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

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

FORM 10-Q

(Mark One)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 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 x No o

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

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

The number of shares outstanding of each of the registrant's classes of common equity stock, as of May 1, 2008 common stock, no par value: 7,094,733 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)	03/31/08	12/31/07	03/31/07
Assets			
Cash and due from banks	$ 19,698	$ 14,336	$ 15,697
Federal funds sold and interest-bearing deposits	44,042	21,976	23,417
Securities:			
Available for sale	79,726	64,855	62,794
Held to maturity (market value of $34,577, $33,639 and $37,521, respectively)	34,622	33,736	38,121
Total securities	114,348	98,591	100,915
Loans:			
SBA held for sale	23,632	24,640	9,298
SBA held to maturity	71,798	68,875	68,314
Commercial	372,695	365,786	318,905
Residential mortgage	76,734	73,697	63,615
Consumer	58,084	57,134	55,430
Total loans	602,943	590,132	515,562
Less: Allowance for loan losses	8,650	8,383	7,757
Net loans	594,293	581,749	507,805
Premises and equipment, net	12,067	12,102	11,525
Bank-owned life insurance	5,622	5,570	5,421
Accrued interest receivable	4,131	3,994	3,594
Loan servicing asset	1,990	2,056	2,261
Goodwill and other intangibles	1,585	1,588	1,599
Other assets	10,098	10,234	9,068
Total assets	$ 807,874	$ 752,196	$ 681,302
Liabilities and Shareholders' Equity			
Liabilities:			
Deposits			
Noninterest-bearing demand deposits	$ 80,960	$ 70,600	$ 75,928
Interest-bearing checking	76,256	78,019	89,313
Savings deposits	188,628	196,390	214,636
Time deposits, under $100,000	211,739	168,244	105,724
Time deposits, $100,000 and over	84,699	88,015	55,798
Total deposits	642,282	601,268	541,399
Borrowed funds	95,000	85,000	65,000
Subordinated debentures	15,465	15,465	24,744
Accrued interest payable	794	635	523
Accrued expense and other liabilities	6,437	2,568	1,811
Total liabilities	759,978	704,936	633,477
Commitments and contingencies	-	-	-
Shareholders' equity:			

Common stock, no par value: 12,500 shares authorized	49,600	49,447	44,677
Retained earnings	3,379	2,472	4,067
Treasury stock (425 shares at March 31, 2008 and December 31, 2007 and 25 shares at March 31, 2007)	(4,169)	(4,169)	(242)
Accumulated other comprehensive loss	(914)	(490)	(677)
Total Shareholders' Equity	47,896	47,260	47,825
Total Liabilities and Shareholders' Equity	$ 807,874	$ 752,196	$ 681,302
Issued common shares	7,509	7,488	7,370
Outstanding common shares	7,084	7,063	7,345

See Accompanying Notes to the Consolidated Financial Statements

Unity Bancorp
Consolidated Statements of Income
(unaudited)

(In thousands, except per share amounts)	For the three months ended March 31, 2008	2007
Interest and dividend income:		
Fed funds sold and interest on deposits	$ 180	$ 262
Bankers bank stock	100	58
Securities:		
Available for sale	875	722
Held to maturity	437	540
Total securities	1,312	1,262
Loans:		
SBA loans	2,328	2,340
Commercial loans	6,735	5,988
Residential mortgage loans	1,079	888
Consumer loans	901	904
Total loan interest income	11,043	10,120
Total interest and dividend income	12,635	11,702
Interest expense:		
Interest-bearing demand deposits	366	552
Savings deposits	1,349	2,171
Time deposits	3,220	1,970
Borrowed funds and subordinated debentures	1,065	990
Total interest expense	6,000	5,683
Net interest income	6,635	6,019
Provision for loan losses	450	200
Net interest income after provision for loan losses	6,185	5,819
Noninterest income:		
Service charges on deposit accounts	320	349
Service and loan fee income	300	366
Gain on sales of SBA loans, net	576	679
Net security gains	70	10
Bank-owned life insurance	51	49
Other income	138	226
Total noninterest income	1,455	1,679
Noninterest expense:		
Compensation and benefits	3,220	2,955
Occupancy	701	673
Processing and communications	570	550
Furniture and equipment	388	400
Professional services	198	136
Loan servicing costs	102	90
Advertising	62	94
Other expenses	529	519
Total noninterest expense	5,770	5,417
Net income before provision for income taxes	1,870	2,081
Provision for income taxes	626	630

Net income	$	1,244	$	1,451
Net income per common share - Basic	$	0.18	$	0.20
Net income per common share - Diluted		0.17		0.19
Weighted average shares outstanding – Basic		7,076		7,325
Weighted average shares outstanding – Diluted		7,271		7,649

Unity Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
For the three months ended March 31, 2008 and 2007
(unaudited)

(In thousands)	Outstanding Shares	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, December 31, 2006	7,296	$ 44,343	$ 2,951	$ (242)	$ (824)	$ 46,228
Comprehensive income:						
Net Income			1,451			1,451
Net unrealized holding gain on securities					147	147
Total comprehensive income						1,598
Cash dividends declared on common stock of $.05 per share			(335)			(335)
Issuance of common stock	31	262				262
Stock-based compensation	18	71				71
Balance, March 31, 2007	7,345	$ 44,677	$ 4,067	$ (242)	$ (677)	$ 47,825

(In thousands)	Outstanding Shares	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, December 31, 2007	7,063	$ 49,447	$ 2,472	$ (4,169)	$ (490)	$ 47,260
Comprehensive income:						
Net Income			1,244			1,244
Net unrealized securities loss					(68)	(68)
Net unrealized loss on cash flow hedge derivatives					(356)	(356)
Total comprehensive income						820
Cash dividends declared on common stock of $.05 per share			(337)			(337)
Issuance of common stock	9	84				84
	12	69				69

Stock-based compensation						
Balance, March 31, 2008	7,084	$ 49,600	$ 3,379	$ (4,169)	$ (914)	$ 47,896

See Accompanying Notes to the Unaudited Consolidated Financial Statements.

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

(In thousands)	For the three months ended March 31, 2008	2007
Operating activities:		
Net income	$ 1,244	$ 1,451
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	450	200
Net amortization of purchase premium (discount) on securities	6	28
Depreciation and amortization	267	206
(Decrease) increase in deferred income taxes	(347)	(449)
Net gain on sale of securities	(70)	(10)
Stock compensation expense net of tax benefits	57	85
Gain on sale of SBA loans held for sale	(576)	(679)
Gain on sale of mortgage loans	(21)	(9)
Origination of mortgage loans held for sale	(1,291)	(729)
Origination of SBA loans held for sale	(10,499)	(7,618)
Proceeds from the sale of mortgage loans held for sale	1,312	738
Proceeds from the sale of SBA loans	12,083	11,272
Net change in other assets and liabilities	3,923	1,099
Net cash provided by operating activities	6,538	5,585
Investing activities:		
Purchases of securities held to maturity	(2,780)	-
Purchases of securities available for sale	(21,460)	(2,199)
Purchases of banker’s bank stock	(225)	(675)
Maturities and principal payments on securities held to maturity	1,887	4,679
Maturities and principal payments on securities available for sale	5,857	2,282
Proceeds from the sale of securities available for sale	790	184
Proceeds from the redemption of banker’s bank stock	450	225
Proceeds from the sale of other real estate owned	309	-
Net increase in loans	(14,435)	(11,059)
Purchases of premises and equipment	(265)	(173)
Net cash used in investing activities:	(29,872)	(6,736)
Financing activities:		
Net increase (decrease) in deposits	41,014	(25,066)
Proceeds from new borrowings	15,000	15,000
Repayments of borrowings	(5,000)	(5,000)
Proceeds from the issuance of common stock	84	227
Dividends paid	(336)	(332)
Net cash provided by (used in) financing activities	50,762	(15,171)
Increase (decrease) in cash and cash equivalents	27,428	(16,322)
Cash and cash equivalents at beginning of year	36,312	55,436
Cash and cash equivalents at end of period	$ 63,740	$ 39,114

Supplemental disclosures:				
Cash:				
Interest paid	$	5,841	$	5,635
Income taxes paid		13		971
Non-Cash investing activities:				
Transfer of loans to Other Real Estate Owned	$	470	$	229

See Accompanying Notes to the Consolidated Financial Statements.

Unity Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
March 31, 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 months ended March 31, 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-Based Compensation

On April 24, 2008, the Company announced a 5 percent stock dividend payable on June 27, 2008 to all shareholders of record as of June 13, 2008 and accordingly, all share amounts have been restated to include the effect of the distribution. On April 24, 2008, $2.7 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 benefit 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 March 31, 2008, 1,520,529 shares have been reserved for issuance upon the exercise of options, 800,975 option grants are outstanding, and 571,736 option grants have been exercised, forfeited or expired leaving 147,818 shares available for grant.

During the three months ended March 31, 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 March 31, 2008	Three Months Ended March 31, 2007
Number of options granted	39,113	66,977
Weighted average exercise price	$ 7.61	$ 12.56
Weighted average fair value of options	$ 1.61	$ 3.45
Expected life (years)	3.78	4.01
Expected volatility	30.92 %	29.72%
Risk-free interest rate	2.44%	4.86%
Dividend yield	2.50%	1.45%

Transactions under the Company's stock option plans during the three months ended March 31, 2008 are summarized as follows:

	Number of Shares	Exercise Price per Share	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2007	766,062	$ 2.70 – 14.01	$ 6.28		
Options granted	39,113	7.31 – 7.70	7.61		
Options exercised	-	–	-		
Options expired	(4,200)	7.31– 12.62	11.95		
Outstanding at March 31, 2008	800,975	$ 2.70 – 14.01	$ 6.31	5.15	$1,675,550
Exercisable at March 31, 2008	666,773	$ 2.70 – 14.01	$ 5.68	4.30	$ 1,658,462

Compensation expense related to stock options totaled $30 thousand and $29 thousand for the three months ended March 31, 2008 and 2007, respectively. As of March 31, 2008, there was approximately $301 thousand of unrecognized compensation cost related to non-vested, 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 1.5 years.

The total intrinsic value (spread between the market value and exercise price) of the stock options exercised during the three months ended March 31, 2007 was $118 thousand. There were no options exercised during the first three months of 2008, while options to purchase 22,961 shares were exercised during the prior years' comparable quarter.

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 first three months of 2008 and 2007 were as follows:

	Three Months Ended March 31,	
	2008	2007
Number of shares granted	11,550	19,019
Weighted average grant date fair value	$ 7.60	$ 12.59
Vested as of period end	22,636	9,719

Compensation expense related to the restricted stock awards totaled $39 thousand and $42 thousand for the three months ended March 31, 2008 and 2007, respectively. As of March 31, 2008, 121,551 shares of restricted stock were reserved for issuance, of which 63,940 shares are outstanding, 2,044 shares have been issued and 55,567 shares are available for grant.

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The following table summarizes nonvested restricted stock award activity for the three months ended March 31, 2008:

	Shares		Average Grant Date Fair Value
Nonvested restricted stock at December 31, 2007	44,611	$	12.30
Granted	11,550		7.60
Vested	(11,967)		12.27
Forfeited	(2,890)		10.47
Nonvested restricted stock at March 31, 2008	41,304	$	11.12

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.

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.

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.

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

	Three Months ended March 31,	
(In thousands, except per share data)	2008	2007
Net Income to common shareholders	$ 1,244	$ 1,451
Basic weighted-average common shares outstanding	7,076	7,325
Plus: Common stock equivalents	195	324
Diluted weighted-average common shares outstanding	7,271	7,649
Net Income per Common share:		
Basic	$ 0.18	$ 0.20
Diluted	0.17	0.19

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

	Pre-tax	Tax	After-tax
Net unrealized security losses			
Balance at December 31, 2006			(824)
Unrealized holding gain on securities arising during the period	247	93	154
Less: Reclassification adjustment for gains included in net income	10	3	7
Net unrealized gains on securities arising during the period	237	90	147

Balance at March 31, 2007			(677)
Balance at December 31, 2007			(476)
Unrealized holding loss on securities arising during the period	(681)	(233)	(448)
Less: Reclassification adjustment for loss included in net income	(571)	(191)	(380)
Net unrealized loss on securities arising during the period	(110)	(42)	(68)
Balance at March 31, 2008			(544)
Net unrealized losses on cash flow hedges			
Balance at December 31, 2007			(14)
Unrealized holding loss arising during the period	(574)	(218)	(356)
Balance at March 31, 2008			(370)

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

Fair Value Measurement

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

Level 1 Inputs

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

Level 2 Inputs

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in markets that are not active.
- 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 market participant including market discount rates and prepayment speeds. The fair value of SBA servicing rights as of March 31, 2008 was determined using a discount rate of 15 percent, constant prepayment rates of 15 to 18 CPR, and interest strip multiples ranging from 2.68 to 3.25, 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.

	Level 1	Level 2	Level 3	Total
Financial Assets				
Securities available for sale	$ 65	$ 77,324	$ 2,337	$ 79,726
SBA servicing assets			1,990	1,990
Financial Liabilities				
Interest rate swap agreements		597		597

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

	Securities Available for Sale	SBA Servicing Asset
Beginning balance December 31, 2007	$ 2,711	$ 2,056
Total net gains (losses) included in:		
Net income	-	-
Other comprehensive income	(374)	-
Purchases, sales, issuances and settlements, net	-	(66)
Transfers in and/or out of Level 3	-	-
Ending balance March 31, 2008	$ 2,337	$ 1,990

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

Fair Value on a Nonrecurring Basis

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the FAS 157 hierarchy (as described above) as of March 31, 2008, for which a nonrecurring change in fair value has been recorded during the three months ended March 31, 2008.

	Level 1	Level 2	Level 3	Total	Total Fair Value Loss during 3 Months ended March 31, 2008
Financial Assets					
SBA loans held for sale		$ 25,163		$ 25,163	$ -
Impaired loans			3,756	3,756	13

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 loans is derived in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Fair value is determined based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. The valuation allowance for impaired loans at March 31, 2008 was $385 thousand. During the quarter ended March 31, 2008, the valuation allowance for impaired loans increased $13 thousand from $372 thousand at December 31, 2007.

Fair Value of Financial Instruments -
The table below represents the carrying value and fair value of the Company's financial instruments. The fair value represents management's best estimates based on a range of methodologies and assumptions.

- Cash and Federal Funds Sold - For these short-term instruments, the carrying value is a reasonable estimate of fair value.
- Securities – For the held to maturity and available for sale portfolios, fair values are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.
- SBA loans held for sale – These loans are carried at the lower of cost or market. The fair values were estimated using quoted prices for similar assets in active markets.
- Loans, net of allowance - The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the credit, collateral and interest rate risk inherent in the loan.
- Bankers Bank Stock (FHLB and ACBB) – For these restricted investments, the carrying value approximates fair value.
- Deposit Liabilities - The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using current market rates.
- Borrowings and Subordinated Debentures – The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.
- Accrued Interest – The carrying amounts of accrued interest approximate fair value.
- Interest Rate Swap Liabilities – Fair values are based upon the amounts required to settle the contracts.

	2008		2007	
(In thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets -				
Cash and Federal funds sold	$ 63,740	$ 63,740	$ 39,114	$ 39,114
Securities held to maturity	34,622	34,577	38,121	37,521
Securities available for sale	79,726	79,726	62,794	62,794
SBA loans held for sale	23,632	25,163	9,298	9,298
Loans, net of allowance for possible loan losses	570,661	574,492	506,264	505,704
Accrued interest receivable	4,131	4,131	3,594	3,594
Bankers bank stock	4,170	4,170	3,403	3,403
SBA servicing asset	1,990	1,990	2,261	2,261
Goodwill and other intangibles	1,585	1,585	1,599	1,599
Financial liabilities -				
Total deposits	642,282	635,663	541,399	522,730
Total borrowings and subordinated debentures	110,465	112,962	89,744	89,283
Accrued interest payable	794	794	523	523
Interest rate swap agreements	597	597	-	-

Note 7. New Accounting Pronouncements

SFAS No. 160 Non-controlling Interests in Consolidated Financial Statements. This Statement requires all entities to report non-controlling (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 non-controlling 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. Also SFAS 161 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 IA-Risk factors, 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 17 branch offices located in Hunterdon, Somerset, Middlesex, Union and Warren counties in New Jersey, and Northampton County in Pennsylvania. These services include the acceptance of demand, savings, and time deposits and the extension of consumer, real estate, Small Business Administration and other commercial credits. Unity Investment Services, Inc., a wholly-owned subsidiary of the Bank, is used to hold part of the Bank’s investment portfolio. Unity Participation Company, Inc., a wholly-owned subsidiary of the Bank is used for holding and administering certain loan participations.

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

Earnings Summary

The interest rate, economic and competitive environments during the first three months of 2008 remained challenging for financial institutions. Factors such as lack of liquidity in the credit markets, continued fall out from the subprime mortgage crisis, asset “fair market” value write-downs, capital adequacy and credit quality concerns resulted in lack of confidence by the markets in the financial industry. In addition, rising costs, reduced consumer confidence and fears of recession exist. In response to this outlook, the Federal Reserve Board lowered rates three times for a total of 200 basis points during the first quarter. These rate reductions brought the Fed Funds target rate down to 2.25 percent by quarter end and the Prime lending rate to 5.25 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. In addition, deposit gathering remained extremely competitive and highly priced throughout the New Jersey and Eastern Pennsylvania market places.

Despite this challenging operating environment, our performance in the first quarter of 2008 included the following accomplishments:

- Total assets exceeded $800 million,
- Loans increased 16.9 percent and deposits increased 18.6 percent compared to the prior year's quarter,
- The Company remained well capitalized and paid a quarterly dividend of $.05 per share, and
- The level of nonperforming assets fell from the prior year's first quarter and year-end.

Net income for the three months ended March 31, 2008, was $1.2 million, a decrease of $207 thousand or 14.3 percent, from net income of $1.5 million for the same period in 2007.

	Three Months ended March 31,	
(In thousands, except per share data)	2008	2007
Net Income per Common share:		
Basic	$ 0.18	$ 0.20
Diluted	0.17	0.19
Return on average assets	0.65%	0.87%
Return on average common equity		