

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K  
FOR ANNUAL AND TRANSITIONAL REPORTS PURSUANT TO  
SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-12431

Unity Bancorp, Inc.

(Exact Name of Registrant as Specified in Its Charter)



New Jersey

(State or Other Jurisdiction of Incorporation or Organization)

22-3282551

(I.R.S. Employer Identification No.)

64 Old Highway 22, Clinton, NJ

(Address of Principal Executive Offices)

08809

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Exchange Act:

Common Stock, no par value

(Title of Each Class)

NASDAQ

(Name of Exchange on Which Registered)

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

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 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ X ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Exchange Act

Yes ☐ No ☒

As of June 30, 2010, the aggregate market value of the registrant’s Common Stock, no par value per share, held by non-affiliates of the registrant was \$24,876,805 and 4,649,870 shares of the Common Stock were outstanding to non-affiliates. As of March 1, 2011, 7,222,449 shares of the registrant’s Common Stock were outstanding.

Documents incorporated by reference:

Portions of Unity Bancorp’s Annual Report to Shareholders for the fiscal year ended December 31, 2010 are incorporated by reference into Parts I, II and IV of this Annual Report on Form 10-K.

Portions of Unity Bancorp’s Proxy Statement for the Annual Meeting of Shareholders to be filed no later than 120 days from December 31, 2010 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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## **PART I**

### **Item 1. Business:**

#### **a) General**

Unity Bancorp, Inc., (the "Company" or "Registrant"), is a bank holding company incorporated under the laws of the State of New Jersey to serve as a holding company for Unity Bank (the "Bank"). The Company was originally organized under the laws of the State of Delaware in 1994. Subsequently, in 2002, the Company effected a re-incorporation merger to become a New Jersey corporation. The Company was organized at the direction of the Board of Directors of the Bank for the purpose of acquiring all of the capital stock of the Bank. Pursuant to the New Jersey Banking Act of 1948 (the "Banking Act"), and pursuant to approval of the shareholders of the Bank, the Company acquired the Bank and became its holding company on December 1, 1994. The only significant activity of the Company is ownership and supervision of the Bank. The Company also owns 100% of the common equity of Unity (NJ) Statutory Trust II and Unity (NJ) Statutory Trust III. The trusts have issued \$10.3 million and \$5.2 million of preferred securities to investors, respectively.

The Bank opened for business on September 16, 1991. The Bank received its charter from the New Jersey Department of Banking and Insurance on September 13, 1991. The Bank is a full-service commercial bank, providing a wide range of business and consumer financial services through its main office in Clinton, New Jersey and fourteen New Jersey branches located in Clinton, Colonia, Edison, Flemington, Highland Park, Linden, Middlesex, North Plainfield, Phillipsburg, Scotch Plains, South Plainfield, Springfield, Union and Whitehouse. In addition, the Bank has two Pennsylvania branches: one located in Forks Township and a second branch on William Penn Highway in Easton. The Bank's primary service area encompasses the Route 22/Route 78 corridors between the Forks Township and Easton, Pennsylvania offices and its Linden, New Jersey branch.

The principal executive offices of the Company are located at 64 Old Highway 22, Clinton, New Jersey 08809, and the telephone number is (908) 730-7630. The Company's website address is [www.unitybank.com](http://www.unitybank.com).

#### **Business of the Company**

The Company's primary business is ownership and supervision of the Bank. The Company, through the Bank, conducts a traditional and community-oriented commercial banking business and offers services, including personal and business checking accounts, time deposits, money market accounts and regular savings accounts. The Company structures its specific services and charges in a manner designed to attract the business of the small and medium sized business and professional community, as well as that of individuals residing, working and shopping in its service area. The Company engages in a wide range of lending activities and offers commercial, Small Business Administration ("SBA"), consumer, mortgage, home equity and personal loans.

#### **Service Areas**

The Company's primary service area is defined as the neighborhoods served by the Bank's offices. The Bank's main office, located in Clinton, NJ, in combination with its Flemington and Whitehouse offices, serves the greater area of Hunterdon County. The Bank's North Plainfield office serves those communities located in the northern, eastern and central parts of Somerset County and the southernmost communities of Union County. The Bank's Scotch Plains, Linden, Union, and Springfield offices serve the majority of the communities in Union County and the southwestern communities of Essex County. The offices in Middlesex, South Plainfield, Highland Park, Edison, and Colonia Township extend the Company's service area into Middlesex County. The Bank's Phillipsburg office serves Warren County. The Bank's Forks Township office and William Penn office serve Northampton County, Pennsylvania.

## Competition

The Company is located in an extremely competitive area. The Company's service area is already serviced by major regional banks, large thrift institutions and a variety of credit unions. In addition, since passage of the Gramm-Leach-Bliley Financial Modernization Act of 1999 (the "Modernization Act"), securities firms and insurance companies have been allowed to acquire or form financial institutions, thereby increasing competition in the financial services market. Most of the Company's competitors have substantially more capital, and therefore greater lending limits than the Company. The Company's competitors generally have established positions in the service area and have greater resources than the Company with which to pay for advertising, physical facilities, personnel and interest on deposited funds. The Company relies on the competitive pricing of its loans, deposits and other services, as well as its ability to provide local decision-making and personal service in order to compete with these larger institutions.

## Employees

At December 31, 2010, the Company employed 167 full-time and 9 part-time employees. None of the Company's employees are represented by any collective bargaining units. The Company believes that its relations with its employees are good.

## Executive Officers of Registrant

The following table sets forth certain information as of December 31, 2010, regarding each executive officer of the Company who is not also a director.

Name, Age and Position	Officer Since	Principal Occupation During Past Five Years
John Kauchak, 57, Chief Operating Officer and Executive Vice President of the Company and Bank	2002	Previously, Mr. Kauchak was the head of Deposit Operations for Unity Bank from 1996 to 2002.
Alan J. Bedner, 40, Chief Financial Officer and Executive Vice President of the Company and Bank	2003	Previously, Mr. Bedner was Controller for Unity Bank from 2001 to 2003.
Ray Kenwell, 59, Chief Lending Officer and Executive Vice President of the Company and Bank	2010	Previously, President and Chief Operating Officer, Universal Interlock Corporation; Executive Vice President, Division Head of Lending of United Trust Bank

## SUPERVISION AND REGULATION

### General Supervision and Regulation

Bank holding companies and banks are extensively regulated under both federal and state law. These laws and regulations are intended to protect depositors, not stockholders. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in the applicable law or regulation may have a material effect on the business and prospects of the Company and the Bank. Over the past several years, a number of legislative proposals have been debated in Congress concerning modernization of the nation's financial system, and in the summer of 2010, Congress passed, and the President signed, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act")(discussed below). Many of these proposals will substantially alter the current regulatory framework, particularly as it relates to bank holding companies and their powers. Management of the Company is unable to predict, at this time, the specific impact of these regulatory proposals on the business of the Company.

## General Bank Holding Company Regulation

General: As a bank holding company registered under the Bank Holding Company Act of 1956, as amended, (the "BHCA"), the Company is subject to the regulation and supervision of the Federal Reserve Board (the "FRB"). The Company is required to file with the FRB annual reports and other information regarding its business operations and those of its subsidiaries. Under the BHCA, the Company's activities and those of its subsidiaries are limited to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries or engaging in any other activity which the FRB determines to be so closely related to banking or managing or controlling banks as to be properly incident thereto.

The BHCA requires, among other things, the prior approval of the FRB in any case where a bank holding company proposes to: (i) acquire all or substantially all of the assets of any other bank; (ii) acquire direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank (unless it owns a majority of such bank's voting shares); or (iii) merge or consolidate with any other bank holding company. The FRB will not approve any acquisition, merger or consolidation that would have a substantially anti-competitive effect, unless the anti-competitive impact of the proposed transaction is clearly outweighed by a greater public interest in meeting the convenience and needs of the community to be served. The FRB also considers capital adequacy and other financial and managerial resources and future prospects of the companies and the banks concerned, together with the convenience and needs of the community to be served, when reviewing acquisitions or mergers.

The BHCA also generally prohibits a bank holding company, with certain limited exceptions, from: (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company; or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries, unless such non-banking business is determined by the FRB to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such determinations, the FRB is required to weigh the expected benefits to the public such as, greater convenience, increased competition or gains in efficiency, against the possible adverse effects; such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

The BHCA was substantially amended through the Modernization Act. The Modernization Act permits bank holding companies and banks, which meet certain capital, management and Community Reinvestment Act standards, to engage in a broader range of non-banking activities. In addition, bank holding companies, which elect to become financial holding companies, may engage in certain banking and non-banking activities without prior FRB approval. Finally, the Modernization Act imposes certain new privacy requirements on all financial institutions and their treatment of consumer information. At this time, the Company has elected not to become a financial holding company.

There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the Federal Deposit Insurance Corporation (the "FDIC") insurance fund in the event the depository institution becomes in danger of default. Under a policy of the FRB with respect to bank holding company operations, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such policy. The FRB also has the authority under the BHCA to require a bank holding company to terminate any activity or to relinquish control of a non-bank subsidiary upon the FRB's determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

Capital Adequacy Guidelines for Bank Holding Companies: The FRB has adopted risk-based capital guidelines for bank holding companies. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad-risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The risk-based guidelines apply on a consolidated basis to bank holding companies with consolidated assets of \$500 million or more. The minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 4% of the total capital is required to be "Tier I," consisting of common stockholders' equity and certain preferred stock and other qualifying hybrid instruments, less certain goodwill items and other intangible assets. The remainder, "Tier II Capital," may consist of: (a) the allowance for loan losses of up to 1.25% of risk-weighted assets; (b) excess of qualifying preferred stock; (c) hybrid capital instruments; (d) debt; (e) mandatory convertible securities; and (f) qualifying subordinated debt. Total capital is the sum of Tier I and Tier II capital, less reciprocal holdings of other banking organizations' capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FRB (determined on a case-by-case basis or as a matter of policy after formal rule-making).

Bank holding company assets are given risk-weights of 0%, 20%, 50% and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset-equivalent amounts to which an appropriate risk-weighting will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first-mortgage loans that are fully secured by residential property, which carry a 50% risk-weighting. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weighting, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. Government, which have a 0% risk-weighting. In converting off-balance sheet items, direct credit substitutes (including general guarantees and standby letters of credit backing financial obligations) are given a 100% risk-weighting. Transaction-related contingencies, such as standby letters of credit backing non-financial obligations and undrawn commitments (including commercial credit lines with an initial maturity of more than one year), have a 50% risk-weighting. Short-term commercial letters of credit have a 20% risk-weighting and certain short-term unconditionally cancelable commitments have a 0% risk-weighting.

In addition to the risk-based capital guidelines, the FRB has adopted a minimum Tier I capital (leverage) ratio, under which a bank holding company must maintain a minimum level of Tier I capital to average total consolidated assets of at least 3% in the case of a bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

The Company is currently in compliance with these minimum Federal capital requirements.

### **General Bank Regulation**

As a New Jersey-chartered commercial bank, the Bank is subject to the regulation, supervision, and control of the New Jersey Department of Banking and Insurance (the "Department"). As an FDIC-insured institution, the Bank is subject to regulation, supervision and control of the FDIC, an agency of the federal government. The regulations of the FDIC and the Department affect virtually all activities of the Bank, including the minimum level of capital that the Bank must maintain, the ability of the Bank to pay dividends, the ability of the Bank to expand through new branches or acquisitions and various other matters.

Insurance of Deposits: The Dodd-Frank Act has caused significant changes in the FDIC's insurance of deposit accounts. Among other things, the Dodd-Frank Act permanently increased the FDIC deposit insurance limit to \$250 thousand per depositor. In addition, the Dodd-Frank Act includes provisions replacing, by statute, the FDIC's program to provide unlimited deposit insurance coverage for noninterest bearing transactional accounts. Institutions are not required to opt into this coverage, and can not opt out of the program. In addition, institutions are not required to pay an additional assessment for this additional coverage. Under the Dodd-Frank Act, this unlimited coverage for non-interest bearing transaction accounts will expire on December 31, 2013.

The FDIC has significantly increased deposit insurance assessment rates, beginning in the second quarter of 2009. As increased, the adjusted base assessment rates range from 12.0 to 77.5 basis points of deposits, a significant increase over premium rates for the past several years. The FDIC also levied a special assessment of 5 basis points on assets less than Tier 1 Capital as of June 30, 2009, paid September 30, 2009. The 5 basis point special assessment resulted in a charge to the Bank of approximately \$408 thousand. The FDIC also required insured depository institutions to pre-pay deposit insurance premiums for the next two and one-half years in 2009. Premium assessments are to increase by three basis points in 2011. These additional costs have and will adversely affect the Company's results of operations.

On February 7, 2011 the FDIC announced the approval of the assessment system mandated by the Dodd-Frank Act. Dodd-Frank required that the base on which deposit insurance assessments are charged be revised from one based on domestic deposits to one based on assets. The FDIC's rule to base the assessment base on average total consolidated assets minus average tangible equity instead of domestic deposits may lower assessments for community banks with less than \$10 billion in assets. The new rate schedule is effective during the second quarter of 2011 and may reduce the Company's costs.

**Dividend Rights:** Under the Banking Act, a bank may declare and pay dividends only if, after payment of the dividend, the capital stock of the bank will be unimpaired and either the bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the bank's surplus.

On December 5, 2008, the Company completed a transaction with the U.S. Treasury under the Capital Purchase Program ("CPP") through which the Treasury purchased \$20.6 million in preferred stock from the Company. As part of the CPP, the Company's future ability to pay cash dividends is limited for so long as the Treasury holds the preferred stock. As so limited the Company may not increase its quarterly cash dividend above \$.05 per share, the quarterly rate in effect at the time the CPP program was announced, without the prior approval of the Treasury.

#### **Sarbanes-Oxley Act**

On July 30, 2002, the Sarbanes-Oxley Act ("SOX") was enacted. SOX is not a banking law, but applies to all public companies, including the Company. The stated goals of SOX are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. SOX is the most far-reaching U.S. securities legislation enacted in some time. SOX generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended.

SOX includes very specific additional disclosure requirements and corporate governance rules and requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of specific issues by the SEC. SOX represents significant federal involvement in matters traditionally left to state regulatory systems such as, the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

SOX addresses, among other matters:

- Audit Committees;
- certification of financial statements by the Chief Executive Officer and the Chief Financial Officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement;
- a prohibition on insider trading during pension plan black-out periods;



- disclosure of off-balance sheet transactions;
- a prohibition on personal loans to officers and directors, unless subject to Federal Reserve Regulation O;
- expedited filing requirements for Form 4 statements of changes of beneficial ownership of securities required to be filed by officers, directors and 10% shareholders;
- disclosure of whether or not a company has adopted a code of ethics;
- “real time” filing of periodic reports;
- auditor independence; and
- various increased criminal penalties for violations of securities laws.

Complying with the requirements of SOX as implemented by the SEC may increase our compliance costs and could make it more difficult to attract and retain board members.

#### **The American Recovery and Reinvestment Act of 2009**

The American Recovery and Reinvestment Act of 2009 (the “ARRA”) became law on February 17, 2009. The main purpose of the ARRA is to provide fiscal stimulus to the U.S. economy and help foster job creation and economic activity. However, portions of the ARRA amend the Emergency Economic Stabilization Act and the terms of the CPP, and impose new requirements on institutions participating in the CPP, like the Company. Among other things, these provisions, and the regulations issued by the Treasury to implement them, require substantial new restrictions on executive compensation, prohibiting severance payments regardless of the cause of an executive’s departure and bonus payments to certain officers of institutions participating in the CPP, and require the adoption of various policies and procedures affecting compensation. The ARRA also imposes new certification requirements on management of an institution participating in the CPP, and new review requirements on the compensation committee of such an institution. These restrictions may make it more difficult for the Company to attract and retain senior management.

#### **Dodd-Frank Wall Street Reform and Consumer Protection Act**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was signed into law on July 21, 2010. Generally, the Dodd-Frank Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law, many of which will not become effective until various Federal regulatory agencies have promulgated rules implementing the statutory provisions. Uncertainty remains as to the ultimate impact of the Dodd-Frank Act, which could have a material adverse impact on the financial services industry by increasing compliance costs and reducing some sources of revenue. The Dodd-Frank Act, among other things:

- Directs the Federal Reserve to issue rules which are expected to limit debit-card interchange fees;
- Provides for an increase in the FDIC assessment for depository institutions with assets of \$10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% and changes the basis for determining FDIC premiums from deposits to assets;
- Permanently increases the deposit insurance coverage to \$250 thousand and allows depository institutions to pay interest on checking accounts;
- Creates a new consumer financial protection bureau that will have rule-making authority for a wide range of consumer protection laws that would apply to all banks and would have broad powers to supervise and enforce consumer protection laws directly for large institutions;
- Provides for new disclosure and other requirements relating to executive compensation and corporate governance;
- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries;
- Provides mortgage reform provisions regarding a customer’s ability to repay, restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by using the maximum rate that will apply during the first five years of a variable-rate loan term, and making more loans subject to provisions for higher cost loans, new disclosures, and certain other revisions; and
- Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

b) **Statistical Information**

The table below provides a cross-reference to portions of Unity Bancorp. Inc.'s Annual Report to Shareholders for the year ended December 31, 2010 (Exhibit 13 hereto), which, to the extent indicated, is incorporated by reference herein. Information that is not applicable is indicated by (N/A):

Description of Financial Data		Annual Report Pages
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**Item 1A. Risk Factors:**

Our business, financial condition, results of operations and the trading prices of our securities can be materially and adversely affected by many events and conditions including the following:

***Risks affecting Our Business:***

**The nationwide recession may adversely affect our business by reducing real estate values in our trade area and stressing the ability of our customers to repay their loans.**

Our New Jersey trade area, like the rest of the United States, is currently experiencing economic contraction. As a result, many companies have experienced reduced revenues and have laid off employees. These factors have stressed the ability of both commercial and consumer customers to repay their loans, and have, and may in the future, result in higher levels of nonaccrual loans. In addition, real estate values have declined in our trade area. Since the majority of our loans are secured by real estate, declines in the market value of real estate impact the value of the collateral securing our loans, and could lead to greater losses in the event of defaults on loans secured by real estate.

**We have a significant level of nonperforming assets, and this has, and will continue, to affect our results of operations.**

At December 31, 2010, our total nonperforming assets equaled \$24.0 million or 3.88 percent of total loans and OREO. This is a significant level of nonperforming assets compared to our peer group institutions. Our level of nonperforming assets reflects the general economic slowdown in our marketplace and its effect on our borrowers, and our focus on SBA lending, which may entail greater credit risk than other types of lending. This deterioration in credit quality has negatively impacted our results of operations, through additional provisions for loan losses and reduced interest income, and will continue to impact our performance until these assets are resolved. In addition, future increases in our nonperforming assets will further negatively affect our results of operations. We can give you no assurance that our nonperforming assets will not increase further.

**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 2008, there has been significant turmoil and volatility in global financial markets. Nationally, we have seen economic factors such as a recession, a rise in unemployment, and a weakened U.S. dollar. Recent market uncertainty regarding the financial sector has increased. In addition to the impact on the economy, 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 or realized losses on the sale of securities. The value of securities in our portfolio are affected by factors that impact the U.S. securities markets in general as well specific financial sector factors such as the deterioration of the credit worthiness of issuers. Further declines in these sectors may result in future other-than-temporary impairment charges and/or realized losses on the sale of securities.
- 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.

**Our business strategy could be adversely affected if we are not able to attract and retain skilled employees and manage our expenses.**

We expect to continue to experience growth in the scope of our operations ; and, correspondingly, in the number of our employees and customers. We may not be able to successfully manage our business as a result of the strain on our management and operations that may result from this growth. Our ability to manage this growth will depend upon our ability to continue to attract, hire and retain skilled employees. Our ability to attract and retain senior management may be adversely affected by the restrictions imposed upon us under the CPP, as revised by the American Reinvestment and Recovery Act. Our success will also depend on the ability of our officers and key employees to continue to implement and improve our operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage our employees.

**Curtailment of the Small Business Administration loan program could negatively affect the Company; the absence of a secondary market for SBA loans could negatively affect our operation.**

The Company has historically been a participant in various SBA lending programs, and the Company's activity under these programs has contributed significantly to its net income. Proposals have been made from time to time to curtail the Federal Government's funding of the SBA loan programs. Any reduction in SBA funding for its loan programs could negatively affect our results of operations.

**There is a risk that the SBA will not honor their guarantee.**

The Company has historically been a participant in various SBA lending programs which guarantee up to 90% of the principal on the underlying loan. There is a risk that the SBA will not honor their guarantee if a loan is not underwritten to SBA guidelines. The Company follows the underwriting guidelines of the SBA, however our ability to manage this will depend on our ability to continue to attract, hire and retain skilled employees who have knowledge of the SBA program.

**Our ability to earn significant noninterest income from the sale of SBA loans into the secondary market has been negatively impacted by current market conditions affecting the secondary market for SBA loans.**

Historically, the Company has earned significant noninterest income from the sale into the secondary market of substantially all of the guaranteed portion of its loans originated under the SBA's loan programs. However, starting in the fall of 2008, the secondary market for SBA loans lost liquidity, and SBA loan program participants like the Company have had difficulty selling SBA loans in the secondary market. In order to manage our capital levels, and in order to avoid holding a significant amount of these SBA loans in our portfolio, we have elected to substantially curtail our participation in SBA lending programs, closing our loan origination operations outside of our New York, New Jersey and Pennsylvania primary trade areas and only offering SBA loan products as an adjunct to community banking business. As a result, our noninterest income has substantially declined, and will not likely return to historic levels.

***Risks Related to the Banking Industry:***

**The banking business is subject to significant government regulations.**

We are subject to extensive governmental supervision, regulation and control. These laws and regulations are subject to change, and may require substantial modifications to our operations or may cause us to incur substantial additional compliance costs. In addition, future legislation and government policy could adversely affect the commercial banking industry and our operations. Such governing laws can be anticipated to continue to be the subject of future modification. Our management cannot predict what effect any such future modifications will have on our operations. In addition, the primary focus of Federal and state banking regulation is the protection of depositors and not the shareholders of the regulated institutions.

For example, the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") will result in substantial new compliance costs, and may restrict certain sources of revenue. The Dodd-Frank Act was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law, many of which will not become effective until various Federal regulatory agencies have promulgated rules implementing the statutory provisions. Uncertainty remains as to the ultimate impact of the Dodd-Frank Act, which could have a material adverse impact either on the financial services industry as a whole, or on our business, results of operations and financial condition. The Dodd-Frank Act, among other things:

- Directs the Federal Reserve to issue rules which are expected to limit debit-card interchange fees;
- Provides for an increase in the FDIC assessment for depository institutions with assets of \$10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% and changes the basis for determining FDIC premiums from deposits to assets;
- Permanently increases the deposit insurance coverage to \$250 thousand and allows depository institutions to pay interest on checking accounts;

- Creates a new consumer financial protection bureau that will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and would have broad powers to supervise and enforce consumer protection laws;
- Provides for new disclosure and other requirements relating to executive compensation and corporate governance;
- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries;
- Provides mortgage reform provisions regarding a customer's ability to repay, restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by using the maximum rate that will apply during the first five years of a variable-rate loan term, and making more loans subject to provisions for higher cost loans, new disclosures, and certain other revisions; and
- Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

**Changes in local economic conditions could adversely affect our loan portfolio.**

Our success depends to a great extent upon the general economic conditions of the local markets that we serve. Unlike larger banks that are more geographically diversified, we provide banking and financial services primarily to customers in the six counties in the New Jersey market and one county in Pennsylvania in which we have branches, so any decline in the economy of New Jersey or eastern Pennsylvania could have an adverse impact on us.

Our loans, the ability of borrowers to repay these loans, and the value of collateral securing these loans are impacted by economic conditions. Our financial results, the credit quality of our existing loan portfolio, and the ability to generate new loans with acceptable yield and credit characteristics may be adversely affected by changes in prevailing economic conditions, including declines in real estate values, changes in interest rates, adverse employment conditions and the monetary and fiscal policies of the federal government. Although economic conditions in our primary market have fared better than other areas of the United States, we cannot assure you that these conditions will continue to prevail. We cannot assure you that positive trends or developments discussed in this annual report will continue or that negative trends or developments will not have a significant adverse effect on us.

**There is a risk that we may not be repaid in a timely manner, or at all, for loans we make.**

The risk of nonpayment (or deferred or delayed payment) of loans is inherent in commercial banking. Such nonpayment, or delayed or deferred payment of loans to the Company, if they occur, may have a material adverse effect on our earnings and overall financial condition. Additionally, in compliance with applicable banking laws and regulations, the Company maintains an allowance for loan losses created through charges against earnings. As of December 31, 2010, the Company's allowance for loan losses was \$14.4 million, or 2.33% of our total loan portfolio and 66.3% of our nonperforming assets. The Company's marketing focus on small to medium size businesses may result in the assumption by the Company of certain lending risks that are different from or greater than those which would apply to loans made to larger companies. We seek to minimize our credit risk exposure through credit controls, which include evaluation of potential borrowers' available collateral, liquidity and cash flow. However, there can be no assurance that such procedures will actually reduce loan losses.

**Our allowance for loan losses may not be adequate to cover actual losses.**

Like all financial institutions, we maintain an allowance for loan losses to provide for loan defaults and nonperformance. Our allowance for loan losses may not be adequate to cover actual losses, and future provisions for loan losses could materially and adversely affect the results of our operations. Risks within the loan portfolio are analyzed on a continuous basis by management; and, periodically, by an independent loan review function and by the Audit Committee. A risk system, consisting of multiple-grading categories, is utilized as an analytical tool to assess risk and the appropriate level of loss reserves. Along with the risk system, management further evaluates risk characteristics of the loan portfolio under current economic conditions and considers such factors as the financial condition of the borrowers, past and expected loan loss experience and other factors management feels deserve recognition in establishing an adequate reserve. 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. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond our control, and these losses may exceed current estimates. State and federal regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses and have in the past required an increase in our allowance for loan losses. Although we believe that our allowance for loan losses is adequate to cover probable and reasonably estimated losses, we cannot assure you that we will not further increase the allowance for loan losses or that our regulators will not require us to increase this allowance. Either of these occurrences could adversely affect our earnings.

**We are in competition with many other banks, including larger commercial banks which have greater resources than us.**

The banking industry within the State of New Jersey is highly competitive. The Company's principal market area is also served by branch offices of large commercial banks and thrift institutions. In addition, in 1999 the Gramm-Leach-Bliley Financial Modernization Act of 1999 was passed into law. The Modernization Act permits other financial entities, such as insurance companies and securities firms, to acquire or form financial institutions, thereby further increasing competition. A number of our competitors have substantially greater resources than we do to expend upon advertising and marketing, and their substantially greater capitalization enables them to make much larger loans. Our success depends a great deal upon our judgment that large and mid-size financial institutions do not adequately serve small businesses in our principal market area and upon our ability to compete favorably for such customers. In addition to competition from larger institutions, we also face competition for individuals and small businesses from recently formed banks seeking to compete as "hometown" institutions. Most of these new institutions have focused their marketing efforts on the smaller end of the small business market we serve.

**The laws that regulate our operations are designed for the protection of depositors and the public, but not our stockholders.**

The federal and state laws and regulations applicable to our operations give regulatory authorities extensive discretion in connection with their supervisory and enforcement responsibilities and generally have been promulgated to protect depositors and the deposit insurance funds and not for the purpose of protecting stockholders. These laws and regulations can materially affect our future business. Laws and regulations now affecting us may be changed at any time, and the interpretation of such laws and regulations by bank regulatory authorities is also subject to change. We can give no assurance that future changes in laws and regulations or changes in their interpretation will not adversely affect our business.

**We may be subject to higher operating costs as a result of government regulation.**

We are subject to extensive federal and state legislation, regulation and supervision which are intended primarily to protect depositors and the Federal Deposit Insurance Corporation's Deposit Insurance Fund, rather than investors. Legislative and regulatory changes may increase our costs of doing business; or, otherwise, adversely affect us and create competitive advantages for non-bank competitors.

**We cannot predict how changes in technology will impact our business.**

The financial services market, including banking services, is increasingly affected by advances in technology, including developments in:

- telecommunications;
- data processing;
- automation;
- Internet-based banking;
- Tele-banking; and
- debit cards and so-called "smart cards."

Our ability to compete successfully in the future will depend on whether we can anticipate and respond to technological changes. To develop these and other new technologies, we will likely have to make additional capital investments. Although we continually invest in new technology, we cannot assure you that we will have sufficient resources or access to the necessary proprietary technology to remain competitive in the future.

**The Company's information systems may experience an interruption or breach in security.**

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer-relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur; or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of the Company's information systems could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny or expose the Company to civil litigation and possible financial liability; any of which could have a material adverse affect on the Company's financial condition and results of operations.

**Item 1B. Unresolved Staff Comments: None**

**Item 2. Properties:**

The Company presently conducts its business through its main office located at 64 Old Highway 22, Clinton, New Jersey, and its sixteen branch offices.

The following table sets forth certain information regarding the Company's properties from which it conducts business as of December 31, 2010.

Location	Leased or Owned	Date Leased or Acquired	Lease Expiration	2010 Annual Rental Fee
Clinton, NJ	Leased	1996	2013	\$ 410,000
Colonia, NJ	Leased	1998	2012	38,672
Flemington, NJ	Owned	2005	-----	-----
Linden, NJ	Owned	1997	-----	-----
Highland Park, NJ	Leased	1999	2014	91,193
North Plainfield, NJ	Owned	1991	-----	-----
Scotch Plains, NJ	Owned	2004	-----	-----
Springfield, NJ	Leased	1995	2011	32,935
South Plainfield, NJ	Leased	1999	2014	110,459
Union, NJ	Owned	2002	-----	-----
Edison, NJ	Leased	1999	2014	128,143
Whitehouse, NJ	Owned	1998	-----	-----
Phillipsburg, NJ	Leased	2005	2015	82,588
Middlesex, NJ	Owned	2007	-----	-----
Forks Township, PA	Leased	2006	2010	56,938
William Penn (Easton), PA	Leased	2007	2010	67,911
Great Neck, NY	Leased	2006	2010	39,820

**Item 3. 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 operating results of the Company.

**Item 4. Removed and Reserved**

## PART II

### **Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities:**

#### (a) Market Information

The Company's Common Stock is quoted on the NASDAQ Global Market under the symbol "UNTY." The following table sets forth the high and low closing prices of the Common Stock as reported on the NASDAQ Global Market for the periods indicated.

<b>Year Ended December 31, 2010:</b>	<b>High</b>	<b>Low</b>
4th Quarter	\$ 6.10	\$ 5.20
3rd Quarter	5.70	4.83
2nd Quarter	5.63	5.04
1st Quarter	5.50	3.94
<b>Year Ended December 31, 2009</b>	<b>High</b>	<b>Low</b>
4th Quarter	\$ 4.49	\$ 3.95
3rd Quarter	4.45	3.15
2nd Quarter	4.00	3.00
1st Quarter	3.90	2.75

#### (b) Holders

As of March 1, 2011, there were approximately 477 shareholders of record of the Company's Common Stock.

#### (c) Dividends

The Company did not pay any cash dividends in 2010 or 2009.

Under the terms of the CPP, we are limited in our ability to pay cash dividends. Without the approval of the Treasury, we cannot pay a quarterly cash dividend in excess of \$0.05 per share, the amount of our last quarterly cash dividend prior to October 14, 2008. In addition, during the third quarter of 2008, 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 had paid a quarterly cash 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 percent of the Company's earnings, subject to adjustment based upon factors existing at the time of the dividend and the Company's projected capital needs. Under this policy, the Board would pay a cash dividend once annually after this policy is in effect.

### **Item 6. Selected Financial Data:**

The information under the caption, "Selected Consolidated Financial Data," on page 63 of the Company's Annual Report to Shareholders for the year ended December 31, 2010, is incorporated by reference herein.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations:**

The information under the caption, "Management's Discussion and Analysis of Financial Condition and Results of Operations," on pages 6 through 24 of the Company's Annual Report to Shareholders for the year ended December 31, 2010, is incorporated by reference herein.



**Item 7A. Quantitative and Qualitative Disclosures About Market Risk:**

The information under the caption, "Market Risk," on pages 19 through 20 of the Company's Annual Report to Shareholders for the year ended December 31, 2010, is incorporated by reference herein.

**Item 8. Financial Statements and Supplementary Data:**

The Financial Statements and Notes to Consolidated Financial Statements on pages 27 through 63 of the Company's Annual Report to Shareholders for the year ended December 31, 2010, are incorporated by reference herein.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure: None**

**Item 9A. Controls and Procedures:**

**(a) Evaluation of disclosure controls and procedures:**

Based on their evaluation, as of the end of the period covered by this Annual Report on Form 10-K, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

**(b) Management's Report on Internal Control Over Financial Reporting:**

The information under the caption, "Management's Report on Internal Control Over Financial Reporting," on page 25 of the Company's Annual Report to Shareholders for the year ended December 31, 2010, is incorporated by reference herein.

**(c) Changes in internal controls:**

There were not any significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

**Item 9B. Other Information: None**

**PART III**

**Item Directors, Executive Officers and Corporate Governance; Compliance with Section 16(a) of the Exchange Act:  
10.**

The information concerning the directors and executive officers of the Company under the caption "Election of Directors," and the information under the captions, "Compliance with Section 16(a) of the Securities Exchange Act of 1934," and, "Governance of the Company," in the Proxy Statement for the Company's 2011 Annual Meeting of Shareholders, is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2011.

Also, refer to the information under the caption, "Executive Officers of Registrant," in Part I of this Annual Report on Form 10-K for a description of the Company's executive officers, who are not also directors.

**Item 11. Executive Compensation:**

The information concerning executive compensation under the caption, “Executive Compensation,” in the Proxy Statement for the Company’s 2011 Annual Meeting of Shareholders, is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2011.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters:**

The information concerning the security ownership of certain beneficial owners and management under the caption, “Security Ownership of Certain Beneficial Owners and Management,” in the Proxy Statement for the Company’s 2011 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2011.

**Securities Authorized for Issuance under Equity Compensation Plans**

The following table provides information with respect to the equity securities that are authorized for issuance under the Company’s compensation plans as of December 31, 2010.

EQUITY COMPENSATION PLAN INFORMATION			
	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation stock option plans approved by security holders	775,468	\$ 5.90	27,857
Equity compensation plans approved by security holders (Restricted Stock Plan)	43,367	-	12,335
Equity compensation plans not approved by security holders	-	-	-
Total	818,835	\$ 5.59	40,192

There were no share repurchases during 2010 or 2009. Pursuant to the requirements of the Treasury’s Capital Purchase Program, the Company has suspended its stock repurchase program.

**Item 13. Certain Relationships and Related Transactions and Director Independence:**

The information concerning certain relationships and related transactions under the caption, “Interest of Management and Others in Certain Transactions; Review, Approval or Ratification of Transactions with Related Persons,” in the Proxy Statement for the Company’s 2011 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2011.

**Item 14. Principal Accountant Fees and Services:**

The information concerning principal accountant fees and services, as well as related pre-approval policies, under the caption, “Independent Registered Public Accounting Firm,” in the Proxy Statement for the Company’s 2011 Annual Meeting of Shareholders is incorporated by reference herein. It is expected that such Proxy Statement will be filed with the Securities and Exchange Commission no later than April 29, 2011.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules:**

(a) FINANCIAL STATEMENTS:

The following Consolidated Financial Statements of the Company and subsidiaries included in the Company's Annual Report to Shareholders for the year ended December 31, 2010, are incorporated by reference in Part II, Item 8.

Report of Independent Registered Public Accounting Firm (page 26)

Consolidated Balance Sheets (page 27)

Consolidated Statements of Operations (page 28)

Consolidated Statements of Changes in Shareholders' Equity (page 29)

Consolidated Statements of Cash Flows (page 30)

Notes to Consolidated Financial Statements (pages 31 through 61)

(b) EXHIBITS:

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
3(i)	Certificate of Incorporation of the Company, as amended (2)
3(ii)	Bylaws of the Company (7)
4(i)	Form of Stock Certificate (7)
10(i)	1994 Stock Option Plan for Non-Employee Directors (1)
10(ii)	1997 Stock Option Plan (3)
10(iii)	1997 Stock Bonus Plan (3)
10(iv)	1998 Stock Option Plan (4)
10(v)	1999 Stock Option Plan (5)
10(vi)	Employment Agreement dated March 23, 2004 with James A. Hughes (8)
10(vii)	Settlement Agreement and General Release dated December 31, 2003 with Anthony J. Feraro (8)
10(ix)	Retention Agreement dated March 23, 2004 with Michael F. Downes (8)
10(x)	Retention Agreement dated March 23, 2004 with Alan J. Bedner (8)
10(xi)	Retention Agreement dated March 23, 2004 with John Kauchak (8)
10(xiii)	2002 Stock Option Plan (6)
10(xiv)	Second Amendment dated September 19, 2003 to Lease Agreement between Unity Bank and Clinton Unity Group (8)
10(xv)	Real Estate Purchase Agreement dated October 23, 2003 between Unity Bank and Premiere Development II, LLC (8)
10(xvi)	2004 Stock Bonus Plan (9)
10(xvii)	2006 Stock Option Plan (10)
10(xviii)	Third Amendment to Lease by and between Clinton Unity Group, LLC and Unity Bank dated July 31, 2009 (11)
13	Portion of Unity Bancorp. Inc. 2010 Annual Report to Shareholders
21	Subsidiaries of the Registrant
23.1	Consent of McGladrey & Pullen, LLP
31.1	Certification of President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of President, Chief Executive Officer, and Chief Financial Officer pursuant to Section 906
99.1	Certification of President and Chief Executive Officer pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act of 2008
99.2	Certification of Chief Financial Officer pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act of 2008

- (1) Previously filed with the Securities and Exchange Commission as an Exhibit to the Registration Statement on Form S-4 (File No. 33-76392) and incorporated by reference herein.
- (2) Previously filed with the Securities and Exchange Commission as an Exhibit to the Current Report on Form 8-K filed on July 22, 2002 and incorporated by reference herein.
- (3) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 4, 1997.
- (4) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on March 30, 1998.
- (5) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 2, 1999.
- (6) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 10, 2002.
- (7) Previously filed with the Securities and Exchange Commission as an Exhibit to the Annual Report on Form 10-K filed March 26, 2003.
- (8) Previously filed with the Securities and Exchange Commission as an Exhibit to the Annual Report on Form 10-K filed March 26, 2004.
- (9) Previously filed with the Securities and Exchange Commission as an Exhibit to the Proxy Statement for the Annual Meeting of Shareholders filed on April 15, 2004.
- (10) Previously filed with the Securities and Exchange Commission as an Exhibit to the Current Report on Form 8-K filed on April 27, 2006 and incorporated by reference herein.
- (11) Previously filed with the Securities and Exchange Commission as an Exhibit to the Current Report on Form 8-K filed on August 4, 2009 and incorporated by reference herein.
- (c) Not applicable

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Alan J. Bedner, Jr.  
Alan J. Bedner, Jr.  
Executive Vice President  
Chief Financial Officer

Date: March 17, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
<u>/s/ David D. Dallas</u> David D. Dallas	Chairman of the Board and Director	March 17, 2011
<u>/s/ James A. Hughes</u> James A. Hughes	President, Chief Executive Officer And Director	March 17, 2011
<u>/s/ Alan J. Bedner, Jr.</u> Alan J. Bedner, Jr.	Chief Financial Officer (Principal Financial and Accounting Officer)	March 17, 2011
<u>/s/ Dr. Mark S. Brody</u> Dr. Mark S. Brody	Director	March 17, 2011
<u>/s/ Wayne Courtright</u> Wayne Courtright	Director	March 17, 2011
<u>/s/ Robert H. Dallas, II</u> Robert H. Dallas, II	Director	March 17, 2011
<u>/s/ Mary Gross</u> Mary Gross	Director	March 17, 2011
<u>/s/ Peter E. Maricondo</u> Peter E. Maricondo	Director	March 17, 2011
<u>/s/ Raj Patel</u> Raj Patel	Director	March 17, 2011
<u>/s/ Allen Tucker</u> Allen Tucker	Director	March 17, 2011

# Management's Discussion & Analysis of Financial Condition & Results of Operations

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the notes relating thereto included herein. When necessary, reclassifications have been made to prior period's data for purposes of comparability with current period presentation without impacting earnings.

## Overview

Unity Bancorp, Inc. (the "Parent Company") is a bank holding company incorporated in New Jersey and registered 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") is chartered by the New Jersey Department of Banking and Insurance. The Bank provides a full range of commercial and retail banking services through the Internet and its sixteen branch offices located in Hunterdon, Middlesex, Somerset, 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 ("SBA") and other commercial credits.

## Results of Operations

Net Income available to common share holders for the year ended December 31, 2010 was \$720 thousand compared to a loss of \$2.6 million in 2009. The increase was attributable to an increase in net interest income, an increase in noninterest income and continued expense management. During 2010, we have seen signs of economic recovery albeit at a moderate pace. However there continues to be stress on the financial industry in terms of asset quality and loan demand. Credit quality continues to remain a primary focus as delinquencies are inflated throughout the industry. Due to this, in 2010 the Company intentionally decreased the size of the balance sheet and loan portfolio to focus on improving credit quality and capital management.

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

- Continued growth in net interest income,
- The net interest margin expanded 45 basis points to 3.67 percent,
- Noninterest income, excluding the effect of OTTI charges and security gains, increased 27.9 percent due to record gains on mortgage loan sales,
- Nonperforming assets declined \$3 million to \$24 million from \$27 million at year-end 2009,
- The mix of our deposits improved, and
- The Company remained well capitalized.

Items which materially impacted earnings for the year included:

- A \$7.3 million provision for loan losses due to the increased level of charge offs and the inherent credit risk within the loan portfolio, and
- A \$1.1 million increase in expenses on other real estate owned ("OREO")

The Company's performance ratios are listed below:

	2010	2009
Net income (loss) per common share - Basic (1)	\$ 0.10	\$ (0.36)
Net income (loss) per common share - Diluted (1)	\$ 0.10	\$ (0.36)
Return (loss) on average assets	0.26%	(0.12)%
Return (loss) on average equity (2)	1.43%	(5.29)%
Efficiency ratio	71.43%	75.49 %

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

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

## Net Interest Income

The primary source of income for the Company is net interest income, the difference between the interest earned on earning assets such as investments and loans, and the interest paid on deposits and borrowings. Factors that impact the Company's net interest income include the interest rate environment, the volume and mix of interest-earning assets and interest-bearing liabilities, and the competitive nature of the Company's marketplace.

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

During 2010, tax-equivalent interest income decreased \$5.4 million or 10.9 percent to \$44.1 million. This decrease was driven by the lower average yield on earning assets and a decrease in the average volume of earning assets:

- Of the \$5.4 million decrease in interest income on a tax-equivalent basis, \$2.5 million was attributed to reduced yields on interest-earning assets, and \$2.9 million was due to the decrease in average interest-earning assets.
- The average volume of interest-earning assets decreased \$45.9 million to \$821.0 million in 2010 compared to \$866.9 million in 2009. This was due primarily to a \$25.3 million decrease in average investment securities and a \$28.3 million decrease in average loans, partially offset by an \$8.2 million increase in federal funds sold and interest-bearing deposits.

- The yield on interest-earning assets decreased 33 basis points to 5.38 percent in 2010 due to the continued re-pricing in an overall lower interest rate environment. Yields on most earning assets, particularly those with variable rates, fell due to these lower market rates. There was a slight increase in the yield on residential mortgage loans.

Total interest expense was \$14.0 million in 2010, a decrease of \$7.5 million or 35.0 percent compared to 2009. This decrease was driven by the lower overall interest rate environment combined with the shift in deposit mix away from higher priced products and a decrease in the average volume of interest-bearing liabilities:

- Of the \$7.5 million decrease in interest expense in 2010, \$4.3 million was attributed to a decrease in the rates paid on interest-bearing liabilities, and \$3.3 million was due to the decrease in the volume of average interest-bearing liabilities.
- Interest-bearing liabilities averaged \$707.8 million in 2010, a decrease of \$49.6 million, or 6.5 percent, compared to 2009. The decrease in interest-bearing liabilities was a result of decreases in average time deposits and borrowed funds, partially offset by increases in all other deposit categories.
- The average cost of interest-bearing liabilities decreased 87 basis points to 1.97 percent, primarily due to the repricing of deposits in a lower interest rate environment. This was partially offset by an increase in the cost of borrowings due to the use of low cost overnight lines of credit and a low rate repurchase agreement in 2009 and not in 2010. The cost of interest-bearing deposits decreased 105 basis.
- The lower cost of funding was also attributed to a shift in the mix of deposits from higher cost time deposits to lower cost savings deposits and demand deposits.

Tax-equivalent net interest income amounted to \$30.1 million in 2010, an increase of \$2.1 million, or 7.7 percent, compared to 2009. Net interest margin increased 45 basis points to 3.67 percent for 2010, compared to 3.22 percent in 2009. The net interest spread was 3.41 percent, a 54 basis point increase from 2.87 percent in 2009.

The table on pages 8 and 9 reflects the components of net interest income, setting forth for the periods presented herein: (1) average assets, liabilities and shareholders' equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) net interest spread (which is the average yield on interest-earning assets less the average rate on interest-bearing liabilities), and (5) net interest income/margin on average earning assets. Rates/Yields are computed on a fully tax-equivalent basis, assuming a federal income tax rate of 34 percent.

## Consolidated Average Balance Sheets

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

For the years ended December 31,

	2010			2009		
	Average Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield
<b>ASSETS</b>						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits	\$ 35,349	\$ 87	0.25%	\$ 27,163	\$ 117	0.43%
Federal Home Loan Bank stock	4,646	235	5.06	5,061	277	5.47
Securities:						
Available for sale	118,984	4,353	3.66	135,537	6,189	4.57
Held to maturity	23,496	1,149	4.89	32,292	1,593	4.93
Total securities (A)	142,480	5,502	3.86	167,829	7,782	4.64
Loans, net of unearned discount:						
SBA	95,353	5,264	5.52	103,031	6,246	6.06
SBA 504	66,767	4,305	6.45	73,517	4,821	6.56
Commercial	285,771	18,130	6.34	301,340	19,881	6.60
Residential mortgage	132,414	7,684	5.80	126,474	7,252	5.73
Consumer	58,200	2,926	5.03	62,481	3,160	5.06
Total loans (A),(B)	638,505	38,309	6.00	666,843	41,360	6.20
Total interest-earning assets	\$ 820,980	\$ 44,133	5.38%	\$ 866,896	\$ 49,536	5.71%
Noninterest-earning assets:						
Cash and due from banks	20,672			18,948		
Allowance for loan losses	(14,667)			(11,721)		
Other assets	41,817			33,913		
Total noninterest-earning assets	47,822			41,140		
Total Assets	\$ 868,802			\$ 908,036		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 100,729	\$ 737	0.73%	\$ 89,500	\$ 1,063	1.19%
Savings deposits	289,156	2,829	0.98	214,274	3,574	1.67
Time deposits	216,488	6,173	2.85	341,233	12,523	3.67
Total interest-bearing deposits	606,373	9,739	1.61	645,007	17,160	2.66
Borrowed funds and subordinated debentures	101,449	4,296	4.18	112,403	4,422	3.88
Total interest-bearing liabilities	\$ 707,822	\$ 14,035	1.97%	\$ 757,410	\$ 21,582	2.84%
Noninterest-bearing liabilities:						
Demand deposits	87,684			79,252		
Other liabilities	4,174			4,313		
Total noninterest-bearing liabilities	91,858			83,565		
Shareholders' equity	69,122			67,061		
Total Liabilities and Shareholders' Equity	\$ 868,802			\$ 908,036		
Net interest spread		\$ 30,098	3.41%		\$ 27,954	2.87%
Tax-equivalent basis adjustment		(98)			(126)	
Net interest income		\$ 30,000			\$ 27,828	
Net interest margin			3.67 %			3.22 %

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

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



2008			2007			2006		
Average Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield	Average Balance	Interest	Rate/ Yield
\$ 26,686	\$ 471	1.76%	\$ 22,290	\$ 1,068	4.79%	\$ 21,606	\$ 1,042	4.82%
4,353	240	5.51	3,336	258	7.73	2,340	139	5.94
74,243	3,761	5.07	65,853	3,253	4.94	64,134	2,964	4.62
31,710	1,654	5.22	37,724	1,986	5.26	41,156	2,069	5.03
105,953	5,415	5.11	103,577	5,239	5.06	105,290	5,033	4.78
101,430	8,370	8.25	84,185	9,039	10.74	84,113	8,615	10.24
74,617	5,572	7.47	66,393	5,345	8.05	54,462	4,514	8.29
308,751	21,424	6.94	275,448	20,393	7.40	240,311	17,400	7.24
100,110	5,971	5.96	68,443	3,995	5.84	59,933	3,305	5.51
59,291	3,462	5.84	54,789	3,722	6.79	47,652	3,208	6.73
644,199	44,799	6.95	549,258	42,494	7.74	486,471	37,042	7.61
\$ 781,191	\$ 50,925	6.52%	\$ 678,461	\$ 49,059	7.23%	\$ 615,707	\$ 43,256	7.02%
17,529			13,467			12,439		
(9,179)			(8,184)			(7,493)		
31,667			29,304			29,302		
40,017			34,587			34,248		
\$ 821,208			\$ 713,048			\$ 649,955		
\$ 84,336	\$ 1,468	1.74%	\$ 85,750	\$ 1,928	2.25%	\$ 117,730	\$ 2,648	2.25%
168,784	3,644	2.16	204,214	8,064	3.95	183,815	6,948	3.78
330,174	13,836	4.19	213,407	10,206	4.78	169,572	7,101	4.19
583,294	18,948	3.25	503,371	20,198	4.01	471,117	16,697	3.54
108,214	4,526	4.18	84,962	4,276	5.03	55,756	2,735	4.91
\$ 691,508	\$ 23,474	3.39%	\$ 588,333	\$ 24,474	4.16%	\$ 526,873	\$ 19,432	3.69%
78,282			75,581			77,747		
2,531			2,416			2,218		
80,813			77,997			79,965		
48,887			46,718			43,117		
\$ 821,208			\$ 713,048			\$ 649,955		
	\$ 27,451	3.13%		\$ 24,585	3.07%		\$ 23,824	3.33%
	(160)			(159)			(79)	
	\$ 27,291			\$ 24,426			\$ 23,745	
		3.51%			3.62%			3.87%

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

Year ended December 31, (In thousands on a tax-equivalent basis)	2010 versus 2009			2009 versus 2008		
	Increase (Decrease) Due to change in			Increase (Decrease) Due to change in		
	Volume	Rate	Net	Volume	Rate	Net
<b>Interest Income:</b>						
Federal funds sold and interest-bearing deposits	\$ 28	\$ (58)	\$ (30)	\$ 8	\$ (362)	\$ (354)
Federal Home Loan Bank stock	(22)	(20)	(42)	39	(2)	37
Investment securities	(1,129)	(1,151)	(2,280)	2,862	(495)	2,367
Net loans	(1,750)	(1,301)	(3,051)	1,242	(4,681)	(3,439)
Total interest income	\$ (2,873)	\$ (2,530)	\$ (5,403)	\$ 4,151	\$ (5,540)	\$ (1,389)
<b>Interest Expense:</b>						
Interest-bearing demand deposits	\$ 122	\$ (448)	\$ (326)	\$ 85	\$ (490)	\$ (405)
Savings deposits	1,014	(1,759)	(745)	861	(931)	(70)
Time deposits	(3,941)	(2,409)	(6,350)	451	(1,764)	(1,313)
Total deposits	\$ (2,805)	\$ (4,616)	\$ (7,421)	\$ 1,397	\$ (3,185)	\$ (1,788)
Borrowed funds and subordinated debentures	(452)	326	(126)	192	(296)	(104)
Total interest expense	\$ (3,257)	\$ (4,290)	\$ (7,547)	\$ 1,589	\$ (3,481)	\$ (1,892)
Net interest income – fully tax-equivalent	\$ 384	\$ 1,760	\$ 2,144	\$ 2,562	\$ (2,059)	\$ 503
Decrease (increase) in tax-equivalent adjustment			28			34
Net interest income			\$ 2,172			\$ 537

#### Provision for Loan Losses

The provision for loan losses totaled \$7.3 million for 2010, a decrease of \$750 thousand compared to \$8.0 million for 2009. Each period's loan loss provision is the result of management's analysis of the loan portfolio and reflects changes in the size and composition of the portfolio, the level of net charge-offs, delinquencies, current economic conditions and other internal and external factors impacting the risk within the loan portfolio. Additional information may be found under the caption, "Financial Condition - Allowance for Loan Losses and Unfunded Loan Commitments." The current provision is considered appropriate under management's assessment of the adequacy of the allowance for loan losses.

#### Noninterest Income

Noninterest income was \$5.1 million for 2010, a \$2.9 million increase compared to \$2.1 million for 2009. The increase is primarily due to other-than-temporary impairment ("OTTI") charges recorded during 2009, compared to no OTTI charges during 2010 and to higher gains on the sale of residential mortgage loans. Excluding OTTI, noninterest income would have increased \$318 thousand. The following table shows the components of noninterest income for 2010 and 2009:

(In thousands)	2010	2009
Branch fee income	\$ 1,424	\$ 1,418
Service and loan fee income	979	1,214
Gain on sale of SBA loans held for sale, net	500	393
Gain on sale of mortgage loans	1,052	217
Bank owned life insurance	310	222
Other-than-temporary impairment charges on securities	-	(2,611)
Net security gains	85	855
Other income	719	432
Total noninterest income	\$ 5,069	\$ 2,140

Changes in our noninterest income reflect:

- Branch fee income was relatively flat for 2010 when compared to 2009.
- Service and loan fee income decreased \$235 thousand, primarily as a result of lower levels of prepayment fees.

- Net gains on SBA loan sales amounted to \$500 thousand on \$4.8 million in sales.
- Gains on the sale of mortgage loans increased \$835 thousand due to a higher volume of loans sold. Sales of mortgage loans totaled \$54.3 million and \$17.7 million for 2010 and 2009, respectively.
- In December 2004, the Company purchased \$5.0 million of bank owned life insurance ("BOLI"). An additional \$2.5 million was purchased in January 2010 to help offset the rising costs of employee benefits. The increase in the cash surrender value of BOLI was \$310 thousand for 2010, compared to \$222 thousand in 2009.
- No OTTI charges on securities were recorded in 2010. During 2009, the Company recognized \$2.6 million of credit related other-than-temporary impairment losses on two held to maturity securities due to the deterioration in the underlying collateral. These two pooled trust preferred securities, which had a cost basis of \$3.0 million, had been previously written down \$306 thousand in December of 2008. The remaining book value of the trust preferred securities is approximately \$50 thousand as of December 31, 2010.
- The Company realized net security gains of \$85 thousand on the sale of securities in 2010 compared to \$855 thousand in 2009. The gross gains during 2010 are primarily attributed to the Company selling approximately \$11.0 million in book value of mortgage-backed securities, resulting in pretax gains of approximately \$329 thousand, five called structured agency securities with resulting gains of \$8 thousand, and one called held to maturity municipal security with a resulting gain of \$4 thousand. These gains were partially offset by losses of \$166 thousand on the sale of approximately \$3.5 million in book value of three mortgage-backed securities and losses of \$90 thousand on the sale of five held to maturity tax-exempt municipal securities with a total book value of approximately \$2.0 million. Although designated as held to maturity, these municipal securities were sold due to deterioration in the issuer's creditworthiness, as evidenced by downgrades in their credit ratings. The gross gains of \$855 thousand in 2009 are primarily attributed to the Company selling approximately \$31.5 million in book value of mortgage-backed securities, resulting in pretax gains of approximately \$827 thousand on the sales. The Company also sold its remaining callable Freddie Mac perpetual preferred securities resulting in pretax gains of \$28 thousand. There were no realized losses in 2009.
- Other income totaled \$719 thousand and \$432 thousand in 2010 and 2009, respectively. The increase is primarily due to a refund of New Jersey state sales tax for overpayment in previous years received during the second quarter of 2010.

## Noninterest Expense

Total noninterest expense was \$25.0 million for 2010, an increase of \$1.0 million or 4.4 percent over 2009. The following table presents a breakdown of noninterest expense for the years ended December 31, 2010 and 2009:

(In thousands)	2010	2009
Compensation and benefits	\$ 11,875	\$ 11,243
Occupancy	2,522	2,552
Processing and communications	2,139	2,077
Furniture and equipment	1,755	1,829
Professional services	737	1,042
Loan collection costs	964	1,023
OREO expense	1,316	220
Deposit insurance	1,301	1,707
Advertising	624	530
Other expenses	1,757	1,724
Total noninterest expense	\$ 24,990	\$ 23,947

Changes in noninterest expense reflect:

- Compensation and benefits expense, the largest component of noninterest expense, increased \$632 thousand or 5.6 percent. This increase is attributable to an increase in compensation, higher employee medical benefits costs, and increased residential mortgage commissions due to higher sales volumes, partially offset by lower incentive bonus payouts. At December 31, 2010 and 2009 there were 172 and 165 full-time equivalent employees, respectively.
- Occupancy expense declined \$30 thousand or 1.2 percent due primarily to the renegotiation of the lease on the Company's corporate headquarters and a decline in depreciation expenses on capital expenditures, partially offset by an increase in seasonal snow removal costs, property taxes, and janitorial expenses.
- Processing and communications expenses increased \$62 thousand or 3.0 percent. This increase was primarily the result of increased data processing line costs and cell phone expenses.
- Furniture and equipment expense decreased \$74 thousand or 4.0 percent due to lower depreciation expense as capital expenditures declined, as well as lower maintenance costs on equipment.
- Professional service fees decreased \$305 thousand or 29.3 percent in 2010 due to lower audit, legal and loan review fees.
- Loan collection costs decreased \$59 thousand or 5.8 percent due to decreased collections costs on a lower level of past due loans.
- OREO expenses increased \$1.1 million due to increased maintenance and valuation related expenses on OREO properties.
- Deposit insurance expense decreased \$406 thousand in 2010 due primarily to the \$408 thousand special assessment in the second quarter of 2009, while there was no comparable charge in 2010.

- Advertising expense increased \$94 thousand or 17.7 percent in 2010, which reflects the Company's sales initiatives and brand recognition efforts.
- Other expenses increased \$33 thousand or 1.9 percent compared to the prior year. This increase was due primarily to uninsured losses.

#### Income Tax Expense

For 2010, the Company reported income tax expense of \$589 thousand for a 20.8 percent effective tax rate compared to an income tax benefit of \$898 thousand or a 45.4 percent effective tax rate in 2009. The benefit in 2009 was due to a net loss. The Company anticipates a higher effective tax rate in 2011.

#### Financial Condition

Total assets decreased \$111.9 million or 12.0 percent, to \$818.4 million at December 31, 2010, compared to \$930.4 million at December 31, 2009. This decrease was due to a \$41.1 million decrease in total loans, a \$40.8 million decrease in total securities, and a \$29.7 million decrease in cash and cash equivalents, while total deposits decreased \$103.5 million and total borrowed funds and subordinated debentures declined \$10.0 million. Total shareholders' equity increased \$2.2 million from the prior year. Average total assets for 2010 were \$868.8 million, a \$39.2 million decrease from the prior year's \$908.0 million average balance. Further discussion of these fluctuations is discussed in the sections that follow.

#### Investment Securities Portfolio

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

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

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

AFS securities totaled \$107.1 million at December 31, 2010, a decrease of \$33.6 million or 23.9 percent, compared to \$140.8 million at December 31, 2009. This net decrease was the result of the following:

- \$65.9 million in principal payments, maturities and called bonds,
- \$14.3 million in sales net of realized gains, which consisted primarily of mortgage-backed securities and collateralized mortgage obligations ("CMOs"), and
- \$836 thousand in net amortization of premiums, partially offset by
- \$46.7 million in purchases, which consisted of \$24.4 million of mortgage-backed securities and CMOs, \$13.0 million of U.S. Government sponsored entities, \$8.3 million state and political subdivision bonds, and \$1.0 million of Community Reinvestment Act ("CRA") investments, and
- \$705 thousand appreciation in the fair value of the portfolio. At December 31, 2010, the portfolio had a net unrealized gain of \$697 thousand compared to a net unrealized loss of \$8 thousand at the end of the prior year. These unrealized gains (losses) are reflected net of tax in shareholders' equity as accumulated other comprehensive income (loss).

The average balance of securities available for sale amounted to \$119.0 million in 2010 compared to \$135.5 million in 2009. The average yield earned on the available for sale portfolio decreased 91 basis points, to 3.66 percent in 2010 from 4.57 percent in 2009. The weighted average repricing of securities available for sale, adjusted for prepayments, amounted to 2.5 years at December 31, 2010 and 2009.

At December 31, 2010, the Company's available for sale portfolio included one bank trust preferred security with a book value of \$977 thousand and a fair value of \$565 thousand. The Company monitors the credit worthiness of the issuer of this security quarterly. At December 31, 2010, the Company had not taken any OTTI credit loss adjustments on this security. Management will continue to monitor the performance of the security and the underlying institution for impairment.

HTM securities were \$21.1 million at December 31, 2010, a decrease of \$7.1 million or 25.3 percent, from year-end 2009. This net decrease was the result of:

- \$8.9 million in principal payments, maturities and called bonds,
- \$2.0 million in sales net of realized losses, which consisted primarily of state and political subdivision bonds which were downgraded, and
- \$45 thousand in net amortization of premiums, partially offset by
- \$3.8 million in purchases of mortgage-backed securities and obligations of state and political subdivisions.

As of December 31, 2010 and 2009, the fair value of held to maturity securities was \$21.4 million and \$28.4 million, respectively. The average balance of securities held to maturity amounted to \$23.5 million in 2010 compared to \$32.3 million in 2009. The average yield earned on held to maturity securities decreased 4 basis points, from 4.93 percent in 2009 to 4.89 percent in 2010. The weighted average repricing of held to maturity securities, adjusted for prepay-

ments, amounted to 3.5 years and 2.7 years at December 31, 2010 and December 31, 2009, respectively.

During 2009, the Company recognized \$2.6 million of credit related other-than-temporary impairment losses on two held to maturity securities due to the deterioration in the underlying collateral. These two securities were transferred from the AFS portfolio to the HTM portfolio during 2008 at fair value with the adjustment being posted to other comprehensive income in shareholders' equity. Consequently, the \$2.6 million OTTI charge resulted in a \$1.5 million net decrease to HTM securities and a \$1.1 million increase to other comprehensive income in shareholders' equity. These two pooled trust preferred securities, which had a cost basis of \$3.0 million, had been previously written down by \$306 thousand in December of 2008. The remaining book value of the trust preferred securities was approximately \$50 thousand at December 31, 2010.

Securities with a carrying value of \$63.4 million and \$71.4 million at December 31, 2010 and 2009, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law.

Approximately 84 percent of the total investment portfolio had a fixed rate of interest at December 31, 2010.

#### Loan Portfolio

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

Total loans decreased \$41.1 million or 6.3 percent to \$615.9 million at December 31, 2010, compared to \$657.0 million at year-end 2009. The declines occurred in all loan types, are a direct result of the economic downturn, low consumer and business confidence levels, and reflect the impact of loan sales and reduced loan demand. Creditworthy borrowers are cutting back on capital expenditures or postponing their purchases in hopes that the economy will improve. In general, banks are lending less because consumers and businesses are demanding less credit.

The following table sets forth the classification of loans by major category, including unearned fees, deferred costs and excluding the allowance for loan losses for the past five years at December 31:

	2010		2009		2008		2007		2006	
(In thousands)	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
SBA held for sale	\$ 10,397	1.7%	\$ 21,406	3.3%	\$ 22,181	3.2%	\$ 24,640	4.2%	\$ 12,273	2.4%
SBA held to maturity	75,741	12.3	77,844	11.8	83,127	12.1	68,875	11.7	66,802	13.2
SBA 504	64,276	10.4	70,683	10.8	76,802	11.2	72,145	12.2	58,067	11.4
Commercial	281,205	45.7	293,739	44.6	308,165	44.9	293,641	49.7	254,128	50.1
Residential mortgage	128,400	20.8	133,059	20.3	133,110	19.5	73,697	12.5	63,493	12.5
Consumer	55,917	9.1	60,285	9.2	62,561	9.1	57,134	9.7	52,927	10.4
Total loans	\$ 615,936	100.0%	\$ 657,016	100.0%	\$ 685,946	100.0%	\$ 590,132	100.0%	\$ 507,690	100.0%

Average loans decreased \$28.3 million or 4.2 percent from \$666.8 million in 2009 to \$638.5 million in 2010. The decrease in average loans was due to a decline in all loan products except residential mortgage loans. The yield on the overall loan portfolio fell 20 basis points to 6.00 percent in 2010 compared to 6.20 percent in 2009. This decrease was the result of variable rate, prime-based loan products such as SBA loans and home equity lines of credit repricing lower as market rates remained low in 2010. The prime rate has remained at 3.25 percent since December 2008.

SBA loans, on which the SBA provides guarantees of up to 90 percent of the principal balance, are considered a higher risk loan product for the Company than its other loan products. The Company's SBA loans were historically sold in the secondary market with the nonguaranteed portion held in the portfolio as a loan held for investment. During the third and fourth quarters of 2008, as a result of the significantly reduced premiums on sale and the ongoing credit crisis, the Company closed all SBA production offices outside of its New Jersey, Pennsylvania and New York primary trade area. Consequently, the volume of new SBA loans and gains on SBA loans declined in 2010 and 2009. In addition, new authoritative accounting guidance under FASB ASC Topic 860, "Transfers and Servicing," requires that the gains on sales of SBA 7(a) loans be deferred for a 90-day period after the sale.

SBA 7(a) loans held for sale, carried at the lower of cost or market, amounted to \$10.4 million at December 31, 2010, a decrease of \$11.0 million from \$21.4 million at December 31, 2009. SBA 7(a) loans held to maturity amounted to \$75.7 million at December 31, 2010, a decrease of \$2.1 million from \$77.8 million at December 31, 2009. The yield on SBA loans, which are generally floating and adjust quarterly to the Prime rate, was 5.52 percent for 2010, compared to 6.06 percent for the prior year due to the continued low interest rate environment.

At December 31, 2010, SBA 504 loans totaled \$64.3 million, a decrease of \$6.4 million from \$70.7 million at December 31, 2009. The SBA 504 program consists of real estate backed commercial mortgages where the Company has the first mortgage and the SBA has the second mortgage on the property. Generally, the Company has a 50 percent loan to value ratio on SBA 504 program loans. The yield on SBA 504 loans dropped 11 basis points to 6.45 percent for 2010 compared to 6.56 percent for 2009.

Commercial loans are generally made in the Company's market place for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. These loans amounted to \$281.2 million at December 31, 2010, a decrease of \$12.5 million from year-end 2009. This decrease can be attributed to principal pay-downs on these loans with minimal new loan volume. The yield on commercial loans was 6.34 percent for 2010, compared to 6.60 percent for the prior year.

Residential mortgage loans consist of loans secured by 1 to 4 family residential properties. These loans amounted to \$128.4 million at December 31, 2010, a decrease of \$4.7 million from \$133.1 million at year-end 2009. New loan volume during the year was offset by the sale of mortgage loans totaling \$54.3 million. The yield on residential mortgages was 5.80 percent for the year ended December 31, 2010, compared to 5.73 percent for 2009.

Consumer loans consist of home equity loans and loans for the purpose of financing the purchase of consumer goods, home improvements, and other personal needs, and are generally secured by the personal property being purchased. These loans amounted to \$55.9 million at December 31, 2010, a decrease of \$4.4 million from December 31, 2009. The yield on consumer loans was 5.03 percent for 2010, compared to 5.06 percent for the prior year.

As of December 31, 2010, approximately 12 percent of the Company's total loan portfolio consisted of loans to various unrelated and unaffiliated borrowers in the Hotel/Motel industry. Such loans are collateralized by the underlying real property financed and/or partially guaranteed by the SBA. There are no other concentrations of loans to any borrowers or group of borrowers exceeding 10 percent of the total loan portfolio. There are no foreign loans in the portfolio. As a preferred SBA lender, a portion of the SBA portfolio is to borrowers outside the Company's lending area. However, during late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area.

The following table shows the maturity distribution or repricing of the loan portfolio and the allocation of floating and fixed interest rates at December 31, 2010:

(In thousands)	Within 1 Year	1-5 Years	After 5 Years	Total
SBA	\$ 62,733	\$ 12,712	\$ 10,693	\$ 86,138
SBA 504	18,079	40,768	5,429	64,276
Commercial	119,728	137,285	24,192	281,205
Residential mortgage	30,152	55,084	43,164	128,400
Consumer	37,567	11,723	6,627	55,917
Total	\$ 268,259	\$ 257,572	\$ 90,105	\$ 615,936
Amount of loans with maturities or repricing dates greater than one year:				
Fixed interest rates			\$	173,867
Floating or adjustable interest rates				173,810
Total			\$	347,677

#### Asset Quality

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

The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. The current state of the economy and the downturn in the real estate market have resulted in increased loan delinquencies and defaults. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market. In response to the credit risk in its portfolio, the Company has increased staffing in its credit monitoring department and increased efforts in the collection and analysis of borrowers' financial statements and tax returns.

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

The following table sets forth information concerning nonperforming loans and nonperforming assets at December 31 for the past five years:

(In thousands)	2010	2009	2008	2007	2006
<b>Nonperforming by category:</b>					
SBA (1)	\$ 8,162	\$ 6,559	\$ 4,228	\$ 2,110	\$ 5,212
SBA 504	2,714	5,575	4,600	-	-
Commercial	5,452	7,397	5,247	1,630	3,172
Residential mortgage	5,085	5,578	1,808	1,192	322
Consumer	249	387	237	529	203
Total nonperforming loans	\$ 21,662	\$ 25,496	\$ 16,120	\$ 5,461	\$ 8,909
OREO	2,346	1,530	710	106	211
Total nonperforming assets	\$ 24,008	\$ 27,026	\$ 16,830	\$ 5,567	\$ 9,120
<b>Past due 90 days or more and still accruing interest:</b>					
SBA	\$ 374	\$ 592	\$ 332	\$ 114	\$ -
SBA 504	-	-	-	-	-
Commercial	-	469	146	41	-
Residential mortgage	-	1,196	2,058	-	78
Consumer	-	29	-	-	-
Total	\$ 374	\$ 2,286	\$ 2,536	\$ 155	\$ 78
Nonperforming loans to total loans	3.52%	3.88%	2.35%	0.93%	1.75%
Nonperforming assets to total loans and OREO	3.88	4.10	2.45	0.94	1.80
Nonperforming assets to total assets	2.93	2.90	1.87	0.74	1.31
(1) SBA loans guaranteed	\$ 2,706	\$ 1,931	\$ 1,983	\$ 714	\$ 2,953

The current state of the economy largely impacts the Company's level of delinquent and nonperforming loans. The recession that began in 2008 continues to put a strain on the Company's borrowers and their ability to pay their loan obligations. Unemployment rates are at the highest level in 25 years and businesses are reluctant to hire. Unemployment and flat wages have caused consumer spending and demand for goods to decline, impacting the profitability of small businesses. Consequently, the Company's nonperforming loans remain at an elevated level.

Nonperforming loans were \$21.7 million at December 31, 2010, a \$3.8 million decrease from \$25.5 million at year-end 2009. Nonperforming loans decreased in all loan categories, except for SBA loans. Included in nonperforming loans at December 31, 2010, are approximately \$2.7 million of loans guaranteed by the SBA, compared to \$1.9 million at December 31, 2009. In addition, there were \$374 thousand and \$2.3 million in loans past due 90 days or more and still accruing interest at December 31, 2010 and December 31, 2009, respectively.

Other real estate owned ("OREO") properties totaled \$2.3 million at December 31, 2010, an increase of \$816 thousand from \$1.5 million at year-end 2009. During the year, the Company took title to nineteen properties totaling \$9.7 million and sold sixteen properties totaling \$8.9 million. A net loss of \$807 thousand was realized on the sales during 2010.

Potential problem loans are those loans where information about possible credit problems of borrowers causes management to have doubts as to the ability of such borrowers to comply with loan repayment terms. These loans are not included in nonperforming loans as they continue to perform. Potential problem loans totaled \$5.5 million at December 31, 2010, an increase of \$3.9 million from \$1.6 million at December 31, 2009. The increase is due to the addition of \$8.8 million during 2010 which consisted primarily of SBA and commercial loans, partially offset by the removal of \$4.9 million during the period.

The Company has defined impaired loans to be all nonperforming loans and troubled debt restructurings. Troubled debt restructurings ("TDRs") occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate, extending the maturity of a loan, or a combination of both. At December 31, 2010, there were fifteen loans totaling \$14.1 million that were classified as TDRs by the Company and are deemed impaired, compared to four loans totaling \$6.6 million at December 31, 2009. TDRs are not included in the nonperforming or potential problem loan figures listed above, as they continue to perform under their modified terms.

## Allowance for Loan Losses and Unfunded Loan Commitments

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

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

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

Beginning in 2009, the Company significantly increased its loan loss provisions in response to the inherent credit risk within its loan portfolio and changes to some of the environmental factors noted above. The inherent credit risk was evidenced by the increase in net charge-offs during the year, 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.

The allowance for loan losses totaled \$14.4 million and \$13.8 million at December 31, 2010 and December 31, 2009, respectively, with a resulting allowance to total loan ratios of 2.33 percent and 2.11 percent, respectively. Net charge-offs amounted to \$6.7 million in 2010, compared to \$4.5 million in 2009. The increase in net charge-offs was primarily related to the SBA 504 and commercial loan portfolios, most of which are secured by real estate. Net charge-offs to average loan ratios are shown in the table below for each major loan category. In 2010, the highest net charge-off ratio can be seen in the Company's higher risk SBA 504 portfolio.



The following is a summary of the allowance for loan losses for the past five years:

(In thousands)	2010	2009	2008	2007	2006
Balance, beginning of year	\$ 13,842	\$ 10,326	\$ 8,383	\$ 7,624	\$ 6,892
Provision charged to expense	7,250	8,000	4,500	1,550	1,550
Charge-offs:					
SBA	1,351	1,874	1,246	770	573
SBA 504	1,548	812	1,000	-	-
Commercial	3,627	1,845	408	155	298
Residential mortgage	500	216	25	-	-
Consumer	245	27	145	50	62
Total charge-offs	7,271	4,774	2,824	975	933
Recoveries:					
SBA	243	123	177	147	20
SBA 504	-	27	-	-	-
Commercial	296	134	39	18	75
Residential mortgage	-	-	-	-	-
Consumer	4	6	51	19	20
Total recoveries	543	290	267	184	115
Total net charge-offs	6,728	4,484	2,557	791	818
Balance, end of year	\$ 14,364	\$ 13,842	\$ 10,326	\$ 8,383	\$ 7,624
Selected loan quality ratios:					
Net charge-offs to average loans:					
SBA	1.16%	1.70%	1.05%	0.74%	0.66%
SBA 504	2.32	1.07	1.34	0.00	0.00
Commercial	1.17	0.57	0.12	0.05	0.09
Residential mortgage	0.38	0.17	0.02	0.00	0.00
Consumer	0.41	0.03	0.16	0.06	0.09
Total loans	1.05	0.67	0.40	0.14	0.17
Allowance to total loans	2.33	2.11	1.51	1.42	1.50
Allowance to nonperforming loans	66.31	54.29	64.06	153.49	85.58

The following table sets forth, for each of the major lending categories, the amount of the allowance for loan losses allocated to each category and the percentage of total loans represented by such category, as of December 31st of each year. The allocated allowance is the total of identified specific and general reserves by loan category. The allocation is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of the portfolio.

	2010		2009		2008		2007		2006	
(In thousands)	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Balance applicable to:										
SBA	\$ 4,198	14.0%	\$ 3,247	15.1%	\$ 2,579	15.3%	\$ 2,181	15.9%	\$ 1,961	15.6%
SBA 504	1,551	10.4	1,872	10.8	1,065	11.2	902	12.2	726	11.4
Commercial	6,011	45.7	6,013	44.6	4,415	44.9	4,186	49.7	3,728	50.1
Residential mortgage	1,679	20.8	1,615	20.3	1,464	19.5	564	12.5	221	12.5
Consumer	586	9.1	632	9.2	646	9.1	505	9.7	319	10.4
Unallocated	339	-	463	-	157	-	45	-	669	-
Total	\$ 14,364	100.0%	\$ 13,842	100.0%	\$ 10,326	100.0%	\$ 8,383	100.0%	\$ 7,624	100.0%

In addition to the allowance for loan losses, the Company maintains an allowance for unfunded loan commitments at a level that management believes is adequate to absorb estimated probable losses. Management determines this amount using estimates of future loan funding and losses related to those credit exposures. Adjustments to the allowance are made through other expense and applied to the allowance which is maintained in other liabilities. At December 31, 2010, a \$66 thousand commitment reserve was reported on the balance sheet as an "other liability" compared to a \$76 thousand commitment reserve at December 31, 2009.

## Deposits

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

The following are period-end deposit balances for each of the last three years:

At December 31,	2010		2009		2008	
(In thousands)	Amount	%	Amount	%	Amount	%
Ending balance:						
Noninterest-bearing demand deposits	\$ 91,272	13.9%	\$ 80,100	10.6%	\$ 74,090	10.5%
Interest-bearing demand deposits	105,530	16.1	100,046	13.2	87,046	12.3
Savings deposits	277,394	42.5	286,334	37.7	134,875	19.1
Time deposits	180,592	27.5	291,759	38.5	411,106	58.1
Total deposits	\$ 654,788	100.0%	\$ 758,239	100.0%	\$ 707,117	100.0%

Total deposits decreased \$103.5 million to \$654.8 million at December 31, 2010, from \$758.2 million at December 31, 2009. The decrease in deposits was the result of a \$111.2 million decrease in time deposits and an \$8.9 million decrease in savings deposits, partially offset by an \$11.2 million increase in noninterest-bearing demand deposits and a \$5.5 million increase in interest-bearing demand deposits. The decline in time deposits was due to the planned run off of a maturing high rate promotion done at the end of 2008 to bolster liquidity. The increase in noninterest-bearing and interest-bearing demand deposits was a result of new sales initiatives and efforts by branch personnel to bring in deposit relationships.

The mix of deposits shifted to a more favorable mix during 2010 as the concentration of time deposits fell from 38.5 percent of total deposits at December 31, 2009 to 27.5 percent of total deposits at December 31, 2010. The average cost of interest-bearing deposits in 2010 was 1.61 percent compared to 2.66 percent for 2009. The decrease in the cost of deposits is attributed to the lower interest rate environment and the favorable shift from higher cost time deposits to demand and savings deposits.

The following are average deposits for each of the last three years:

	2010		2009		2008	
(In thousands)	Amount	%	Amount	%	Amount	%
Average balance:						
Noninterest-bearing demand deposits	\$ 87,684	12.6%	\$ 79,252	10.9%	\$ 78,282	11.8%
Interest-bearing demand deposits	100,729	14.5	89,500	12.4	84,336	12.7
Savings deposits	289,156	41.7	214,274	29.6	168,784	25.5
Time deposits	216,488	31.2	341,233	47.1	330,174	50.0
Total deposits	\$ 694,057	100.0%	\$ 724,259	100.0%	\$ 661,576	100.0%

## Borrowed Funds and Subordinated Debentures

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

As of December 31, 2010, borrowed funds totaled \$90.5 million, a decrease of \$10.0 million from the prior year-end. This decrease was due to the maturity of a \$10.0 million fixed rate FHLB advance in December 2010.

As of December 31, 2010 and 2009, the Company was a party to the following transactions:

(In thousands)	2010	2009
FHLB borrowings:		
Fixed rate advances	\$ 30,000	\$ 40,000
Repurchase agreements	30,000	30,000
Other repurchase agreements	15,000	15,000
Subordinated debentures	15,465	15,465

At December 31, 2010, the Company had \$73.2 million of additional credit available at the FHLB. Pledging additional collateral in the form of 1 to 4 family residential mortgages or investment securities can increase the line with the FHLB.

For additional information, see Note 10 to the Consolidated Financial Statements.

## Market Risk

Based on the Company's business, the two largest risks facing the Company are market risk and credit risk. Market risk for the Company is primarily limited to interest rate risk, which is the impact that changes in interest rates would have on future earnings. The Company's Risk Management Committee ("RMC") manages this risk. The principal objectives of RMC 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 Board-approved guidelines. RMC reviews the maturities and repricing of loans, investments, deposits and borrowings, cash flow needs, current market conditions, and interest rate levels.

The Company uses various techniques to evaluate risk levels on both a short and long-term basis. One of the monitoring tools is the "gap" ratio. A gap ratio, as a percentage of assets, is calculated to determine the maturity and repricing mismatch between interest rate-sensitive assets and interest rate-sensitive liabilities. A gap is considered positive when the amount of interest rate-sensitive assets repricing exceeds the amount of interest rate-sensitive liabilities repricing in a designated time period. A positive gap should result in higher net interest income with rising interest rates, as the amount of the assets repricing exceed the amount of liabilities repricing. Conversely, a gap is considered negative when the amount of interest rate-sensitive liabilities exceeds interest rate-sensitive assets, and lower rates should result in higher net interest income.

Repricing of mortgage-related securities are shown by contractual amortization and estimated prepayments based on the most recent 3-month constant prepayment rate. Callable agency securities are shown based upon their option-adjusted spread modified duration date ("OAS"), rather than the next call date or maturity date. The OAS date considers the coupon on the security, the time to the next call date, the maturity date, market volatility and current rate levels. Fixed rate loans are allocated based on expected amortization.

The following table sets forth the gap ratio at December 31, 2010. Assumptions regarding the repricing characteristics of certain assets and liabilities are critical in determining the projected level of rate sensitivity. Certain savings and interest checking accounts are less sensitive to market interest rate changes than other interest-bearing sources of funds. Core deposits such as interest-bearing demand, savings and money market deposits are allocated based on their expected repricing in relation to changes in market interest rates.

(In thousands)	Under six months	Six months through one year	More than one year through three years	More than three years through five years	More than five years through ten years	More than ten years and not repricing	Total
<b>Assets</b>							
Cash & due from banks	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 17,637	\$ 17,637
Federal funds sold and interest-bearing deposits	26,289	-	-	-	-	-	26,289
Federal Home Loan Bank stock	-	-	-	-	-	4,206	4,206
Securities	28,485	16,999	37,526	14,031	18,189	13,012	128,242
Loans	205,362	62,897	171,664	85,908	47,708	42,397	615,936
Other assets	-	-	-	-	-	26,100	26,100
<b>Total Assets</b>	<b>\$ 260,136</b>	<b>\$ 79,896</b>	<b>\$ 209,190</b>	<b>\$ 99,939</b>	<b>\$ 65,897</b>	<b>\$ 103,352</b>	<b>\$ 818,410</b>
<b>Liabilities and Shareholders' Equity</b>							
Noninterest-bearing demand deposits	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 91,272	\$ 91,272
Savings and interest-bearing demand deposits	156,307	943	103,784	72,881	49,009	-	382,924
Time deposits	61,296	42,952	65,103	10,935	306	-	180,592
Borrowed funds and subordinated debentures	15,000	-	-	10,000	65,000	465	90,465
Other liabilities	-	-	-	-	-	3,072	3,072
Shareholders' equity	-	-	-	-	-	70,085	70,085
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 232,603</b>	<b>\$ 43,895</b>	<b>\$ 168,887</b>	<b>\$ 93,816</b>	<b>\$ 114,315</b>	<b>\$ 164,894</b>	<b>\$ 818,410</b>
Interest Rate Swap	\$ 15,000	\$ (10,000)	\$ (5,000)	\$ -	\$ -	\$ -	\$ -
Gap	\$ 42,533	\$ 26,001	\$ 35,303	\$ 6,123	\$ (48,418)	\$ (61,542)	\$ -
Cumulative Gap	\$ 42,533	\$ 68,534	\$ 103,837	\$ 109,960	\$ 61,542	\$ -	\$ -
Cumulative Gap to Total Assets%	5.2%	8.4%	12.7 %	13.4%	7.5 %	-	-

At December 31, 2010, there was a six-month asset-sensitive gap of \$42.5 million and a one-year asset-sensitive gap of \$68.5 million, as compared to asset-sensitive gaps of \$31.6 million and \$38.2 million at December 31, 2009. The six-month and one-year cumulative gap to total assets ratios were within the Board-approved guidelines of +/- 20 percent.

Other models are also used in conjunction with the static gap table, which is not able to capture the risk of changing spread relationships over time, the effects of projected growth in the balance sheet or dynamic decisions such as the modifica-

tion of investment maturities as a rate environment unfolds. For these reasons, a simulation model is used, where numerous interest rate scenarios and balance sheets are combined to produce a range of potential income results. Net interest income is managed within guideline ranges for interest rates rising or falling by 200 basis points. Results outside of guidelines require action by RMC to correct the imbalance. Simulations are typically created over a 12 to 24 month time horizon. At December 31, 2010, these simulations show that with a 200 basis point rate increase over a 12 month period, net interest income would decrease by approximately \$140 thousand, or 0.5 percent. A 200 basis point rate decline over a 12 month period would decrease net interest income by approximately \$592 thousand or 1.9 percent. These variances in net interest income are within the Board-approved guidelines of +/- 5 percent.

Finally, to measure the impact of longer-term asset and liability mismatches beyond two years, the Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity ("EVPE") models. 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 RMC. The Company's variance in the economic value of equity with rate shocks of 200 basis points is a decline of 8.46 percent in a rising rate environment and a decline of 9.13 percent in a falling rate environment at December 31, 2010. At December 31, 2009, the Company's variance in the economic value of equity with rate shocks of 200 basis points is a decline of 11.99 percent in a rising rate environment and a decline of 11.86 percent in a falling rate environment. The variance in the EVPE at December 31, 2010 and 2009 is within Board-approved guidelines of +/- 35 percent.

#### Financial Derivatives

In order to manage interest rate risk, the Company may enter into financial derivative contracts such as interest rate swaps. At December 31, 2010 and 2009 the Company was a party to interest rate swap agreements used to hedge variable rate debt as follows:

(In thousands, except percentages and years)	2010	2009
Notional amount	\$ 15,000	\$ 15,000
Weighted average pay rate	4.05%	4.05%
Weighted average receive rate (three-month LIBOR)	0.34%	0.90%
Weighted average maturity in years	0.90	1.90
Unrealized loss relating to interest rate swaps	\$ (499)	\$ (777)

For additional information, see Note 12 to the Company's Consolidated Financial Statements.

#### Operating, Investing and Financing

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At December 31, 2010, the balance of cash and cash equivalents was \$43.9 million, a decrease of \$29.7 million from December 31, 2009.

Net cash provided by operating activities totaled \$17.0 million for the year ended December 31, 2010, compared to \$4.5 million for the prior year. The primary sources of funds were adjustments to net income, such as the provision for loan losses, depreciation expenses, proceeds from SBA loans held for sale and mortgage loans held for sale, offset by originations of SBA and mortgage loans held for sale.

Net cash provided by investing activities amounted to \$67.7 million in 2010, compared to of \$4.5 million in 2009. The cash provided by investing activities was primarily a result of sales, maturities and principal payments on securities and a net decrease in loans, partially offset by purchases of securities.

Net cash used in financing activities was \$114.4 million in 2010, compared to net cash provided by financing activities of \$30.2 million for 2009. Net cash used in financing activities consisted of a decline in deposits, the repayment of borrowings and dividends paid on preferred stock, partially offset by proceeds from the exercise of stock options and related tax benefits.

#### Liquidity

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

#### Parent Company

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

At December 31, 2010, the Parent Company had \$4.1 million in cash and \$98 thousand in marketable securities, valued at fair market value compared to \$5.1 million in cash and \$90 thousand in marketable securities at December 31, 2009. The decrease in cash at the Parent Company was primarily due to the payment of cash dividends on preferred stock.

#### Consolidated Bank

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

greatly influenced by general interest rates, economic conditions and competition.

Total FHLB borrowings amounted to \$60.0 million and third party repurchase agreements totaled \$15.0 million as of December 31, 2010. At December 31, 2010, \$73.2 million was available for additional borrowings from the FHLB. Pledging additional collateral in the form of 1 to 4 family residential mortgages or investment securities can increase the line with the FHLB. An additional source of liquidity is the securities available for sale portfolio and SBA loans held for sale portfolio, which amounted to \$107.1 million and \$10.4 million, respectively, at December 31, 2010.

As of December 31, 2010, deposits included \$36.3 million of Government deposits, as compared to \$29.2 million at year-end 2009. These deposits are generally short in duration and are very sensitive to price competition. The Company believes that the current level of these types of deposits is appropriate. Included in the portfolio were \$32.1 million of deposits from five municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.

The Company was committed to advance approximately \$66.0 million to its borrowers as of December 31, 2010, compared to \$76.2 million at December 31, 2009. At December 31, 2010, \$17.2 million of these commitments expire after one year, compared to \$32.7 million a year earlier. At December 31, 2010, the Company had \$1.5 million in standby letters of credit compared to \$6.4 million at December 31, 2009. The estimated fair value of these guarantees is not significant. The Company believes it has the necessary liquidity to honor all commitments. Many of these commitments will expire and never be funded.

#### Off-Balance Sheet Arrangements and Contractual Obligations

The following table shows the amounts and expected maturities of off-balance sheet arrangements as of December 31, 2010. Further discussion of these commitments is included in Note 11 to the Consolidated Financial Statements.

(In thousands)	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Standby letters of credit	\$ 1,419	\$ -	\$ -	\$ 48	\$ 1,467

The following table shows the contractual obligations of the Company by expected payment period, as of December 31, 2010. Further discussion of these commitments is included in Notes 10 and 11 to the Consolidated Financial Statements.

(In thousands)	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Borrowed funds and subordinated debentures	\$ -	\$ -	\$ 10,000	\$ 80,465	\$ 90,465
Operating lease obligations	1,035	2,082	291	-	3,408
Purchase obligations	1,070	353	-	-	1,423
Total	\$ 2,105	\$ 2,435	\$ 10,291	\$ 80,465	\$ 95,296

Borrowed funds and subordinated debentures include fixed term borrowings from the Federal Home Loan Bank, repurchase agreements and subordinated debentures. The borrowings have defined terms and under certain circumstances are callable at the option of the lender.

Operating leases represent obligations, net of any sublease agreements, entered into by the Company for the use of land, premises and equipment. The leases generally have escalation terms based upon certain defined indexes.

Purchase obligations represent legally binding and enforceable agreements to purchase goods and services from third parties and consist primarily of contractual obligations under data processing service agreements.

#### Capital

A significant measure of the strength of a financial institution is its capital base. Federal regulators have classified and defined capital into the following components: (1) tier 1 capital, which includes tangible shareholders' equity for common stock, qualifying preferred stock and other qualifying hybrid instruments, and (2) tier 2 capital, which includes a portion of the allowance for loan losses, certain qualifying long-term debt and preferred stock which does not qualify as tier 1 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 predefined credit risk factors (risk-weighted assets). A bank is required to maintain, at a minimum, tier 1 capital as a percentage of risk-weighted assets of 4 percent and combined tier 1 and tier 2 capital as a percentage of risk-weighted assets of 8 percent.

In addition, banks are required to meet a leverage capital requirement, which measures tier 1 capital against average assets. Banks which are highly rated and not experiencing significant growth are required to maintain a leverage ratio of 3 percent while all other banks are expected to maintain a leverage ratio 1 to 2 percentage points higher.

The following table summarizes the Company's and the Bank's risk-based and leveraged capital ratios at December 31, 2010 and 2009, as well as the minimum regulatory capital ratios required to be deemed "well-capitalized."

<b>Company</b>	<b>2010</b>	<b>2009</b>	<b>Adequately Capitalized Requirements</b>	<b>Well-Capitalized Requirements</b>
Leverage ratio	<b>9.97%</b>	8.83%	4.00%	N/A
Tier 1 risk-based capital ratio	<b>13.04</b>	11.75	4.00	N/A
Total risk-based capital ratio	<b>14.30</b>	13.01	8.00	N/A

  

<b>Bank</b>	<b>2010</b>	<b>2009</b>	<b>Adequately Capitalized Requirements</b>	<b>Well-Capitalized Requirements</b>
Leverage ratio	<b>8.48%</b>	7.38%	4.00%	5.00%
Tier 1 risk-based capital ratio	<b>11.10</b>	9.82	4.00	6.00%
Total risk-based capital ratio	<b>13.69</b>	12.30	8.00	10.00%

At December 31, 2010, shareholders' equity was \$70.1 million, an increase of \$2.2 million from year-end 2009. The increase in shareholders' equity was due to net income of \$2.2 million, \$430 thousand from the issuance of common stock under employee benefit plans, \$418 thousand in net unrealized gains on the available for sale securities portfolio, and \$166 thousand in net unrealized gains on cash flow hedge derivatives, partially offset by \$1.0 million in dividends accrued on preferred stock. The issuance of common stock under employee benefit plans includes nonqualified stock options, restricted stock expense, employee option exercises and the tax benefit of options exercised.

On December 5, 2008, the Company completed a transaction with the U.S. Treasury under the Capital Purchase Program ("CPP") through which the Treasury purchased \$20.6 million in preferred stock from the Company. As part of the CPP, the Company's future ability to pay cash dividends is limited for so long as the Treasury holds the preferred stock. Consequently the Company may not increase its quarterly cash dividend above \$0.05 per share, the quarterly rate in effect at the time the CPP program was announced, without the prior approval of the Treasury. No dividends were paid in 2010 or 2009. The Company is currently preserving capital and will resume paying dividends when earnings improve and credit quality improves.

The Company pays quarterly dividends to the U.S. Treasury on the preferred stock which it holds. During 2010, the Company accrued \$1.0 million in dividends payable and \$486 thousand in the accretion of the discount on the preferred stock. The accrued preferred stock dividends and discount accretion are presented in the Consolidated Statements of Operations and Consolidated Statements of Changes in Shareholders' Equity. Amounts accrued and unpaid are included on the Consolidated Balance Sheets as "Accrued expenses and other liabilities." Cash dividends paid to the U.S. Treasury totaled \$1.0 million during 2010 and appear on the Consolidated Statements of Cash Flows.

Pursuant to the requirements of the Treasury's CPP, the Company has suspended its stock repurchase program. The Company's share repurchase program, which was approved on October 21, 2002, authorized the repurchase of up to 10 percent of its outstanding common stock. The amount and timing of purchases is dependent on a number of factors, including the price and availability of the Company's shares, general market conditions and competing alternate uses of funds. As of December 31, 2010 the Company had repurchased a total of 556 thousand shares of which 131 thousand shares have been retired, leaving 153 thousand shares remaining to be repurchased under the plan.

#### Forward-Looking Statements

This report contains certain forward-looking statements, either expressed or implied, which are provided to assist the reader in understanding anticipated future financial performance. These statements involve certain risks, uncertainties, estimates and assumptions by management.

Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to those listed under Item 1A - "Risk Factors" in the Company's Annual Report on Form 10-K; the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in tax, accounting or regulatory practices and requirements; and technological changes. Although management has taken certain steps to mitigate the negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on future profitability.

#### Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations" is based upon the Company's Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2010, contains a summary of the

Company's significant accounting policies. Management believes the Company's policies with respect to the methodology for the determination of the allowance for loan losses, income taxes, servicing assets, cash flow hedges and other-than-temporary impairment on securities involve a higher degree of complexity and require management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies are periodically reviewed with the Audit Committee and the Board of Directors.

#### **Allowance for Loan Losses**

The provision for loan losses is based upon management's evaluation of the adequacy of the allowance for loan losses, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which the full ability to collect may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Company's loans are secured by real estate. Accordingly, the ability to collect a substantial portion of the carrying value of the Company's loan portfolio is susceptible to changes in local real estate market conditions and may be adversely affected should real estate values continue to decline. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Company's control.

For additional information on the allowance for loan losses, see Note 6 to the Consolidated Financial Statements.

#### **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 would be recognized in income tax expense on the income statement.

For additional information on income taxes, see Note 16 to the Consolidated Financial Statements.

#### **Servicing Assets**

Servicing assets represent the allocated value of retained servicing rights on loans sold. Servicing assets are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on stratifying the underlying financial assets by date of origination and term. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment, if temporary, would be reported as a valuation allowance.

For additional information on servicing assets, see Note 5 to the Consolidated Financial Statements.

#### **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 December 31, 2010, all of the Company's derivative instruments qualified as hedging instruments.

For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based on the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. The Company does not have any fair value hedges or hedges of foreign operations.

The Company formally documents the relationship between the hedging instruments and the 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.

For additional information on derivative instruments, see Note 12 to the Consolidated Financial Statements.

#### **Other-Than-Temporary Impairment**

The Company has a process in place to identify debt securities that could potentially have a credit impairment that is other-than-temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. This evaluation considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value.

Management assesses their intent to sell or whether it is more likely than not that they will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired with no intent to sell and no requirement to sell prior to recovery of its amortized cost basis, the amount of the impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

For additional information on other-than-temporary impairment, see Note 4 to the Consolidated Financial Statements.



## Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f) under the Securities Exchange Act of 1934. Under the supervision and with the participation of the principal executive officer and the principal financial officer, management conducted an evaluation of the effectiveness of our control over financial reporting based on the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on our evaluation under the framework, management has concluded that our internal control over financial reporting was effective as of December 31, 2010.

Pursuant to the rules of the Securities and Exchange Commission, management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2010 has not been attested to by McGladrey & Pullen, LLP, the independent registered public accounting firm that audited the Company's Consolidated Financial Statements for the year ended December 31, 2010, as stated in their report which is included herein.

/s/ James A. Hughes  
James A. Hughes  
President and Chief Executive Officer

/s/ Alan J. Bedner  
Alan J. Bedner  
Executive Vice President and Chief Financial Officer

# Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders  
Unity Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Unity Bancorp, Inc. and subsidiaries ("the Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Unity Bancorp, Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey & Pullen, LLP  
McGladrey & Pullen, LLP  
Blue Bell, Pennsylvania  
March 17, 2011

# Consolidated Balance Sheets

(In thousands)

December 31,	2010	2009
<b>ASSETS</b>		
Cash and due from banks	\$ 17,637	\$ 23,517
Federal funds sold and interest-bearing deposits	26,289	50,118
Cash and cash equivalents	43,926	73,635
Securities:		
Available for sale	107,131	140,770
Held to maturity (fair value of \$21,351 and \$28,406 in 2010 and 2009, respectively)	21,111	28,252
Total securities	128,242	169,022
Loans:		
SBA held for sale	10,397	21,406
SBA held to maturity	75,741	77,844
SBA 504	64,276	70,683
Commercial	281,205	293,739
Residential mortgage	128,400	133,059
Consumer	55,917	60,285
Total loans	615,936	657,016
Less: Allowance for loan losses	14,364	13,842
Net loans	601,572	643,174
Premises and equipment, net	10,967	11,773
Bank owned life insurance	8,812	6,002
Deferred tax assets	7,550	7,308
Federal Home Loan Bank stock	4,206	4,677
Accrued interest receivable	3,791	4,225
Prepaid FDIC insurance	3,266	4,739
Other real estate owned ("OREO")	2,346	1,530
Other assets	2,188	2,713
Goodwill and other intangibles	1,544	1,559
Total Assets	\$ 818,410	\$ 930,357
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Deposits:		
Noninterest-bearing demand deposits	\$ 91,272	\$ 80,100
Interest-bearing demand deposits	105,530	100,046
Savings deposits	277,394	286,334
Time deposits, under \$100,000	119,478	183,377
Time deposits, \$100,000 and over	61,114	108,382
Total deposits	654,788	758,239
Borrowed funds	75,000	85,000
Subordinated debentures	15,465	15,465
Accrued interest payable	556	710
Accrued expenses and other liabilities	2,516	3,078
Total Liabilities	748,325	862,492
Commitments and contingencies (Note 11)	-	-
Shareholders' equity:		
Cumulative perpetual preferred stock, Series B, \$1 liquidation preference per share, 500 shares authorized, 21 shares issued and outstanding in 2010 and 2009	19,019	18,533
Common stock, no par value, 12,500 shares authorized, 7,636 shares issued and 7,211 outstanding in 2010; 7,569 shares issued and 7,144 outstanding in 2009	55,884	55,454
Accumulated deficit	(772)	(1,492)
Treasury stock at cost (425 shares in 2010 and 2009)	(4,169)	(4,169)
Accumulated other comprehensive income (loss)	123	(461)
Total Shareholders' Equity	70,085	67,865
Total Liabilities and Shareholders' Equity	\$ 818,410	\$ 930,357

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

# Consolidated Statements of Operations

(In thousands, except per share amounts)

For the years ended December 31,

	2010	2009
<b>INTEREST INCOME</b>		
Federal funds sold and interest-bearing deposits	\$ 87	\$ 117
Federal Home Loan Bank stock	235	277
Securities:		
Available for sale	4,287	6,136
Held to maturity	1,117	1,520
Total securities	5,404	7,656
Loans:		
SBA	5,264	6,246
SBA 504	4,305	4,821
Commercial	18,130	19,881
Residential mortgage	7,684	7,252
Consumer	2,926	3,160
Total loans	38,309	41,360
Total interest income	44,035	49,410
<b>INTEREST EXPENSE</b>		
Interest-bearing demand deposits	737	1,063
Savings deposits	2,829	3,574
Time deposits	6,173	12,523
Borrowed funds and subordinated debentures	4,296	4,422
Total interest expense	14,035	21,582
Net interest income	30,000	27,828
Provision for loan losses	7,250	8,000
Net interest income after provision for loan losses	22,750	19,828
<b>NONINTEREST INCOME</b>		
Branch fee income	1,424	1,418
Service and loan fee income	979	1,214
Gain on sale of SBA loans held for sale, net	500	393
Gain on sale of mortgage loans	1,052	217
Bank owned life insurance	310	222
Other-than-temporary impairment charges	-	(2,611)
Net security gains	85	855
Other income	719	432
Total noninterest income	5,069	2,140
<b>NONINTEREST EXPENSE</b>		
Compensation and benefits	11,875	11,243
Occupancy	2,522	2,552
Processing and communications	2,139	2,077
Furniture and equipment	1,755	1,829
Professional services	737	1,042
Loan collection costs	964	1,023
OREO expenses	1,316	220
Deposit insurance	1,301	1,707
Advertising	624	530
Other expenses	1,757	1,724
Total noninterest expense	24,990	23,947
Income (loss) before provision (benefit) for income taxes	2,829	(1,979)
Provision (benefit) for income taxes	589	(898)
Net income (loss)	2,240	(1,081)
Preferred stock dividends and discount accretion	1,520	1,496
Income available (loss attributable) to common shareholders	\$ 720	\$ (2,577)
Net income (loss) per common share - Basic	\$ 0.10	\$ (0.36)
Net income(loss) per common share - Diluted	0.10	(0.36)
Weighted average common shares outstanding - Basic	7,173	7,121
Weighted average common shares outstanding - Diluted	7,447	7,121

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

## Consolidated Statements of Changes in Shareholders' Equity

(In thousands)	Preferred Stock	Common Stock		Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Shareholders' Equity
		Shares	Amount			Loss	
Balance, December 31, 2008	\$ 18,064	7,119	\$ 55,179	\$ 1,085	\$ (4,169)	\$ (2,356)	\$ 67,803
Comprehensive income:							
Net loss				(1,081)			(1,081)
Net unrealized gains on securities						1,733	1,733
Net unrealized gains on cash flow hedge derivatives						162	162
Total comprehensive income							814
Accretion of discount on preferred stock	469			(469)			-
Dividends on preferred stock (5% annually)				(1,027)			(1,027)
Common stock issued and related tax effects		25	275				275
Balance, December 31, 2009	\$ 18,533	7,144	\$ 55,454	\$ (1,492)	\$ (4,169)	\$ (461)	\$ 67,865
Comprehensive income:							
Net income				2,240			2,240
Net unrealized gains on securities						418	418
Net unrealized gains on cash flow hedge derivatives						166	166
Total comprehensive income							2,824
Accretion of discount on preferred stock	486			(486)			-
Dividends on preferred stock (5% annually)				(1,034)			(1,034)
Common stock issued and related tax effects		67	430				430
Balance, December 31, 2010	\$ 19,019	7,211	\$ 55,884	\$ (772)	\$ (4,169)	\$ 123	\$ 70,085

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

# Consolidated Statements of Cash Flows

(In thousands)

For the years ended December 31,

	2010	2009
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 2,240	\$ (1,081)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	7,250	8,000
Net amortization of purchase premiums and discounts on securities	881	535
Depreciation and amortization	1,282	1,418
Deferred income tax benefit	(641)	(2,084)
Other-than-temporary impairment charges on securities	-	2,611
Net security gains	(85)	(855)
Stock compensation expense	317	310
Loss on sale of OREO	807	150
Gain on sale of SBA loans held for sale, net	(500)	(393)
Gain on sale of mortgage loans	(1,052)	(217)
Origination of mortgage loans held for sale	(54,299)	(17,711)
Origination of SBA loans held for sale	(1,573)	(6,446)
Proceeds from the sale of mortgage loans held for sale, net	55,351	17,928
Proceeds from the sale of SBA loans held for sale, net	5,286	5,626
Loss on the sale of premises and equipment	9	6
Net change in other assets and liabilities	1,702	(3,283)
<b>Net cash provided by operating activities</b>	<b>16,975</b>	<b>4,514</b>
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities held to maturity	(3,765)	(4,036)
Purchases of securities available for sale	(46,711)	(104,779)
Purchases of Federal Home Loan Bank stock, at cost	-	(8,469)
Maturities and principal payments on securities held to maturity	8,882	6,362
Maturities and principal payments on securities available for sale	65,877	50,318
Proceeds from sale of securities held to maturity	1,893	-
Proceeds from sale of securities available for sale	14,513	32,403
Proceeds from redemption of Federal Home Loan Bank stock	471	8,649
Proceeds from the sale of OREO	8,078	2,272
Net decrease in loans	21,353	22,290
Purchase of bank owned life insurance	(2,500)	-
Proceeds from the sale of premises and equipment	35	20
Purchases of premises and equipment	(421)	(496)
<b>Net cash provided by investing activities</b>	<b>67,705</b>	<b>4,534</b>
<b>FINANCING ACTIVITIES:</b>		
Net (decrease) increase in deposits	(103,451)	51,122
Proceeds from new borrowings	-	22,000
Repayments of borrowings	(10,000)	(42,000)
Proceeds from issuance of common stock	94	9
Cash dividends paid on preferred stock	(1,032)	(975)
<b>Net cash (used in) provided by financing activities</b>	<b>(114,389)</b>	<b>30,156</b>
(Decrease) increase in cash and cash equivalents	(29,709)	39,204
Cash and cash equivalents at beginning of year	73,635	34,431
Cash and cash equivalents at end of year	\$ 43,926	\$ 73,635
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash		
Interest paid	\$ 14,189	\$ 21,677
Income taxes paid	1,328	1,056
Noncash investing activities:		
Transfer of AFS SBA loans to HTM SBA loans	7,796	1,988
Transfer of loans to OREO	9,700	3,242

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

# Notes to Consolidated Financial Statements

## 1. Summary of Significant Accounting Policies

### Overview

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”). All significant intercompany balances and transactions have been eliminated in consolidation.

Unity Bancorp, Inc. is a bank holding company incorporated in New Jersey and registered under the Bank Holding Company Act of 1956, as amended. Its wholly-owned subsidiary, the Bank, is chartered by the New Jersey Department of Banking and Insurance. The Bank provides a full range of commercial and retail banking services through 16 branch offices located in Hunterdon, Middlesex, Somerset, 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 (“SBA”) and other commercial credits.

Unity Bank has eight wholly-owned subsidiaries, Unity Investment Services, Inc., Unity Financial Services, Inc., AJB Residential Realty Enterprises, Inc., AJB Commercial Realty, Inc., MKCD Commercial, Inc., JAH Commercial, Inc., UB Commercial LLC, and ASBC Holdings LLC. Unity Investment Services, Inc. is used to hold and administer part of the Bank’s investment portfolio. Unity Financial Services, Inc. sells third party investments such as insurance and annuities. The other subsidiaries hold, administer and maintain the Bank’s other real estate owned (“OREO”) properties.

The Company has two statutory trust subsidiaries that are wholly-owned by Unity Bancorp, Inc. See details in Note 10 to the Consolidated Financial Statements.

### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Amounts requiring the use of significant estimates include the allowance for loan losses, valuation of deferred tax and servicing assets, the carrying value of loans held for sale and other real estate owned, the determination of other-than-temporary impairment for securities and fair value disclosures. Actual results could differ from those estimates.

### Reclassifications

Certain reclassifications have been made to the prior year to conform to the current year presentation, with no impact on prior year earnings.

### Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and interest-bearing deposits.

### Securities

The Company classifies its securities into two categories, available for sale and held to maturity.

Securities that are classified as available for sale are stated at fair value. Unrealized gains and losses on securities available for sale are excluded from results of operations and are reported as other comprehensive income, a separate component of shareholders’ equity, net of taxes. Securities classified as available for sale include securities that may be sold in response to changes in interest rates, changes in prepayment risks or for asset/liability management purposes. The cost of securities sold is determined on a specific identification basis. Gains and losses on sales of securities are recognized in the statements of operations on the date of sale.

Securities are classified as held to maturity based on management’s intent and ability to hold them to maturity. Such securities are stated at cost, adjusted for unamortized purchase premiums and discounts using the level yield method.

Transfers between the available for sale and held to maturity portfolios are accounted for at fair value. Unrealized holding gains and losses are accounted for at the date of transfer. For securities transferred to available for sale from held to maturity, unrealized gains or losses as of the date of the transfer are recognized in other comprehensive income (loss), a separate component of shareholders’ equity. For securities transferred into the held to maturity portfolio from the available for sale portfolio, unrealized gains or losses as of the date of transfer continue to be reported in other comprehensive income (loss), a separate component of shareholders’ equity and are amortized over the remaining life of the security as an adjustment to its yield, consistent with amortization of the premium or accretion of the discount.

The Company has a process in place to identify debt securities for impairment that is other-than-temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. This evaluation considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or

whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value.

Management assesses their intent to sell or whether it is more likely than not that they will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired with no intent to sell and no requirement to sell prior to recovery of the amortized cost basis, the amount of the impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income (loss).

The present value of expected future cash flows is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

For additional information on securities, see Note 4 to the Consolidated Financial Statements.

#### **Federal Home Loan Bank Stock**

Federal law requires a member institution of the Federal Home Loan Bank ("FHLB") system to hold stock of its district FHLB according to a predetermined formula. The stock is carried at cost. Management reviews the stock for impairment based on the ultimate recoverability of the cost basis in the stock. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. Management considers such criteria as the significance of the decline in net assets, if any, of the FHLB, the length of time this situation has persisted, commitments by the FHLB to make payments required by law or regulation, the impact of legislative and regulatory changes on the customer base of the FHLB and the liquidity position of the FHLB.

#### **Loans Held To Maturity and Loans Held For Sale**

Loans held to maturity are stated at the unpaid principal balance, net of unearned discounts and net of deferred loan origination fees and costs. Loan origination fees, net of direct loan origination costs, are deferred and are recognized over the estimated life of the related loans as an adjustment to the loan yield utilizing the level yield method.

Interest is credited to operations primarily based upon the principal amount outstanding. When management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan, interest accruals are discontinued and all past due interest, previously recognized as income, is reversed and charged against current period earnings. Payments received on nonaccrual loans are applied as principal. Loans are returned to an accrual status when the ability to collect is reasonably assured and when the loan is brought current as to principal and interest.

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

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

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

The Company evaluates its loans for impairment. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company has defined impaired loans to be all troubled debt restructurings and nonaccrual loans. Impairment is evaluated in total for smaller-balance loans of a similar nature (consumer and residential mortgage loans), and on an individual basis for other loans. Troubled debt restructurings occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate. Impairment 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 fair value. The net amount of loan origination fees on loans sold is included in the carrying value and in the gain or loss on the sale.

The Company originates loans to customers under an SBA program that generally provides for SBA guarantees of up to 90 percent of each loan. In the past, the Company generally sold the guaranteed portion of its SBA loans to a third party and retained the servicing, holding the nonguaranteed portion in its portfolio. However, during the third quarter of 2007, the Company announced a change in its strategy to retain more SBA loans in its portfolio due to lower premiums received on the sale of these loans. During late 2008, the Company withdrew from SBA lending as a primary line of business, but continues to offer SBA loan products as an additional credit product to its customers. If sales of SBA loans do occur, the premium received on the sale and the present value of future cash flows of the servicing assets are recognized in income.

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

For additional information on loans, see Note 5 to the Consolidated Financial Statements.

#### **Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

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

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

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

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

For additional information, see Note 6 to the Consolidated Financial Statements.

#### **Premises and Equipment**

Land is carried at cost. Buildings and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, not to exceed 30 years. For additional information on premises and equipment, see Note 7 to the Consolidated Financial Statements.

#### **Other Real Estate Owned**

Other real estate owned is recorded at the fair value, less estimated costs to sell, at the date of acquisition, with a charge to the allowance for loan losses for any excess of the loan carrying value over such amount. Subsequently, other real estate owned is carried at the lower of cost or fair value, as determined by current appraisals, less estimated selling costs. Certain costs incurred in preparing properties for sale are capitalized to the extent that the appraisal amount exceeds the carry value, and expenses of holding foreclosed properties are charged to operations as incurred.

#### **Income Taxes**

The Company follows FASB ASC Topic 740, "Income Taxes," which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

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

Interest and penalties associated with unrecognized tax benefits are recognized in income tax expense on the income statement.

For additional information on income taxes, see Note 16 to the Consolidated Financial Statements.

#### **Net Income Per Share**

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

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. However, when a net loss rather than net income is recognized, diluted earnings per share equals basic earnings per share.

For additional information on income per share, see Note 17 to the Consolidated Financial Statements.

#### **Other Comprehensive Income (Loss)**

Other comprehensive income (loss) consists of the change in unrealized gain (loss) on securities available for sale and derivatives designated as cash flow hedges that were reported as a component of shareholders' equity, net of tax. For additional information on other comprehensive income, see Note 22 to the Consolidated Financial Statements.

#### **Derivative Instruments and Hedging Activities**

The Company uses derivative instruments, such as interest rate swaps, to manage interest rate risk. The Company recognizes all derivative instruments at fair value as either assets or liabilities in other assets or other liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as an accounting hedge, the gain or loss is recognized in trading noninterest income.

For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based on the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. The Company does not have any fair value hedges or hedges of foreign operations.

The Company formally documents the relationship between the hedging instruments and the hedged item, as well as the risk management objective and strategy before undertaking 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. The change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

Hedge accounting discontinues when it is determined that the derivative no longer qualifies as an effective hedge; the derivative expires or is sold, terminated or exercised; or the derivative is no longer 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.

For additional information on derivative instruments, see Note 12 to the Consolidated Financial Statements.

#### **Stock-Based Compensation**

The Company accounts for its stock-based compensation awards in accordance with FASB ASC Topic 718, "Compensation – Stock Compensation", which requires recognition of compensation expense related to stock-based compensation awards over the period during which an employee is required to provide service for the award. Compensation expense is equal to the fair value of the award, net of estimated forfeitures, and is recognized over the vesting period of such awards. For additional information on the Company's stock-based compensation, see Note 19 to the Consolidated Financial Statements.

**Treasury Stock**

Treasury stock is accounted for under the cost method and accordingly is presented as a reduction in shareholders' equity.

**Bank Owned Life Insurance**

The Company purchased life insurance policies on certain members of management. Bank owned life insurance ("BOLI") is recorded at its cash surrender value or the amount that can be realized.

**Advertising**

The Company expenses the costs of advertising in the period incurred.

**Dividend Restrictions**

Banking regulations require maintaining certain capital levels that may limit the dividends paid by our bank to our holding company or by our holding company to our shareholders. In addition, the Company's participation in the U.S. Department of Treasury's Capital Purchase Program places restrictions on increased dividend declarations.

**Operating Segments**

While management monitors the revenue streams of its various products and services, operating results and financial performance are evaluated on a company-wide basis. The Company's management uses consolidated results to make operating and strategic decisions. Accordingly, there is only one reportable segment.

**Servicing Assets**

Servicing assets represent the estimated fair value of retained servicing rights at the time loans are sold. Servicing assets are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on stratifying the underlying financial assets by date of origination and term. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment, if temporary, would be reported as a valuation allowance.

**Fair Value**

The Company follows FASB ASC Topic 820, "Fair Value Measurement and Disclosures," which provides a framework for measuring fair value under generally accepted accounting principles. ASC Topic 820 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 and requires 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. The Company has presently elected not to report any of its existing financial assets or liabilities at fair value and consequently does not have any fair value related adjustments.

For additional information on the fair value of the Company's financial instruments, see Note 20 to the Consolidated Financial Statements.

**Recent Accounting Pronouncements**

FASB ASC Topic 310, "Receivables." New authoritative accounting guidance (Accounting Standards Update No. 2010-20) under ASC Topic 310, "Receivables", amends the current disclosures required by ASC Topic 310. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. This new disclosure guidance did not have an impact on the Company's reported financial condition or results of operations. See Note 6 for new disclosures required by this guidance.

FASB ASC Topic 820, "Fair Value Measurements and Disclosures." New authoritative accounting guidance (Accounting Standards Update No. 2010-6) provides amendments to ASC Topic 820 that require new disclosures as follows: 1) A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and 2) In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). The new authoritative guidance also clarifies existing disclosures as follows: 1) A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3. These new disclosures and clarifications of existing disclosures were effective for the Company's financial statements beginning after December 15, 2009 (except for the disclosures about the purchases, sales, issuances, and settlements in the roll forward activity of Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010) and did not have an impact on the Company's financial statements.

FASB ASC Topic 860, "Transfers and Servicing." New authoritative accounting guidance under ASC Topic 860, "Transfers and Servicing," amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC Topic 860 was effective

January 1, 2010 and did not have a significant impact on the Company's financial statements; however the guidance defers the gains of SBA 7(a) loans for a 90-day period after the sale of the loan. There were no SBA 7(a) loan sales during the fourth quarter of 2010 that needed to be deferred.

## 2. Goodwill

The Company accounts for goodwill and other intangible assets in accordance with FASB ASC Topic 350, "Intangibles – Goodwill and Other", which includes requirements to test goodwill and indefinite-lived intangible assets on an annual basis for impairment, rather than amortize them. Management conducted an annual test and determined that the Company's recorded goodwill totaling \$1.5 million, which resulted from the 2005 acquisition of its Phillipsburg, New Jersey branch, is not impaired as of December 31, 2010.

## 3. Restrictions on Cash

Federal law requires depository institutions to maintain a prescribed amount of cash or noninterest-bearing balances with the Federal Reserve Bank. As of December 31, 2010 and 2009, the Company was required to maintain reserve balances of \$80 thousand. In addition, the Company's contract with its current electronic funds transfer ("EFT") provider requires a pre-determined balance be maintained in a settlement account controlled by the provider equal to the Company's average daily net settlement position multiplied by four days. The required balance was \$179 thousand as of December 31, 2010 and 2009. This balance can be adjusted periodically to reflect actual transaction volume and seasonal factors.

## 4. Securities

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

	2010				2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(In thousands)								
<b>Available for sale:</b>								
US Government sponsored entities	\$ 6,415	\$ 47	\$ -	\$ 6,462	\$ 16,198	\$ 20	\$ (211)	\$ 16,007
State and political subdivisions	11,246	23	(306)	10,963	2,946	9	(13)	2,942
Residential mortgage-backed securities	84,359	2,022	(640)	85,741	115,397	1,849	(1,021)	116,225
Commercial mortgage-backed securities	1,827	3	(4)	1,826	4,651	-	(24)	4,627
Trust preferred securities	977	-	(412)	565	976	-	(586)	390
Other securities	1,610	-	(36)	1,574	610	-	(31)	579
Total securities available for sale	\$ 106,434	\$ 2,095	\$ (1,398)	\$ 107,131	\$ 140,778	\$ 1,878	\$ (1,886)	\$ 140,770
<b>Held to maturity:</b>								
US Government sponsored entities	\$ -	\$ -	\$ -	\$ -	\$ 2,000	\$ 76	\$ -	\$ 2,076
State and political subdivisions	2,297	-	(66)	2,231	3,156	4	(92)	3,068
Residential mortgage-backed securities	14,722	444	(318)	14,848	18,700	545	(527)	18,718
Commercial mortgage-backed securities	4,042	217	-	4,259	4,346	185	-	4,531
Trust preferred securities	50	-	(37)	13	50	-	(37)	13
Total securities held to maturity	\$ 21,111	\$ 661	\$ (421)	\$ 21,351	\$ 28,252	\$ 810	\$ (656)	\$ 28,406

This table provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at December 31, 2010 is primarily distributed by contractual maturity. Mortgage-backed securities and other securities, which may have principal prepayment provisions, are distributed based on contractual maturity. Expected maturities will differ materially from contractual maturities as a result of early prepayments and calls. The total weighted average yield excludes equity securities.

(In thousands)	Within one year		After one year through five years		After five years through ten years		After ten years		Total carrying value	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
<b>Available for sale at fair value:</b>										
US Government sponsored entities	\$ -	-%	\$ 893	2.36%	\$ 2,594	2.48%	\$ 2,975	4.26%	\$ 6,462	3.28%
State and political subdivisions	-	-	170	6.50	3,263	3.12	7,530	3.81	10,963	3.64
Residential mortgage-backed securities	-	-	1,091	2.58	5,912	5.24	78,738	3.06	85,741	3.21
Commercial mortgage-backed securities	-	-	-	-	-	-	1,826	6.11	1,826	6.11
Trust preferred securities	-	-	-	-	-	-	565	1.07	565	1.07
Other securities	-	-	-	-	-	-	1,574	3.49	1,574	3.49
Total securities available for sale	\$ -	-%	\$ 2,154	2.80%	\$ 11,769	4.05%	\$ 93,208	3.22%	\$ 107,131	3.30%
<b>Held to maturity at cost:</b>										
State and political subdivisions	\$ -	-%	\$ -	-%	\$ -	-%	\$ 2,297	5.15%	\$ 2,297	5.15%
Residential mortgage-backed securities	-	-	494	4.28	3,829	4.77	10,399	4.67	14,722	4.68
Commercial mortgage-backed securities	-	-	-	-	-	-	4,042	5.55	4,042	5.55
Trust preferred securities	-	-	-	-	-	-	50	-	50	-
Total securities held to maturity	\$ -	-%	\$ 494	4.28%	\$ 3,829	4.77%	\$ 16,788	4.93%	\$ 21,111	4.89%

The fair value of securities with unrealized losses by length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2010 and 2009 are as follows:

	2010						
		Less than 12 months		12 months and greater		Total	
	Total						
(In thousands)	Number in a Loss Position	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
<b>Available for sale:</b>							
State and political subdivisions	31	\$ 9,051	\$ (306)	\$ -	\$ -	\$ 9,051	\$ (306)
Residential mortgage-backed securities	17	14,651	(422)	3,547	(218)	18,198	(640)
Commercial mortgage-backed securities	1	-	-	1,516	(4)	1,516	(4)
Trust preferred securities	1	-	-	565	(412)	565	(412)
Other equities	4	-	-	1,074	(36)	1,074	(36)
Total temporarily impaired investments	54	\$ 23,702	\$ (728)	\$ 6,702	\$ (670)	\$ 30,404	\$ (1,398)
<b>Held to maturity:</b>							
State and political subdivisions	4	\$ 2,231	\$ (66)	\$ -	\$ -	\$ 2,231	\$ (66)
Residential mortgage-backed securities	5	2,243	(75)	2,651	(243)	4,894	(318)
Trust preferred securities	2	-	-	13	(37)	13	(37)
Total temporarily impaired investments	11	\$ 4,474	\$ (141)	\$ 2,664	\$ (280)	\$ 7,138	\$ (421)
		2009					
		Less than 12 months		12 months and greater		Total	
	Total						
(In thousands)	Number in a Loss Position	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
<b>Available for sale:</b>							
U.S. Government sponsored entities	10	\$ 12,807	\$ (210)	\$ 96	\$ (1)	\$ 12,903	\$ (211)
State and political subdivisions	7	1,820	(13)	-	-	1,820	(13)
Residential mortgage-backed securities	24	17,372	(207)	7,735	(814)	25,107	(1,021)
Commercial mortgage-backed securities	4	4,627	(24)	-	-	4,627	(24)
Trust preferred securities	1	-	-	390	(586)	390	(586)
Other equities	3	-	-	579	(31)	579	(31)
Total temporarily impaired investments	49	\$ 36,626	\$ (454)	\$ 8,800	\$ (1,432)	\$ 45,426	\$ (1,886)
<b>Held to maturity:</b>							
State and political subdivisions	6	\$ 1,753	\$ (32)	\$ 999	\$ (60)	\$ 2,752	\$ (92)
Residential mortgage-backed securities	5	124	(10)	3,844	(517)	3,968	(527)
Trust preferred securities	2	5	(6)	26	(31)	31	(37)
Total temporarily impaired investments	13	\$ 1,882	\$ (48)	\$ 4,869	\$ (608)	\$ 6,751	\$ (656)

#### Unrealized Losses

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

*U.S. Government sponsored entities and state and political subdivision securities:* The unrealized losses on investments in this type of security were caused by the increase in interest rate spreads. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2010.

*Residential and commercial mortgage-backed securities:* The unrealized losses on investments in mortgage-backed securities were caused by interest rate increases. The majority of contractual cash flows of these securities are guaranteed by Fannie Mae, Ginnie Mae and the Federal Home Loan Mortgage Corporation. It is expected that the securities would not be settled at a price significantly less than the par value of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2010.

*Trust preferred securities:* The unrealized losses on trust preferred securities were caused by an inactive trading market and changes in market credit spreads. At December 31, 2010, this category consisted of one single-issuer trust preferred security. The Company that issued the trust preferred security is considered a well capitalized institution per regulatory standards and significantly strengthened its capital position. In addition, the Company has ample liquidity, bolstered its allowance for loan losses, was profitable in 2010 and is projected to be profitable in 2011. The contractual terms do not allow the security to be settled at a price less than the par value. Because the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, which may be at maturity, the Company does not consider this security to be other-than-temporarily impaired as of December 31, 2010.

*Other securities:* Included in this category is stock of other financial institutions and Community Reinvestment Act ("CRA") investments. The unrealized losses on other securities are caused by decreases in the market prices of the shares. The Company has evaluated the prospects of the issuer and has forecasted a recovery period; therefore these investments are not considered other-than-temporarily impaired as of December 31, 2010.

#### Realized Gains and Losses and Other-Than-Temporary Impairment

Gross realized gains (losses) on securities and other-than-temporary impairment charges for 2010 and 2009 are detailed in the table below:

(In thousands)	2010	2009
<b>Available for sale:</b>		
Realized gains	\$ 337	\$ 855
Realized losses	(166)	-
Other-than-temporary impairment charges	-	-
Total securities available for sale	\$ 171	\$ 855
<b>Held to maturity:</b>		
Realized gains	\$ 4	\$ -
Realized losses	(90)	-
Other-than-temporary impairment charges	-	(2,611)
Total securities held to maturity	\$ (86)	\$ (2,611)
Net gains (losses) on sales of securities and other-than-temporary impairment charges	\$ 85	\$ (1,756)

The net realized gains and losses are included in noninterest income in the Consolidated Statements of Operations as net securities gains (losses). For 2010 and 2009, gross realized gains on sales of securities amounted to \$341 thousand and \$855 thousand, respectively, and gross realized losses were \$256 thousand and \$0, respectively. The gross gains during 2010 are primarily attributed to the Company selling approximately \$11.0 million in book value of mortgage-backed securities, resulting in pretax gains of approximately \$329 thousand, five called structured agency securities with resulting gains of \$8 thousand, and one called held to maturity municipal security with a resulting gain of \$4 thousand. These gains were partially offset by losses of \$166 thousand on the sale of approximately \$3.5 million in book value of three mortgage-backed securities and losses of \$90 thousand on the sale of five tax-exempt municipal securities with a total book value of approximately \$2.0 million. Although designated as held to maturity, these municipal securities were sold due to deterioration in the issuer's creditworthiness, as evidenced by downgrades in their credit ratings. The gross gains of \$855 thousand in 2009 are primarily attributed to the Company selling approximately \$31.5 million in book value of mortgage-backed securities, resulting in pretax gains of approximately \$827 thousand on the sales. The Company also sold its remaining callable Freddie Mac perpetual preferred securities resulting in pretax gains of \$28 thousand. There were no realized losses in 2009.

Also included in noninterest income for 2009 are other-than-temporary-impairment charges of \$2.6 million. During 2009, the Company recognized \$2.6 million of credit related other-than-temporary impairment losses on two held to maturity securities due to the deterioration in the underlying collateral. The remaining book value of the trust preferred securities is approximately \$50 thousand. In estimating the present value of the expected cash flows on the two trust preferred securities which were other-than-temporarily impaired as of December 31, 2009, the following assumptions were made:

- Moderate conditional repayment rates ("CRR") were used due to the lack of new trust preferred issuances and the poor conditions of the financial industry. A CRR of 2 percent was used for performing issuers and 0 percent for nonperformers.
- Conditional deferral rates ("CDR") have been established based on the financial condition of the underlying trust preferred issuers in the pools. These ranged from 0.75 percent to 2.35 percent for performing issuers. Nonperforming issues were stated at 100 percent CDR.
- Expected loss severities of 95 percent were assumed (i.e. recoveries occur on only 5 percent of defaulted securities) for all performing issuers and ranged from 57.22 percent to 80.33 percent for nonperforming issues.
- Internal rates of return ("IRR") are the pre-tax yield used to discount the future cash flow stream expected from the collateral cash flows. The IRR used was 17 percent.

#### Pledged Securities

Securities with a carrying value of \$63.4 million and \$71.4 million at December 31, 2010 and 2009, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law. Included in these figures was \$2.9 million pledged against Government deposits at December 31, 2010 and 2009.

## 5. Loans

The composition of the loan portfolio, net of unearned discount and deferred loan origination fees and costs, at December 31, 2010 and 2009 was as follows:

(In thousands)	2010	2009
SBA held for sale	\$ 10,397	\$ 21,406
SBA held to maturity	75,741	77,844
SBA 504	64,276	70,683
Commercial	281,205	293,739
Residential mortgage	128,400	133,059
Consumer	55,917	60,285
Total loans	\$ 615,936	\$ 657,016

SBA loans sold to others and serviced by the Company are not included in the accompanying consolidated balance sheets. The total amount of such loans serviced, but owned by outside investors, amounted to approximately \$126.0 million and \$131.3 million at December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the carrying value, which approximates fair value, of servicing assets was \$512 thousand and \$897 thousand, respectively and is included in Other Assets. The fair value of servicing assets was determined using a discount rate of 15 percent, constant prepayment speeds ranging from 15 to 18, and interest strip multiples ranging from 2.08 to 3.80, depending on each individual credit. A summary of the changes in the related servicing assets for the past two years follows:

(In thousands)	Years ending December 31,	
	2010	2009
Balance, beginning of year	\$ 897	\$ 1,503
SBA servicing assets capitalized	74	83
Amortization of expense	(459)	(689)
Provision for loss in fair value	-	-
Balance, end of year	\$ 512	\$ 897

In addition, the Company had a \$574 thousand and \$1.0 million discount related to the retained portion of the unsold SBA loans at December 31, 2010 and 2009, respectively.

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

The majority of the Company's loans are secured by real estate. The declines in the market values of real estate in the Company's trade area impact the value of the collateral securing its loans. This could lead to greater losses in the event of defaults on loans secured by real estate. Specifically, 89 percent of SBA 7(a) loans are secured by commercial or residential real estate and 11 percent by other non-real estate collateral. Commercial real estate secures 100 percent of all SBA 504 loans. Approximately 97 percent of consumer loans are secured by owner-occupied residential real estate, with the other 3 percent secured by automobiles or other. The detailed allocation of the Company's commercial loan portfolio collateral as of December 31, 2010 is shown in the table below:

(In thousands)	Concentration	
	Balance	Percent
Commercial real estate – owner occupied	\$ 138,942	49.4%
Commercial real estate – investment property	114,146	40.6
Undeveloped land	17,458	6.2
Other non-real estate collateral	10,659	3.8
Total commercial loans	\$ 281,205	100.0%

As of December 31, 2010, approximately 12 percent of the Company's total loan portfolio consists of loans to various unrelated and unaffiliated borrowers in the Hotel/Motel industry. Such loans are collateralized by the underlying real property financed and/or partially guaranteed by the SBA.

As of December 31, 2010, residential mortgages provided \$47.4 million in borrowing capacity at the Federal Home Loan Bank compared to \$47.3 million at December 31, 2009.

In the ordinary course of business, the Company may extend credit to officers, directors or their associates. These loans are subject to the Company's normal lending policy. An analysis of such loans, all of which are current as to principal and interest payments, is as follows:

(In thousands)	2010
Loans to officers, directors or their associates at December 31, 2009	\$ 16,438
New loans	1,717
Repayments	(650)
Loans to officers, directors or their associates at December 31, 2010	\$ 17,505

## 6. Allowance for Loan Losses & Unfunded Loan Commitments

Management reviews the level of the allowance for loan losses on a quarterly basis. The standardized methodology used to assess the adequacy of the allowance includes the allocation of specific and general reserves. The same standard methodology is used, regardless of loan type. Specific reserves are made to individual impaired loans, (see Note 1 for additional information on this term). The general reserve is set based upon a representative average historical net charge-off rate adjusted for certain environmental factors such as: delinquency and impairment trends, charge-off and recovery trends, volume and loan term trends, risk and underwriting policy trends, staffing and experience changes, national and local economic trends, industry conditions and credit concentration changes.



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

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

An analysis of the change in the allowance for loan losses for the years 2010 and 2009 is presented in the table below. The allocated allowance is the total of identified specific and general reserves by loan category. The allocation is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of the portfolio.

2010							
(In thousands)	SBA	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
<b>Allowance for credit losses:</b>							
Beginning balance	\$ 3,247	\$ 1,872	\$ 6,013	\$ 1,615	\$ 632	\$ 463	\$ 13,842
Charge-offs	(1,351)	(1,548)	(3,627)	(500)	(245)	-	(7,271)
Recoveries	243	-	296	-	4	-	543
Net charge-offs	(1,108)	(1,548)	(3,331)	(500)	(241)	-	(6,728)
Provision for loan losses charged to expense	2,059	1,227	3,329	564	195	(124)	7,250
Ending balance	\$ 4,198	\$ 1,551	\$ 6,011	\$ 1,679	\$ 586	\$ 339	\$ 14,364
<b>Ending balance:</b>							
Individually evaluated for impairment	\$ 1,761	\$ 87	\$ 609	\$ -	\$ -	\$ -	\$ 2,457
Collectively evaluated for impairment	2,437	1,464	5,402	1,679	586	339	11,907
Totals	\$ 4,198	\$ 1,551	\$ 6,011	\$ 1,679	\$ 586	\$ 339	\$ 14,364
<b>Loan ending balances:</b>							
Individually evaluated for impairment	\$ 6,888	\$ 10,622	\$ 10,194	\$ -	\$ -	\$ -	\$ 27,704
Collectively evaluated for impairment	79,250	53,654	271,011	128,400	55,917	-	588,232
Total ending balance	\$ 86,138	\$ 64,276	\$ 281,205	\$ 128,400	\$ 55,917	\$ -	\$ 615,936

2009							
<b>Allowance for credit losses:</b>							
Beginning balance							\$ 10,326
Charge-offs							(4,774)
Recoveries							290
Net charge-offs							(4,484)
Provision for loan losses charged to expense							8,000
Ending balance							\$ 13,842

In addition to the allowance for loan losses, the Company maintains an allowance for unfunded loan commitments that is maintained at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the allowance are made through other expense and applied to the allowance which is maintained in other liabilities. At December 31, 2010, a \$66 thousand commitment reserve was reported on the balance sheet as an "other liability" compared to a \$76 thousand commitment reserve at December 31, 2009.

**Credit Risk:** Inherent in the lending function is credit risk, which is the possibility a borrower may not perform in accordance with the contractual terms of their loan. A borrower's inability to pay their obligations according to the contractual terms can create the risk of past due loans and, ultimately, credit losses, especially on collateral deficient loans. The Company minimizes its credit risk by loan diversification and

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

For SBA 7(a), SBA 504 and commercial loans, management uses internally assigned risk ratings as the best indicator of credit quality. A loan's internal risk rating is updated at least annually and more frequently if circumstances warrant a change in risk rating. The Company uses a 1 through 10 loan grading system that follows regulatory accepted definitions.

- Risk ratings of 1 through 6 are used for loans that are performing, as they meet, and are expected to continue to meet, all of the terms and conditions set forth in the original loan documentation, and are generally current on principal and interest payments. These performing loans are termed "Pass".
- Criticized loans are assigned a risk rating of 7 and termed "Special Mention", as the borrowers exhibit potential credit weaknesses or downward trends deserving management's close attention. If not checked or corrected, these trends will weaken the Bank's collateral and position. While potentially weak, these borrowers are currently marginally acceptable and no loss of interest or principal is anticipated. As a result, special mention assets do not expose an institution to sufficient risk to warrant adverse classification. Included in "Special Mention" could be turnaround situations, such as borrowers with deteriorating trends beyond one year, borrowers in start up or deteriorating industries, or borrowers with a poor market share in an average industry. An element of asset quality, financial flexibility, or management is below average. Management and ownership may have limited depth or experience. Regulatory agencies have agreed on a consistent definition of "Special Mention" as an asset with potential weaknesses which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. This definition is intended to ensure that the "Special Mention" category is not used to identify assets that have as their sole weakness credit data exceptions or collateral documentation exceptions that are not material to the repayment of the asset.
- Classified loans are assigned a risk rating of an 8 or 9, depending upon the prospect for collection, and deemed "Substandard". A risk rating of 8 is used for borrowers with well-defined weaknesses that jeopardize the orderly liquidation of debt. The loan is inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. There is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified "Substandard". A risk rating of 9 is used for borrowers that have all the weaknesses inherent in a loan with a risk rating of 8, with the added characteristic that the weaknesses make collection of debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely. The possibility of loss is extremely high, but because of certain important, reasonably specific pending factors that may work to strengthen the assets, the loans' classification as estimated losses is deferred until a more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures; capital injection; perfecting liens on additional collateral; and refinancing plans. Partial charge-offs are likely.
- Once a borrower is deemed incapable of repayment of unsecured debt, the risk rating becomes a 10, the loan is termed a "Loss", and charged-off immediately. Loans to such borrowers are considered uncollectible and of such little value that continuance as active assets of the Bank is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may be affected in the future.

For residential mortgage and consumer loans, management uses performing versus nonperforming as the best indicator of credit quality. Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. These credit quality indicators are updated on an ongoing basis, as a loan is placed on nonaccrual status as soon as management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan.

The tables below detail the Company's loans by class according to their credit quality indicators discussed in the paragraphs above as of December 31, 2010 and 2009:

2010				
SBA, SBA 504 & Commercial Loans - Internal Risk Ratings				
(In thousands)	Pass	Special Mention	Substandard	Total
<b>SBA loans</b>	\$ 48,500	\$ 25,668	\$ 11,970	\$ 86,138
<b>SBA 504 loans</b>	30,235	15,366	18,675	64,276
<b>Commercial loans</b>				
Commercial other	17,402	4,764	2,102	24,268
Commercial real estate	169,093	67,305	10,493	246,891
Commercial real estate construction	6,197	2,715	1,134	10,046
<b>Total commercial loans</b>	<b>\$ 192,692</b>	<b>\$ 74,784</b>	<b>\$ 13,729</b>	<b>\$ 281,205</b>

2010			
Residential Mortgage & Consumer Loans - Performing/Nonperforming			
(In thousands)	Performing	Nonperforming	Total
<b>Residential mortgage loans</b>			
Residential mortgages	\$ 114,716	\$ 2,453	\$ 117,169
Residential construction	2,711	-	2,711
Purchased residential mortgages	5,888	2,632	8,520
<b>Total residential mortgage loans</b>	<b>\$ 123,315</b>	<b>\$ 5,085</b>	<b>\$ 128,400</b>
<b>Consumer loans</b>			
Home equity	\$ 54,024	\$ 249	\$ 54,273
Consumer other	1,644	-	1,644
<b>Total consumer loans</b>	<b>\$ 55,668</b>	<b>\$ 249</b>	<b>\$ 55,917</b>
<b>Total loans</b>			<b>\$ 615,936</b>

2009				
SBA, SBA 504 & Commercial Loans - Internal Risk Ratings				
(In thousands)	Pass	Special Mention	Substandard	Total
<b>SBA loans</b>	\$ 57,725	\$ 18,506	\$ 23,019	\$ 99,250
<b>SBA 504 loans</b>	35,984	18,770	15,929	70,683
<b>Commercial loans</b>				
Commercial other	18,421	4,442	2,554	25,417
Commercial real estate	183,579	45,499	27,086	256,164
Commercial real estate construction	2,974	5,911	3,273	12,158
<b>Total commercial loans</b>	<b>\$ 204,974</b>	<b>\$ 55,852</b>	<b>\$ 32,913</b>	<b>\$ 293,739</b>

2009			
Residential Mortgage & Consumer Loans - Performing/Nonperforming			
(In thousands)	Performing	Nonperforming	Total
<b>Residential mortgage loans</b>			
Residential mortgages	\$ 115,587	\$ 5,078	\$ 120,665
Residential construction	3,353	-	3,353
Purchased residential mortgages	8,541	500	9,041
<b>Total residential mortgage loans</b>	<b>\$ 127,481</b>	<b>\$ 5,578</b>	<b>\$ 133,059</b>
<b>Consumer loans</b>			
Home equity	\$ 57,756	\$ 387	\$ 58,143
Consumer other	2,142	-	2,142
<b>Total consumer loans</b>	<b>\$ 59,898</b>	<b>\$ 387</b>	<b>\$ 60,285</b>
<b>Total loans</b>			<b>\$ 657,016</b>

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

The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. The current state of the economy and the downturn in the real estate market have resulted in increased loan delinquencies and defaults. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market. In response to the credit risk in its portfolio, the Company has increased staffing in its credit monitoring department and increased efforts in the collection and analysis of borrowers' financial statements and tax returns.

The following tables set forth an aging analysis of past due and nonaccrual loans as of December 31, 2010 and December 31, 2009:

2010							
(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans
<b>SBA loans</b>	\$ 1,297	\$ 1,181	\$ 374	\$ 8,162	\$ 11,014	\$ 75,124	\$ 86,138
<b>SBA 504 loans</b>	-	1,339	-	2,714	4,053	60,223	64,276
<b>Commercial loans</b>							
Commercial other	693	86	-	179	958	23,310	24,268
Commercial real estate	3,051	176	-	4,139	7,366	239,525	246,891
Commercial real estate construction	-	-	-	1,134	1,134	8,912	10,046
<b>Residential mortgage loans</b>							
Residential mortgages	2,123	144	-	2,453	4,720	112,449	117,169
Residential construction	-	-	-	-	-	2,711	2,711
Purchased residential mortgages	117	-	-	2,632	2,749	5,771	8,520
<b>Consumer loans</b>							
Home equity	175	325	-	249	749	53,524	54,273
Consumer other	5	-	-	-	5	1,639	1,644
<b>Total loans</b>	<b>\$ 7,461</b>	<b>\$ 3,251</b>	<b>\$ 374</b>	<b>\$ 21,662</b>	<b>\$ 32,748</b>	<b>\$ 583,188</b>	<b>\$ 615,936</b>

  

2009							
(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans
<b>SBA loans</b>	\$ 3,508	\$ 995	\$ 592	\$ 6,559	\$ 11,654	\$ 87,596	\$ 99,250
<b>SBA 504 loans</b>	2,963	1,614	-	5,575	10,152	60,531	70,683
<b>Commercial loans</b>							
Commercial other	789	-	150	617	1,556	23,861	25,417
Commercial real estate	3,287	4,335	319	5,977	13,918	242,246	256,164
Commercial real estate construction	-	339	-	803	1,142	11,016	12,158
<b>Residential mortgage loans</b>							
Residential mortgages	2,246	103	1,196	5,078	8,623	112,042	120,665
Residential construction	-	-	-	-	-	3,353	3,353
Purchased residential mortgages	469	1,671	-	500	2,640	6,401	9,041
<b>Consumer loans</b>							
Home equity	400	-	-	387	787	57,356	58,143
Consumer other	9	-	29	-	38	2,104	2,142
<b>Total loans</b>	<b>\$ 13,671</b>	<b>\$ 9,057</b>	<b>\$ 2,286</b>	<b>\$ 25,496</b>	<b>\$ 50,510</b>	<b>\$ 606,506</b>	<b>\$ 657,016</b>

*Impaired Loans:* The Company has defined impaired loans to be all nonperforming loans and troubled debt restructurings. Impairment is evaluated in total for smaller-balance loans of a similar nature, (consumer and residential mortgage loans), and on an individual basis for other loans. Troubled debt restructurings (“TDRs”) occur when a creditor, for economic or legal reasons related to a debtor’s financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate, extending the maturity of a loan, or a combination of both. At December 31, 2010, there were fifteen loans totaling \$14.1 million that were classified as TDRs by the Company and are deemed impaired, compared to four loans totaling \$6.6 million at December 31, 2009. TDRs are not included in the nonperforming loan figures listed above, as they continue to perform under their modified terms.

The following tables provide detail on the Company's impaired loans as of December 31, 2010 and 2009:

	2010						
(In thousands)	Recorded Investment (Balance less specific reserves)	Outstanding Principal Balance	Related Allowance	Average Recorded Investment	Lost Interest on Impaired Loans	Interest Income Collected on Impaired Loans	
With no related allowance:							
SBA loans <sup>(1)</sup>	\$ 2,362	\$ 2,362	\$ -				
SBA 504 loans	8,145	8,145	-				
Commercial loans							
Commercial other	179	179	-				
Commercial real estate	7,891	7,891	-				
Total commercial loans	8,070	8,070	-				
Total impaired loans with no related allowance	\$ 18,577	\$ 18,577	\$ -				
With an allowance:							
SBA loans <sup>(1)</sup>	\$ 2,765	\$ 4,526	\$ 1,761				
SBA 504 loans	2,390	2,477	87				
Commercial loans							
Commercial real estate	764	990	226				
Commercial real estate construction	751	1,134	383				
Total commercial loans	1,515	2,124	609				
Total impaired loans with a related allowance	\$ 6,670	\$ 9,127	\$ 2,457				
Total individually evaluated impaired loans:							
SBA loans <sup>(1)</sup>	\$ 5,127	\$ 6,888	\$ 1,761	\$ 6,792	\$ 317	\$ 234	
SBA 504 loans	10,535	10,622	87	6,454	133	69	
Commercial loans							
Commercial other	179	179	-	425	16	1	
Commercial real estate	8,655	8,881	226	10,964	367	143	
Commercial real estate construction	751	1,134	383	813	84	47	
Total commercial loans	9,585	10,194	609	12,202	467	191	
Total individually evaluated impaired loans	\$ 25,247	\$ 27,704	\$ 2,457	\$ 25,448	\$ 917	\$ 494	
Homogeneous loans collectively evaluated for impairment:							
Residential mortgage loans							
Residential mortgages	\$ 2,453	\$ 2,453	\$ -	\$ 4,632	\$ 147	\$ -	
Purchased mortgages	2,632	2,632	-	1,897	136	-	
Total residential mortgage loans	5,085	5,085	-	6,529	283	-	
Consumer loans							
Home equity	249	249	-	341	2	9	
Total other homogeneous loans evaluated for impairment	5,334	5,334	-	6,870	285	9	
Total impaired loans	\$ 30,581	\$ 33,038	\$ 2,457	\$ 32,318	\$ 1,202	\$ 503	

(1) Balances are reduced by amount guaranteed by the Small Business Administration

2009							
(In thousands)	Recorded Investment (Balance less specific reserves)	Outstanding Principal Balance	Related Allowance	Average Recorded Investment	Lost Interest on Impaired Loans	Interest Income Collected on Impaired Loans	
Total impaired loans with no related allowance	\$ 7,896	\$ 7,896	\$ -				
Total impaired loans with a related allowance	21,712	24,176	2,464				
Total impaired loans	\$ 29,608	\$ 32,072	\$ 2,464	\$ 26,775	\$ 1,967	\$ 388	

## 7. Premises and Equipment

The detail of premises and equipment as of December 31, 2010 and 2009 is as follows:

(In thousands)	2010	2009
Land and buildings	\$ 10,606	\$ 10,497
Furniture, fixtures and equipment	6,724	6,488
Leasehold improvements	2,463	2,431
Gross premises and equipment	19,793	19,416
Less: Accumulated depreciation	(8,826)	(7,643)
Net premises and equipment	\$ 10,967	\$ 11,773

Amounts charged to noninterest expense for depreciation of premises and equipment amounted to \$1.2 million in 2010 and \$1.3 million in 2009.

The Company currently accounts for all of its leases as operating leases. In addition, the Company has one lease with a related party. The Company leases its Clinton, New Jersey headquarters from a partnership in which two Board members, Messrs. D. Dallas and R. Dallas are partners. Under the lease for the facility, the partnership received aggregate rental payments of \$410 thousand in 2010 and \$400 thousand in 2009. This lease was renegotiated in 2009 and the Company believes that rental payments reflect market rents and that the lease reflects terms that are comparable to those which could have been obtained in a lease with an unaffiliated third party. This lease has a five-year term, expiring at the end of 2013. After year one, the annual base rent of \$400 thousand per annum is increased each year by the increase in the Consumer Price Index ("CPI") for the New York Metropolitan area (not to exceed 3 percent).

## 8. Other Assets

The detail of other assets as of December 31, 2010 and 2009 is as follows:

(In thousands)	2010	2009
SBA servicing assets	\$ 512	\$ 897
Net receivable due from SBA	463	354
Prepaid expenses	378	363
Taxes receivable	-	268
Other	835	831
Total other assets	\$ 2,188	\$ 2,713

## 9. Deposits

The following schedules detail the maturity distribution of time deposits:

(In thousands)	3 months or less	More than 3 months through 6 months	More than 6 months through 12 months	More than 12 months	Total
<b>At December 31, 2010</b>					
\$100,000 or more	\$ 19,248	\$ 6,227	\$ 12,903	\$ 22,736	\$ 61,114
Less than \$100,000	23,235	12,586	30,049	53,608	119,478
<b>At December 31, 2009</b>					
\$100,000 or more	\$ 40,726	\$ 17,523	\$ 19,819	\$ 30,314	\$ 108,382
Less than \$100,000	42,896	17,257	44,066	79,158	183,377

(In thousands)	2011	2012	2013	2014	2015	Thereafter
Balance Maturing	\$ 104,248	\$ 42,032	\$ 23,052	\$ 6,571	\$ 4,365	\$ 324

## 10. Borrowed Funds and Subordinated Debentures

The following tables present the period-end and average balances of borrowed funds and subordinated debentures for the last two years with resultant rates, as well as expected maturities over the next five years:

(In thousands)	2010		2009	
	Amount	Rate	Amount	Rate
<b>FHLB borrowings and repurchase agreements :</b>				
At December 31,	\$ 60,000	3.94%	\$ 70,000	4.08%
Year-to-date average	69,671	4.08	80,048	3.63
Maximum outstanding	70,000		121,000	
<b>Repurchase agreements:</b>				
At December 31,	\$ 15,000	3.67%	\$ 15,000	3.67%
Year-to-date average	15,000	3.65	16,890	3.59
Maximum outstanding	15,000		25,000	
<b>Subordinated debentures:</b>				
At December 31,	\$ 15,465	5.49%	\$ 15,465	5.35%
Year-to-date average	15,465	5.50	15,465	5.47
Maximum outstanding	15,465		15,465	

(In thousands)	2011	2012	2013	2014	2015	Thereafter
FHLB borrowings and repurchase agreements	\$ -	\$ -	\$ -	\$ -	\$ 10,000	\$ 50,000
Other repurchase agreements	-	-	-	-	-	15,000
Subordinated debentures	-	-	-	-	-	15,465
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 10,000</b>	<b>\$ 80,465</b>

### FHLB Borrowings

FHLB borrowings at December 31, 2010 consisted of three \$10.0 million advances and three \$10.0 million repurchase agreements compared to four \$10.0 million advances and three \$10.0 million repurchase agreements at December 31, 2009. The terms of these transactions are as follows:

- The FHLB advance that was issued on April 27, 2005 has a fixed rate of 3.70 percent, matures on April 27, 2015 and is callable on April 27, 2008 and quarterly thereafter on the 27th of July, October, January and April.
- The FHLB advance that was issued on December 19, 2000 had a fixed rate of interest at 4.92 percent, matured on December 20, 2010 and was callable quarterly on the 19th of March, June, September and December.
- The FHLB advance that was issued on November 2, 2006 has a fixed rate of 4.03 percent, matures on November 2, 2016 and is callable on November 2, 2007 and quarterly thereafter on the 2nd of February, May, August and November.
- The FHLB advance that was issued on August 10, 2007 has a fixed rate of 4.23 percent, matures on August 10, 2017 and is callable on August 10, 2009 and quarterly thereafter on the 10th of November, February, May and August.
- The FHLB repo-advance that was issued on December 15, 2006 has a fixed rate of 4.13 percent, matures on December 15, 2016 and is callable on December 15, 2008 and quarterly thereafter on the 15th of March, June, September and December.
- The FHLB repo-advance that was issued on April 5, 2007 has a fixed rate of 4.21 percent, matures on April 5, 2017 and is callable on April 5, 2009 and quarterly thereafter on the 5th of July, October, January and April.
- The FHLB repo-advance that was issued on December 20, 2007 has a fixed rate of 3.34 percent, matures on December 20, 2017 and is callable on December 20, 2010 and quarterly thereafter on the 20th of March, June, September and December.

Due to the call provisions of these advances, the expected maturity could differ from the contractual maturity.

### Repurchase Agreements

At December 31, 2010 and 2009, the Company was a party to the following Repurchase Agreement:

- A \$15.0 million repurchase agreement that was entered into in February 2008 has a term of 10 years expiring on February 28, 2018, and a rate of 3.67 percent. The borrowing may be called by the issuer on the repurchase date of May 29, 2008 and quarterly thereafter.

Due to the call provisions of these advances, the expected maturity could differ from the contractual maturity.

### Subordinated Debentures

At December 31, 2010 and 2009, the Company was a party in the following subordinated debenture transactions:

- On July 24, 2006, Unity (NJ) Statutory Trust II, a statutory business trust and wholly-owned subsid-



ary of Unity Bancorp, Inc., issued \$10.0 million of floating rate capital trust pass through securities to investors due on July 24, 2036. The subordinated debentures are redeemable in whole or part, prior to maturity but after July 24, 2011. The floating interest rate on the subordinated debentures is the three-month LIBOR plus 159 basis points and reprices quarterly. The floating interest rate at December 31, 2010 was 1.89 percent and 1.84 percent at December 31, 2009.

- On December 19, 2006, Unity (NJ) Statutory Trust III, a statutory business trust and wholly-owned subsidiary of Unity Bancorp, Inc., issued \$5.0 million of floating rate capital trust pass through securities to investors due on December 19, 2036. The subordinated debentures are redeemable in whole or part, prior to maturity but after December 19, 2011. The floating interest rate on the subordinated debentures is the three-month LIBOR plus 165 basis points and reprices quarterly. The floating interest rate at December 31, 2010 was 1.95 percent and 1.91 percent at December 31, 2009.
- In connection with the formation of the statutory business trusts, the trusts also issued \$465 thousand of common equity securities to the Company, which together with the proceeds stated above were used to purchase the subordinated debentures, under the same terms and conditions.

The rates paid on subordinated debentures which are presented in the table on page 48 include the cost of the related interest rate swap agreements. These agreements provide for the Company to receive variable rate payments based on the three-month LIBOR index in exchange for making payments at a fixed rate. For additional information, see Note 12 "Derivative Instruments and Hedging Activities".

The Company has the ability to defer interest payments on the subordinated debentures for up to five years without being in default.

The capital securities in each of the above transactions have preference over the common securities with respect to liquidation and other distributions and qualify as Tier I capital. Under the terms of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act, these securities will continue to qualify as Tier 1 capital as the Company has less than \$10 billion in assets. In accordance with FASB ASC Topic 810, "Consolidation," the Company does not consolidate the accounts and related activity of Unity (NJ) Statutory Trust II and Unity (NJ) Statutory Trust III. The additional capital from each of these transactions was used to bolster the Company's capital ratios and for general corporate purposes, including among other things, capital contributions to Unity Bank.

Due to the redemption provisions of these securities, the expected maturity could differ from the contractual maturity.

## 11. Commitments and Contingencies

### Facility Lease Obligations

The Company operates sixteen branches, nine branches under operating leases, including its headquarters, and seven branches are owned. In addition, the Company has a lease on one other location, which is subleased to a third party, with the third party paying rent in an amount equal to the Company's rental obligation under the lease agreement between the Company and the lessor. The leases' contractual expiration range is generally between the years 2011 and 2015. The following schedule summarizes the contractual rent payments for the future years.

(In thousands)	Operating Lease Rental Payments	Rent from Sublet Locations	Net Rent Obligation
2011	1,112	77	1,035
2012	1,054	-	1,054
2013	1,028	-	1,028
2014	274	-	274
2015	17	-	17
Thereafter	-	-	-

Rent expense totaled \$1.1 million for 2010 and 2009. The Company currently accounts for all of its leases as operating leases.

### Litigation

The Company may, in the ordinary course of business, become a party to litigation involving collection matters, contract claims and other legal proceedings relating to the conduct of its business. In the best judgment of management, based upon consultation with counsel, the consolidated financial position and results of operations of the Company will not be affected materially by the final outcome of any pending legal proceedings or other contingent liabilities and commitments.

### Commitments to Borrowers

Commitments to extend credit are legally binding loan commitments with set expiration dates. They are intended to be disbursed, subject to certain conditions, upon the request of the borrower. The Company was committed to advance approximately \$66.0 million to its borrowers as of December 31, 2010, compared to \$76.2 million at December 31, 2009. At December 31, 2010, \$17.2 million of these commitments expire after one year, compared to \$32.7 million a year earlier. At December 31, 2010, the Company had \$1.5 million in standby letters of credit compared to \$6.4 million at December 31, 2009. The estimated fair value of these guarantees is not significant. The Company believes it has the necessary liquidity to honor all commitments.

## 12. Derivative Instruments and Hedging Activities

### Derivative Financial Instruments

The Company has stand alone derivative financial instruments in the form of interest rate swap agreements, which derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments, and the value of the derivatives are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the

calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instruments, is reflected on the Company's balance sheet as other assets or other liabilities.

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

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

#### **Risk Management Policies – Hedging Instruments**

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

#### **Interest Rate Risk Management – Cash Flow Hedging Instruments**

The Company has long-term variable rate debt as a source of funds for use in the Company's lending and investment activities and for other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, hedged a portion of its variable-rate interest payments. To meet this objective, management entered into interest rate swap agreements whereby the Company receives variable interest rate payments and makes fixed interest rate payments during the contract period. At December 31, 2010 and 2009, the information pertaining to outstanding interest rate swap agreements used to hedge variable rate debt is as follows:

(In thousands, except percentages and years)		2010	2009
Notional amount	\$	15,000	\$ 15,000
Weighted average pay rate		4.05%	4.05%
Weighted average receive rate (three-month LIBOR)		0.34%	0.90%
Weighted average maturity in years		0.90	1.90
Unrealized loss relating to interest rate swaps	\$	(499)	\$ (777)

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 December 31, 2010 and 2009, 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.

#### **13. Shareholders' Equity**

Shareholders' equity increased \$2.2 million to \$70.1 million at December 31, 2010 due to net income of \$2.2 million, \$430 thousand from the issuance of common stock under employee benefit plans, \$418 thousand in net unrealized gains on the available for sale securities portfolio, and \$166 thousand in net unrealized gains on cash flow hedge derivatives, partially offset by \$1.0 million in dividends accrued on preferred stock. The issuance of common stock under employee benefit plans includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act of 2008 ("EESA"), which provided the U.S. Secretary of the Treasury with broad authority to implement certain actions to help restore stability and liquidity to the U.S. markets. One of the programs resulting from the EESA was the Treasury's Capital Purchase Program ("CPP") which provided direct equity investment of perpetual preferred stock by the U.S. Treasury in qualified financial institutions. This program was voluntary and requires an institution to comply with several restrictions and provisions, including limits on executive compensation, stock redemptions, and declaration of dividends. The perpetual preferred stock has a dividend rate of 5 percent per year until the fifth anniversary of the Treasury investment and a dividend of 9 percent thereafter. The Company received an investment in perpetual preferred stock of \$20.6 million on December 5, 2008. These proceeds were allocated between the preferred stock and warrants based on relative fair value in accordance with FASB ASC Topic 740, "Debt." The allocation of proceeds resulted in a discount on the preferred stock that is being accreted over five years. The Company issued 764,778 common stock warrants to the U.S. Treasury and \$2.6 million of the proceeds were allocated to the warrants. The warrants are accounted for as equity securities and have a contractual life of ten years and an exercise price of \$4.05.

As part of the CPP, the Company's future ability to pay cash dividends is limited for so long as the Treasury holds the preferred stock. As so limited, the Company may not increase its quarterly cash dividend above \$0.05 per share, the quarterly rate in effect at the time the CPP program was

announced, without the prior approval of the Treasury. No dividends were paid in 2010 or 2009. The Company is currently preserving capital and will resume paying dividends when earnings and credit quality improve.

The Company has suspended its share repurchase program, as required by the CPP and consequently, there were no shares repurchased in 2010 or 2009. 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. As of December 31, 2010, the Company had repurchased a total of 556 thousand shares, of which 131 thousand shares have been retired, leaving 153 thousand shares remaining to be repurchased under the plan when it is reinstated.

#### 14. Other Income

The components of other income for the years ended December 31, 2010 and 2009 are as follows:

(In thousands)	2010	2009
ATM and check card fees	\$ 267	\$ 203
Wire transfer fees	81	76
Safe deposit box fees	53	52
Other	318	101
Total other income	\$ 719	\$ 432

#### 15. Other Expenses

The components of other expenses for the years ended December 31, 2010 and 2009 are as follows:

(In thousands)	2010	2009
Travel, entertainment, training and recruiting	\$ 603	\$ 618
Director fees	346	339
Insurance	325	312
Stationery and supplies	221	209
Other	262	246
Total other expenses	\$ 1,757	\$ 1,724

#### 16. Income Taxes

The components of the provision (benefit) for income taxes are as follows:

(In thousands)	2010	2009
Federal – current provision	\$ 1,212	\$ 973
Federal – deferred benefit	(530)	(1,099)
Total Federal provision (benefit)	682	(126)
State – current provision	18	213
State – deferred benefit	(111)	(985)
Total State benefit	(93)	(772)
Total provision (benefit) for income taxes	\$ 589	\$ (898)

A reconciliation between the reported income tax provision (benefit) and the amount computed by multiplying income before taxes by the statutory Federal income tax rate is as follows:

(In thousands)	2010	2009
Federal income tax provision (benefit) at statutory rate	\$ 962	\$ (673)
Increases (decreases) resulting from:		
Tax-exempt interest	(105)	(88)
Bank owned life insurance	(68)	(75)
Meals and entertainment	15	15
True up to return	(180)	-
State income taxes, net of federal income tax effect	86	-
Other, net	(121)	(77)
Provision (benefit) for income taxes	\$ 589	\$ (898)
Effective tax rate	20.8%	46.0%

Deferred income taxes are provided for temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. The components of the net deferred tax asset at December 31, 2010 and 2009 are as follows:

(In thousands)	2010	2009
Deferred tax assets:		
Allowance for loan losses	\$ 5,737	\$ 5,438
Reserve for impaired securities	1,179	730
Lost interest on nonaccrual loans	855	1,102
State net operating loss	323	450
Stock-based compensation	290	242
Depreciation	240	65
Net unrealized cash flow hedge losses	199	311
Net unrealized security losses	-	13
Other	127	229
Gross deferred tax assets	8,950	8,580
Valuation allowance	(323)	(450)
Net deferred tax assets	8,627	8,130
Deferred tax liabilities:		
Deferred loan costs	433	469
Net unrealized security gains	274	-
Goodwill	205	165
Bond accretion	165	188
Total deferred tax liabilities	1,077	822
Net deferred tax asset	\$ 7,550	\$ 7,308

The Company computes deferred income taxes under the asset and liability method. Deferred income taxes are recognized for tax consequences of “temporary differences” by applying enacted statutory tax rates to differences between the financial reporting and the tax basis of existing assets and liabilities. A deferred tax liability is recognized for all temporary differences that will result in future taxable income. A deferred tax asset is recognized for all temporary differences that will result in future tax deductions subject to

reduction of the asset by a valuation allowance.

During 2009, the Company established a \$450 thousand valuation allowance for deferred tax assets related to its state net operating loss carry-forward deferred tax asset, the balance of which was \$323 thousand at December 31, 2010 due to subsequent utilization of the net operating loss carry-forwards. The Company's state net operating loss carry-forwards totaled approximately \$5.4 million at December 31, 2010 and \$7.6 million at December 31, 2009 and expire between 2014 and 2029.

Included as a component of deferred tax assets is an income tax expense (benefit) related to unrealized losses on securities available for sale and cash flow hedges. The after tax component of the unrealized gain on securities available for sale of \$423 thousand and \$5 thousand in 2010 and 2009, respectively, is included in other comprehensive income in shareholders' equity. In addition, other comprehensive income included \$(300) thousand and \$(466) thousand related to cash flow hedges at December 31, 2010 and 2009, respectively.

The Company follows FASB ASC Topic 740, "Income Taxes," which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes. The Company did not recognize or accrue any interest or penalties related to income taxes during the years ended December 31, 2010 and 2009. The Company does not have an accrual for uncertain tax positions as of December 31, 2010 or 2009, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2006 and thereafter are subject to future examination by tax authorities.

## 17. Net Income per Share

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

(In thousands, except per share amounts)	2010	2009
Net income (loss)	\$ 2,240	\$ (1,081)
Less: Preferred stock dividends and discount accretion	1,520	1,496
Income available (loss attributable) to common shareholders	\$ 720	\$ (2,577)
Weighted average common shares outstanding (basic)	7,173	7,121
Plus: Potential dilutive common stock	274	-
Weighted average common shares outstanding (diluted)	7,447	7,121
Net income (loss) per common share -		
Basic	\$ 0.10	\$ (0.36)
Diluted	0.10	(0.36)
Stock options and common stock excluded from the income per share computation as their effect would have been anti-dilutive	444	1,403

The 2010 potential dilutive common stock figure shown in the prior table includes the dilutive impact of 764,778 common stock warrants issued to the U.S. Department of Treasury under the Capital Purchase Program in 2008. During 2009, these common stock warrants were anti-dilutive and reported as such in the prior table.

## 18. Regulatory Capital

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

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

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

The Company's capital amounts and ratios for the last two years are presented in the following table.

(In thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2010</b>						
Leverage ratio	\$ 83,550	9.97%	≥ \$ 33,531	4.00%	≥ \$ 41,914	N/A
Tier I risk-based capital ratio	83,550	13.04	25,628	4.00	38,442	N/A
Total risk-based capital ratio	91,638	14.30	51,257	8.00	64,071	N/A
<b>As of December 31, 2009</b>						
Leverage ratio	\$ 81,824	8.83%	≥ \$ 37,058	4.00%	≥ \$ 46,323	N/A
Tier I risk-based capital ratio	81,824	11.75	27,852	4.00	41,778	N/A
Total risk-based capital ratio	90,592	13.01	55,704	8.00	69,630	N/A

The Bank's capital amounts and ratios for the last two years are presented in the following table.

(In thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2010</b>						
Leverage ratio	\$ 71,053	8.48%	≥ \$ 33,497	4.00%	≥ \$ 41,871	5.00%
Tier I risk-based capital ratio	71,053	11.10	25,595	4.00	38,393	6.00
Total risk-based capital ratio	87,631	13.69	51,191	8.00	63,988	10.00
<b>As of December 31, 2009</b>						
Leverage ratio	\$ 68,299	7.38%	≥ \$ 37,020	4.00%	≥ \$ 46,275	5.00%
Tier I risk-based capital ratio	68,299	9.82	27,815	4.00	41,722	6.00
Total risk-based capital ratio	85,555	12.30	55,630	8.00	69,537	10.00

## 19. Employee Benefit Plans

The Bank has a 401(k) savings plan covering substantially all employees. Under the Plan, an employee can contribute up to 80 percent of their salary on a tax deferred basis. The Bank may also make discretionary contributions to the Plan. The Bank contributed \$211 thousand and \$192 thousand to the Plan in 2010 and 2009, respectively.

The Company has a deferred fee plan for Directors and executive management. Directors of the Company have the option to elect to defer up to 100% of their respective retainer and Board of Director fees, and each member of executive management has the option to elect to defer 100% of their year-end cash bonuses. Director and executive deferred fees totaled \$15 thousand in 2010 and \$14 thousand in 2009, and the interest paid on deferred balances totaled \$14 thousand in 2010 and \$13 thousand in 2009.

Certain members of management are also enrolled in a split-dollar life insurance plan with a post retirement death benefit of \$250 thousand. Total expenses related to this plan were \$40 thousand in 2010. There were no expenses in 2009.

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.

The Bank does not currently provide any other post retirement or post employment benefits to its employees other than the plans mentioned above.

## Stock Option Plans

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of December 31, 2010, 1,520,529 shares have been reserved for issuance upon the exercise of options, 775,468 option grants are outstanding, and 717,204 option grants have been exercised, forfeited or expired, leaving 27,857 shares available for grant.

The Company granted no options in 2010 as compared to 59,250 options in 2009. The fair value of the options

granted in 2009 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2010	2009
Number of options granted	-	59,250
Weighted average exercise price	\$ -	\$ 3.98
Weighted average fair value of options	\$ -	\$ 1.86
Expected life (years)	-	4.26
Expected volatility	-%	57.37%
Risk-free interest rate	-%	1.73%
Dividend yield	-%	-%

The expected life of the options was estimated based on historical employee behavior and represents the period of time that options granted are expected to be outstanding. Expected volatility of the Company's stock price was based on the historical volatility over the period commensurate with the expected life of the options. The risk-free interest rate is the U.S. Treasury rate commensurate with the expected life of the options on the date of grant. The expected dividend yield is the projected annual yield based on the grant date stock price.

FASB ASC Topic 718, "Compensation - Stock Compensation," requires an entity to recognize the fair value of equity awards as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period). Compensation expense related to stock options totaled \$202 thousand and \$156 thousand in 2010 and 2009, respectively. The related income tax benefit was approximately \$80 thousand and \$58 thousand in 2010 and 2009, respectively. As of December 31, 2010, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company's stock option plans totaled approximately \$115 thousand. That cost is expected to be recognized over a weighted average period of 1.5 years.

Transactions under the Company's stock option plans for the last two years are summarized in the following table:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2008	871,422	\$ 5.94	5.0	\$ 252,815
Options granted	59,250	3.98		
Options exercised	(3,261)	2.70		
Options forfeited	(1,267)	5.38		
Options expired	(39,858)	7.91		
Outstanding at December 31, 2009	886,286	\$ 5.73	4.6	\$ 293,911
Options granted	-	-		
Options exercised	(80,626)	2.79		
Options forfeited	(5,524)	4.44		
Options expired	(24,668)	10.37		
Outstanding at December 31, 2010	775,468	\$ 5.90	3.9	\$ 1,049,184
Exercisable at December 31, 2010	690,338	\$ 6.06	3.4	\$ 903,094

The following table summarizes information about stock options outstanding at December 31, 2010:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Shares Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
\$ 0.00 - 4.00	332,821	3.6	\$ 3.45	271,326	\$ 3.34
4.01 - 8.00	248,163	4.2	5.73	224,528	5.67
8.01 - 12.00	129,022	3.2	9.20	129,022	9.20
12.01 - 16.00	65,462	5.9	12.55	65,462	12.55
Total	775,468	3.9	\$ 5.90	690,338	\$ 6.06

The following table presents information about options exercised:

	2010	2009
Number of options exercised	80,626	3,261
Total intrinsic value of options exercised	\$ 136,723	\$ 4,659
Cash received from options exercised	93,721	8,814
Tax deduction realized from options exercised	54,607	1,861

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

#### Restricted Stock Awards

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value and amortized into salary expense on a straight line basis over the vesting period. As of December 31, 2010, 121,551 shares of restricted stock were reserved for issuance, of which 12,335 shares are available for grant.

Restricted stock awards granted during the past two years include:

Grant Year	Shares	Average Grant Date Fair Value
2010	13,200	\$ 5.30
2009	21,400	\$ 3.98

Compensation expense related to the restricted stock awards totaled \$115 thousand in 2010 and \$154 thousand in 2009. As of December 31, 2010, there was approximately \$165 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.9 years.

The following table summarizes nonvested restricted stock activity for the twelve months ended December 31, 2010:

	Shares	Average Grant Date Fair Value
Nonvested restricted stock at December 31, 2009	54,282	\$ 7.25
Granted	13,200	5.30
Vested	(21,688)	9.03
Forfeited	(2,427)	6.18
Nonvested restricted stock at December 31, 2010	43,367	\$ 5.83

## 20. Fair Value

#### Fair Value Measurement

The Company follows FASB ASC Topic 820, "Fair Value Measurement and Disclosures," which requires additional disclosures about the Company's assets and liabilities that are measured at fair value. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed as follows:

#### Level 1 Inputs

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

#### Level 2 Inputs

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

#### Level 3 Inputs

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



**Fair Value on a Recurring Basis**

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

*Securities Available for Sale*

The fair value of available for sale (“AFS”) securities is the market value based on quoted market prices for identical securities, when available, or market prices provided by recognized broker dealers (Level 1). If listed prices or quotes are not available, fair value is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

As of December 31, 2010, the fair value of the Company’s AFS securities portfolio was \$107.1 million. Approximately 80 percent of the portfolio was made up of residential mortgage-backed securities, which had a fair value of \$85.7 million at December 31, 2010. Approximately \$75.4 million of the residential mortgage-backed securities are guaranteed by the Government National Mortgage Association (“GNMA”), the Federal National Mortgage Association (“FNMA”) or the Federal Home Loan Mortgage Corporation (“FHLMC”). The underlying loans for these securities are residential mortgages that are geographically dispersed throughout the United States. All AFS securities were classified as Level 2 assets at December 31, 2010. The valuation of AFS securities using Level 2 inputs was primarily determined using the market approach, which uses quoted prices for similar assets or liabilities in active markets and all other relevant information. It includes model pricing, defined as valuing securities based upon their relationship with other benchmark securities.

*Interest Rate Swap Agreements*

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

There were no changes in the inputs or methodologies used to determine fair value during the year ended December 31, 2010 as compared to the year ended December 31, 2009.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and December 31, 2009.

As of December 31, 2010				
(In thousands)	Level 1	Level 2	Level 3	Total
<b>Financial Assets:</b>				
Securities available for sale:				
U.S. government sponsored entities	\$ -	\$ 6,462	\$ -	\$ 6,462
State and political subdivisions	-	10,963	-	10,963
Residential mortgage-backed securities	-	85,741	-	85,741
Commercial mortgage-backed securities	-	1,826	-	1,826
Trust preferred securities	-	565	-	565
Other equities	-	1,574	-	1,574
Total securities available for sale	-	107,131	-	107,131
<b>Financial Liabilities:</b>				
Interest rate swap agreements	-	499	-	499

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

The changes in Level 1 assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are summarized as follows:

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

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

The changes in Level 2 assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are summarized as follows:

	As of December 31, 2010	
	Securities Available for Sale	Interest Rate Swap Agreements
(In thousands)		
Beginning balance January 1, 2010	\$ 131,514	\$ 777
Total net gains (losses) included in:		
Net income	171	-
Other comprehensive income	705	(278)
Purchases, sales, issuances and settlements, net	34,015	-
Transfers in and/or out of Level 2	8,756	-
Ending balance December 31, 2010	\$ 107,131	\$ 499

There were no gains or losses (realized or unrealized) included in earnings for assets and liabilities held at December 31, 2010 or December 31, 2009.

#### Fair Value on a Nonrecurring Basis

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis:

#### Other Real Estate Owned ("OREO")

The fair value was determined using appraisals, which may be discounted based on management's review and changes in market conditions (Level 3 Inputs).

#### Impaired Collateral-Dependent Loans

The fair value of impaired collateral-dependent loans is derived in accordance with FASB ASC Topic 310, "Receivables." Fair value is determined based on the loan's observable market price or the fair value of the collateral. The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. During the twelve months ended December 31, 2010, the valuation allowance for impaired loans decreased \$7 thousand to \$2.5 million at December 31, 2010. During the twelve months ended December 31, 2009, the valuation allowance for impaired loans increased \$1.5 million from \$957 thousand at December 31, 2008 to \$2.5 million at December 31, 2009.

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

As of December 31, 2010					
	Level 1	Level 2	Level 3	Total	Total fair value gain (loss) during year ended December 31, 2010
(In thousands)					
<b>Financial Assets:</b>					
Other real estate owned ("OREO")	\$ -	-	\$ 2,346	\$ 2,346	\$ (807)
Impaired collateral-dependent loans	-	-	6,054	6,054	(7)

As of December 31, 2009					
	Level 1	Level 2	Level 3	Total	Total fair value loss during year ended December 31, 2009
(In thousands)					
<b>Financial Assets:</b>					
Other real estate owned ("OREO")	\$ -	\$ -	\$ 1,530	\$ 1,530	\$ 150
Impaired collateral-dependent loans	-	-	21,712	21,712	1,507

**Fair Value of Financial Instruments**

FASB ASC Topic 825, "Financial Instruments," requires the disclosure of the estimated fair value of certain financial instruments, including those financial instruments which the Company does not record at fair value. These estimated fair values as of December 31, 2010 and December 31, 2009 have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop estimates of fair value. The estimates presented are not necessarily indicative of amounts the Company could realize in a current market exchange. The use of alternative market assumptions and estimation methodologies could have had a material effect on these estimates of fair value. The methodology for estimating the fair value of financial assets and liabilities that are measured on a recurring or nonrecurring basis are discussed above. The following methods and assumptions were used to estimate the fair value of other financial instruments for which it is practicable to estimate that value:

**Cash and Cash Equivalents**

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

**Loans**

The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the interest rate risk inherent in the loan, except for previously discussed impaired loans.

**Federal Home Loan Bank Stock**

Federal Home Loan Bank stock is carried at cost. Carrying value approximates fair value based on the redemption provisions of the issues.

**Deposit Liabilities**

The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using current market rates.

**Borrowed Funds & Subordinated Debentures**

The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.

**Accrued Interest**

The carrying amounts of accrued interest approximate fair value.

**Standby Letters of Credit**

At December 31, 2010, the Bank had standby letters of credit outstanding of \$1.5 million, as compared to \$6.4 million at December 31, 2009. The fair value of these commitments is nominal.

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

	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(In thousands)				
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 43,926	\$ 43,926	\$ 73,635	\$ 73,635
Securities available for sale	107,131	107,131	140,770	140,770
Securities held to maturity	21,111	21,351	28,252	28,406
Loans, net of allowance for possible loan losses	601,572	599,567	643,174	640,246
Federal Home Loan Bank stock	4,206	4,206	4,677	4,677
SBA servicing assets	512	512	897	897
Accrued interest receivable	3,791	3,791	4,225	4,225
<b>Financial liabilities:</b>				
Deposits	654,788	634,713	758,239	739,909
Borrowed funds and subordinated debentures	90,465	103,704	100,465	113,227
Accrued interest payable	556	556	710	710
Interest rate swap agreements	499	499	777	777

**21. Condensed Financial Statements of Unity Bancorp, Inc.**  
**(Parent Company Only)**

<b>Balance Sheets</b> (In thousands)	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Assets:</b>		
Cash	\$ 4,056	\$ 5,077
Securities available for sale	98	90
Capital note due from Bank	8,500	8,500
Investment in subsidiaries	72,888	69,806
Other assets	669	783
<b>Total Assets</b>	<b>\$ 86,211</b>	<b>\$ 84,256</b>
<b>Liabilities &amp; Shareholders' Equity:</b>		
Other liabilities	\$ 661	\$ 926
Other borrowings	15,465	15,465
Shareholders' equity	70,085	67,865
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>\$ 86,211</b>	<b>\$ 84,256</b>

<b>Statements of Operations</b> (In thousands)	<b>Years ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Interest income	\$ 746	\$ 745
Interest expense	862	858
Net interest expense	(116)	(113)
Net security gains	-	2
Other expenses	21	19
Loss before income tax benefit and equity in undistributed net income (loss) of subsidiary	(137)	(130)
Income tax benefit	(45)	(43)
Loss before equity in undistributed net (loss) of subsidiary	(92)	(87)
Equity in undistributed net income (loss) of subsidiary	2,332	(994)
Net income (loss)	2,240	(1,081)
Preferred stock dividends and discount accretion	1,520	1,496
Income available (loss attributable) to common shareholders	\$ 720	\$ (2,577)

<b>Statements of Cash Flows</b> (In thousands)	<b>Years ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating Activities:</b>		
Net income (loss)	\$ 2,240	\$ (1,081)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Equity in undistributed net (income) loss of subsidiary	(2,332)	994
Gains on sales of securities available for sale	-	(2)
Net change in other assets and liabilities	9	21
<b>Net cash used in operating activities</b>	<b>(83)</b>	<b>(68)</b>
<b>Investing Activities:</b>		
Sales and maturities of securities available for sale	-	17
<b>Net cash provided by investing activities</b>	<b>-</b>	<b>17</b>
<b>Financing Activities:</b>		
Proceeds from issuance of common stock	94	9
Cash dividends on preferred stock	(1,032)	(975)
<b>Net cash used in financing activities</b>	<b>(938)</b>	<b>(966)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(1,021)</b>	<b>(1,017)</b>
Cash, beginning of year	5,077	6,094
Cash, end of year	\$ 4,056	\$ 5,077
Supplemental disclosures: Interest paid	\$ 860	\$ 860

22. Other Comprehensive Income (Loss)

(In thousands)	Pre-tax	Tax	After-tax
<b>Net unrealized security gains (losses):</b>			
Balance at December 31, 2008			\$ (1,728)
Unrealized holding gain on securities arising during the period	\$ 1,821	\$ 266	1,555
Less: Reclassification adjustment for gains included in net income	855	286	569
Less: Reclassification adjustment for OTTI charges included in net income	(1,123)	(376)	(747)
Net unrealized gain on securities arising during the period	2,089	356	1,733
Balance at December 31, 2009			5
Unrealized holding gain on securities arising during the period	790	315	475
Less: Reclassification adjustment for gains included in net income	85	28	57
Net unrealized gain on securities arising during the period	705	287	418
Balance at December 31, 2010			\$ 423
<b>Net unrealized losses on cash flow hedges:</b>			
Balance at December 31, 2008			\$ (628)
Unrealized holding gain on cash flow hedges arising during the period	\$ 236	\$ 74	162
Balance at December 31, 2009			(466)
Unrealized holding gain on cash flow hedges arising during the period	278	112	166
Balance at December 31, 2010			(300)
Total Accumulated Other Comprehensive Income at December 31, 2010			\$ 123

Two securities with a market value of \$1.9 million were transferred from the available for sale category to held to maturity during the third quarter of 2008, consistent with the Company's intent and ability to hold these securities until maturity. Unrealized losses at the date of transfer amounted to \$1.1 million and were included in accumulated other comprehensive income as of December 31, 2008. During 2009, other-than-temporary impairment charges were taken on these same two securities; therefore reversing the unrealized losses recorded in 2008 from other comprehensive income, as they were now realized losses.

## Quarterly Financial Information (Unaudited)

The following quarterly financial information for the years ended December 31, 2010 and 2009 is unaudited. However, in the opinion of management, all adjustments, which include normal recurring adjustments necessary to present fairly the results of operations for the periods, are reflected.

(In thousands, except per share data)				
2010	March 31	June 30	September 30	December 31
Total interest income	\$ 11,513	\$ 10,944	\$ 10,726	\$ 10,852
Total interest expense	4,049	3,681	3,314	2,991
Net interest income	7,464	7,263	7,412	7,861
Provision for loan losses	1,500	1,500	1,500	2,750
Net interest income after provision for loan losses	5,964	5,763	5,912	5,111
Total noninterest income	910	1,170	1,460	1,529
Total noninterest expense	5,941	6,040	6,404	6,605
Income before provision (benefit) for income taxes	933	893	968	35
Provision (benefit) for income taxes	185	212	242	(50)
Net income	748	681	726	85
Preferred stock dividends and discount accretion	373	379	385	383
Income available (loss attributable) to common shareholders	\$ 375	\$ 302	\$ 341	\$ (298)
Net income (loss) per common share - Basic	\$ 0.05	\$ 0.04	\$ 0.05	\$ (0.04)
Net income (loss) per common share - Diluted	\$ 0.05	\$ 0.04	\$ 0.05	\$ (0.04)

(In thousands, except per share data)				
2009	March 31	June 30	September 30	December 31
Total interest income	\$ 12,590	\$ 12,531	\$ 12,185	\$ 12,104
Total interest expense	5,816	5,673	5,327	4,766
Net interest income	6,774	6,858	6,858	7,338
Provision for loan losses	1,500	1,500	3,000	2,000
Net interest income after provision for loan losses	5,274	5,358	3,858	5,338
Total noninterest income (loss)	1,348	(907)	1,162	537
Total noninterest expense	5,555	6,203	6,110	6,079
Income (loss) before provision (benefit) for income taxes	1,067	(1,752)	(1,090)	(204)
Provision (benefit) for income taxes	336	(552)	(343)	(339)
Net income (loss)	731	(1,200)	(747)	135
Preferred stock dividends and discount accretion	379	372	372	373
Income available (loss attributable) to common shareholders	\$ 352	\$ (1,572)	\$ (1,119)	\$ (238)
Net income (loss) per common share - Basic	\$ 0.05	\$ (0.22)	\$ (0.16)	\$ (0.03)
Net income (loss) per common share - Diluted	\$ 0.05	\$ (0.22)	\$ (0.16)	\$ (0.03)

## Selected Consolidated Financial Data

(In thousands)

At or for the years ended December 31,

	2010	2009	2008	2007	2006
<b>Selected Results of Operations</b>					
Interest income	\$ 44,035	\$ 49,410	\$ 50,765	\$ 48,900	\$ 43,177
Interest expense	14,035	21,582	23,474	24,474	19,432
Net interest income	30,000	27,828	27,291	24,426	23,745
Provision for loan losses	7,250	8,000	4,500	1,550	1,550
Noninterest income	5,069	2,140	2,694	5,940	7,638
Noninterest expense	24,990	23,947	22,939	22,113	21,045
Provision (benefit) for income taxes	589	(898)	616	1,978	2,943
Net income (loss)	2,240	(1,081)	1,930	4,725	5,845
Preferred stock dividends and discount accretion	1,520	1,496	110	-	-
Income available (loss attributable) to common shareholders	720	(2,577)	1,820	4,725	5,845
<b>Per Share Data</b>					
Net income (loss) per common share - Basic	\$ 0.10	\$ (0.36)	\$ 0.26	\$ 0.65	\$ 0.81
Net income (loss) per common share - Diluted	0.10	(0.36)	0.25	0.63	0.77
Book value per common share	7.08	6.91	6.99	6.70	6.34
Market value per common share	6.05	4.02	3.90	8.10	13.34
Cash dividends declared on common shares	-	-	0.10	0.19	0.18
<b>Selected Balance Sheet Data</b>					
Assets	\$ 818,410	\$ 930,357	\$ 898,310	\$ 752,196	\$ 694,106
Loans	615,936	657,016	685,946	590,132	507,690
Allowance for loan losses	14,364	13,842	10,326	8,383	7,624
Securities	128,242	169,022	149,509	98,591	105,457
Deposits	654,788	758,239	707,117	601,268	566,465
Borrowed funds and subordinated debentures	90,465	100,465	120,465	100,465	79,744
Shareholders' equity	70,085	67,865	67,803	47,260	46,228
Common shares outstanding	7,211	7,144	7,119	7,063	7,296
<b>Performance Ratios</b>					
Return (loss) on average assets	0.26%	(0.12) %	0.23%	0.66%	0.90%
Return (loss) on average equity	1.43	(5.29)	3.72	10.11	13.56
Efficiency ratio	71.43	75.49	71.90	71.48	67.21
Net interest spread	3.41	2.87	3.13	3.07	3.33
Net interest margin	3.67	3.22	3.51	3.62	3.87
<b>Asset Quality Ratios</b>					
Allowance for loan losses to loans	2.33%	2.11 %	1.51%	1.42%	1.50%
Allowance for loan losses to nonperforming loans	66.31	54.29	64.06	153.49	85.58
Nonperforming loans to total loans	3.52	3.88	2.35	0.93	1.75
Nonperforming assets to total loans and OREO	3.88	4.10	2.45	0.94	1.80
Nonperforming assets to total assets	2.93	2.90	1.87	0.74	1.31
Net charge-offs to average loans	1.05	0.67	0.40	0.14	0.17
<b>Capital Ratios – Company</b>					
Leverage ratio	9.97%	8.83 %	9.54%	8.25%	9.08%
Tier I risk-based capital ratio	13.04	11.75	12.02	9.81	10.80
Total risk-based capital ratio	14.30	13.01	13.27	11.06	13.60
<b>Capital Ratios – Bank</b>					
Leverage ratio	8.48%	7.38 %	7.88%	7.06%	7.20%
Tier I risk-based capital ratio	11.10	9.82	9.93	8.39	8.55
Total risk-based capital ratio	13.69	12.30	12.41	11.00	12.38

All share amounts have been adjusted for the 5% stock distributions paid on June 27, 2008, June 29, 2007, and June 30, 2006.



**EXHIBIT 21**

**SUBSIDIARIES OF REGISTRANT**

The Registrant has three subsidiaries, Unity Bank, Unity (NJ) Statutory Trust II and Unity (NJ) Statutory Trust III.

Unity Bank has eight subsidiaries, Unity Investment Services, Inc., Unity Financial Services, Inc., AJB Residential Realty Enterprises, Inc., AJB Commercial Realty, Inc., MKCD Commercial, Inc., JAH Commercial, Inc., UB Commercial LLC and ASBC Holdings LLC.

**EXHIBIT 23.1**

Consent of Independent Registered Public Accounting Firm

We consent to incorporation by reference in the registration statement Nos. 333-134360, 333-64612, 333-64614, 333-20687, 333-105045, and 333-121409 on Form S-8 of Unity Bancorp, Inc., of our report dated March 17, 2011, relating to the audit of the 2010 consolidated financial statements of Unity Bancorp, Inc., which appears in the Annual Report to Shareholders, which report is incorporated by reference in the Annual Report on Form 10-K of Unity Bancorp, Inc. for the year ended December 31, 2010.

/s/ McGladrey & Pullen, LLP

Blue Bell, Pennsylvania  
March 17, 2011

**EXHIBIT 31.1**

Certifications

I, James A. Hughes, certify that:

1. I have reviewed this annual report on Form 10-K of Unity Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 17, 2011

/s/James A. Hughes  
James A. Hughes  
President and Chief Executive Officer

**EXHIBIT 31.2**

**Certifications**

I, Alan J. Bedner, certify that:

1. I have reviewed this annual report on Form 10-K of Unity Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 17, 2011

/s/ Alan J. Bedner  
Alan J. Bedner  
Executive Vice President and Chief Financial Officer

# EXHIBIT 32.1

**CERTIFICATION PURSUANT TO 18 U.S.C.  
Section 1350, AS ADOPTED  
PURSUANT TO SECTION 906 of SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Unity Bancorp. Inc. (the “Company”), certifies that:

- (1) to the best of my knowledge, the Annual Report on Form 10-K of the Company for the annual period ended December 31, 2010 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
- (2) to the best of my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 17, 2011

/s/ James A. Hughes  
James A. Hughes  
President and Chief Executive Officer

Dated: March 17, 2011

/s/ Alan J. Bedner  
Alan J. Bedner  
Executive Vice President and Chief Financial Officer

This certification is made solely for the purposes of 18 U.S.C. Section 1350, subject to the knowledge standard contained therein, and not for any other purpose.

# EXHIBIT 99.1

Certification of James A. Hughes, President and Chief Executive Officer  
of Unity Bancorp, Inc.  
Pursuant to §111(b)(4) of the Emergency Economic Stabilization Act of 2008 and 31 C.F.R. 30.15

I, James A. Hughes, certify, based on my knowledge, that:

- (i) The compensation committee of Unity Bancorp, Inc. has discussed, reviewed, and evaluated with senior risk officers at least every six months during the period beginning on the later of September 14, 2009, or ninety days after the closing date of the agreement between the TARP recipient and Treasury and ending with the last day of the TARP recipient's fiscal year containing that date (the applicable period), the senior executive officer (SEO) compensation plans and the employee compensation plans and the risks these plans pose to Unity Bancorp, Inc.;
- (ii) The compensation committee of Unity Bancorp, Inc. has identified and limited during the applicable period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Unity Bancorp, Inc., and during that same applicable period has identified any features of the employee compensation plans that pose risks to Unity Bancorp, Inc. and has limited those features to ensure that Unity Bancorp, Inc. is not unnecessarily exposed to risks;
- (iii) The compensation committee has reviewed, at least every six months during the applicable period, the terms of each employee compensation plan and identified any features of the plan that could encourage the manipulation of reported earnings of Unity Bancorp, Inc. to enhance the compensation of an employee, and has limited any such features;
- (iv) The compensation committee of Unity Bancorp, Inc. will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;
- (v) The compensation committee of Unity Bancorp, Inc. will provide a narrative description of how it limited during any part of the most recently completed fiscal year that included a TARP period the features in
  - (A) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Unity Bancorp, Inc.;
  - (B) Employee compensation plans that unnecessarily expose Unity Bancorp, Inc. to risks; and
  - (C) Employee compensation plans that could encourage the manipulation of reported earnings of Unity Bancorp, Inc. to enhance the compensation of an employee;
- (vi) Unity Bancorp, Inc. has required that bonus payments, as defined in the regulations and guidance established under section 111 of EESA (bonus payments), of the SEOs and twenty next most highly compensated employees be subject to a recovery or "clawback" provision during any part of the most recently completed fiscal year that was a TARP period if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;
- (vii) Unity Bancorp, Inc. has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to an SEO or any of the next five most highly compensated employees during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (viii) Unity Bancorp, Inc. has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (ix) The board of directors of Unity Bancorp, Inc. has established an excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA, by the later of September 14, 2009, or ninety days after the closing date of the agreement between the TARP recipient and Treasury; this policy has been provided to Treasury and its primary regulatory agency; Unity Bancorp, Inc. and its employees have complied with this policy during the applicable period; and any expenses that, pursuant to this policy, required approval of the board of directors, a committee of the board of directors, an SEO, or an executive officer with a similar level of responsibility were properly approved;
- (x) Unity Bancorp, Inc. will permit a non-binding shareholder resolution in compliance with any applicable Federal securities rules and regulations on the disclosures provided under the Federal securities laws related to SEO compensation paid or accrued during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (xi) Unity Bancorp, Inc. will disclose the amount, nature, and justification for the offering during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds \$25,000 for any employee who is subject to the bonus payment limitations identified in paragraph (viii);
- (xii) Unity Bancorp, Inc. will disclose whether Unity Bancorp, Inc., the board of directors of Unity Bancorp, Inc., or the compensation committee of Unity Bancorp, Inc. has engaged during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date, a compensation consultant; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;
- (xiii) Unity Bancorp, Inc. has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (xiv) Unity Bancorp, Inc. has substantially complied with all other requirements related to employee compensation that are provided in the agreement between Unity Bancorp, Inc. and Treasury, including any amendments;
- (xv) Unity Bancorp, Inc. has submitted to Treasury a complete and accurate list of the SEOs and the twenty next most highly compensated employees for the current fiscal year and the most recently completed fiscal year, with the non-SEO's ranked in descending order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and
- (xvi) I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both. ( See, for example, 18 U.S.C. 1001.)"

Date: March 17, 2011

/s/ James A. Hughes  
James A. Hughes  
President and Chief Executive Officer

## EXHIBIT 99.2

Certification of Alan J. Bedner, Executive Vice President and Chief Financial Officer  
of Unity Bancorp, Inc.  
Pursuant to §111(b)(4) of the Emergency Economic Stabilization Act of 2008 and 31 C.F.R. 30.15

I, Alan J. Bedner, certify, based on my knowledge, that:

- (i) The compensation committee of Unity Bancorp, Inc. has discussed, reviewed, and evaluated with senior risk officers at least every six months during the period beginning on the later of September 14, 2009, or ninety days after the closing date of the agreement between the TARP recipient and Treasury and ending with the last day of the TARP recipient's fiscal year containing that date (the applicable period), the senior executive officer (SEO) compensation plans and the employee compensation plans and the risks these plans pose to Unity Bancorp, Inc.;
- (ii) The compensation committee of Unity Bancorp, Inc. has identified and limited during the applicable period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Unity Bancorp, Inc., and during that same applicable period has identified any features of the employee compensation plans that pose risks to Unity Bancorp, Inc. and has limited those features to ensure that Unity Bancorp, Inc. is not unnecessarily exposed to risks;
- (iii) The compensation committee has reviewed, at least every six months during the applicable period, the terms of each employee compensation plan and identified any features of the plan that could encourage the manipulation of reported earnings of Unity Bancorp, Inc. to enhance the compensation of an employee, and has limited any such features;
- (iv) The compensation committee of Unity Bancorp, Inc. will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;
- (v) The compensation committee of Unity Bancorp, Inc. will provide a narrative description of how it limited during any part of the most recently completed fiscal year that included a TARP period the features in
  - (A) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Unity Bancorp, Inc.;
  - (B) Employee compensation plans that unnecessarily expose Unity Bancorp, Inc. to risks; and
  - (C) Employee compensation plans that could encourage the manipulation of reported earnings of Unity Bancorp, Inc. to enhance the compensation of an employee;
- (vi) Unity Bancorp, Inc. has required that bonus payments, as defined in the regulations and guidance established under section 111 of EESA (bonus payments), of the SEOs and twenty next most highly compensated employees be subject to a recovery or "clawback" provision during any part of the most recently completed fiscal year that was a TARP period if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;
- (vii) Unity Bancorp, Inc. has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to an SEO or any of the next five most highly compensated employees during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (viii) Unity Bancorp, Inc. has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (ix) The board of directors of Unity Bancorp, Inc. has established an excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA, by the later of September 14, 2009, or ninety days after the closing date of the agreement between the TARP recipient and Treasury; this policy has been provided to Treasury and its primary regulatory agency; Unity Bancorp, Inc. and its employees have complied with this policy during the applicable period; and any expenses that, pursuant to this policy, required approval of the board of directors, a committee of the board of directors, an SEO, or an executive officer with a similar level of responsibility were properly approved;
- (x) Unity Bancorp, Inc. will permit a non-binding shareholder resolution in compliance with any applicable Federal securities rules and regulations on the disclosures provided under the Federal securities laws related to SEO compensation paid or accrued during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (xi) Unity Bancorp, Inc. will disclose the amount, nature, and justification for the offering during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds \$25,000 for any employee who is subject to the bonus payment limitations identified in paragraph (viii);
- (xii) Unity Bancorp, Inc. will disclose whether Unity Bancorp, Inc., the board of directors of Unity Bancorp, Inc., or the compensation committee of Unity Bancorp, Inc. has engaged during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date, a compensation consultant; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;
- (xiii) Unity Bancorp, Inc. has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during the period beginning on the later of the closing date of the agreement between the TARP recipient and Treasury or June 15, 2009 and ending with the last day of the TARP recipient's fiscal year containing that date;
- (xiv) Unity Bancorp, Inc. has substantially complied with all other requirements related to employee compensation that are provided in the agreement between Unity Bancorp, Inc. and Treasury, including any amendments;
- (xv) Unity Bancorp, Inc. has submitted to Treasury a complete and accurate list of the SEOs and the twenty next most highly compensated employees for the current fiscal year and the most recently completed fiscal year, with the non-SEO's ranked in descending order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and
- (xvi) I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both. ( See, for example, 18 U.S.C. 1001.)"

Date: March 17, 2011

/s/ Alan J. Bedner  
Alan J. Bedner  
Executive Vice President and Chief Financial Officer