million for the nine months ended September 30, 2008, compared to \$18.2 million for the same period a year ago. Net interest margin remained flat at 3.61 percent. The net interest spread was 3.21 percent for the nine months ended September 30, 2008, compared to 3.06 percent for the same period a year ago.



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

|   | Three Months Ended |           |                | September 30, 2007 |           |                |
|---|--------------------|-----------|----------------|--------------------|-----------|----------------|
|   | Average<br>Balance | Interest  | Rate/<br>Yield | Average<br>Balance | Interest  | Rate/<br>Yield |
| <b>Assets</b>   |                    |           |                |                    |           |                |
| Interest-earning assets:                                    |                    |           |                |                    |           |                |
| Federal funds sold and interest-bearing deposits with banks | \$ 24,118          | \$ 113    | 1.86%          | \$ 31,449          | \$ 390    | 4.92%          |
| Bankers bank stock  | 4,415              | 58        | 5.23           | 3,509              | 66        | 7.46           |
| Securities:   |                    |           |                |                    |           |                |
| Available for sale  | 72,658             | 920       | 5.06           | 71,522             | 910       | 5.09           |
| Held to maturity  | 31,209             | 399       | 5.11           | 36,047             | 471       | 5.23           |
| Total securities (a)  | 103,867            | 1,319     | 5.08           | 107,569            | 1,381     | 5.14           |
| Loans, net of unearned discount:                            |                    |           |                |                    |           |                |
| SBA loans   | 102,383            | 2,043     | 7.98           | 81,693             | 2,190     | 10.72          |
| Commercial  | 393,626            | 6,877     | 6.95           | 350,555            | 6,600     | 7.47           |
| Residential mortgages                                       | 114,058            | 1,720     | 6.03           | 71,401             | 1,047     | 5.87           |
| Consumer  | 59,933             | 866       | 5.75           | 54,064             | 933       | 6.85           |
| Total loans (a),(b)   | 670,000            | 11,506    | 6.84           | 557,713            | 10,770    | 7.68           |
| Total interest-earning assets                               | \$ 802,400         | \$ 12,996 | 6.45%          | \$ 700,240         | \$ 12,607 | 7.16%          |
| Noninterest-earning assets:                                 |                    |           |                |                    |           |                |
| Cash and due from banks                                     | 19,166             |           |                | 14,911             |           |                |
| Allowance for loan losses                                   | (9,092 )           |           |                | (8,330)            |           |                |
| Other assets  | 32,229             |           |                | 29,503             |           |                |
| Total noninterest-earning assets                            | 42,303             |           |                | 36,084             |           |                |
| Total Assets  | \$ 844,703         |           |                | \$ 736,324         |           |                |
| <b>Liabilities and Shareholders' Equity</b>                 |                    |           |                |                    |           |                |
| Interest-bearing deposits:                                  |                    |           |                |                    |           |                |
| Interest-bearing checking                                   | \$ 87,903          | \$ 404    | 1.83%          | \$ 79,188          | \$ 451    | 2.26%          |
| Savings deposits  | 161,707            | 774       | 1.90           | 199,483            | 1,995     | 3.97           |
| Time deposits   | 353,743            | 3,553     | 4.00           | 243,358            | 2,994     | 4.88           |
| Total interest-bearing deposits                             | 603,353            | 4,731     | 3.12           | 522,029            | 5,440     | 4.13           |
| Borrowed funds and subordinated debentures                  | 110,684            | 1,152     | 4.14           | 89,892             | 1,153     | 5.09           |
| Total interest-bearing liabilities                          | 714,037            | 5,883     | 3.28           | 611,921            | 6,593     | 4.27           |
| Noninterest-bearing liabilities:                            |                    |           |                |                    |           |                |

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|  |            |       |            |       |
|--|------------|-------|------------|-------|
| Demand deposits                            | 81,157     |       | 75,218     |       |
| Other liabilities                          | 2,321      |       | 2,216      |       |
| Total noninterest-bearing liabilities      | 83,478     |       | 77,434     |       |
| Shareholders' equity                       | 47,188     |       | 46,969     |       |
| Total Liabilities and Shareholders' Equity | \$ 844,703 |       | \$ 736,324 |       |
| Net interest spread                        | \$ 7,113   | 3.17% | \$ 6,014   | 2.89% |
| Tax-equivalent basis adjustment            | (31 )      |       | (41)       |       |
| Net interest income                        | \$ 7,082   |       | \$ 5,973   |       |
| Net interest margin                        |            | 3.55% |            | 3.44% |

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

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

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

|   | Nine Months Ended  |           |                |                    |           |                |
|---|--------------------|-----------|----------------|--------------------|-----------|----------------|
|   | September 30, 2008 |           |                | September 30, 2007 |           |                |
|   | Average<br>Balance | Interest  | Rate/<br>Yield | Average<br>Balance | Interest  | Rate/<br>Yield |
| <b>Assets</b>   |                    |           |                |                    |           |                |
| <b>Interest-earning assets:</b>                             |                    |           |                |                    |           |                |
| Federal funds sold and interest-bearing deposits with banks | \$ 23,135          | \$ 404    | 2.33%          | \$ 23,749          | \$ 873    | 4.91%          |
| Bankers bank stock  | 4,330              | 234       | 7.22           | 3,185              | 180       | 7.56           |
| <b>Securities:</b>  |                    |           |                |                    |           |                |
| Available for sale  | 73,337             | 2,789     | 5.07           | 65,208             | 2,378     | 4.86           |
| Held to maturity  | 32,297             | 1,270     | 5.24           | 38,589             | 1,525     | 5.27           |
| Total securities (a)  | 105,634            | 4,059     | 5.12           | 103,797            | 3,903     | 5.01           |
| <b>Loans, net of unearned discount:</b>                     |                    |           |                |                    |           |                |
| SBA loans   | 100,674            | 6,399     | 8.47           | 82,185             | 6,732     | 10.92          |
| Commercial  | 381,497            | 20,279    | 7.10           | 334,875            | 18,966    | 7.57           |
| Residential mortgages                                       | 89,551             | 4,008     | 5.97           | 66,551             | 2,902     | 5.81           |
| Consumer  | 58,679             | 2,613     | 5.95           | 54,239             | 2,788     | 6.87           |
| Total loans (a),(b)   | 630,401            | 33,299    | 7.05           | 537,850            | 31,388    | 7.79           |
| Total interest-earning assets                               | \$ 763,500         | \$ 37,996 | 6.64%          | \$ 668,581         | \$ 36,344 | 7.26%          |
| <b>Noninterest-earning assets:</b>                          |                    |           |                |                    |           |                |
| Cash and due from banks                                     | 16,189             |           |                | 13,113             |           |                |
| Allowance for loan losses                                   | (8,866 )           |           |                | (8,078)            |           |                |
| Other assets  | 31,268             |           |                | 29,363             |           |                |
| Total noninterest-earning assets                            | 38,591             |           |                | 34,398             |           |                |
| Total Assets  | \$ 802,091         |           |                | \$ 702,979         |           |                |
| <b>Liabilities and Shareholders' Equity</b>                 |                    |           |                |                    |           |                |
| <b>Interest-bearing deposits:</b>                           |                    |           |                |                    |           |                |
| Interest-bearing checking                                   | \$ 83,050          | \$ 1,120  | 1.80%          | \$ 87,095          | \$ 1,480  | 2.27%          |
| Savings deposits  | 179,254            | 3,041     | 2.27           | 207,238            | 6,288     | 4.06           |
| Time deposits   | 304,298            | 9,779     | 4.29           | 199,798            | 7,117     | 4.76           |
| Total interest-bearing deposits                             | 566,602            | 13,940    | 3.29           | 494,131            | 14,885    | 4.03           |
| Borrowed funds and subordinated debentures                  | 107,345            | 3,372     | 4.20           | 84,334             | 3,279     | 5.20           |
| Total interest-bearing liabilities                          | 673,947            | 17,312    | 3.43           | 578,465            | 18,164    | 4.20           |

|  |            |        |            |        |
|--|------------|--------|------------|--------|
| Noninterest-bearing liabilities:           |            |        |            |        |
| Demand deposits                            | 78,259     |        | 75,303     |        |
| Other liabilities                          | 2,354      |        | 2,466      |        |
| Total                                      |            |        | 77,769     |        |
| noninterest-bearing liabilities            | 80,613     |        |            |        |
| Shareholders' equity                       | 47,531     |        | 46,745     |        |
| Total Liabilities and Shareholders' Equity | \$ 802,091 |        | \$ 702,979 |        |
|  |            |        |            |        |
| Net interest spread                        | \$20,684   | 3.21 % | \$ 18,180  | 3.06%  |
| Tax-equivalent basis adjustment            | (129 )     |        | (101)      |        |
| Net interest income                        | \$20,555   |        | \$ 18,079  |        |
| Net interest margin                        |            | 3.61 % |            | 3.61 % |

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

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

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

| Rate Volume Table<br>(In thousands)                     | Amount of Increase (Decrease)         |            |          |                                      |            |          |
|---|---------------------------------------|------------|----------|--------------------------------------|------------|----------|
|   | Three months ended September 30, 2008 |            |          | Nine months ended September 30, 2008 |            |          |
|   | versus September 30, 2007             |            |          | versus September 30, 2007            |            |          |
|   | Due to change in:                     |            |          | Due to change in:                    |            |          |
|   | Volume                                | Rate       | Total    | Volume                               | Rate       | Total    |
| <b>Interest Income</b>                                  |                                       |            |          |                                      |            |          |
| SBA   | \$ 484                                | \$ (631)   | \$ (147) | \$ 1,345                             | \$ (1,678) | \$ (333) |
| Commercial  | 762                                   | (485)      | 277      | 2,538                                | (1,225)    | 1,313    |
| Residential mortgage                                    | 643                                   | 30         | 673      | 1,024                                | 82         | 1,106    |
| Consumer  | 93                                    | (160)      | (67)     | 217                                  | (392)      | (175)    |
| Total Loans   | 1,982                                 | (1,246)    | 736      | 5,124                                | (3,213)    | 1,911    |
| <b>Available for sale securities</b>                    |                                       |            |          |                                      |            |          |
|   | 15                                    | (5 )       | 10       | 180                                  | 231        | 411      |
| <b>Held to maturity securities</b>                      |                                       |            |          |                                      |            |          |
|   | (61)                                  | (11)       | (72)     | (246)                                | (9)        | (255)    |
| <b>Federal funds sold and interest-bearing deposits</b> |                                       |            |          |                                      |            |          |
|   | (76)                                  | (201)      | (277)    | (22)                                 | (447)      | (469)    |
| Bankers bank stock                                      | 15                                    | (23)       | (8)      | 62                                   | (8)        | 54       |
| Total interest-earning assets                           | \$ 1,875                              | \$ (1,486) | \$ 389   | \$ 5,098                             | \$ (3,446) | \$ 1,652 |
| <b>Interest Expense</b>                                 |                                       |            |          |                                      |            |          |
| <b>Interest-bearing checking</b>                        |                                       |            |          |                                      |            |          |
|   | \$ 46                                 | \$ (93)    | \$ (47)  | \$ (66)                              | \$ (294)   | \$ (360) |
| Savings deposit   | (324)                                 | (897)      | (1,221)  | (762)                                | (2,485)    | (3,247)  |
| Time deposits   | 1,170                                 | (611)      | 559      | 3,422                                | (760)      | 2,662    |
| Total interest-bearing deposits                         | 892                                   | (1,601)    | (709)    | 2,594                                | (3,539)    | (945)    |
| Borrowings  | 235                                   | (237)      | (2)      | 800                                  | (708)      | 92       |
| Total interest-bearing liabilities                      | 1,127                                 | (1,838)    | (711)    | 3,394                                | (4,247)    | (853)    |
| Tax equivalent net interest income                      | \$ 748                                | \$ 352     | \$ 1,100 | \$ 1,704                             | \$ 801     | \$ 2,505 |
| Tax equivalent adjustment                               |                                       |            | 10       |                                      |            | (28)     |
| Increase in net interest income                         |                                       |            | \$ 1,110 |                                      |            | \$ 2,477 |

Provision for Loan Losses

The provision for loan losses was \$2.1 million for the three months ended September 30, 2008, an increase of \$1.7 million, compared to a provision of \$450 thousand for the same period a year ago. For the nine months ended September 30, 2008, the provision for loan losses was \$3.2 million, an increase of \$2.2 million compared to the \$1.0 million provision for the prior year's period.

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

#### Noninterest Income

Noninterest income was (\$344) thousand for the three months ended September 30, 2008, a decrease of \$1.8 million compared with the same period in 2007. For the nine month period, noninterest income fell \$2.7 million to \$2.1 million. The components of noninterest income are as follows:

|   | Three months ended September 30, |          |          | Nine months ended September 30, |          |         |
|---|----------------------------------|----------|----------|---------------------------------|----------|---------|
|   |                                  |          | Percent  |                                 |          | Percent |
| (In thousands)  | 2008                             | 2007     | Change   | 2008                            | 2007     | Change  |
| Service charges on deposit accounts                       | \$ 381                           | \$ 338   | 12.7%    | \$ 1,042                        | \$ 1,026 | 1.6 %   |
| Service and loan fee income                               | 334                              | 428      | (22.0)   | 936                             | 1,174    | (20.3)  |
| Gain on sales of SBA loans, net                           | 215                              | 316      | (32.0)   | 1,208                           | 1,819    | (33.6)  |
| Other-than-temporary impairment charges on AFS securities | (946)                            | -        | NM       | (1,201)                         | -        | NM      |
| Net security (losses) gains                               | (512)                            | 22       | NM       | (393)                           | 32       | NM      |
| Bank-owned life insurance                                 | 53                               | 53       | (0.0)    | 157                             | 148      | 6.1     |
| Other income  | 131                              | 303      | (56.8)   | 390                             | 688      | (43.3)  |
| Total noninterest income                                  | \$ (344)                         | \$ 1,460 | (123.6)% | \$ 2,139                        | \$ 4,887 | (56.2)% |

NM = Not meaningful

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Service charges on deposit accounts increased quarter over quarter due to a higher volume of overdraft fees and commercial analysis account fees. Service charges on deposit accounts remained relatively flat for the nine months ended September 30, 2008, when compared to the same period a year ago.

Service and loan fee income decreased \$94 thousand for the three month period and \$238 thousand for the nine month period ended September 30, 2008 when compared to the same period a year ago. The decrease in loan and servicing fees quarter over quarter was the result of lower levels of letter of credit, loan processing fee income and lower levels of loan prepayment fees. Year-to-date, service and loan fee income decreased due to lower levels of prepayment fees, letter of credit fees and SBA servicing fees. Average serviced SBA loans totaled \$141.2 million and \$142.6 million for the nine months ended September 30, 2008 and 2007, respectively. It is anticipated that the level of loan service fee income will decline in the future as the Company maintains a higher proportion of SBA loans in its portfolio and as loans with higher servicing rates payoff and are replaced by new loans with lower servicing rates.

Net gains on SBA loan sales decreased \$101 thousand for the quarter and \$611 thousand for the nine months ended September 30, 2008, compared to the same period a year ago, as a result of a lower volume of loans sold and lower premiums on the sales due to market conditions. SBA loan sales totaled \$24.8 million for the nine months ended September 30, 2008, compared to \$33.1 million for nine months ended September 30, 2007. As a result of the significant reduced premium resulting from the recent credit crisis, the Company has closed all SBA production offices outside of its New Jersey, Pennsylvania and New York footprint. Consequently, management believes that net gains on SBA loans will decline substantially for the foreseeable future.

There were \$1.5 million and \$1.6 million in security losses realized during the three and nine months ended September 30, 2008. These losses were primarily due to the classification of three Freddie Mac perpetual preferred callable securities as other-than-temporarily impaired securities due to the decline in market value of these securities and the eventual placement of FHLMC in conservatorship that occurred in September of 2008. Unity sold approximately \$909 thousand in book value of these securities in August 2008 and recorded a pretax loss of approximately \$518 thousand on this sale. In addition, the market value of the remaining securities was written down \$946 thousand as of September 30, 2008, due to actions by the U.S. Treasury and the OFHEO (now FHFA) placing Freddie Mac under conservatorship. The aggregate amount of security losses and other than temporary impairment ("OTTI") charges related to Freddie Mac perpetual preferred stock for the third quarter of 2008 were \$1.5 million, pre-tax, or \$950 thousand, \$0.13 per diluted share after tax. Over the nine month period, security losses and OTTI charges of \$1.6 million were realized on the FHLMC perpetual preferred stock.

Bank owned life insurance income totaled \$53 thousand and \$157 thousand for the three and nine months ended September 30, 2008, respectively.

Other noninterest income decreased \$172 thousand and \$298 thousand for the three and nine months ended September 30, 2008, respectively due to lower loan referral fees and a onetime nonrecurring credit which was posted in the third quarter 2007.

#### Noninterest Expense

Total noninterest expense increased \$278 thousand or 5.1 percent to \$5.8 million for the three months ended September 30, 2008 compared to a year ago. For the nine months ended September 30, 2008, noninterest expense increased \$981 thousand or 6.1 percent. Although, we closed the SBA lending offices outside of our New Jersey, New York and Pennsylvania primary trade areas late in the third quarter of 2008, quarter over quarter operational expense increases may be attributed to branch expansion and growth of our SBA lending franchise. The components of noninterest expense are as follows:

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| (In thousands)                | Three months ended September 30, |          |                | Nine months ended September 30 |           |                |
|-------------------------------|----------------------------------|----------|----------------|--------------------------------|-----------|----------------|
|                               | 2008                             | 2007     | Percent Change | 2008                           | 2007      | Percent Change |
| Compensation and benefits     | \$ 2,948                         | \$ 2,816 | 4.7 %          | \$ 9,148                       | \$ 8,494  | 7.7 %          |
| Occupancy                     | 688                              | 699      | (1.6)          | 2,102                          | 2,016     | 4.3            |
| Processing and communications | 554                              | 645      | (14.1)         | 1,668                          | 1,758     | (5.1)          |
| Furniture and equipment       | 423                              | 419      | 1.0            | 1,224                          | 1,213     | 0.9            |
| Professional services         | 285                              | 116      | 145.7          | 626                            | 414       | 51.2           |
| Loan servicing costs          | 206                              | 184      | 12.0           | 446                            | 443       | 0.7            |
| Advertising                   | 158                              | 113      | 39.8           | 299                            | 312       | (4.2)          |
| Deposit insurance             | 117                              | 16       | NM             | 291                            | 50        | NM             |
| Other expenses                | 400                              | 493      | (18.9)         | 1,362                          | 1,485     | (8.3)          |
| Total noninterest expense     | \$ 5,779                         | \$ 5,501 | 5.1 %          | \$ 17,166                      | \$ 16,185 | 6.1 %          |

NM = Not meaningful

Compensation and benefits expense, the largest component of noninterest expense, increased \$132 thousand for the three months ended September 30, 2008 compared to the same period a year ago. Compensation and benefits expense increased \$654 thousand for the nine months ended September 30, 2008 compared to the same period a year ago. The increase in compensation and benefits expense was a result of cost of living increases and merit increases. Full-time equivalent employees amounted to 176 at September 30, 2008, compared to 195 at September 30, 2007. During September and October of 2008, the Company significantly reduced its head count. The full benefit of this reduction will not be realized until the first quarter of 2009.

Occupancy expense decreased \$11 thousand for the three months ended September 30, 2008 compared to the same period a year ago due to reduced lease and leasehold improvement related expenses due to the closure of our Bridgewater, NJ location during the second quarter 2008. For the nine months ended September 30, 2008, occupancy expense increased \$86 thousand due to the expansion of our branch network and the writeoff of capitalized expenses related to the closure of our Bridgewater, NJ location.

Processing and communications expense decreased \$91 thousand for the three months ended and \$90 thousand for the nine month period ended September 30, 2008, compared to the same period a year ago. This was the result of cost savings initiatives put in place over the last twelve months.

Furniture and equipment expense remained relatively flat for the three months and nine months ended September 30, 2008, compared to the same period a year ago.

Professional services increased \$169 thousand for the three months and increased \$212 thousand for the nine months ended September 30, 2008, compared to the same period a year ago. Higher consulting fees attributed to the quarter over quarter increase. Year to date, higher consulting fees related to tax planning and Sarbanes-Oxley Act of 2002 compliance contributed to the increase.

Loan servicing costs increased \$22 thousand for the three months and remained relatively flat for the nine months ended September 30, 2008, compared to the same period a year ago. Quarter over quarter increases were due to higher collection expenses associated with delinquent loans.





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Advertising expense increased \$45 thousand for the three months due to deposit promotions being run during this period and decreased \$13 thousand for the nine months ended September 30, 2008, compared to the same period a year ago due to the use of less expensive delivery channels related to new business generation.

Deposit insurance expense increased \$101 thousand for the three months and \$241 thousand for the nine months ended September 30, 2008. Prior to the current year, deposit insurance assessments for the Bank were reduced by one-time credits provided by the FDIC. In the current year these credits have expired, hence deposit insurance assessments have increased. Deposit insurance expense is expected to continue to increase in the foreseeable future.

Other operating expenses decreased \$94 thousand for the quarter and decreased \$124 thousand for the nine months ended September 30, 2008, compared to the prior year due to lower operating losses, employee recruitment fees and office supply expense, partially offset by additional loan commitment reserve funding.

Income Tax Expense

For the quarter ended September 30, 2008, a tax benefit of \$139 thousand was recorded, compared to a tax provision of \$430 thousand for the same period a year ago. For the nine months ended September 30, 2008, the provision for income taxes was \$982 thousand, compared to \$1.7 million for the same period a year ago. The current 2008 tax provision represents an effective tax rate of approximately 42.2 percent as compared to 30.0 percent for the prior year. Management anticipates an effective rate of approximately 30 to 33 percent for the remainder of 2008.

Financial Condition at September 30, 2008

Total assets at September 30, 2008 were \$864.1 million compared to \$746.8 million a year ago and \$752.2 million at year-end 2007. Compared to year-end 2007, total assets increased due primarily to the investment of time deposit balances into loans.

Securities

The Company's investment securities portfolio is maintained for asset-liability management purposes as an additional source of liquidity and as an additional source of earnings. The securities portfolio consists of available for sale ("AFS") and held to maturity ("HTM") investments. 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. HTM securities, which are carried at amortized cost, are investments for which there is the positive intent and ability to hold to maturity. Management determines the appropriate security classification of AFS or HTM at the time of purchase. The portfolio is comprised of obligations of the U.S. Government and government sponsored agencies, collateralized mortgage obligations, corporate and equity securities. Approximately 89 percent of the total investment portfolio has a fixed rate of interest.

AFS securities totaled \$70.1 million at September 30, 2008, an increase of \$5.3 million from year-end 2007. This increase was the result of \$30.3 million in purchases, partially offset by \$15.8 million in maturities, calls and principal payments received, \$4.1 million in sales and \$2.1 million in depreciation in the market value of the portfolio. In addition, two securities with a book value of \$1.9 million were transferred from AFS to HTM during the quarter, consistent with the Company's intent and ability to hold these securities until maturity. Purchases during the quarter consisted of US Government agency and mortgage backed securities. The yield on the AFS securities portfolio was 5.07 percent for the nine months ended September 30, 2008, compared to 4.86 percent a year ago. The weighted average life of the AFS portfolio was 5.03 years and the effective duration of the portfolio was 3.31 years at September 30, 2008, compared to 7.18 years and 2.82 years, respectively at December 31, 2007.

At September 30, 2008, AFS securities included three Federal Home Loan Mortgage Corporation ("FHLMC") perpetual callable preferred securities with a total book value of \$13 thousand. These securities were initially classified as other-than-temporarily impaired ("OTTI") in December 2007 due to their declines in market value and the uncertainty that they would recover their book value. During the second quarter, an impairment charge of \$222 thousand was recognized reducing the book value of these securities to \$1.9 million. During the third quarter, the Company sold approximately \$909 thousand in book value of these securities and recorded a pretax loss of approximately \$518 thousand on this sale. In addition, the market value of the remaining securities was written down \$946 thousand as of September 30, 2008, due to actions by the U.S. Treasury and the OFHEO (now FHFA) placing Freddie Mac under conservatorship. The aggregate amount of security losses and OTTI charges related to Freddie Mac perpetual preferred stock for the third quarter of 2008 were \$1.5 million, pretax, or \$950 thousand, \$0.13 per diluted share after tax.

HTM securities totaled \$29.3 million at September 30, 2008, a decrease of \$4.5 million compared to \$33.7 million at December 31, 2007. This decrease was the result of \$2.8 million in purchases, offset by \$9.1 million in calls and principal payments received. The yield on HTM securities was 5.24 percent for the nine months ended September 30, 2008, compared to 5.27 percent for the same period a year ago. As of September 30, 2008, and December 31, 2007, the market value of HTM securities was \$27.1 million and \$33.6 million, respectively. The weighted average life of the HTM portfolio was 6.93 years and the effective duration of the portfolio was 3.87 years at September 30, 2008, compared to 4.0 years and 3.01 years, respectively at December 31, 2007.

Securities with a carrying value of \$86.7 million and \$61.9 million at September 30, 2008 and December 31, 2007, respectively, were pledged to secure government deposits, other borrowings and for other purposes required or permitted by law. Included in pledged securities is \$2.8 million in securities pledged to secure governmental deposits under the requirements of the New Jersey Department of Banking and Insurance.

#### Loan Portfolio

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

Total loans at September 30, 2008, increased \$94.9 million or 16.1 percent to \$685.0 million compared to \$590.1 million at year-end 2007 due to growth in all loan product lines. The loan portfolio concentration consisted of the following:

|                     | September 30,<br>2008 | December 31,<br>2007 |
|---------------------|-----------------------|----------------------|
| SBA Loans           | 15%                   | 16%                  |
| Commercial<br>Loans | 57                    | 62                   |
| Mortgage<br>Loans   | 19                    | 12                   |
| Consumer<br>Loans   | 9                     | 10                   |

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Commercial loans are generally made in the Company's marketplace 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 \$394.2 million at September 30, 2008, and increased \$28.4 million from \$365.8 million at year-end 2007. The yield on commercial loans was 7.10 percent for the nine months ended September 30, 2008 compared to 7.57 percent for the same period a year ago.

SBA loans, on which the SBA provides guarantees of up to 85 percent of the principal balance, were historically generally sold in the secondary market by the Company with the nonguaranteed portion held in the portfolio as a loan held for investment. However during the third quarter of 2007, the Company announced a strategic decision to begin retaining a portion of its SBA 7(A) program loans in its portfolio, rather than selling them into the secondary market. SBA loans held for investment amounted to \$82.6 million at September 30, 2008, an increase of \$13.7 million from year-end 2007. SBA loans held for sale, carried at the lower of aggregate cost or market, amounted to \$19.9 million at September 30, 2008, a decrease of \$4.8 million from year-end 2007. The yield on SBA loans, which are generally floating and adjust quarterly to the Prime rate, was 8.47 percent for the nine months ended September 30, 2008, compared to 10.92 percent for the same period a year ago. As a result of the significant reduced premium resulting from the recent credit crisis, the Company has closed all SBA production offices outside of its New Jersey, Pennsylvania and New York primary trade area. Consequently, management believes that there will be a significant decline in the volume of new SBA loans and gains on SBA loans will decline substantially for the foreseeable future.

Residential mortgage loans consist of loans secured by residential properties. These loans increased \$54.5 million to \$128.2 million at September 30, 2008, compared to \$73.7 million at December 31, 2007. The yield on residential mortgages was 5.97 percent for the nine months ended September 30, 2008, compared to 5.81 percent for the same period a year ago. Year-to-date growth was due to a new relationship with an established builder of high end residential properties. The Company expects this growth to slow in the foreseeable future due to current market conditions.

Consumer loans consist of home equity loans and loans for the purpose of financing the purchase of consumer goods, home improvements, and other personal needs, and are generally secured by the personal property being purchased. These loans amounted to \$60.2 million at September 30, 2008, an increase of \$3.0 million from \$57.1 million at December 31, 2007. The yield on consumer loans was 5.95 percent for the nine months ended September 30, 2008, compared to 6.87 percent for the same period a year ago.

The reduced yields throughout the loan portfolio reflect the re-pricing of variable rate products downward as the Prime lending rate has declined.

#### Asset Quality

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

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

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

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

| (In thousands)  | September<br>30, 2008 | December 31, 2007 | September 30, 2007 |
|---|-----------------------|-------------------|--------------------|
| <b>Nonperforming loans:</b>                                 |                       |                   |                    |
| SBA (1)   | \$ 3,040              | \$ 1,630          | \$ 1,676           |
| Commercial  | 6,099                 | 2,110             | 1,881              |
| Residential mortgage  | 1,267                 | 1,192             | 432                |
| Consumer  | 230                   | 529               | 196                |
| Total nonperforming loans                                   | 10,636                | 5,461             | 4,185              |
| OREO  | 318                   | 106               | 134                |
| Total Nonperforming assets                                  | \$ 10,954             | \$ 5,567          | \$ 4,319           |
| <b>Past Due 90 days or more and still accruing interest</b> |                       |                   |                    |
| SBA   | \$ -                  | \$ 114            | \$ 111             |
| Commercial  | 1,571                 | 41                | 229                |
| Residential mortgage  | 1,961                 | -                 | -                  |
| Consumer  | -                     | -                 | -                  |
| Total accruing loans 90 days or more past due               | \$ 3,532              | \$ 155            | \$ 340             |
| Nonperforming assets to total assets                        | 1.27%                 | 0.93%             | 0.58%              |
| Nonperforming assets to loans and OREO                      | 1.60%                 | 0.94%             | 0.76%              |
| (1) SBA Loans Guaranteed                                    | \$ 998                | \$ 714            | \$ 781             |

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Nonperforming loans amounted to \$10.6 million at September 30, 2008, an increase of \$5.2 million from year-end 2007. This increase was due primarily to the transfer of three commercial credits totaling \$5.0 million to nonaccrual status. This increase in nonperforming loans reflects the slow down in the economy generally and its impact on our customer base. There were \$3.5 million and \$155 thousand in loans past due 90 days or more and still accruing interest at September 30, 2008 and December 31, 2007, respectively. Included in nonperforming assets at September 30, 2008, are approximately \$998 thousand of loans guaranteed by the SBA, compared to \$714 thousand at December 31, 2007.

Potential problem loans are those where information about possible credit problems of borrowers causes management to have doubt as to the ability of such borrowers to comply with loan repayment terms. These loans are not included in nonperforming loans as they continue to perform. Potential problem loans totaled \$2.5 million at September 30, 2008, a decrease of \$164 thousand from December 31, 2007.

### Allowance for Loan Losses

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

The allowance for loan losses totaled \$9.9 million, \$8.4 million and \$8.2 million at September 30, 2008, December 31, 2007, and September 30, 2007, respectively, with a resulting allowance to total loan ratios of 1.45 percent, 1.42 percent and 1.44 percent, respectively. Net charge-offs amounted to \$1.1 million for the three months ended September 30, 2008, compared to \$264 thousand for the three months ended September 30, 2007. Net charge-offs amounted to \$1.7 million for the nine months ended September 30, 2008, compared to \$441 thousand for the nine months ended September 30, 2007.

The following is a reconciled summary of the allowance for loan losses for the three months ended September 30, 2008 and 2007:

| Allowance for Loan Loss Activity<br>(In thousands) | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2008                                | 2007     | 2008                               | 2007     |
| Balance, beginning of period                       | \$ 8,945                            | \$ 7,997 | \$ 8,383                           | \$ 7,624 |
| Provision charged to expense                       | 2,100                               | 450      | 3,200                              | 1,000    |
| Charge-offs:                                       |                                     |          |                                    |          |
| SBA  | 423                                 | 270      | 936                                | 510      |
| Commercial   | 700                                 | 24       | 760                                | 29       |
| Residential mortgage                               | -                                   | -        | 25                                 | -        |
| Consumer   | 78                                  | 28       |                                    |          |