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)
(X) 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 x No o

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

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

The number of shares outstanding of each of the registrant's classes of common equity stock, as of 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:			

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

Unity Bancorp
Consolidated Statements of Income
(unaudited)

(In thousands, except per share amounts)	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 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

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

Unity Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 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 (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 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 (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, including cash-in-lieu		2,532	(2,535)			(3)
Stock issued, including related tax benefits	34	259				259
Stock-based compensation	13	215				215
Balance, September 30, 2008	7,110	$ 52,453	$ 591	$ (4,169)	$ (2,336)	$ 46,539

See Accompanying Notes to the Unaudited Consolidated Financial Statements.

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

(In thousands)	For the nine months ended September 30, 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)

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.

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.

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 September 30,		Nine Months Ended 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 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	766,054	$ 2.70 – 14.01	$ 6.28		
Options granted	47,263	6.12 – 7.70	7.44		
Options exercised	(536)	5.04 – 5.04	5.04		
Options expired	(29,154)	5.04 – 12.62	9.21		
Outstanding at September 30, 2008	783,627	$ 2.70 – 14.01	$ 6.24	4.53	$ 275,096
Exercisable at September 30, 2008	653,020	$ 2.70 – 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 September 30,		Nine Months Ended 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 Grant Date Fair Value
Nonvested restricted stock at 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 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.

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 30,		Nine months ended September 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.

Fair Value Measurement

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

Level 1 Inputs
- Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain US Treasury and US Government and agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs
- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities.
- Inputs other than quoted prices that are obserbable, either directly or indirectly, for the term of the asset or liability (e.g., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes US Government and agency mortgage-backed securities, corporate debt securities, derivative contracts and loans held for sale.

Level 3 Inputs
- Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
- These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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
Financial Assets:				
Securities available for sale	$ 40	$ 70,104	$ -	$ 70,144
SBA servicing assets	-	-	1,721	1,721
Total	40	70,104	1,721	71,865
Financial Liabilities:				
Interest rate swap agreements	-	214	-	214
Total	-	214	-	214

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

(In thousands)	Securities Available for Sale	SBA Servicing Asset
Beginning balance December 31, 2007	$ 2,711	$ 2,056
Total net gains (losses) included in:		
Net income	-	-
Other comprehensive income	(851)	-
Purchases, sales, issuances and 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 Gain during 9 months ended September 30, 2008
Financial Assets:					
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.

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 IA-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.

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.

	Three Months ended September 30,		Nine months ended September 30,	
(In thousands, except per share data)	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.

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 demaand 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.

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

	Three Months Ended					
	September 30, 2008			September 30, 2007		
	Average Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield
Assets						
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		
Liabilities and Shareholders' Equity						
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:						

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 Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield
Assets						
Interest-earning assets:						
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
Securities:						
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
Loans, net of unearned discount:						
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%
Noninterest-earning assets:						
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		
Liabilities and Shareholders' Equity						
Interest-bearing deposits:						
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 noninterest-bearing liabilities	80,613			77,769		
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	Amount of Increase (Decrease)					
(In thousands)	Three months ended September 30, 2008 versus September 30, 2007			Nine months ended September 30, 2008 versus September 30, 2007		
	Due to change in:			Due to change in:		
	Volume	Rate	Total	Volume	Rate	Total
Interest Income						
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
Available for sale securities	15	(5)	10	180	231	411
Held to maturity securities	(61)	(11)	(72)	(246)	(9)	(255)
Federal funds sold and interest-bearing deposits	(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
Interest Expense						
Interest-bearing checking	$ 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,		
(In thousands)	2008	2007	Percent Change	2008	2007	Percent 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

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:

(In thousands)	Three months ended September 30, 2008	2007	Percent Change	Nine months ended September 30 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.

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, 2008	December 31, 2007
SBA Loans	15%	16%
Commercial Loans	57	62
Mortgage Loans	19	12
Consumer Loans	9	10

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 30, 2008	December 31, 2007	September 30, 2007
Nonperforming loans:			
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
Past Due 90 days or more and still accruing interest			
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

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:

	Three months ended September 30,		Nine months ended September 30,	
Allowance for Loan Loss Activity (In thousands)	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	140	29
Total Charge-offs	1,201	322	1,861	568
Recoveries:				
SBA	40	41	105	94
Commercial	29	7	35	15
Residential mortgage	-	-	-	-

Consumer	-	10	51	18
Total recoveries	69	58	191	127
Total net charge-offs	1,132	264	1,670	441
Balance, end of period	9,913	$ 8,183	9,913	$ 8,183
Selected loan quality ratios:				
Net charge offs to average loans (annualized)	0.67 %	0.19%	0.35 %	0.12%
Allowance for loan losses to total loans at period end	1.45 %	1.44%	1.45 %	1.44%
Allowance for loan losses to nonperforming loans	93.19 %	195.53%	93.19 %	195.53%

Deposits

Deposits, which include noninterest and interest-bearing demand deposits and interest-bearing savings and time deposits, are the primary source of the Company's funds. The Company offers a variety of products designed to attract and retain customers, with primary focus on building and expanding relationships.

During the first nine months of 2008, total deposits increased $83.4 million to $684.7 million at September 30, 2008, from $601.3 million at December 31, 2007. The increase in deposits was primarily the result of a $110.6 million increase in time deposits, an $11.6 million increase in noninterest-bearing demand deposits and a $9.6 million increase in interest-bearing demand deposits, partially offset by a $48.4 million decrease in savings deposits.

This activity has resulted in a shift in our deposit concentration from 33 percent savings and 43 percent time deposits at December 31, 2007, to 22 percent savings and 54 percent time deposits at September 30, 2008. The concentration of demand deposits equaled 12 percent and interest-bearing demand deposits equaled 13 percent at September 30, 2008 and December 31, 2007.

Borrowed Funds and Subordinated Debentures

Borrowed funds and subordinated debentures totaled $130.5 million at September 30, 2008, an increase of $30.0 million or 29.9 percent from December 31, 2007. This net increase was due to the addition of $35.0 million in net borrowings, offset in part by $5.0 million in repayments. As of September 30, 2008, the Company was a party to the following borrowed funds and subordinated debenture transactions:

(In thousands)	September 30, 2008	December 31, 2007
FHLB Borrowings:		
Overnight line of credit	$ 20,000	$ 5,000
Fixed rate advances	40,000	40,000
Repurchase agreements	30,000	30,000
Other repurchase agreements	25,000	10,000
Subordinate debentures	15,465	15,465

Interest Rate Sensitivity

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

The Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity ("EVPE") models to measure the impact of longer-term asset and liability mismatches beyond two years. The modified duration of equity measures the potential price risk of equity to changes in interest rates. A longer modified duration of equity indicates a greater degree of risk to rising interest rates. Because of balance sheet optionality, an EVPE analysis is also used to dynamically model the present value of asset and liability cash flows with rate shocks of 200 basis points. The economic value of equity is likely to be different as interest rates change. Like the simulation model, results falling outside prescribed ranges require action by the ALCO. The Company's variance in the economic value of equity, as a percentage of assets with rate shocks of 200 basis points at September 30, 2008, is a decline of 1.82 percent in a rising-rate environment and an increase of 0.04 percent in a falling-rate environment. Both variances are within the Board-approved guidelines of +/- 3.00 percent. At December 31, 2007, the economic value of equity with rate shocks of 200 basis points was a decline of 2.02 percent in a rising-rate environment and an increase of 0.34 percent in a falling-rate environment.

Operating, Investing, and Financing Cash

Cash and cash equivalents amounted to $51.3 million at September 30, 2008, an increase of $15.0 million from December 31, 2007. Net cash provided by operating activities for the nine months ended September 30, 2008, amounted to $4.7 million, primarily due to proceeds from the sale of SBA loans and net income from operations, offset by originations of loans held for sale. Net cash used in investing activities amounted to $102.3 million for the nine months ended September 30, 2008, primarily due to loan originations and security purchases, partially offset by proceeds from the maturities and sales of securities available for sale. Net cash provided by financing activities, amounted to $112.6 million for the nine months ended September 30, 2008, attributable to increased deposits, borrowings and proceeds from the exercise of stock options, partially offset by the repayment of borrowings and payment of dividends.

Liquidity

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

Parent Company

At September 30, 2008, the Parent Company had $456 thousand in cash and $134 thousand in marketable securities, valued at fair market value, compared to $433 thousand in cash and $216 thousand in marketable securities at December 31, 2007. The increase in cash at the parent company was due to the payment of dividends by the Bank, partially offset by the payment of dividends to shareholders and other operating expenses. Expenses at the Parent Company are minimal, and management believes that the Parent Company has adequate liquidity to fund its obligations.

Consolidated Bank

The principal sources of funds are deposits, scheduled amortizations and repayments of loan principal, sales and maturities of investment securities and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Due to current market conditions management believes there will be continued pressure on liquidity; however, management believes it has adequate liquidity to fund its obligations.

At September 30, 2008, $18.8 million was available for additional borrowings from the FHLB of New York. Pledging additional collateral in the form of 1-4 family residential mortgages or investment securities can increase the line with the FHLB. An additional source of liquidity is Federal Funds sold, which were $29.4 million at September 30, 2008.

As of September 30, 2008, deposits included $16.5 million of Government deposits, as compared to $30.5 million at December 31, 2007. These deposits are generally short in duration and are sensitive to price competition. The Company believes the current portfolio of these deposits to be appropriate. Included in the portfolio are $13.2 million of deposits from five municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.

At September 30, 2008, the Bank had $156.8 million of loan commitments, which will generally either expire or be funded within one year. The Company believes it has the necessary liquidity to honor all commitments. Many of these commitments will expire and never be funded. In addition, approximately $25.9 million of these commitments are for SBA loans, which may be sold into the secondary market.

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Regulatory Capital

A significant measure of the strength of a financial institution is its capital base. Federal regulators have classified and defined capital into the following components: (1) Tier I capital, which includes tangible shareholders' equity for common stock and qualifying hybrid instruments; and (2) Tier II capital, which includes a portion of the allowance for loan losses, certain qualifying long-term debt, preferred stock and hybrid instruments, which do not qualify for Tier I capital. Minimum capital levels are regulated by risk-based capital adequacy guidelines, which require a bank to maintain certain capital as a percent of assets, and certain off-balance sheet items adjusted for pre-defined, credit-risk factors (risk-adjusted assets). A bank is required to maintain, at a minimum, Tier I capital as a percentage of risk-adjusted assets of 4.0 percent and combined Tier I and Tier II capital as a percentage of risk-adjusted assets of 8.0 percent.

In addition to the risk-based guidelines, regulators require that a bank, which meets the regulator’s highest performance and operation standards maintain a minimum leverage ratio (tier 1 capital as a percentage of tangible assets) of 4 percent. For those banks with higher levels of risk or that are experiencing or anticipating significant growth, the minimum leverage ratio will be proportionately increased. Minimum leverage ratios for each bank are evaluated through the ongoing regulatory examination process.

Section 301 of the Emergency Economic Stabilization Act of 2008 (the "Act") provided tax relief to banks that have suffered losses on certain holdings of Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") perpetual preferred stock by changing the character of these losses from capital to ordinary for federal income tax purposes. However, since the Act was not enacted until the fourth quarter of 2008, the Company could not recognize this benefit under Generally Accepted Accounting Principals. The federal banking agencies, however, will allow banks to recognize the effect of the tax change enacted in Section 301 in their third quarter regulatory capital calculations. The regulatory capital calculations below recognize the effect of the tax change enacted in Section 301 as permitted by the federal banking agencies.

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

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(In thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2008						
Leverage Ratio	62,519	7.42 %	^{3} 33,723	4.00%	^{3} 42,154	N/A
Tier I risk-based ratio	62,519	9.07 %	^{3} 27,562	4.00%	^{3} 41,343	N/A
Total risk-based ratio	71,150	10.33 %	^{3} 55,123	8.00%	^{3} 68,904	N/A
As of December 31, 2007						
Leverage Ratio	61,157	8.25%	^{3} 29,654	4.00%	^{3} 37,067	N/A
Tier I risk-based ratio	61,157	9.81%	^{3} 24,947	4.00%	^{3} 37,421	N/A
Total risk-based ratio	68,962	11.06%	^{3} 49,895	8.00%	^{3} 62,369	N/A

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

Actual	For Capital Adequacy Purposes	To Be Well Capitalized

							Under Prompt Corrective Action Provisions	
(In thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio
As of September 30, 2008								
Leverage Ratio	53,439	6.34.%	³	33,696	4.00%	³	42,120	5.00%
Tier I risk-based ratio	53,439	7.76%	³	27,532	4.00%	³	41,298	6.00%
Total risk-based ratio	70,561	10.25%	³	55,064	8.00%	³	68,830	10.00%
As of December 31, 2007								
Leverage Ratio	52,249	7.06%	³	29,617	4.00%	³	37,021	5.00%
Tier I risk-based ratio	52,249	8.39%	³	24,919	4.00%	³	37,378	6.00%
Total risk-based ratio	68,545	11.00%	³	49,837	8.00%	³	62,297	10.00%

Shareholders’ Equity

Shareholders' equity decreased $721 thousand, or 1.5 percent, to $46.5million at September 30, 2008, compared to $47.3 million at December 31, 2007. This decrease was the result of $1.3 million in net income, $259 thousand in proceeds from the issuance of stock and related tax benefits and $215 thousand in employee stock based compensation credits, offset by $695 thousand in cash dividends declared during the nine months ended September 30, 2008, $1.7 million depreciation in the market value of the securities available for sale portfolio and $119 thousand depreciation in the market value of interest rate swaps.

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 have been restated to include the effect of the distribution.

During the quarter, the Company revised its cash dividend payment policy. The decision was made based upon the current economic environment to retain capital so that the holding company can remain a source of strength to the subsidiary bank. Previously, the Company has paid a cash quarterly dividend at a rate set by the Board based upon a number of factors. The Board has now established a targeted dividend payout ratio of 20% of the Company's earnings, subject to adjustment based upon factors existing at the time of the dividend and the Company's projected capital needs. The Board now intends to pay a cash dividend once annually, in the next succeeding year. During 2008, the Company has already paid cash dividends of $0.15 per share. While the Company cannot project its full year 2008 earnings at this time, to the extent the cash dividends paid to date exceed the targeted percentage of annual 2008 earnings, the Company may not pay any additional cash dividends out of 2008 income.

On October 21, 2002, the Company authorized the repurchase of up to 10% of its outstanding common stock. The amount and timing of purchases would be dependent upon a number of factors, including the price and availability of the Company’s shares, general market conditions and competing alternate uses of funds. There were no shares repurchased during the three months ended September 30, 2008. As of September 30, 2008, the Company had repurchased a total of 556 thousand shares of which 131 thousand shares have been retired, leaving 153 thousand shares remaining to be repurchased under the plan. As part of its ongoing capital management strategy, the Company does not foresee repurchasing additional shares in the near future.

Derivative Financial Instruments

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

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

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

Risk Management Policies – Hedging Instruments

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

Interest Rate Risk Management – Cash Flow Hedging Instruments

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

At September 30, 2008 and 2007 the information pertaining to outstanding interest rate swap agreements used to hedge variable rate debt is as follows:

(Dollars in thousands)	2008	2007
Notional amount	$ 15,000	$ -
Weighted average pay rate	4.05 %	-%
Weighted average receive rate	3.82 %	-%
Weighted average maturity in years	3.2	-
Unrealized loss relating to interest rate swaps	$ (214)	$ -

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

At September 30, 2008, the net unrealized loss relating to interest rate swaps was recorded as a derivative liability. Changes in the fair value of interest rate swaps designated as hedging instruments of the variability of cash flows associated with long-term debt are reported in other comprehensive income. The net spread between the fixed rate of interest which is paid and the variable interest received is classified in interest expense as a yield adjustment in the same period in which the related interest on the long-term debt affects earnings.

Impact of Inflation and Changing Prices

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

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

During 2008, there have been no significant changes in the Company’s assessment of market risk as reported in Item 6 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2007. (See Interest Rate Sensitivity in Management’s Discussion and Analysis Herein.)

ITEM 4. Controls and Procedures

(a) The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2008. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for recording, processing, summarizing and reporting the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms. Such evaluation did not identify any change in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2008, has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

(b) Changes in internal controls over financial reporting – No significant change in the Company’s internal control over financial reporting has occurred during the quarterly period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1.A. Risk Factors

Information regarding this item as of September 30, 2008 appears under the heading, "Risk Factors" within the Company's Form 10-K for the year ended December 31, 2007, except for the following risk factor, which was updated June 30, 2008.

We are subject to interest rate risk and variations in interest rates may negatively affect our financial performance, in addition dislocation and volatility in the credit markets may negatively affect the value of our assets.

Beginning in mid 2007, there has been significant turmoil and volatility in global financial markets. Nationally, economic factors such as inflation or recession, a rise in unemployment, a weakened US dollar, rising consumer and energy costs persist. Recent market uncertainty regarding the financial sector and the government sponsored enterprises Fannie Mae and Freddie Mac has increased. In addition to the impact on the economy generally, changes in interest rates, in the shape of the yield curve, or in valuations in the debt or equity markets or disruptions in the liquidity or other functioning of financial markets, all of which have been seen recently, could directly impact us in one or more of the following ways:

· Net interest income, the difference between interest earned on our interest earning assets and interest paid on interest bearing liabilities, represents a significant portion of our earnings. Both increases and decreases in the interest rate environment may reduce our profits. We expect that we will continue to realize income from the spread between the interest we earn on loans, securities and other interest-earning assets, and the interest we pay on deposits, borrowings and other interest-bearing liabilities. The net interest spread is affected by the differences between the maturity and repricing characteristics of our interest-earning assets and interest-bearing liabilities. Our interest-earning assets may not reprice as slowly or rapidly as our interest-bearing liabilities.

· The market value of our securities portfolio may decline and result in other than temporary charges. The value of securities in our portfolio are affected by factors that impact the U.S. securities market in general as well specific financial sector factors and entities such as the government sponsored enterprises Fannie Mae and Freddie Mac. Recent uncertainty in the market regarding the financial sector and Fannie Mae and Freddie Mac has negatively impacted the value of securities within our portfolio. Further declines in these sectors may result in future other than temporary impairment charges.

· Asset quality may deteriorate as borrowers become unable to repay their loans.

· Lack of liquidity within the capital markets which we use to raise funds to support our business transactions may impact the cost of funds or our ability to raise funds.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) none
(b) none
(c) none

Item 3. Defaults Upon Senior Securities-None

Item 4. Submission of Matters to a Vote of Security Holders - None

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Item 5. Other Information - None

Item 6. Exhibits

(a)	Exhibits
Exhibit 31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

UNITY BANCORP, INC.

Dated: November 13, 2008 /s/ Alan J. Bedner, Jr.

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

EXHIBIT INDEX

QUARTERLY REPORT ON FORM 10-Q

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