

UNITY BANCORP INC /NJ/
Form 10-K
March 15, 2007

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)

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

For the fiscal year ended **December 31, 2006**

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

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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 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.

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

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, 2006, the aggregate market value of the registrant's Common Stock, no par value per share, held by non-affiliates of the registrant was \$71,372,468 and 4,607,648 shares of the Common Stock were outstanding. As of March 1, 2007 6,658,527 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, 2006 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, 2006 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 1991 and subsequently, in 2002, 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 I, Unity (NJ) Statutory Trust II and Unity (NJ) Statutory Trust III. The trusts have issued \$9.3 million, \$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, North Plainfield, Scotch Plains, South Plainfield, Springfield, Union, Bridgewater and Whitehouse. In addition, the Bank added its first Pennsylvania branch located in Forks Township in November 2006. The Bank's primary service area encompasses the Route 22/Route 78 corridors between the Forks Township, Pennsylvania office and its Linden, New Jersey branch. We intend to seek to grow our branch network by one to two additional offices per year, and believe the Lehigh Valley market in Pennsylvania is a natural extension of our existing market.

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.

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. The Bank has recently been awarded nationwide lending authority by the SBA, and intends to expand its SBA lending program to markets beyond the Company's traditional tri-state market area.

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, in combination with its Flemington and Whitehouse offices, serves the greater area of Hunterdon County. The Bank's North Plainfield and Bridgewater offices serve 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 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 serves Northampton County, Pennsylvania. Through our SBA lending program, we also originate a significant number of loans outside of the markets served by our branches. As the Bank has recently been granted nationwide lending authority by the SBA, we expect to continue to generate a significant amount of loan volume in areas that are not part of our trade area.

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 by 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, 2006, the Company employed 175 full-time and 19 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, 2006 about 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, 53 Chief Deposit Officer and Executive Vice President of the Company and the Bank	2002	Previously, Mr. Kauchak was the head of Deposit Operations for Unity Bank from 1996 to 2002.
Michael F. Downes, 44, Chief Lending Officer and Executive Vice President of the Company and Bank	2001	Previously, Mr. Downes was a Commercial Lending Officer for Unity Bank from 1996 to 2001.
Alan J. Bedner, 36 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.

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. Many of these proposals would 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, which, if any, of these legislative proposals may ultimately be adopted and the impact of any such 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 nonbanking activities. In addition, bank holding companies, which elect to become financial holding companies, may engage in certain banking and nonbanking 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, as it does not engage in any nonbanking activities.

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 \$150 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-weight 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 fully secured by residential property which carry a 50% risk-weighting and performing, guaranteed portions of unsold SBA loans which carry a 20% 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-weight, 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-weight. 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.

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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 Bank's deposits are insured up to a maximum of \$100,000 per depositor (\$250,000 per IRA account) under the Deposit Insurance Fund of the FDIC. Pursuant to the Federal Deposit Insurance Corporation Improvements Act of 1991 (FDICIA), the FDIC has established a risk-based assessment system. Premium assessments under this system are based upon: (i) the probability that the insurance fund will incur a loss with respect to the institution; (ii) the likely amount of the loss; and (iii) the revenue needs of the insurance fund. To effectuate this system, the FDIC has developed a matrix that sets the assessment premium for a particular institution in accordance with its capital level and overall rating by the primary regulator. For 2007, assessment rates will be from 5 to 43 basis points of deposits.

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.

Sarbanes-Oxley Act

On July 30, 2002, the Sarbanes-Oxley Act, or 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 new corporate governance rules, 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;

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- 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 will increase our compliance costs and could make it more difficult to attract and retain board members.

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, 2006 (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
I.	Distribution of Assets, Liabilities, and Stockholders Equity; Interest Rates and Interest Differential	
	A. Analysis of Net Interest Earnings	6
	B. Average Balance Sheets	8
	C. Rate/Volume Analysis	10
II.	Investment Portfolio	
	A. Book value of investment securities	32
	B. Investment securities by range of maturity with corresponding average yields	32
	C. Securities of issuers exceeding ten percent of stockholders equity	N/A