

UNITY BANCORP INC /NJ/
Form 10-Q
August 08, 2016

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____ to ____.

Commission File Number 1-12431

Unity Bancorp, Inc.
(Exact name of registrant as specified in its charter)

New Jersey 22-3282551
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

64 Old Highway 22, Clinton, NJ 08809
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (908) 730-7630

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act):

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 July 31, 2016
common stock, no par value: 8,486,832 shares outstanding.

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PART I CONSOLIDATED FINANCIAL INFORMATION

ITEM 1 Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.

Consolidated Balance Sheets

(Unaudited)

(In thousands)	June 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks	\$20,169	\$22,681
Federal funds sold and interest-bearing deposits	75,908	65,476
Cash and cash equivalents	96,077	88,157
Securities:		
Securities available for sale	45,266	52,865
Securities held to maturity (fair value of \$29,333 and \$18,607 respectively)	28,728	18,471
Total securities	73,994	71,336
Loans:		
SBA loans held for sale	13,245	13,114
SBA loans held for investment	40,006	39,393
SBA 504 loans	27,038	29,353
Commercial loans	481,713	465,518
Residential mortgage loans	268,774	264,523
Consumer loans	84,267	77,057
Total loans	915,043	888,958
Allowance for loan losses	(12,758)	(12,759)
Net loans	902,285	876,199
Premises and equipment, net	20,397	15,171
Bank owned life insurance ("BOLI")	13,568	13,381
Deferred tax assets	6,223	5,968
Federal Home Loan Bank ("FHLB") stock	5,092	4,600
Accrued interest receivable	3,953	3,884
Other real estate owned ("OREO")	1,702	1,591
Goodwill and other intangibles	1,516	1,516
Other assets	3,563	3,063
Total assets	\$1,128,370	\$1,084,866
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing demand	\$210,024	\$185,267
Interest-bearing demand	117,189	130,605
Savings	318,184	301,447
Time, under \$100,000	144,394	134,468
Time, \$100,000 and over, under \$250,000	91,770	104,106
Time, \$250,000 and over	30,637	38,600
Total deposits	912,198	894,493
Borrowed funds	114,000	92,000
Subordinated debentures	10,310	15,465
Accrued interest payable	368	461
Accrued expenses and other liabilities	6,527	3,977
Total liabilities	1,043,403	1,006,396

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Commitments and contingencies

Shareholders' equity:

Common stock	59,844	59,371
Retained earnings	25,916	19,566
Accumulated other comprehensive (loss)	(793)	(467)
Total shareholders' equity	84,967	78,470
Total liabilities and shareholders' equity	\$1,128,370	\$1,084,866
Issued and outstanding common shares	8,487	8,436

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

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

(In thousands, except per share amounts)	For the three months ended		For the six months ended	
	June 30, 2016	2015	June 30, 2016	2015
INTEREST INCOME				
Federal funds sold and interest-bearing deposits	\$41	\$6	\$85	\$16
FHLB stock	55	38	107	81
Securities:				
Taxable	427	363	791	750
Tax-exempt	55	71	117	143
Total securities	482	434	908	893
Loans:				
SBA loans	788	605	1,509	1,284
SBA 504 loans	344	369	729	715
Commercial loans	5,860	5,276	11,538	10,342
Residential mortgage loans	2,937	2,716	5,878	5,298
Consumer loans	980	774	1,911	1,473
Total loans	10,909	9,740	21,565	19,112
Total interest income	11,487	10,218	22,665	20,102
INTEREST EXPENSE				
Interest-bearing demand deposits	124	103	261	209
Savings deposits	381	271	748	535
Time deposits	954	725	1,904	1,411
Borrowed funds and subordinated debentures	686	750	1,421	1,558
Total interest expense	2,145	1,849	4,334	3,713
Net interest income	9,342	8,369	18,331	16,389
Provision for loan losses	400	—	600	200
Net interest income after provision for loan losses	8,942	8,369	17,731	16,189
NONINTEREST INCOME				
Branch fee income	286	373	619	719
Service and loan fee income	267	466	522	762
Gain on sale of SBA loans held for sale, net	637	—	945	363
Gain on sale of mortgage loans, net	593	687	1,308	1,031
BOLI income	93	95	187	189
Net security gains	81	28	175	28
Gain on repurchase of subordinated debt	—	—	2,264	—
Other income	277	244	494	442
Total noninterest income	2,234	1,893	6,514	3,534
NONINTEREST EXPENSE				
Compensation and benefits	3,709	3,481	7,258	6,952
Occupancy	513	601	1,131	1,273
Processing and communications	600	614	1,198	1,210
Furniture and equipment	395	422	815	795
Professional services	239	242	494	478
Loan costs	59	160	257	382
OREO expenses	82	67	105	103

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Deposit insurance	165	150	326	333
Advertising	303	343	544	525
Other expenses	663	572	1,210	1,103
Total noninterest expense	6,728	6,652	13,338	13,154
Income before provision for income taxes	4,448	3,610	10,907	6,569
Provision for income taxes	1,624	1,182	3,878	2,202
Net income	\$2,824	\$2,428	\$7,029	\$4,367
Net income per common share - Basic	\$0.33	\$0.29	\$0.83	\$0.52
Net income per common share - Diluted	\$0.33	\$0.28	\$0.82	\$0.51
Weighted average common shares outstanding - Basic	8,471	8,425	8,465	8,421
Weighted average common shares outstanding - Diluted	8,608	8,524	8,597	8,519

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

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

(In thousands)	For the three months ended					
	June 30, 2016			June 30, 2015		
	Before tax amount	Income tax expense (benefit)	Net of tax amount	Before tax amount	Income tax expense (benefit)	Net of tax amount
Net income	\$4,448	\$ 1,624	\$2,824	\$3,610	\$ 1,182	\$2,428
Other comprehensive income (loss)						
Investment securities available for sale:						
Unrealized holding gains (losses) on securities arising during the period	284	109	175	(201)	(80)	(121)
Less: reclassification adjustment for gains on securities included in net income	81	28	53	28	10	18
Total unrealized gains (losses) on securities available for sale	203	81	122	(229)	(90)	(139)
Adjustments related to defined benefit plan:						
Initial recognition of prior service cost	—	—	—	(830)	(332)	(498)
Amortization of prior service cost	21	7	14	42	17	25
Total adjustments related to defined benefit plan	21	7	14	(788)	(315)	(473)
Net unrealized (losses) from cash flow hedges:						
Unrealized holding loss on cash flow hedges arising during the period	(366)	(138)	(228)	—	—	—
Total unrealized loss on cash flow hedges	(366)	(138)	(228)	—	—	—
Total other comprehensive (loss)	(142)	(50)	(92)	(1,017)	(405)	(612)
Total comprehensive income	\$4,306	\$ 1,574	\$2,732	\$2,593	\$ 777	\$1,816

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

(In thousands)	For the six months ended					
	June 30, 2016			June 30, 2015		
	Before tax amount	Income tax expense (benefit)	Net of tax amount	Before tax amount	Income tax expense (benefit)	Net of tax amount
Net income	\$10,907	\$3,878	\$7,029	\$6,569	\$2,202	\$4,367
Other comprehensive income (loss)						
Investment securities available for sale:						
Unrealized holding gains (losses) on securities arising during the period	436	164	272	(139)	(55)	(84)
Less: reclassification adjustment for gains on securities included in net income	175	61	114	28	10	18
Total unrealized gains (losses) on securities available for sale	261	103	158	(167)	(65)	(102)
Adjustments related to defined benefit plan:						
Initial recognition of prior service cost	—	—	—	(830)	(332)	(498)
Amortization of prior service cost	41	7	34	42	17	25
Total adjustments related to defined benefit plan	41	7	34	(788)	(315)	(473)
Net unrealized (losses) from cash flow hedges:						
Unrealized holding loss on cash flow hedges arising during the period	(858)	(340)	(518)	—	—	—
Total unrealized loss on cash flow hedges	(858)	(340)	(518)	—	—	—
Total other comprehensive income (loss)	(556)	(230)	(326)	(955)	(380)	(575)
Total comprehensive income	\$10,351	\$3,648	\$6,703	\$5,614	\$1,822	\$3,792

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

Consolidated Statements of Changes in Shareholders' Equity
 For the six months ended June 30, 2016 and 2015
 (Unaudited)

	Common stock		Retained earnings	Accumulated other comprehensive (loss)	Total shareholders' equity
(In thousands)	Shares	Amount			
Balance, December 31, 2015	8,436	\$59,371	\$19,566	\$ (467)	\$ 78,470
Net income			7,029		7,029
Other comprehensive loss, net of tax				(326)	(326)
Dividends on common stock (\$0.08 per share)		48	(679)		(631)
Common stock issued and related tax effects (1)	51	425			425
Balance, June 30, 2016	8,487	\$59,844	\$25,916	\$ (793)	\$ 84,967

	Common stock		Retained earnings	Accumulated other comprehensive (loss)	Total shareholders' equity
(In thousands)	Shares	Amount			
Balance, December 31, 2014	8,388	\$58,785	\$11,195	\$ 143	\$ 70,123
Net income			4,367		4,367
Other comprehensive loss, net of tax				(575)	(575)
Dividends on common stock (\$0.06 per share)		33	(507)		(474)
Common stock issued and related tax effects (1)	37	249			249
Balance, June 30, 2015	8,425	\$59,067	\$15,055	\$ (432)	\$ 73,690

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

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

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

	For the six months ended June 30,	
	2016	2015
(In thousands)		
OPERATING ACTIVITIES:		
Net income	\$7,029	\$4,367
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	600	200
Net amortization of purchase premiums and discounts on securities	172	279
Depreciation and amortization	504	352
Deferred income tax expense	10	345
Net security gains	(175)	(28)
Gain on sale of subordinated debt	(2,264)	—
Stock compensation expense	271	226
(Loss) gain on sale of OREO	(44)	22
Gain on sale of mortgage loans held for sale, net	(783)	(911)
Gain on sale of SBA loans held for sale, net	(945)	(363)
Origination of mortgage loans held for sale	(51,052)	(42,184)
Origination of SBA loans held for sale	(11,174)	(9,866)
Proceeds from sale of mortgage loans held for sale, net	51,835	43,095
Proceeds from sale of SBA loans held for sale, net	11,563	3,829
BOLI income	(187)	(189)
Net change in other assets and liabilities	1,226	733
Net cash provided by (used in) financing activities	6,586	(93)
INVESTING ACTIVITIES		
Purchases of securities held to maturity	(11,109)	—
Purchases of securities available for sale	(4,249)	(1,002)
Purchases of FHLB stock, at cost	(3,012)	(9,570)
Maturities and principal payments on securities held to maturity	823	1,350
Maturities and principal payments on securities available for sale	5,547	4,414
Proceeds from sales of securities available for sale	6,594	528
Proceeds from redemption of FHLB stock	2,520	9,967
Proceeds from sale of OREO	1,518	1,044
Net increase in loans	(27,585)	(55,953)
Purchases of premises and equipment	(6,001)	(676)
Net cash used in investing activities	(34,954)	(49,898)
FINANCING ACTIVITIES		
Net increase in deposits	17,705	21,086
Proceeds from new borrowings	59,000	50,000
Repayments of borrowings	(37,000)	(60,000)
Repurchase of subordinated debentures	(2,891)	—
Proceeds from exercise of stock options	105	—
Dividends on common stock	(631)	(474)
Net cash provided by financing activities	36,288	10,612
Increase (decrease) in cash and cash equivalents	7,920	(39,379)
Cash and cash equivalents, beginning of period	88,157	129,821
Cash and cash equivalents, end of period	\$96,077	\$90,442

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

	For the six months ended June 30,	
(In thousands)	2016	2015
SUPPLEMENTAL DISCLOSURES		
Cash:		
Interest paid	\$4,427	\$3,767
Income taxes paid	3,112	1,868
Noncash investing activities:		
Capitalization of servicing rights	835	240
Transfer of loans to OREO	1,473	2,194

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

Unity Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
June 30, 2016

NOTE 1. Significant Accounting Policies

The accompanying Consolidated Financial Statements include the accounts of Unity Bancorp, Inc. (the "Parent Company") and its wholly-owned subsidiary, Unity Bank (the "Bank" or when consolidated with the Parent Company, the "Company"), and reflect all adjustments and disclosures which are generally routine and recurring in nature, and in the opinion of management, necessary for a fair presentation of interim results. The Bank has multiple subsidiaries used to hold part of its investment and loan portfolios and OREO properties. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings or shareholders' equity. The financial information has been prepared in accordance with U.S. generally accepted accounting principles and has not been audited. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the reporting periods. Actual results could differ from those estimates. Amounts requiring the use of significant estimates include the allowance for loan losses, valuation of deferred tax and servicing assets, the carrying value of loans held for sale and other real estate owned, the valuation of securities and the determination of other-than-temporary impairment for securities and fair value disclosures. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions. The Company has evaluated subsequent events for potential recognition and/or disclosure through the date the Consolidated Financial Statements included in this Quarterly Report on Form 10-Q were available to be issued.

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") and consist of normal recurring adjustments necessary for the fair presentation of interim results. The results of operations for the three and six months ended June 30, 2016 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. Certain information and financial disclosures required by U.S. generally accepted accounting principles have been condensed or omitted from interim reporting pursuant to SEC rules. Interim financial statements should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Stock Transactions

Stock Option Plans

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. Transactions under the Company's stock option plans for the six months ended June 30, 2016 are summarized in the following table:

	Shares	Weighted average exercise price	Weighted average remaining contractual life in years	Aggregate intrinsic value
Outstanding at December 31, 2015	475,396	\$ 7.09	5.1	\$2,562,175
Options granted	89,000	11.06		

Options exercised	(18,525)	5.65		
Options forfeited	—	—		
Options expired	—	—		
Outstanding at June 30, 2016	545,871	\$ 7.79	5.4	\$2,685,821
Exercisable at June 30, 2016	392,042	\$ 6.81	3.9	\$2,312,616

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of June 30, 2016, 1,920,529 shares have been reserved for issuance upon the exercise of options, 545,871 option grants are outstanding, and 1,271,073 option grants have been exercised, forfeited or expired, leaving 103,585 shares available for grant.

The fair values of the options granted during the three and six months ended June 30, 2016 and 2015 were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Number of options granted	—	—	89,000	40,000
Weighted average exercise price	\$ —	\$ —	\$11.06	\$ 9.12
Weighted average fair value of options	\$ —	\$ —	\$3.50	\$ 3.82
Expected life in years (1)	0.00	0.00	6.85	6.69
Expected volatility (2)	—%	—%	31.91%	46.76%
Risk-free interest rate (3)	—%	—%	1.79%	1.80%
Dividend yield (4)	—%	—%	1.44%	1.33%

(1) The expected life of the options was estimated based on historical employee behavior and represents the period of time that options granted are expected to be outstanding.

(2) The expected volatility of the Company's stock price was based on the historical volatility over the period commensurate with the expected life of the options.

(3) The risk-free interest rate is the U.S. Treasury rate commensurate with the expected life of the options on the date of grant.

(4) The expected dividend yield is the projected annual yield based on the grant date stock price.

Upon exercise, the Company issues shares from its authorized but unissued common stock to satisfy the options. The following table presents information about options exercised during the three and six months ended June 30, 2016 and 2015:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Number of options exercised	18,525	—	18,525	—
Total intrinsic value of options exercised	\$116,992	—	\$116,992	—
Cash received from options exercised	—	—	—	—
Tax deduction realized from options	—	—	—	—

The following table summarizes information about stock options outstanding and exercisable at June 30, 2016:

Range of exercise prices	Options outstanding			Weighted average exercise price	Options exercisable	
	Options outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price		Options exercisable	Weighted average exercise price
\$0.00 - 4.00	87,000	2.7	\$ 3.85	87,000	\$ 3.85	
4.01 - 8.00	265,425	4.9	6.79	247,593	6.71	
8.01 - 12.00	102,551	9.1	9.71	15,554	9.32	
12.01 - 16.00	90,895	5.4	12.32	41,895	12.62	
Total	545,871	5.4	\$ 7.79	392,042	\$ 6.81	

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 718, "Compensation - Stock Compensation," requires an entity to recognize the fair value of equity awards as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period).

Compensation expense related to stock options and the related income tax benefit for the three and six months ended June 30, 2016 and 2015 are detailed in the following table:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Compensation expense	\$57,765	\$39,072	\$113,748	\$68,990
Income tax benefit	23,684	15,605	46,466	27,555

As of June 30, 2016, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company's stock option plans totaled approximately \$430 thousand. That cost is expected to be recognized over a weighted average period of 2.2 years.

Restricted Stock Awards

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. The following table summarizes nonvested restricted stock activity for the six months ended June 30, 2016:

	Shares	Average grant date fair value
Nonvested restricted stock at December 31, 2015	80,800	\$ 8.50
Granted	30,350	11.21
Cancelled	(2,000)	5.35
Vested	(14,950)	8.26
Nonvested restricted stock at June 30, 2016	94,200	\$ 9.48

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value at the time of grant and amortized into salary expense on a straight line basis over the vesting period. As of June 30, 2016, 471,551 shares of restricted stock were reserved for issuance, of which 146,350 shares are available for grant.

Restricted stock awards granted during the three and six months ended June 30, 2016 and 2015 were as follows:

	For the three months ended June 30, 2016		For the six months ended June 30, 2015	
Number of shares granted	—	—	30,350	34,800
Average grant date fair value	\$ —	\$ —	\$ 11.21	\$ 9.27

Compensation expense related to restricted stock for the three and six months ended June 30, 2016 and 2015 is detailed in the following table:

	For the three months ended June 30, 2016		For the six months ended June 30, 2015	
Compensation expense	\$81,110	\$79,961	\$157,229	\$157,510
Income tax benefit	32,545	31,937	64,230	62,909

As of June 30, 2016, there was approximately \$716 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.7 years.

401(k) Savings Plan

The Bank has a 401(k) savings plan covering substantially all employees. Under the Plan, an employee can contribute up to 80 percent of their salary on a tax deferred basis. The Bank may also make discretionary contributions to the Plan. The Bank contributed \$179 thousand and \$145 thousand to the Plan during the six months ended June 30, 2016 and 2015, and \$90 thousand and \$69 thousand during the three months ended June 30, 2016 and 2015, respectively.