

UNITY BANCORP INC /NJ/
Form 10-Q
August 12, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from ____ to ____.

Commission File Number 1-12431

Unity Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

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

Large accelerated filer Accelerated filer Nonaccelerated filer Smaller reporting company

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

Yes No

The number of shares outstanding of each of the registrant's classes of common equity stock, as of July 31, 2015
common stock, no par value: 8,426,455 shares outstanding.

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PART I CONSOLIDATED FINANCIAL INFORMATION

ITEM 1 Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.

Consolidated Balance Sheets

(Unaudited)

(In thousands)	June 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	\$ 28,240	\$ 29,351
Federal funds sold and interest-bearing deposits	62,202	100,470
Cash and cash equivalents	90,442	129,821
Securities:		
Securities available for sale	55,766	60,073
Securities held to maturity (fair value of \$18,729 and \$20,281, respectively)	18,609	20,009
Total securities	74,375	80,082
Loans:		
SBA loans held for sale	11,368	5,179
SBA loans held for investment	39,663	40,401
SBA 504 loans	29,125	34,322
Commercial loans	428,371	401,949
Residential mortgage loans	243,259	220,878
Consumer loans	69,910	59,096
Total loans	821,696	761,825
Allowance for loan losses	(12,404)	(12,551)
Net loans	809,292	749,274
Premises and equipment, net	15,385	15,231
Bank owned life insurance ("BOLI")	13,190	13,001
Deferred tax assets	5,928	5,860
Federal Home Loan Bank ("FHLB") stock	5,635	6,032
Accrued interest receivable	3,690	3,518
Other real estate owned ("OREO")	2,265	1,162
Goodwill and other intangibles	1,516	1,516
Other assets	2,585	3,291
Total assets	\$ 1,024,303	\$ 1,008,788
LIABILITIES AND SHAREHOLDERS' EQUITY		

Liabilities:

Deposits:

Noninterest-bearing demand	\$ 175,287	\$ 152,785
Interest-bearing demand	117,988	128,875
Savings	284,369	300,348
Time, under \$100,000	113,846	113,119
Time, \$100,000 and over	123,937	99,214
Total deposits	815,427	794,341
Borrowed funds	115,000	125,000
Subordinated debentures	15,465	15,465
Accrued interest payable	418	474
Accrued expenses and other liabilities	4,303	3,385
Total liabilities	950,613	938,665
Commitments and contingencies	-	-
Shareholders' equity:		
Common stock	59,067	58,785
Retained earnings	15,055	11,195
Accumulated other comprehensive (loss) income	(432)	143
Total shareholders' equity	73,690	70,123
Total liabilities and shareholders' equity	\$ 1,024,303	\$ 1,008,788
Issued and outstanding common shares	8,425	8,388

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

Unity Bancorp, Inc.

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share amounts)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
INTEREST INCOME				
Federal funds sold and interest-bearing deposits	\$ 6	\$ 10	\$ 16	\$ 19
FHLB stock	38	40	81	87
Securities:				
Taxable	363	552	750	1,278
Tax-exempt	71	90	143	195
Total securities	434	642	893	1,473
Loans:				
SBA loans	605	643	1,284	1,226
SBA 504 loans	369	433	715	832
Commercial loans	5,276	4,738	10,342	9,340
Residential mortgage loans	2,716	2,052	5,298	4,110
Consumer loans	774	544	1,473	1,039
Total loans	9,740	8,410	19,112	16,547
Total interest income	10,218	9,102	20,102	18,126
INTEREST EXPENSE				
Interest-bearing demand deposits	103	109	209	220
Savings deposits	271	188	535	370
Time deposits	725	693	1,411	1,337
Borrowed funds and subordinated debentures	750	807	1,558	1,606
Total interest expense	1,849	1,797	3,713	3,533
Net interest income	8,369	7,305	16,389	14,593
Provision for loan losses	-	550	200	1,150
Net interest income after provision for loan losses	8,369	6,755	16,189	13,443
NONINTEREST INCOME				
Branch fee income	373	342	719	718
Service and loan fee income	466	285	762	580
Gain on sale of SBA loans held for sale, net	-	255	363	337
Gain on sale of mortgage loans, net	687	188	1,031	553
BOLI income	95	96	189	192

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Net security gains	28	268	28	378
Other income	244	206	442	408
Total noninterest income	1,893	1,640	3,534	3,166
NONINTEREST EXPENSE				
Compensation and benefits	3,481	3,122	6,952	6,340
Occupancy	601	619	1,273	1,279
Processing and communications	614	597	1,210	1,179
Furniture and equipment	422	379	795	735
Professional services	242	247	478	458
Loan costs	160	174	382	344
OREO expenses	67	95	103	342
Deposit insurance	150	171	333	349
Advertising	343	287	525	438
Other expenses	572	453	1,103	939
Total noninterest expense	6,652	6,144	13,154	12,403
Income before provision for income taxes	3,610	2,251	6,569	4,206
Provision for income taxes	1,182	723	2,202	1,385
Net income	\$ 2,428	\$ 1,528	\$ 4,367	\$ 2,821
Net income per common share - Basic	\$ 0.29	\$ 0.20	\$ 0.52	\$ 0.37
Net income per common share - Diluted	\$ 0.28	\$ 0.20	\$ 0.51	\$ 0.37
Weighted average common shares outstanding - Basic	8,425	7,605	8,421	7,596
Weighted average common shares outstanding - Diluted	8,524	7,690	8,519	7,672

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

Unity Bancorp, Inc.

Consolidated Statements of Comprehensive Income

(Unaudited)

	For the three months ended			June 30, 2014		
	June 30, 2015			June 30, 2014		
	Before tax amount	Income tax expense (benefit)	Net of tax amount	Before tax amount	Income tax expense (benefit)	Net of tax amount
(In thousands)						
Net income	\$ 3,610	\$ 1,182	\$ 2,428	\$ 2,251	\$ 723	\$ 1,528
Other comprehensive (loss) income						
Investment securities available for sale:						
Unrealized holding (losses) gains on securities arising during the period	(201)	(80)	(121)	553	202	351
Less: reclassification adjustment for gains on securities included in net income	28	10	18	268	90	178
Total unrealized (losses) gains on securities available for sale	(229)	(90)	(139)	285	112	173
Adjustments related to defined benefit plan:						
Initial recognition of prior service cost	(830)	(332)	(498)	-	-	-
Amortization of prior service cost	42	17	25	-	-	-
Total adjustments related to defined benefit plan	(788)	(315)	(473)	-	-	-
Total other comprehensive (loss) income	(1,017)	\$ (405)	\$ (612)	285	\$ 112	\$ 173
Total comprehensive income	\$ 2,593	\$ 777	\$ 1,816	\$ 2,536	\$ 835	\$ 1,701

	For the six months ended			June 30, 2014		
	June 30, 2015			June 30, 2014		
	Before tax amount	Income tax expense (benefit)	Net of tax amount	Before tax amount	Income tax expense (benefit)	Net of tax amount
(In thousands)						
Net income	\$ 6,569	\$ 2,202	\$ 4,367	\$ 4,206	\$ 1,385	\$ 2,821
Other comprehensive (loss) income						
Investment securities available for sale:						
Unrealized holding (losses) gains on securities arising during the period	(139)	(55)	(84)	1,171	437	734
Less: reclassification adjustment for gains on securities included in net income	28	10	18	378	127	251

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Total unrealized (losses) gains on securities available for sale	(167)	(65)	(102)	793	310	483
Adjustments related to defined benefit plan:						
Initial recognition of prior service cost	(830)	(332)	(498)	-	-	-
Amortization of prior service cost	42	17	25	-	-	-
Total adjustments related to defined benefit plan	(788)	(315)	(473)	-	-	-
Total other comprehensive (loss) income	(955)	\$ (380)	\$ (575)	793	\$ 310	\$ 483
Total comprehensive income	\$ 5,614	\$ 1,822	\$ 3,792	\$ 4,999	\$ 1,695	\$ 3,304

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

Unity Bancorp, Inc.

Consolidated Statements of Changes in Shareholders' Equity

For the six months ended June 30, 2015 and 2014

(Unaudited)

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

	Common stock		Retained	Accumulated	Total
(In thousands)	Shares	Amount	earnings	other comprehensive income (loss)	shareholders' equity
Balance, December 31, 2013	7,577	\$ 52,051	\$ 5,598	\$ (476)	\$ 57,173
Net income			2,821		2,821
Other comprehensive income, net of tax				483	483
Dividends on common stock (\$0.04 per share)		21	(305)		(284)
Common stock issued and related tax effects (1)	30	284			284
Balance, June 30, 2014	7,607	\$ 52,356	\$ 8,114	\$ 7	\$ 60,477

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

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

Unity Bancorp, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	For the six months ended June 30,	
(In thousands)	2015	2014
OPERATING ACTIVITIES:		
Net income	\$ 4,367	\$ 2,821
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	200	1,150
Net amortization of purchase premiums and discounts on securities	279	270
Depreciation and amortization	352	610
Deferred income tax expense	345	293
Net security gains	(28)	(378)
Stock compensation expense	226	206
Loss on sale of OREO	22	99
Gain on sale of mortgage loans held for sale, net	(911)	(406)
Gain on sale of SBA loans held for sale, net	(363)	(337)
Origination of mortgage loans held for sale	(42,184)	(28,597)
Origination of SBA loans held for sale	(9,866)	(4,009)
Proceeds from sale of mortgage loans held for sale, net	43,095	29,003
Proceeds from sale of SBA loans held for sale, net	3,829	3,534
BOLI income	(189)	(192)
Net change in other assets and liabilities	733	(457)
Net cash (used in) provided by operating activities	(93)	3,610
INVESTING ACTIVITIES		
Purchases of securities available for sale	(1,002)	(9,947)
Purchases of FHLB stock, at cost	(9,570)	(4,451)
Maturities and principal payments on securities held to maturity	1,350	4,611
Maturities and principal payments on securities available for sale	4,414	5,360
Proceeds from sales of securities available for sale	528	17,919
Proceeds from redemption of FHLB stock	9,967	3,465
Proceeds from sale of OREO	1,044	2,351
Net increase in loans	(55,953)	(33,830)
Purchases of premises and equipment	(676)	(317)
Net cash used in investing activities	(49,898)	(14,839)
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	21,086	(10,615)
Proceeds from new borrowings	50,000	50,000
Repayments of borrowings	(60,000)	(32,000)
Proceeds from exercise of stock options	-	62
Dividends on common stock	(474)	(284)
Net cash provided by financing activities	10,612	7,163

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Decrease in cash and cash equivalents	(39,379)	(4,066)
Cash and cash equivalents, beginning of period	129,821	99,404
Cash and cash equivalents, end of period	\$ 90,442	\$ 95,338

Unity Bancorp, Inc.

Consolidated Statements of Cash Flows (Continued)

(Unaudited)

(In thousands)	For the six months ended June 30,	
	2015	2014
SUPPLEMENTAL DISCLOSURES		
Cash:		
Interest paid	\$ 3,767	\$ 3,521
Income taxes paid	1,868	1,069
Noncash investing activities:		
Transfer of SBA loans held for sale to held to maturity	-	83
Capitalization of servicing rights	240	258
Transfer of loans to OREO	2,194	2,932

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

Unity Bancorp, Inc.

Notes to the Consolidated Financial Statements (Unaudited)

June 30, 2015

NOTE 1. Significant Accounting Policies

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

The interim unaudited Consolidated Financial Statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission ("SEC") and consist of normal recurring adjustments necessary for the fair presentation of interim results. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, "we" and "us" and "our" refer to Unity Bancorp, Inc., and its consolidated subsidiary, Unity Bank, depending on the context. Certain information and financial disclosures required by U.S. generally accepted accounting principles have been condensed or omitted from interim reporting pursuant to SEC rules. Interim financial statements should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Stock Transactions

Stock Option Plans

The Company has incentive and nonqualified option plans, which allow for the grant of options to officers, employees and members of the Board of Directors. Transactions under the Company's stock option plans for the six months ended June 30, 2015 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, 2014	418,921	\$ 6.76	5.5	\$ 1,257,968
Options granted	40,000	9.12		
Options exercised	-	-		
Options cancelled	-	-		
Outstanding at June 30, 2015	458,921	\$ 6.96	5.4	\$ 1,418,599
Exercisable at June 30, 2015	362,426	\$ 6.64	4.5	\$ 1,262,684

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of June 30, 2015, 1,920,529 shares have been reserved for issuance upon the exercise of options, 458,921 option grants are outstanding, and 1,252,416 option grants have been exercised, forfeited or expired, leaving 209,192 shares available for grant.

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The fair values of the options granted during the three and six months ended June 30, 2015 and 2014 were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Number of options granted	-	1,000	40,000	41,000
Weighted average exercise price	\$ -	\$ 7.94	\$ 9.12	\$ 7.90
Weighted average fair value of options	\$ -	\$ 2.69	\$ 3.82	\$ 3.02
Expected life in years (1)	-	5.40	6.69	5.40
Expected volatility (2)	- %	38.76 %	46.76 %	45.05 %
Risk-free interest rate (3)	- %	1.61 %	1.80 %	1.52 %
Dividend yield (4)	- %	1.01 %	1.33 %	1.02 %

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

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

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

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

Upon exercise, the Company issues shares from its authorized but unissued common stock to satisfy the options. The following table presents information about options exercised during the three and six months ended June 30, 2015 and 2014:

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Number of options exercised	-	-	-	19,950
Total intrinsic value of options exercised	\$ -	\$ -	\$ -	\$ 67,417
Cash received from options exercised	-	-	-	62,445
Tax deduction realized from options exercised	-	-	-	26,926

The following table summarizes information about stock options outstanding and exercisable at June 30, 2015:

Options outstanding

Options exercisable

Range of exercise prices	Options outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Options exercisable	Weighted average exercise price
\$ 0.00 - 4.00	89,000	3.7	\$ 3.85	89,000	\$ 3.85
4.01 - 7.00	166,500	6.2	6.15	150,667	6.16
7.01 - 10.00	155,975	6.5	7.97	80,313	7.46
10.01 - 13.00	47,446	2.4	12.36	42,446	12.60
Total	458,921	5.4	\$ 6.96	362,426	\$ 6.64

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 718, "Compensation - Stock Compensation," requires an entity to recognize the fair value of equity awards as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period). Compensation expense related to stock options and the related income tax benefit for the three and six months ended June 30, 2015 and 2014 are detailed in the following table:

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Compensation expense	\$ 39,072	\$ 43,834	\$ 68,990	\$ 84,397
Income tax benefit	15,605	17,507	27,555	33,708

As of June 30, 2015, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company's stock option plans totaled approximately \$273 thousand. That cost is expected to be recognized over a weighted average period of 2.1 years.

Restricted Stock Awards

Restricted stock is issued under the stock bonus program to reward employees and directors and to retain them by distributing stock over a period of time. The following table summarizes nonvested restricted stock activity for the six months ended June 30, 2015:

	Shares	Average grant date fair value
Nonvested restricted stock at December 31, 2014	77,750	\$ 7.24
Granted	34,800	9.27
Vested	(10,875)	6.77
Forfeited	-	-
Nonvested restricted stock at June 30, 2015	101,675	\$ 7.96

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value at the time of grant and amortized into salary expense on a straight line basis over the vesting period. As of June 30, 2015, 471,551 shares of restricted stock were reserved for issuance, of which 179,700 shares are available for grant.

Restricted stock awards granted during the three and six months ended June 30, 2015 and 2014 were as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Number of shares granted	-	1,000	34,800	11,000
Average grant date fair value	\$ -	\$ 8.78	\$ 9.27	\$ 7.92

Compensation expense related to restricted stock for the three and six months ended June 30, 2015 and 2014 is detailed in the following table:

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Compensation expense	\$ 79,961	\$ 62,380	\$ 157,510	\$ 121,650
Income tax benefit	31,937	24,915	62,909	48,587

As of June 30, 2015, there was approximately \$654 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 2.8 years.

Benefit Plans

In addition to the 401(k) savings plan which covers substantially all employees, the Company has established in 2015 an unfunded supplemental defined benefit plan to provide additional retirement benefits for the President and Chief Executive Officer ("CEO").

On June 4, 2015, the Company approved the Supplemental Executive Retirement Plan (the "SERP") pursuant to which the President and CEO is entitled to receive certain supplemental nonqualified retirement benefits.

Upon separation from service after age 66, the President and CEO will be entitled to an annual benefit in the amount of \$156,000 subject to annual 2% increases. The President and CEO commenced vesting to this retirement benefit on January 1, 2014, and shall vest an additional 3% each year until fully vested on January 1, 2024. In the event that the President and CEO's separation from service from the Registrant were to occur prior to full vesting, the President and CEO would be entitled to and shall be paid the vested portion of the retirement benefit calculated as of the date of separation from service.

Notwithstanding the foregoing, upon a Change in Control, and provided that within 6 months following the Change in Control the President and CEO is involuntary terminated for reasons other than "cause" or the President and CEO resigns for "good reason", as such is defined in the SERP, or the President and CEO voluntarily terminates the his employment after being offered continued employment in a positions that is not a "Comparable Position", as such is also defined in the SERP, the President and CEO shall become 100% vested in the full retirement benefit.

No contributions or payments have been made or are anticipated for the year 2015. The following table summarizes the components of the net periodic pension cost of the defined benefit plan recognized during the three- and six-month periods ended:

(In thousands)	For the three and six months ended June 30, 2015
Components of net periodic benefits cost:	
Service cost	\$ 30
Interest cost	17
Amortization of prior service cost	42
Net periodic benefit cost	\$ 89

Other-Than-Temporary Impairment

The Company has a process in place to identify debt securities that could potentially incur 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 forecasted period of time that allows for the recovery in value.

Management assesses its intent to sell or whether it is more likely than not that it 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. For debt securities where management has the intent to sell, the amount of the impairment is reflected in earnings as realized losses.

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.

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.

Loans

Loans Held for Sale

Loans held for sale represent the guaranteed portion of Small Business Administration (“SBA”) loans and are reflected at the lower of aggregate cost or market value. The Company originates loans to customers under an SBA program that historically has provided for SBA guarantees of up to 90 percent of each loan. The Company generally sells the guaranteed portion of its SBA loans to a third party and retains the servicing, holding the nonguaranteed portion in its portfolio. 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. When 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. All criteria for sale accounting must be met in order for the loan sales to occur; see details under the “Transfers of Financial Assets” heading above.

Servicing assets represent the estimated fair value of retained servicing rights, net of servicing costs, at the time loans are sold. Servicing assets are amortized 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.

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.

Loans Held to Maturity

Loans held to maturity are stated at the unpaid principal balance, net of unearned discounts and deferred loan origination fees and costs. In accordance with the level yield method, loan origination fees, net of direct loan origination costs, are deferred and recognized over the estimated life of the related loans as an adjustment to the loan yield. Interest is credited to operations primarily based upon the principal balance outstanding.

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.

Nonperforming loans consist of loans that are not accruing interest 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 (nonaccrual loans). When a loan is classified as nonaccrual, interest accruals are discontinued and all past due interest previously recognized as income is reversed and charged against current period earnings. 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 may be 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 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 is charged off. All loan charge-offs are approved by the Board of Directors.

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. These concessions typically include reductions in interest rate, extending the maturity of a loan, or a combination of both. Interest income on accruing TDRs is credited to operations primarily based upon the principal amount outstanding, as stated in the

paragraphs above.

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 TDRs and nonperforming loans individually evaluated for impairment. Impairment is evaluated in total for smaller-balance loans of a similar nature (consumer and residential mortgage loans), and on an individual basis for all other loans. Impairment of a loan is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or as a practical expedient, 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 value 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 to the provision for loan losses.

For additional information on loans, see Note 8 to the Consolidated Financial Statements and the section titled "Loan Portfolio" under Item 2. Management's Discussion and Analysis.

Allowance for Loan Losses and Reserve for 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 and TDRs, 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 on the allowance for loan losses and unfunded loan commitments, see Note 9 to the Consolidated Financial Statements and the sections titled "Asset Quality" and "Allowance for Loan Losses and Reserve for Unfunded Loan Commitments" under Item 2. Management's Discussion and Analysis.

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.

NOTE 2. 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.

NOTE 3. Net Income per Share

Basic net income per common share is calculated as net income divided by the weighted average common shares outstanding during the reporting period.

Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally stock options, were issued during the reporting period utilizing the Treasury stock method.

The following is a reconciliation of the calculation of basic and diluted income per share:

(In thousands, except per share amounts)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Net income	\$ 2,428	\$ 1,528	\$ 4,367	\$ 2,821
Weighted average common shares outstanding - Basic	8,425	7,605	8,421	7,596
Plus: Potential dilutive common stock equivalents	99	85	98	76
Weighted average common shares outstanding - Diluted	8,524	7,690	8,519	7,672
Net income per common share - Basic	\$ 0.29	\$ 0.20	\$ 0.52	\$ 0.37
Net income per common share - Diluted	0.28	0.20	0.51	0.37
Stock options and common stock excluded from the income per share calculation as their effect would have been anti-dilutive	141	126	127	114

NOTE 4. 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.

For the quarter ended June 30, 2015, the Company reported income tax expense of \$1.2 million for an effective tax rate of 32.7 percent, compared to an income tax expense of \$723 thousand and an effective tax rate of 32.1 percent for the prior year's quarter. For the six months ended June 30, 2015, the Company reported income tax expense of \$2.2 million for an effective tax rate of 33.5 percent, compared to an income tax expense of \$1.4 million and effective tax rate of 32.9 percent for the six months ended June 30, 2014. The Company did not recognize or accrue any interest or penalties related to income taxes during the three or six months ended June 30, 2015 or 2014. The Company did not have an accrual for uncertain tax positions as of June 30, 2015 or December 31, 2014, 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 2010 and thereafter are subject to future examination by tax authorities.

NOTE 5. Other Comprehensive (Loss) Income

The following tables show the changes in other comprehensive (loss) income for the three and six months ended June 30 2015 and 2014, net of tax:

(In thousands)	For the three months ended June 30, 2015			2014	
	Net unrealized gains (losses) on securities	Adjustments related to defined benefit plan	Accumulated other comprehensive (loss) income	Net unrealized (losses) gains on securities	Accumulated other comprehensive (loss) income
Balance at March 31	\$ 180	\$ -	\$ 180	\$ (166)	\$ (166)
Other comprehensive (loss) income before reclassifications	(121)	(498)	(619)	351	351
Less amounts reclassified from accumulated other comprehensive loss	18	(25)	(7)	178	178
Period change	(139)	(473)	(612)	173	173
Balance at June 30	\$ 41	\$ (473)	\$ (432)	\$ 7	\$ 7

(In thousands)	For the six months ended June 30, 2015			2014	
	Net unrealized gains (losses) on securities	Adjustments related to defined benefit plan	Accumulated other comprehensive (loss) income	Net unrealized (losses) gains on securities	Accumulated other comprehensive (loss) income
Balance at January 1	\$ 143	\$ -	\$ 143	\$ (476)	\$ (476)
Other comprehensive (loss) income before reclassifications	(84)	(498)	(582)	734	734
Less amounts reclassified from accumulated other comprehensive loss	18	(25)	(7)	(251)	(251)
Period change	(102)	(473)	(575)	483	483
Balance at June 30	\$ 41	\$ (473)	\$ (432)	\$ 7	\$ 7

Amounts reclassified out of accumulated other comprehensive income were as follows:

Details about accumulated other comprehensive (loss) income components	Amounts reclassified from accumulated other comprehensive (loss) income		Affected line item in the statement where net income is presented
	For the three months ended June 30, 2015	2014	
(In thousands)			
Investment securities available for sale:			
Reclassification adjustment for gains on securities included in net income	\$ 28	\$ 268	Net security sales
Adjustments related to defined benefit plan:			
Amortization of prior service cost included in net periodic pension cost	(42)	-	Compensation and benefits
Effect on accumulated other loss (income) for the period	(14)	268	Total before tax
Income tax benefit (expense)	7	(90)	Provision for income taxes
Total reclassification for the period	\$ (7)	\$ 178	Net income

Details about accumulated other comprehensive (loss) income components	Amounts reclassified from accumulated other comprehensive (loss) income For the six months ended June 30,		Affected line item in the statement where net income is presented
(In thousands)	2015	2014	
Investment securities available for sale:			
Reclassification adjustment for gains on securities included in net income	\$ 28	\$ 378	Net security sales
Adjustments related to defined benefit plan:			
Amortization of prior service cost included in net periodic pension cost	(42)	-	Compensation and benefits
Effect on accumulated other loss (income) for the period	(14)	378	Total before tax
Income tax benefit (expense)	7	(127)	Provision for income taxes
Total reclassification for the period	\$ (7)	\$ 251	Net income

NOTE 6. 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. 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 agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in 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 on a recurring basis:

Securities Available for Sale

The fair value of available for sale ("AFS") securities is the market value based on quoted market prices, 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 June 30, 2015, the fair value of the Company's AFS securities portfolio was \$55.8 million. Approximately 54 percent of the portfolio was made up of residential mortgage-backed securities, which had a fair value of \$30.3 million at June 30, 2015. Approximately \$29.3 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 of the Company's AFS securities were classified as Level 2 assets at June 30, 2015. 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.

There were no changes in the inputs or methodologies used to determine fair value during the period ended June 30, 2015, as compared to the periods ended December 31, 2014 and June 30, 2014.

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The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014:

(In thousands)	June 30, 2015			
	Level 1	Level 2	Level 3	Total
Securities available for sale:				
U.S. Government sponsored entities	\$ -	\$ 5,479	\$ -	\$ 5,479
State and political subdivisions	-	10,650	-	10,650
Residential mortgage-backed securities	-	30,283	-	30,283
Corporate and other securities	-	9,354	-	9,354
Total securities available for sale	\$ -	\$ 55,766	\$ -	\$ 55,766

(In thousands)	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Securities available for sale:				
U.S. Government sponsored entities	\$ -	\$ 4,618	\$ -	\$ 4,618
State and political subdivisions	-	11,132	-	11,132
Residential mortgage-backed securities	-	34,383	-	34,383
Corporate and other securities	-	9,940	-	9,940
Total securities available for sale	\$ -	\$ 60,073	\$ -	\$ 60,073

The following table summarizes changes in Level 3 assets during the three and six months ended June 30, 2015 and 2014, consisting of commercial mortgage-backed available for sale securities, measured at fair value on a recurring basis:

(In thousands)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Commercial mortgage-backed securities:				
Balance, beginning of period	\$ -	\$ 499	\$ -	\$ 888
Payoffs	-	(342)	-	(714)
Principal paydowns	-	(153)	-	(173)
Total net losses included in:				
Other comprehensive income	-	(4)	-	(1)
Balance, end of period	\$ -	\$ -	\$ -	\$ -

There were no gains or losses (realized or unrealized) on Level 3 securities included in earnings for assets and liabilities held at June 30, 2015 or 2014.

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:

Appraisal Policy

All appraisals must be performed in accordance with the Uniform Standards of Professional Appraisal Practice ("USPAP"). Appraisals are certified to the Company and performed by appraisers on the Company's approved list of appraisers. Evaluations are completed by a person independent of Company management. The content of the appraisal depends on the complexity of the property. Appraisals are completed on a "retail value" and an "as is value".

The Company requires current real estate appraisals on all loans that become OREO or in-substance foreclosure, loans that are classified substandard, doubtful or loss, or loans that are over \$100,000 and nonperforming. Prior to each balance sheet date, the Company values impaired collateral-dependent loans and OREO based upon a third party appraisal, broker's price opinion, drive by appraisal, automated valuation model, updated market evaluation, or a combination of these methods. The amount is discounted for the decline in market real estate values (for original appraisals), for any known damage or repair costs, and for selling and closing costs. The amount of the discount ranges from 10 to 25 percent and is dependent upon the method used to determine the original value. The original appraisal is generally used when a loan is first determined to be impaired. When applying the discount, the Company takes into consideration when the appraisal was performed, the collateral's location, the type of collateral, any known damage to the property and the type of business. Subsequent to entering impaired status and the Company determining that there is a collateral shortfall, the Company will generally, depending on the type of collateral, order a third party appraisal, broker's price opinion, automated valuation model or updated market evaluation. After receiving the third party results, the Company will discount the value 8 to 10 percent for selling and closing costs.

OREO

The fair value of OREO is 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. Partially charged-off loans are measured for impairment based upon an appraisal for collateral-dependent loans. When an updated appraisal is received for a nonperforming loan, the value on the appraisal is discounted in the manner discussed above. If there is a deficiency in the value after the Company applies these discounts, management applies a specific reserve and the loan remains in nonaccrual status. The receipt of an updated appraisal would not qualify as a reason to put a loan back into accruing status. The Company removes loans from nonaccrual status generally when the borrower makes nine months of contractual payments and demonstrates the ability to service the debt going forward. Charge-offs are determined based upon the loss that management believes the Company will incur after evaluating collateral for impairment based upon the valuation methods described above and the ability of the borrower to pay any deficiency.

The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. At June 30, 2015 and December 31, 2014, the valuation allowance for impaired loans was \$1.2 million.

The following tables present the assets and liabilities subject to fair value adjustments (impairment) on a non-recurring basis carried on the balance sheet by caption and by level within the hierarchy (as described above):

(In thousands)	Fair value at June 30, 2015			
	Level 1	Level 2	Level 3	Total
Financial assets:				
OREO	\$ -	\$ -	\$ 2,265	\$ 2,265
Impaired collateral-dependent loans	-	-	8,109	8,109

(In thousands)	Fair value at December 31, 2014			
	Level 1	Level 2	Level 3	Total
Financial assets:				
OREO	\$ -	\$ -	\$ 1,162	\$ 1,162
Impaired collateral-dependent loans	-	-	4,897	4,897

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 for which the Company did not elect the fair value option. These estimated fair values as of June 30, 2015 and December 31, 2014 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.

Securities

The fair value of securities is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

SBA Loans Held for Sale

The fair value of SBA loans held for sale is estimated by using a market approach that includes significant other observable inputs.

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.

FHLB Stock

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

Servicing Assets

SBA servicing assets do not trade in an active, open market with readily observable prices. The Company estimates the fair value of servicing assets using discounted cash flow models incorporating numerous assumptions from the perspective of a market participant including market discount rates and prepayment speeds.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

OREO

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

Deposit Liabilities

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

Borrowed Funds and Subordinated Debentures

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

Standby Letters of Credit

At June 30, 2015, the Bank had standby letters of credit outstanding of \$1.5 million, consistent with December 31, 2014. The fair value of these commitments is nominal.

The table below presents the carrying amount and estimated fair values of the Company's financial instruments presented as of June 30, 2015 and December 31, 2014:

		June 30, 2015		December 31, 2014	
(In thousands)	Fair value level	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:					
Cash and cash equivalents	Level 1	\$ 90,442	\$ 90,442	\$ 129,821	\$ 129,821
Securities (1)	Level 2	74,375	74,495	80,082	80,354
SBA loans held for sale	Level 2	11,368	12,611	5,179	5,655
Loans, net of allowance for loan losses (2)	Level 2	797,924	800,478	744,095	748,093
FHLB stock	Level 2	5,635	5,635	6,032	6,032
Servicing assets	Level 3	872	872	753	753
Accrued interest receivable	Level 2	3,690	3,690	3,518	3,518
OREO	Level 3	2,265	2,265	1,162	1,162
Financial liabilities:					
Deposits	Level 2	815,427	815,799	794,341	794,436
Borrowed funds and subordinated debentures	Level 2	130,465	134,416	140,465	145,333
Accrued interest payable	Level 2	418	418	474	474

- (1) Includes held to maturity ("HTM") commercial mortgage-backed securities that are considered Level 3. These securities had book values of \$4.0 million at June 30, 2015 and December 31, 2014, and market values of \$3.9 million and \$4.0 million at June 30, 2015 and December 31, 2014, respectively.
- (2) Includes collateral-dependent impaired loans that are considered Level 3 and reported separately in the tables under the "Fair Value on a Nonrecurring Basis" heading. Collateral-dependent impaired loans, net of specific reserves totaled \$8.1 million and \$4.9 million at June 30, 2015 and December 31, 2014, respectively.

NOTE 7. Securities

This table provides the major components of AFS and HTM securities at amortized cost and estimated fair value at June 30, 2015 and December 31, 2014:

(In thousands)	June 30, 2015				December 31, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale:								
U.S. Government sponsored entities	\$ 5,564	\$ -	\$ (85)	\$ 5,479	\$ 4,711	\$ -	\$ (93)	\$ 4,618
State and political subdivisions	10,708	73	(131)	10,650	11,055	112	(35)	11,132
Residential mortgage-backed securities	29,886	602	(205)	30,283	33,884	646	(147)	34,383
Corporate and other securities	9,540	71	(257)	9,354	10,188	63	(311)	9,940
Total securities available for sale	\$ 55,698	\$ 746	\$ (678)	\$ 55,766	\$ 59,838	\$ 821	\$ (586)	\$ 60,073
Held to maturity:								
U.S. Government sponsored entities	\$ 4,220	\$ -	\$ (118)	\$ 4,102	\$ 4,440	\$ -	\$ (124)	\$ 4,316
State and political subdivisions	2,413	207	-	2,620	2,417	277	-	2,694
Residential mortgage-backed securities	7,038	178	(50)	7,166	8,164	211	(29)	8,346
Commercial mortgage-backed securities	3,954	-	(71)	3,883	4,005	13	(53)	3,965
Corporate and other securities	984	-	(26)	958	983	-	(23)	960
Total securities held to maturity	\$ 18,609	\$ 385	\$ (265)	\$ 18,729	\$ 20,009	\$ 501	\$ (229)	\$ 20,281

This table provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at June 30, 2015 is 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.

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	Within one year			After one through five years			After five through ten years			After ten years			Total carrying value		
(In thousands, except percentages)	Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield	
Available for sale at fair value:															
U.S. Government sponsored entities	\$ -	-	%	\$ 2,015	1.35	%	\$ 940	2.06	%	\$ 2,524	2.04	%	\$ 5,479	1.79	%
State and political subdivisions	39	6.48		856	2.56		6,258	2.41		3,497	2.56		10,650	2.49	
Residential mortgage-backed securities	-	-		1,350	1.79		2,056	1.90		26,877	2.72		30,283	2.62	
Corporate and other securities	-	-		2,417	1.04		1,384	1.16		5,553	1.27		9,354	1.19	
Total securities available for sale	\$ 39	6.48	%	\$ 6,638	1.48	%	\$ 10,638	2.12	%	\$ 38,451	2.45	%	\$ 55,766	2.28	%
Held to maturity at cost:															
U.S. Government sponsored entities	\$ -	-	%	\$ -	-	%	\$ -	-	%	\$ 4,220	1.97	%	\$ 4,220	1.97	%
State and political subdivisions	309	0.75		-	-		-	-		2,104	4.72		2,413	4.22	
Residential mortgage-backed securities	-	-		329	4.86		236	5.20		6,473	2.56		7,038	2.76	
Commercial mortgage-backed securities	-	-		-	-		-	-		3,954	2.76		3,954	2.76	
Corporate and other securities	-	-		-	-		984	2.95		-	-		984	2.95	
Total securities held to maturity	\$ 309	0.75	%	\$ 329	4.86	%	\$ 1,220	3.39	%	\$ 16,751	2.73	%	\$ 18,609	2.78	%

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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 June 30, 2015 and December 31, 2014 are as follows:

	June 30, 2015						
	Total number in a loss position	Less than 12 months		12 months and greater		Total	
		Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss
(In thousands, except number in a loss position)							
Available for sale:							
U.S. Government sponsored entities	6	\$ 2,933	\$ (11)	\$ 2,541	\$ (74)	\$ 5,474	\$ (85)
State and political subdivisions	8	4,363	(131)	-	-	4,363	(131)
Residential mortgage-backed securities	10	7,273	(45)	5,172	(160)	12,445	(205)
Corporate and other securities	6	1,367	(48)	3,789	(209)	5,156	(257)
Total temporarily impaired securities	30	\$ 15,936	\$ (235)	\$ 11,502	\$ (443)	\$ 27,438	\$ (678)
Held to maturity:							
U.S. Government sponsored entities	2	\$ -	\$ -	\$ 4,102	\$ (118)	\$ 4,102	\$ (118)
Residential mortgage-backed securities	3	-	-	2,117	(50)	2,117	(50)
Commercial mortgage-backed securities	2	3,883	(71)	-	-	3,883	(71)
Corporate and other securities	1	958	(26)	-	-	958	(26)
Total temporarily impaired securities	8	\$ 4,841	\$ (97)	\$ 6,219	\$ (168)	\$ 11,060	\$ (265)

	December 31, 2014						
	Total number in a loss position	Less than 12 months		12 months and greater		Total	
		Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss
(In thousands, except number in a loss position)							
Available for sale:							
U.S. Government sponsored entities	4	\$ -	\$ -	\$ 4,590	\$ (93)	\$ 4,590	\$ (93)
State and political subdivisions	7	-	-	4,103	(35)	4,103	(35)
Residential mortgage-backed securities	9	6,579	(16)	5,889	(131)	12,468	(147)
Corporate and other securities	7	1,053	(46)	3,736	(265)	4,789	(311)
Total temporarily impaired securities	27	\$ 7,632	\$ (62)	\$ 18,318	\$ (524)	\$ 25,950	\$ (586)
Held to maturity:							
U.S. Government sponsored entities	2	\$ -	\$ -	\$ 4,316	\$ (124)	\$ 4,316	\$ (124)
Residential mortgage-backed securities	3	-	-	2,586	(29)	2,586	(29)

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Commercial mortgage-backed securities	1	-	-	1,822	(53)	1,822	(53)
Corporate and other securities	1	-	-	960	(23)	960	(23)
Total temporarily impaired securities	7	\$ -	\$ -	\$ 9,684	\$ (229)	\$ 9,684	\$ (229)

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 these types of securities were caused by the increase in interest rate spreads or the increase in interest rates at the long end of the Treasury curve. 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 investments. 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 basis, which may be at maturity, the Company did not consider these investments to be other-than temporarily impaired as of June 30, 2015. There was no impairment on these securities at December 31, 2014.

Residential and commercial mortgage-backed securities: The unrealized losses on investments in mortgage-backed securities were caused by increases in interest rate spreads or the increase in interest rates at the long end of the Treasury curve. The majority of contractual cash flows of these securities are guaranteed by the FNMA, GNMA, and the FHLMC. 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 basis, which may be at maturity, the Company did not consider these investments to be other-than-temporarily impaired as of June 30, 2015 or December 31, 2014.

Corporate and other securities: Included in this category are corporate debt securities, Community Reinvestment Act (“CRA”) investments, asset-backed securities, and one trust preferred security. The unrealized losses on corporate debt securities were due to widening credit spreads or the increase in interest rates at the long end of the Treasury curve and the unrealized losses on CRA investments were caused by decreases in the market value of underlying bonds and rate changes. The Company evaluated the prospects of the issuers and forecasted a recovery period; and as a result determined it did not consider these investments to be other-than-temporarily impaired as of June 30, 2015 or December 31, 2014. The unrealized loss on the trust preferred security was caused by an inactive trading market and changes in market credit spreads. At June 30, 2015 and December 31, 2014, this category consisted of one single-issuer trust preferred security. 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 did not consider this security to be other-than-temporarily impaired as of June 30, 2015 or December 31, 2014.

Realized Gains and Losses

Gross realized gains (losses) on securities for the three and six months ended June 30, 2015 and 2014 are detailed in the table below:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2015	2014	2015	2014
Available for sale:				
Realized gains	\$ 28	\$ 271	\$ 28	\$ 385
Realized losses	-	(3)	-	(7)
Total securities available for sale	28	268	28	378
Held to maturity:				
Realized gains	-	-	-	-
Realized losses	-	-	-	-

Total securities held to maturity	-	-	-	-
Net gains on sales of securities	\$ 28	\$ 268	\$ 28	\$ 378

The net realized gains are included in noninterest income in the Consolidated Statements of Income as net security gains. For the three and six months ended June 30, 2015 there was a gross realized gain of \$28 thousand. The net realized gain during 2015 was a result of the following:

- For the three months ended June 30, 2015, the Company sold one corporate bond totaling \$500 thousand in book value, resulting in pre-tax gains of approximately \$28 thousand.

For the three and six months ended June 30, 2014, there were gross realized gains of \$271 thousand and \$385 thousand, respectively. For the three and six months ended June 30, 2014, there were gross realized losses of \$3 thousand and \$7 thousand, respectively. The net realized gains during 2014 were a result of the following:

- For the six months ended June 30, 2014, the Company sold approximately \$15.5 million in book value of available for sale municipal securities, mortgage-backed securities, asset-backed securities, and corporate bonds, resulting in pre-tax gains of approximately \$385 thousand.

Pledged Securities

Securities with a carrying value of \$19.5 million and \$50.4 million at June 30, 2015 and December 31, 2014, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law. Securities pledged for Government deposits totaled \$0 and \$32.1 million at June 30, 2015 and December 31, 2014, respectively. In June 2015, the FHLB issued a letter of credit in the name of Unity Bank naming the NJ Dept. of Banking and Insurance as beneficiary. The letter of credit will take the place of securities previously pledged to the state for the Bank's municipal deposits. For additional information on amounts pledged to secure Government deposits at June 30, 2015, see section titled "Borrowed Funds and Subordinated Debentures" under Item 2. Management Discussion and Analysis.

Note 8. Loans

The following table sets forth the classification of loans by class, including unearned fees, deferred costs and excluding the allowance for loan losses as of June 30, 2015 and December 31, 2014:

(In thousands)	June 30, 2015	December 31, 2014
SBA loans held for investment	\$ 39,663	\$ 40,401
SBA 504 loans	29,125	34,322
Commercial loans		
Commercial other	40,578	40,607
Commercial real estate	361,866	339,693
Commercial real estate construction	25,927	21,649
Residential mortgage loans	243,259	220,878
Consumer loans		
Home equity	44,935	41,451
Consumer other	24,975	17,645
Total loans held for investment	\$ 810,328	\$ 756,646
SBA loans held for sale	11,368	5,179
Total loans	\$ 821,696	\$ 761,825

Loans are made to individuals as well as commercial entities. Specific loan terms vary as to interest rate, repayment, and collateral requirements based on the type of loan requested and the credit worthiness of the prospective borrower. Credit risk tends to be geographically concentrated in that a majority of the loan customers are located in the markets serviced by the Bank. As a preferred SBA lender, a portion of the SBA portfolio is to borrowers outside the Company's market 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. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and/or property type. A description of the Company's different loan segments follows:

SBA Loans: SBA 7(a) loans, on which the SBA has historically provided 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 guaranteed portion of the Company's SBA loans is generally sold in the secondary market with the nonguaranteed portion held in the portfolio as a loan held for investment. SBA loans are for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. Loans are guaranteed by the businesses' major owners. SBA loans are made based primarily on the

historical and projected cash flow of the business and secondarily on the underlying collateral provided.

SBA 504 Loans: 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. SBA 504 loans are made based primarily on the historical and projected cash flow of the business and secondarily on the underlying collateral provided. Generally, the Company has a 50 percent loan to value ratio on SBA 504 program loans at origination.

Commercial Loans: Commercial credit is extended primarily to middle market and small business customers. 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. Loans will generally be guaranteed in full or for a meaningful amount by the businesses' major owners. Commercial loans are made based primarily on the historical and projected cash flow of the business and secondarily on the underlying collateral provided.

Residential Mortgage and Consumer Loans: The Company originates mortgage and consumer loans including principally residential real estate and home equity lines and loans. Each loan type is evaluated on debt to income, type of collateral and loan to collateral value, credit history and Company's relationship with the borrower.

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 which in part is derived from ongoing collection and review of borrowers' financial information, as well as independent credit reviews by an outside firm.

The Company's extension of credit is governed by the Credit Risk Policy which was established to control the quality of the Company's loans. These policies and procedures are reviewed and approved by the Board of Directors on a regular basis.

Credit Ratings

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 regulatorily accepted definitions.

Pass: 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".

Special Mention: 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 startup or deteriorating industries, or borrowers with a poor market share in an average industry. "Special Mention" loans may include an element of asset quality, financial flexibility, or below average management. 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.

Substandard: 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 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.

Loss: 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.

At June 30, 2015, the Company owned \$100 thousand of residential consumer properties that were included in OREO in the Consolidated Balance Sheets. Additionally, there were \$1.8 million of residential consumer loans in the process of foreclosure.

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The tables below detail the Company's loan portfolio by class according to their credit quality indicators discussed in the paragraphs above as of June 30, 2015:

June 30, 2015				
SBA, SBA 504 & Commercial loans - Internal risk ratings				
(In thousands)	Pass	Special mention	Substandard	Total
SBA loans held for investment	\$ 35,437	\$ 2,064	\$ 2,162	\$ 39,663
SBA 504 loans	23,664	5,010	451	29,125
Commercial loans				
Commercial other	36,693	2,747	1,138	40,578
Commercial real estate	337,172	20,868	3,826	361,866
Commercial real estate construction	25,229	698	-	25,927
Total commercial loans	399,094	24,313	4,964	428,371
Total SBA, SBA 504 and commercial loans	\$ 458,195	\$ 31,387	\$ 7,577	\$ 497,159

Residential mortgage & Consumer loans - Performing/Nonperforming			
(In thousands)	Performing	Nonperforming	Total
Residential mortgage loans	\$ 241,500	\$ 1,759	\$ 243,259
Consumer loans			
Home equity	44,039	896	44,935
Consumer other	24,975	-	24,975
Total consumer loans	69,014	896	69,910
Total residential mortgage and consumer loans	\$ 310,514	\$ 2,655	\$ 313,169

The tables below detail the Company's loan portfolio by class according to their credit quality indicators discussed in the paragraphs above as of December 31, 2014:

December 31, 2014				
SBA, SBA 504 & Commercial loans - Internal risk ratings				
(In thousands)	Pass	Special mention	Substandard	Total
SBA loans held for investment	\$ 35,827	\$ 2,250	\$ 2,324	\$ 40,401
SBA 504 loans	24,415	5,967	3,940	34,322
Commercial loans				

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Commercial other	38,054	1,270	1,283	40,607
Commercial real estate	315,015	20,555	4,123	339,693
Commercial real estate construction	21,649	-	-	21,649
Total commercial loans	374,718	21,825	5,406	401,949
Total SBA, SBA 504 and commercial loans	\$ 434,960	\$ 30,042	\$ 11,670	\$ 476,672

Residential mortgage & Consumer loans -
Performing/Nonperforming

(In thousands)	Performing	Nonperforming	Total
Residential mortgage loans	\$ 220,233	\$ 645	\$ 220,878
Consumer loans			
Home equity	40,908	543	41,451
Consumer other	17,643	2	17,645
Total consumer loans	58,551	545	59,096
Total residential mortgage and consumer loans	\$ 278,784	\$ 1,190	\$ 279,974

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. Loans past due 90 days or more and still accruing interest are not included in nonperforming loans and generally represent loans that are well collateralized and in a continuing process 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 improved state of the economy has resulted in a substantial reduction in nonperforming loans and loan delinquencies. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market.

The following tables set forth an aging analysis of past due and nonaccrual loans as of June 30, 2015 and December 31, 2014:

(In thousands)	June 30, 2015			Nonaccrual (1)	Total past due	Current	Total loans
	30-59 days past due	60-89 days past due	90+ days and still accruing				
SBA loans held for investment	\$ 857	\$ 77	\$ -	\$ 1,715	\$ 2,649	\$ 37,014	\$ 39,663
SBA 504 loans	-	-	-	276	276	28,849	29,125
Commercial loans							
Commercial other	-	53	-	994	1,047	39,531	40,578
Commercial real estate	1,487	463	-	3,197	5,147	356,719	361,866
Commercial real estate construction	-	-	-	-	-	25,927	25,927
Residential mortgage loans	3,107	454	273	1,759	5,593	237,666	243,259
Consumer loans							
Home equity	449	-	-	896	1,345	43,590	44,935
Consumer other	-	-	-	-	-	24,975	24,975
Total loans held for investment	\$ 5,900	\$ 1,047	\$ 273	\$ 8,837	\$ 16,057	\$ 794,271	\$ 810,328
SBA loans held for sale	-	-	-	-	-	11,368	11,368
Total loans	\$ 5,900	\$ 1,047	\$ 273	\$ 8,837	\$ 16,057	\$ 805,639	\$ 821,696

(1) At June 30, 2015, nonaccrual loans included \$2.8 million of TDRs and \$267 thousand of loans guaranteed by the SBA. The remaining \$3.4 million of TDRs are in accrual status because they are performing in accordance with their restructured terms.

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(In thousands)	December 31, 2014				Total past due	Current	Total loans
	30-59 days past due	60-89 days past due	90+ days and still accruing	Nonaccrual (1)			
SBA loans held for investment	\$ 1,093	\$ 147	\$ 161	\$ 3,348	\$ 4,749	\$ 35,652	\$ 40,401
SBA 504 loans	1,639	-	-	2,109	3,748	30,574	34,322
Commercial loans							
Commercial other	-	-	-	1,129	1,129	39,478	40,607
Commercial real estate	2,812	-	7	3,592	6,411	333,282	339,693
Commercial real estate construction	-	-	-	-	-	21,649	21,649
Residential mortgage loans	2,887	658	722	645	4,912	215,966	220,878
Consumer loans							
Home equity	639	213	-	543	1,395	40,056	41,451
Consumer other	-	6	-	2	8	17,637	17,645
Total loans held for investment	\$ 9,070	\$ 1,024	\$ 890	\$ 11,368	\$ 22,352	\$ 734,294	\$ 756,646
SBA loans held for sale	-	-	-	-	-	5,179	5,179
Total loans	\$ 9,070	\$ 1,024	\$ 890	\$ 11,368	\$ 22,352	\$ 739,473	\$ 761,825

(1) At December 31, 2014, nonaccrual loans included \$3.0 million of TDRs and \$1.6 million of loans guaranteed by the SBA. The remaining \$3.5 million of TDRs are in accrual status because they are performing in accordance with their restructured terms.

Impaired Loans

The Company has defined impaired loans to be all nonperforming loans individually evaluated for impairment and TDRs. Management considers a loan impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract. Impairment is evaluated on an individual basis for SBA, SBA 504, and commercial loans.

The following table provides detail on the Company's impaired loans that are individually evaluated for impairment with the associated allowance amount, if applicable, as of June 30, 2015:

(In thousands)	June 30, 2015		
	Unpaid principal balance	Recorded investment	Specific reserves
With no related allowance:			
SBA loans held for investment (1)	\$ 827	\$ 384	\$ -
SBA 504 loans	2,015	2,015	-
Commercial loans			
Commercial other	973	972	-
Commercial real estate	1,684	1,684	-
Total commercial loans	2,657	2,656	-
Total impaired loans with no related allowance	5,499	5,055	-
With an allowance:			
SBA loans held for investment (1)	2,069	1,490	748
Commercial loans			
Commercial other	34	22	22
Commercial real estate	2,708	2,708	396
Total commercial loans	2,742	2,730	418
Total impaired loans with a related allowance	4,811	4,220	1,166
Total individually evaluated impaired loans:			
SBA loans held for investment (1)	2,896	1,874	748
SBA 504 loans	2,015	2,015	-
Commercial loans			
Commercial other	1,007	994	22
Commercial real estate	4,392	4,392	396
Total commercial loans	5,399	5,386	418
Total individually evaluated impaired loans	\$ 10,310	\$ 9,275	\$ 1,166

(1) Balances are reduced by amount guaranteed by the SBA of \$267 thousand at June 30, 2015.

The following table provides detail on the Company's impaired loans that are individually evaluated for impairment with the associated allowance amount, if applicable, as of December 31, 2014:

(In thousands)	December 31, 2014		
	Unpaid principal balance	Recorded investment	Specific reserves
With no related allowance:			
SBA loans held for investment (1)	\$ 1,719	\$ 1,093	\$ -
SBA 504 loans	2,202	2,202	-
Commercial loans			
Commercial other	878	877	-
Commercial real estate	2,017	1,927	-
Total commercial loans	2,895	2,804	-
Total impaired loans with no related allowance	6,816	6,099	-
With an allowance:			
SBA loans held for investment (1)	1,521	1,127	502
SBA 504 loans	1,676	1,676	510
Commercial loans			
Commercial other	364	252	41
Commercial real estate	3,003	3,003	108
Total commercial loans	3,367	3,255	149
Total impaired loans with a related allowance	6,564	6,058	1,161
Total individually evaluated impaired loans:			
SBA loans held for investment (1)	3,240	2,220	502
SBA 504 loans	3,878	3,878	510
Commercial loans			
Commercial other	1,242	1,129	41
Commercial real estate	5,020	4,930	108
Total commercial loans	6,262	6,059	149
Total individually evaluated impaired loans	\$ 13,380	\$ 12,157	\$ 1,161

(1) Balances are reduced by amount guaranteed by the SBA of \$1.6 million at December 31, 2014.

The following tables present the average recorded investments in impaired loans and the related amount of interest recognized during the time period in which the loans were impaired for the six months ended June 30, 2015 and 2014. The average balances are calculated based on the month-end balances of impaired loans. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal under the cost recovery method, and therefore no interest income is recognized. The interest income recognized on impaired loans noted below represents primarily accruing TDRs and nominal amounts of income recognized on a cash basis for well-collateralized impaired loans.

	For the three months ended June 30,		2014	
	2015	Interest income recognized	Average recorded investment	Interest income recognized
(In thousands)		on impaired loans	on impaired loans	
SBA loans held for investment (1)	\$ 1,873	\$ 2	\$ 3,167	\$ 21
SBA 504 loans	1,996	26	2,238	27
Commercial loans				
Commercial other	1,073	38	75	1
Commercial real estate	4,521	9	6,256	54
Commercial real estate construction	-	-	115	-
Total	\$ 9,463	\$ 75	\$ 11,851	\$ 103

(1) Balances are reduced by the average amount guaranteed by the SBA of \$269 thousand and \$2.0 million for the three months ended June 30, 2015 and 2014, respectively.

	For the six months ended June 30,		2014	
	2015	Interest income recognized	Average recorded investment	Interest income recognized
(In thousands)		on impaired loans	on impaired loans	
SBA loans held for investment (1)	\$ 1,935	\$ 39	\$ 3,108	\$ 56
SBA 504 loans	2,933	53	2,468	55
Commercial loans				
Commercial other	1,095	56	71	2
Commercial real estate	4,778	71	7,143	123
Commercial real estate construction	-	-	146	-
Total	\$ 10,741	\$ 219	\$ 12,936	\$ 236

(1)

Balances are reduced by the average amount guaranteed by the SBA of \$534 thousand and \$1.4 million for the six months ended June 30, 2015 and 2014, respectively.

TDRs

The Company's loan portfolio also includes certain loans that have been modified as TDRs. 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, unless it results in a delay in payment that is insignificant. These concessions typically include reductions in interest rate, extending the maturity of a loan, or a combination of both. When the Company modifies a loan, management evaluates for any possible impairment using either the discounted cash flows method, where the value of the modified loan is based on the present value of expected cash flows, discounted at the contractual interest rate of the original loan agreement, or by using the fair value of the collateral less selling costs if the loan is collateral-dependent. If management determines that the value of the modified loan is less than the recorded investment in the loan, impairment is recognized by segment or class of loan, as applicable, through an allowance estimate or charge-off to the allowance. This process is used, regardless of loan type, and for loans modified as TDRs that subsequently default on their modified terms.

TDRs of \$6.2 million and \$6.5 million are included in the impaired loan numbers as of June 30, 2015 and December 31, 2014, respectively. The decrease was due to principal pay downs. At June 30, 2015, there were specific reserves of \$591 thousand on TDRs, \$182 thousand on performing TDRs and \$409 thousand on nonperforming TDRs. At December 31, 2014, there were specific reserves of \$223 thousand on TDRs, \$24 thousand on performing TDRs and \$199 thousand on nonperforming TDRs. At June 30, 2015, \$2.8 million of TDRs were in nonaccrual status, compared to \$3.0 million at December 31, 2014. The remaining TDRs are in accrual status since they continue to perform in accordance with their restructured terms.

To date, the Company's TDRs consisted of interest rate reductions and maturity extensions. There has been no principal forgiveness. There were no loans modified during the three or six months ended June 30, 2015 and 2014 that were deemed to be TDRs.

There were no loans modified as a TDR within the previous 12 months that subsequently defaulted at some point during the three or six months ended June 30, 2015. There was one loan modified as a TDR within the previous 12 months where a concession was made and the loan subsequently defaulted at some point during the three months ended June 30, 2014. In this case, subsequent default is defined as being transferred to nonaccrual status. There were no additional defaults during the previous year to date period.

	For the three months ended June			
	30, 2015		2014	
	Number	Recorded	Number	Recorded
(In thousands, except number of contracts)	of	investment	of	investment
	contracts		contracts	
SBA loans held for investment	-	\$ -	1	\$ 131
Total	-	\$ -	1	\$ 131

Note 9. Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

Allowance for Loan Losses

The Company has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. At a minimum, the adequacy of the allowance for loan losses is reviewed by management on a quarterly basis. For purposes of determining the allowance for loan losses, the Company has segmented the loans in its portfolio by loan type. Loans are segmented into the following pools: SBA 7(a), SBA 504, commercial, residential mortgages, and consumer loans. Certain portfolio segments are further broken down into classes based on the associated risks within those segments and the type of collateral underlying each loan. Commercial loans are divided into the following four classes: commercial real estate, commercial real estate construction, unsecured business line of credit and commercial other. Consumer loans are divided into two classes as follows: Home equity and other.

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 and TDRs (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 the following environmental factors: delinquency and impairment trends, charge-off and recovery trends, changes in the volume of restructured loans, volume and loan term trends, changes in risk and underwriting policy trends, staffing and experience changes, national and local economic trends, industry conditions and credit concentration changes. Within the five-year historical net charge-off rate, the Company weights the past three years more heavily as it believes it is more indicative of future

charge-offs. 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. Each environmental factor is evaluated separately for each class of loans and risk weighted based on its individual characteristics.

- For SBA 7(a), SBA 504 and commercial loans, the estimate of loss based on pools of loans with similar characteristics is made through the use of a standardized loan grading system that is applied on an individual loan level and updated on a continuous basis. The loan grading system incorporates reviews of the financial performance of the borrower, including cash flow, debt-service coverage ratio, earnings power, debt level and equity position, in conjunction with an assessment of the borrower's industry and future prospects. It also incorporates analysis of the type of collateral and the relative loan to value ratio.
- For residential mortgage and consumer loans, the estimate of loss is based on pools of loans with similar characteristics. Factors such as credit score, delinquency status and type of collateral are evaluated. Factors are updated frequently to capture the recent behavioral characteristics of the subject portfolios, as well as any changes in loss mitigation or credit origination strategies, and adjustments to the reserve factors are made as needed.

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.

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. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in methodologies for estimating allocated and general reserves in the portfolio. The unallocated portion of the allowance increased during the quarter ended June 30, 2015 due to improvements in current period charge off percentages offset by a larger loan portfolio requiring a larger general reserve.

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The following tables detail the activity in the allowance for loan losses by portfolio segment for the three months ended June 30, 2015 and 2014:

(In thousands)	For the three months ended June 30, 2015						
	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	\$ 1,873	\$ 1,162	\$ 5,624	\$ 2,341	\$ 710	\$ 471	\$ 12,181
Charge-offs	(6)	-	(147)	-	(7)	-	(160)
Recoveries	2	-	370	10	1	-	383
Net (charge-offs) recoveries	(4)	-	223	10	(6)	-	223
Provision for loan losses charged to expense	129	(283)	212	194	52	(304)	-
Balance, end of period	\$ 1,998	\$ 879	\$ 6,059	\$ 2,545	\$ 756	\$ 167	\$ 12,404

(In thousands)	For the three months ended June 30, 2014						
	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	\$ 2,346	\$ 947	\$ 6,402	\$ 2,062	\$ 705	\$ 345	\$ 12,807
Charge-offs	(199)	-	(134)	(5)	(203)	-	(541)
Recoveries	10	-	31	-	1	-	42
Net (charge-offs) recoveries	(189)	-	(103)	(5)	(202)	-	(499)
Provision for loan losses charged to expense	348	(18)	(17)	114	238	(115)	550
Balance, end of period	\$ 2,505	\$ 929	\$ 6,282	\$ 2,171	\$ 741	\$ 230	\$ 12,858

The following tables detail the activity in the allowance for loan losses by portfolio segment for the six months ended June 30, 2015 and 2014:

(In thousands)	For the six months ended June 30, 2015						
	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	\$ 1,883	\$ 1,337	\$ 6,270	\$ 2,289	\$ 667	\$ 105	\$ 12,551
Charge-offs	(135)	(589)	(247)	-	(37)	-	(1,008)
Recoveries	40	-	571	49	1	-	661
Net (charge-offs) recoveries	(95)	(589)	324	49	(36)	-	(347)
Provision for loan losses charged to expense	210	131	(535)	207	125	62	200
Balance, end of period	\$ 1,998	\$ 879	\$ 6,059	\$ 2,545	\$ 756	\$ 167	\$ 12,404

For the six months ended June 30, 2014

(In thousands)	SBA						Total
	held for investments	SBA	Commercial	Residential	Consumer	Unallocated	
Balance, beginning of period	\$ 2,587	\$ 957	\$ 6,840	\$ 2,132	\$ 573	\$ 52	\$ 13,141
Charge-offs	(253)	(92)	(588)	(177)	(382)	-	(1,492)
Recoveries	18	-	40	-	1	-	59
Net (charge-offs) recoveries	(235)	(92)	(548)	(177)	(381)	-	(1,433)
Provision for loan losses charged to expense	153	64	(10)	216	549	178	1,150
Balance, end of period	\$ 2,505	\$ 929	\$ 6,282	\$ 2,171	\$ 741	\$ 230	\$ 12,858

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The following tables present loans and their related allowance for loan losses, by portfolio segment, as of June 30, 2015 and December 31, 2014:

	June 30, 2015						
	SBA held						
	for						
(In thousands)	investment SBA 504	Commercial	Residential	Consumer	Unallocated	Total	
Allowance for loan losses ending balance:							
Individually evaluated for impairment	\$ 748	\$ -	\$ 418	\$ -	\$ -	\$ -	\$ 1,166
Collectively evaluated for impairment	1,250	879	5,641	2,545	756	167	11,238
Total	\$ 1,998	\$ 879	\$ 6,059	\$ 2,545	\$ 756	\$ 167	\$ 12,404
Loan ending balances:							
Individually evaluated for impairment	\$ 1,874	\$ 2,015	\$ 5,386	\$ -	\$ -	\$ -	\$ 9,275
Collectively evaluated for impairment	37,789	27,110	422,985	243,259	69,910	-	801,053
Total	\$ 39,663	\$ 29,125	\$ 428,371	\$ 243,259	\$ 69,910	\$ -	\$ 810,328

	December 31, 2014						
	SBA held for investment SBA 504						
(In thousands)	Commercial	Residential	Consumer	Unallocated	Total		
Allowance for loan losses ending balance:							
Individually evaluated for impairment	\$ 502	\$ 510	\$ 149	\$ -	\$ -	\$ -	\$ 1,161
Collectively evaluated for impairment	1,381	827	6,121	2,289	667	105	11,390
Total	\$ 1,883	\$ 1,337	\$ 6,270	\$ 2,289	\$ 667	\$ 105	\$ 12,551
Loan ending balances:							
Individually evaluated for impairment	\$ 2,220	\$ 3,878	\$ 6,059	\$ -	\$ -	\$ -	\$ 12,157
Collectively evaluated for impairment	38,181	30,444	395,890	220,878	59,096	-	744,489
Total	\$ 40,401	\$ 34,322	\$ 401,949	\$ 220,878	\$ 59,096	\$ -	\$ 756,646

Changes in Methodology:

The Company did not make any changes to its allowance for loan losses methodology in the current period.

Reserve for Unfunded Loan Commitments

In addition to the allowance for loan losses, the Company maintains a reserve for unfunded loan commitments at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the reserve are made through other expense and applied to the reserve which is classified as other liabilities. At June 30, 2015, a \$193 thousand commitment reserve was reported on the balance sheet as an “other liability”, compared to a \$151 thousand commitment reserve at December 31, 2014.

Note 10. New Accounting Pronouncements

ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” This ASU has three sections:

Section A – Summary and amendments that creates revenue from contracts with customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40);

Section B – Conforming amendments to other topics and subtopics in the codification and status tables;

Section C – Background information and basis for conclusions.

The accounting changes in this update have been revised to defer the effective date for public business entities for annual reporting periods beginning after December 15, 2017 and the interim periods within that year. Early adoption is permitted as of the first interim or annual period beginning after December 15, 2016. The Company is currently evaluating the impact of the standard.

ASU 2015-01, “Income Statement-Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.” ASU 2015-01 seeks to eliminate from generally accepted accounting principles (“GAAP”) the concept of extraordinary items. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. The guidance was issued as part of an initiative to reduce complexity in accounting standards. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The effective date is the same for both public business entities and all other entities. The Company does not expect adoption of this guidance to have a material effect on the financial condition or results of operations of the Company.

ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the 2014 consolidated audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014. When necessary, reclassifications have been made to prior period data throughout the following discussion and analysis for purposes of comparability. This Quarterly Report on Form 10-Q contains certain “forward looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, which may be identified by the use of such words as “believe”, “expect”, “anticipate”, “should”, “planned”, “estimated” “potential”. Examples of forward looking statements include, but are not limited to, estimates with respect to the financial condition, results of operations and business of Unity Bancorp, Inc. that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, in addition to those items contained in the Company’s Annual Report on Form 10-K under Item 1A-Risk Factors, as updated by our subsequent Quarterly Reports on Form 10-Q, the following: changes in general, economic, and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects Unity Bancorp, Inc.’s interest rate spread or other income anticipated from operations and investments.

Overview

Unity Bancorp, Inc. (the “Parent Company”) is incorporated in New Jersey and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Its wholly-owned subsidiary, Unity Bank (the “Bank” or, when consolidated with the Parent Company, the “Company”) was granted a charter by the New Jersey Department of Banking and Insurance and commenced operations on September 13, 1991. The Bank provides a full range of commercial and retail banking services through 15 branch offices located in Hunterdon, Somerset, Middlesex, Union and Warren counties in New Jersey, and Northampton County in Pennsylvania as well as a loan production office in Bergen County, New Jersey. These services include the acceptance of demand, savings, and time deposits and the extension of consumer, real estate, SBA and other commercial credits. The Bank has multiple subsidiaries used to hold part of its investment and loan portfolios and OREO properties.

Unity (NJ) Statutory Trust II is a statutory business trust and wholly owned subsidiary of Unity Bancorp, Inc. On July 24, 2006, the Trust issued \$10.0 million of trust preferred securities to investors. Unity (NJ) Statutory Trust III is a statutory business trust and wholly owned subsidiary of Unity Bancorp, Inc. On December 19, 2006, the Trust issued \$5.0 million of trust preferred securities to investors. These floating rate securities are treated as subordinated debentures on the Company’s financial statements. However, they qualify as Tier I Capital for regulatory capital compliance purposes, subject to certain limitations. The Company does not consolidate the accounts and related activity of any of its business trust subsidiaries.

Earnings Summary

Net income totaled \$2.4 million, or \$0.28 per diluted share for the quarter ended June 30, 2015, a 58.9 percent increase compared to \$1.5 million, or \$0.20 per diluted share for the same period a year ago. Return on average assets and average common equity for the quarter were 1.01% and 13.35%, respectively, compared to 0.68% and 10.31% for the same period a year ago. The continued improvement in our operating results is the product of our strategic initiatives, which include expansion of our in-market loan and deposit relationships, improving credit quality and core earnings growth.

Second quarter highlights include:

- × 7.9% loan growth since year-end 2014 – 18.3% growth in consumer loans, 10.1% growth in residential mortgage loans, and 6.6% growth in commercial loans.
- × 14.7% increase in noninterest-bearing demand deposits since year-end 2014.
- × 14.6% increase in net interest income compared to the prior year's quarter due to strong loan growth.
- × Net interest margin of 3.70% this quarter compared to 3.49% in the prior year's quarter.
- × Improved credit quality metrics and reduced loan loss provision – net recoveries posted compared to net charge-offs in the prior year's quarter and a 25.9% decrease in nonperforming loans.

For the six months ended June 30, 2015, net income totaled \$4.4 million, or \$0.51 per diluted share, compared to \$2.8 million or \$0.37 per diluted share in the prior year's period. Return on average assets and average common equity for the six month periods were 0.92% and 12.23%, respectively, compared to 0.64% and 9.70% for the same period a year ago.

The Company's quarterly and year-to-date performance ratios may be found in the table below.

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Net income per common share - Basic (1)	\$ 0.29	\$ 0.20	\$ 0.52	\$ 0.37
Net income per common share - Diluted (1)	\$ 0.28	\$ 0.20	\$ 0.51	\$ 0.37
Return on average assets	1.01 %	0.68 %	0.92 %	0.64 %
Return on average equity (2)	13.35 %	10.31 %	12.23 %	9.70 %
Efficiency ratio	64.99 %	70.81 %	66.12 %	71.36 %

(1) Defined as net income divided by weighted average shares outstanding.

(2) Defined as net income divided by average shareholders' equity.

Net Interest Income

The primary source of the Company's operating income is net interest income, which is the difference between interest and dividends earned on earning assets and fees earned on loans, and interest paid on interest-bearing liabilities. Earning assets include loans to individuals and businesses, investment securities, interest-earning deposits and federal funds sold. Interest-bearing liabilities include interest-bearing demand, savings and time deposits, FHLB advances and other borrowings. Net interest income is determined by the difference between the yields earned on earning assets and the rates paid on interest-bearing liabilities ("net interest spread") and the relative amounts of earning assets and interest-bearing liabilities. The Company's net interest spread is affected by regulatory, economic and competitive factors that influence interest rates, loan demand, deposit flows and general levels of nonperforming assets.

During the quarter ended June 30, 2015, tax-equivalent net interest income amounted to \$8.4 million, an increase of \$1.1 million or 14.4 percent when compared to the same period in 2014. The net interest margin increased 21 basis points to 3.70 percent for the quarter ended June 30, 2015, compared to 3.49 percent for the same period in 2014. The net interest spread was 3.49 percent for the second quarter of 2015, an 18 basis point increase compared to the same period in 2014.

During the three months ended June 30, 2015, tax-equivalent interest income was \$10.3 million, an increase of \$1.1 million or 12.1 percent when compared to the same period in the prior year. This increase was mainly driven by the increase in the balance of average loans:

- × Of the \$1.1 million net increase in interest income on a tax-equivalent basis, \$1.2 million of the increase was due to increased average earning assets, primarily loans, partially offset by \$106 thousand in reduced interest income due to decreased yields on the security and loan portfolios.
- × The average volume of interest-earning assets increased \$66.3 million to \$909.9 million for the second quarter of 2015 compared to \$843.7 million for the same period in 2014. This was due primarily to a \$118.9 million increase in average loans, primarily commercial and residential mortgage loans, partially offset by a \$27.6 million decrease in federal funds sold and interest-bearing deposits and a \$24.6 million decrease in average investment securities.
- × The yield on interest-earning assets increased 18 basis points to 4.52 percent for the three months ended June 30, 2015 when compared to the same period in 2014. The yield on the loan portfolio decreased 5 basis points to 4.82 percent.

Total interest expense was \$1.8 million for the three months ended June 30, 2015, an increase of \$52 thousand or 2.9 percent compared to the same period in 2014. This increase was driven by the increase in average savings deposits and increased rates on savings deposits compared to a year ago:

- × Of the \$52 thousand increase in interest expense, \$46 thousand was due to increased rates on interest-bearing liabilities, and \$6 thousand was due to an increase in the volume of average interest-bearing liabilities, primarily savings and time deposits.
- × Interest-bearing liabilities averaged \$719.9 million for the second quarter of 2015, an increase of \$26.0 million or 3.7 percent, compared to the prior year's quarter. The increase in interest-bearing liabilities was a result of an increase in average savings deposits and time deposits, partially offset by a decrease in average interest-bearing demand deposits.
- × The average cost of interest-bearing liabilities remained flat at 1.03 percent. The cost of interest-bearing deposits increased 4 basis points to 0.70 percent for the second quarter of 2015 and the cost of borrowed funds and subordinated debentures decreased 9 basis points to 3.42 percent.

During the six months ended June 30, 2015, tax-equivalent net interest income amounted to \$16.5 million, an increase of \$1.8 million or 12.1 percent when compared to the same period in 2014. The net interest margin increased 14 basis points to 3.67 percent for the six months ended June 30, 2015, compared to 3.53 percent for the same period in 2014. The net interest spread was 3.46 percent for the first six months of 2015, an 11 basis point increase compared to the same period in 2014.

During the six months ended June 30, 2015, tax-equivalent interest income was \$20.2 million, an increase of \$2.0 million or 10.7 percent when compared to the same period in the prior year. This increase was driven by the increase in the balance of average loans:

- × Of the \$2.0 million net increase in interest income on a tax-equivalent basis, \$2.1 million of the increase was due to increased average earning assets, primarily loans, partially offset by \$188 thousand in reduced interest income due to decreased yields on the security and loan portfolios.
- × The average volume of interest-earning assets increased \$64.6 million to \$903.3 million for the first half of 2015 compared to \$838.6 million for the same period in 2014. This was due primarily to a \$108.7 million increase in average loans, primarily commercial and residential mortgage loans, partially offset by a \$27.6 million decrease in average investment securities and a \$16.2 million decrease in federal funds sold and interest-bearing deposits.
- × The yield on interest-earning assets increased 13 basis points to 4.50 percent for the six months ended June 30, 2015 when compared to the same period in 2014. The yield on the loan portfolio remained flat at 4.86 percent.

Total interest expense was \$3.7 million for the six months ended June 30, 2015, an increase of \$180 thousand or 5.1 percent compared to the same period in 2014. This increase was driven by the increase in average savings deposits and increased rates on savings deposits compared to a year ago:

- × Of the \$180 thousand increase in interest expense, \$149 thousand was due to increased rates on interest-bearing liabilities, and \$31 thousand was due to an increase in the volume of average interest-bearing liabilities, primarily savings and time deposits.
- × Interest-bearing liabilities averaged \$719.9 million for first half of 2015, an increase of \$26.0 million or 3.7 percent, compared to the prior year's quarter. The increase in interest-bearing liabilities was a result of an increase in average savings deposits and time deposits, partially offset by a decrease in average interest-bearing demand deposits.
- × The average cost of interest-bearing liabilities increased 2 basis points to 1.04 percent for the six months ended June 30, 2015. The cost of interest-bearing deposits increased 5 basis points to 0.69 percent for the first half of 2015 and the cost of borrowed funds and subordinated debentures decreased 1 basis point to 3.49 percent.

Although our net interest income has increased over the periods noted above, we have been impacted by the sustained low interest rate environment. Recent remarks by the Federal Reserve Open Market Committee ("FOMC") of the Federal Reserve Board indicate that an increase to the federal funds target rate will be appropriate when the committee sees further improvement in the labor market and inflation moves back to its 2 percent objective over the medium term.

The following table 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, 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.

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Consolidated Average Balance Sheets

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

	For the three months ended				June 30, 2014		
	Average				Average		
	Balance	Interest	Rate/Yield		Balance	Interest	Rate/Yield
ASSETS							
Interest-earning assets:							
Federal funds sold and interest-bearing deposits	\$ 20,259	\$ 6	0.12	%	\$ 47,859	\$ 10	0.08
FHLB stock	3,720	38	4.10		4,149	40	3.87
Securities:							
Taxable	63,834	363	2.28		85,598	552	2.58
Tax-exempt	11,803	105	3.57		14,608	133	3.64
Total securities (A)	75,637	468	2.48		100,206	685	2.73
Loans:							
SBA loans	47,249	605	5.14		53,965	643	4.77
SBA 504 loans	29,539	369	5.01		34,415	433	5.05
Commercial loans	422,371	5,276	5.01		370,345	4,738	5.13
Residential mortgage loans	243,821	2,716	4.47		185,016	2,052	4.44
Consumer loans	67,353	774	4.61		47,737	544	4.57
Total loans (B)	810,333	9,740	4.82		691,478	8,410	4.87
Total interest-earning assets	\$ 909,949	\$ 10,252	4.52	%	\$ 843,692	\$ 9,145	4.34
Noninterest-earning assets:							
Cash and due from banks	24,768				24,368		
Allowance for loan losses	(12,430)				(13,037)		
Other assets	43,596				45,410		
Total noninterest-earning assets	55,934				56,741		
Total assets	\$ 965,883				\$ 900,433		
LIABILITIES AND SHAREHOLDERS' EQUITY							
Interest-bearing liabilities:							
Total interest-bearing demand deposits	\$ 123,663	\$ 103	0.33	%	\$ 128,351	\$ 109	0.34
Total savings deposits	287,911	271	0.38		261,419	188	0.29
Total time deposits	220,403	725	1.32		213,122	693	1.30
Total interest-bearing deposits	631,977	1,099	0.70		602,892	990	0.66
Borrowed funds and subordinated debentures							
	87,944	750	3.42		91,069	807	3.51
Total interest-bearing liabilities	\$ 719,921	\$ 1,849	1.03	%	\$ 693,961	\$ 1,797	1.03
Noninterest-bearing liabilities:							
Noninterest-bearing demand deposits	168,585				143,720		
Other liabilities	4,413				3,332		
Total noninterest-bearing liabilities	172,998				147,052		

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Total shareholders' equity	72,964			59,420		
Total liabilities and shareholders' equity	\$ 965,883			\$ 900,433		
Net interest spread	\$ 8,403	3.49	%	\$ 7,348	3.31	%
Tax-equivalent basis adjustment	(34)			(43)		
Net interest income	\$ 8,369			\$ 7,305		
Net interest margin		3.70	%		3.49	%

- (A) Yields related to securities 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 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.

Consolidated Average Balance Sheets

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

	For the six months ended				June 30, 2014		
	June 30, 2015				Average		
	Average				Average		
	Balance	Interest	Rate/Yield		Balance	Interest	Rate/Yield
ASSETS							
Interest-earning assets:							
Federal funds sold and interest-bearing deposits	\$ 28,722	\$ 16	0.11 %		\$ 44,960	\$ 19	0.09 %
FHLB stock	3,783	81	4.32		4,069	87	4.31
Securities:							
Taxable	65,431	750	2.31		89,183	1,278	2.87
Tax-exempt	11,893	212	3.59		15,718	289	3.68
Total securities (A)	77,324	962	2.51		104,901	1,567	2.99
Loans:							
SBA loans	47,824	1,284	5.41		54,375	1,226	4.51
SBA 504 loans	31,457	715	4.58		33,075	832	5.07
Commercial loans	414,278	10,342	5.03		367,360	9,340	5.13
Residential mortgage loans	235,022	5,298	4.55		183,048	4,110	4.49
Consumer loans	64,868	1,473	4.58		46,843	1,039	4.47
Total loans (B)	793,449	19,112	4.86		684,701	16,547	4.86
Total interest-earning assets	\$ 903,278	\$ 20,171	4.50 %		\$ 838,631	\$ 18,220	4.37 %
Noninterest-earning assets:							
Cash and due from banks	27,324				23,881		
Allowance for loan losses	(12,565)				(13,222)		
Other assets	43,403				44,510		
Total noninterest-earning assets	58,162				55,169		
Total assets	\$ 961,440				\$ 893,800		
LIABILITIES AND SHAREHOLDERS' EQUITY							
Interest-bearing liabilities:							
Total interest-bearing demand deposits	\$ 125,120	\$ 209	0.34 %		\$ 129,761	\$ 220	0.34 %
Total savings deposits	288,953	535	0.37		263,856	370	0.28
Total time deposits	215,939	1,411	1.32		209,148	1,337	1.29
Total interest-bearing deposits	630,012	2,155	0.69		602,765	1,927	0.64
Borrowed funds and subordinated debentures	89,916	1,558	3.49		91,167	1,606	3.50

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Total interest-bearing liabilities	\$ 719,928	\$ 3,713	1.04	%	\$ 693,932	\$ 3,533	1.02	%
Noninterest-bearing liabilities:								
Noninterest-bearing demand deposits	165,176				137,976			
Other liabilities	4,359				3,251			
Total noninterest-bearing liabilities	169,535				141,227			
Total shareholders' equity	71,977				58,641			
Total liabilities and shareholders' equity	\$ 961,440				\$ 893,800			
Net interest spread		\$ 16,458	3.46	%		\$ 14,687	3.35	%
Tax-equivalent basis adjustment		(69)				(94)		
Net interest income		\$ 16,389				\$ 14,593		
Net interest margin			3.67	%			3.53	%

- (A) Yields related to securities 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 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

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.

(In thousands on a tax-equivalent basis)	For the three months ended June 30, 2015 versus June 30, 2014			For the six months ended June 30, 2015 versus June 30, 2014		
	Increase (decrease) due to change in:			Increase (decrease) due to change in:		
	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Federal funds sold and interest-bearing deposits	\$ (8)	\$ 4	\$ (4)	\$ (7)	\$ 4	\$ (3)
FHLB stock	(4)	2	(2)	(6)	-	(6)
Securities	(155)	(62)	(217)	(375)	(230)	(605)
Loans	1,380	(50)	1,330	2,527	38	2,565
Total interest income	\$ 1,213	\$ (106)	\$ 1,107	\$ 2,139	\$ (188)	\$ 1,951
Interest expense:						
Demand deposits	\$ (3)	\$ (3)	\$ (6)	\$ (11)	\$ -	\$ (11)
Savings deposits	20	63	83	38	127	165
Time deposits	22	10	32	43	31	74
Total interest-bearing deposits	39	70	109	70	158	228
Borrowed funds and subordinated debentures	(33)	(24)	(57)	(39)	(9)	(48)
Total interest expense	6	46	52	31	149	180
Net interest income - fully tax-equivalent	\$ 1,207	\$ (152)	\$ 1,055	\$ 2,108	\$ (337)	\$ 1,771
Decrease in tax-equivalent adjustment			9			25
Net interest income			\$ 1,064			\$ 1,796

Provision for Loan Losses

There was no provision for loan losses for the three months ended June 30, 2015, compared to \$550 thousand for the three months ended June 30, 2014. For the six months ended June 30, 2015, the provision for loan losses totaled \$200 thousand, compared to \$1.2 million for the same period in 2014. 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 captions "Financial Condition - Asset Quality" and "Financial Condition - Allowance for Loan Losses and Reserve for Unfunded Loan Commitments." The current provision is considered appropriate under management's assessment of the adequacy of the allowance for loan losses.

Noninterest Income

The following table shows the components of noninterest income for the three and six months ended June 30, 2015 and 2014:

(In thousands)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Branch fee income	\$ 373	\$ 342	\$ 719	\$ 718
Service and loan fee income	466	285	762	580
Gain on sale of SBA loans held for sale, net	-	255	363	337
Gain on sale of mortgage loans, net	687	188	1,031	553
BOLI income	95	96	189	192
Net security gains	28	268	28	378
Other income	244	206	442	408
Total noninterest income	\$ 1,893	\$ 1,640	\$ 3,534	\$ 3,166

Our noninterest income consists primarily of branch and loan fee income, gains on the sale of SBA and residential mortgage loans, gains on the sale of securities, and BOLI income. For the three months ended June 30, 2015, noninterest income increased \$253 thousand to \$1.9 million, compared to the same period last year. For the six months ended June 30, 2015, noninterest income increased \$368 thousand to \$3.5 million, compared to the same period a year ago. Quarterly and year-to-date noninterest income increased due to higher gains on the sale of mortgage loans and increased service and loan fee income.

Changes in our noninterest income for the three and six months ended June 30, 2015 versus 2014 reflect:

- For the three months ended June 30, 2015, branch fee income, which consists of deposit service charges and overdraft fees, increased \$31 thousand when compared to the same period in 2014, due to high overdraft volume and an increase in commercial analysis service charges. For the six months ended June 30, 2015, branch fee income remained relatively flat when compared to the same period in 2014.
- For the three and six months ended June 30, 2015, service and loan fee income increased \$181 thousand and \$182 thousand, respectively, when compared to the same periods in the prior year. These increases were due to increased loan processing and payoff charges.
- There were no SBA loan sales for the three months ended June 30, 2015, compared to net gains on SBA loan sales of \$255 thousand on \$2.3 million in sales in the same period in the prior year. For the six months ended June 30, 2015, net gains on SBA loan sales amounted to \$363 thousand on \$3.5 million in sales, compared to net gains of \$337 thousand on \$3.2 million in sales in the same period in the prior year.
- During the quarter, \$49.8 million in residential mortgage loans were originated, of which \$24.0 million were sold at a gain of \$687 thousand, compared to \$36.3 million originated and \$11.1 million sold at a gain of \$188 thousand during the prior year's quarter. For the six month period, \$86.9 million in residential mortgage loans were originated, of which \$42.2 million were sold at a gain of \$1.0 million, compared to \$58.5 million originated and \$28.6 million sold at a gain of \$553 thousand in the first half of 2014. All residential mortgage loans originated in 2015 that are held in portfolio for investment are adjustable rate mortgages or fixed rate mortgages with maturities of 15 year or less.
- BOLI income remained relatively flat for the three and six months ended June 30, 2015, when compared to the same periods in the prior year.
- Net realized gains on the sale of securities amounted to \$28 thousand for the three and six months ended June 30, 2015. For the three and six months ended June 30, 2014, net realized gains on securities amounted to \$268 thousand and \$378 thousand, respectively. For additional information, see Note 7 - Securities.
- For the three and six months ended June 30, 2015, other income, which includes check card related income and miscellaneous service charges, increased \$38 thousand and \$34 thousand, respectively, when compared to the same period in the prior year primarily due to increases in VISA check card interchange fees.

Noninterest Expense

The following table presents a breakdown of noninterest expense for the three and six months ended June 30, 2015 and 2014:

(In thousands)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Compensation and benefits	\$ 3,481	\$ 3,122	\$ 6,952	\$ 6,340
Occupancy	601	619	1,273	1,279
Processing and communications	614	597	1,210	1,179
Furniture and equipment	422	379	795	735

Professional services	242	247	478	458
Loan costs	160	174	382	344
OREO expenses	67	95	103	342
Deposit insurance	150	171	333	349
Advertising	343	287	525	438
Other expenses	572	453	1,103	939
Total noninterest expense	\$ 6,652	\$ 6,144	\$ 13,154	\$ 12,403

Noninterest expense increased \$508 thousand to \$6.7 million for the three months ended June 30, 2015, while year-to-date expenses increased \$751 thousand to \$13.2 million. The majority of the increase in each period was due to higher compensation and benefits expense.

Changes in noninterest expense for the three and six months ended June 30, 2015 versus 2014 reflect:

- Compensation and benefits expense, the largest component of noninterest expense, increased \$359 thousand and \$612 thousand for the three and six months ended June 30, 2015, respectively. Expenses have increased during the intervening period due to increased head count in loan origination and support staff, as well as higher mortgage commission expense due to the larger volume of mortgages originated.
- Occupancy expense decreased \$18 thousand and \$6 thousand for the three and six months ended June 30, 2015, respectively. The decreases for both periods were primarily due to lower landscaping expense and leasehold depreciation, partially offset by increased janitorial expense.
- Processing and communications expenses increased \$17 thousand and \$31 thousand for the three and six months ended June 30, 2015, respectively, primarily due to increased merchant services expense in both periods.
- Furniture and equipment expense increased \$43 thousand and \$60 thousand for the three and six months ended June 30, 2015, respectively, primarily due to higher software maintenance expense.

- Professional service fees remained relatively flat for the three month period. For the six months ended June 30, 2015, professional service fees increased \$20 thousand primarily due to higher internal and external audit expenses associated with Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) testing in 2015.
- Loan costs decreased \$14 thousand for the three months ended June 30, 2015 due to lower appraisal and loan legal expense, partially offset by higher loan property tax expense. For the six months ended June 30, 2015, loan costs increased \$38 thousand due to higher loan property tax expense, mortgage servicing expense, and broker and correspondent fees.
- OREO expenses decreased \$28 thousand and \$239 thousand for the three and six months ended June 30, 2015, respectively. Expenses decreased for the quarterly and six month periods due to lower property tax, maintenance, utility and legal costs to hold these properties.
- Deposit insurance expense decreased \$21 thousand and \$16 thousand for the three and six months ended June 30, 2015, respectively, when compared to the same periods in the prior year. These decreases are due to a lower quarterly assessment resulting from a lower rate as our financial ratios continue to improve.
- Advertising expense increased \$56 thousand and \$87 thousand for the three and six months ended June 30, 2015, respectively, due to increased marketing agreements and seasonal events expense.
- Other expenses increased \$119 thousand and \$164 thousand for the three and six months ended June 30, 2015, respectively, due to higher director fees.

Income Tax Expense

For the quarter ended June 30, 2015, the Company reported income tax expense of \$1.2 million for an effective tax rate of 32.7 percent, compared to an income tax expense of \$723 thousand and an effective tax rate of 32.1 percent for the prior year’s quarter. For the six months ended June 30, 2015 the Company reported income tax expense of \$2.2 million for an effective tax rate of 33.5 percent, compared to an income tax expense of \$1.4 million and effective tax rate of 32.9 percent for the six months ended June 30, 2014.

Financial Condition at June 30, 2015

Total assets increased \$15.5 million or 1.5 percent, to \$1.0 billion at June 30, 2015, when compared to year-end 2014.

This increase was primarily due to increases of \$60.0 million in net loans, partially offset by decreases of \$39.4 million in cash and cash equivalents and \$5.7 million in securities. Total deposits increased \$21.1 million, due to increases of \$25.5 million and \$22.5 million in time deposits and noninterest-bearing demand deposits, respectively, partially offset by decreases of \$16.0 million and \$10.9 million in savings deposits and interest-bearing demand deposits. Borrowed funds decreased \$10.0 million over year-end 2014 due to the maturity of a \$10.0 million non-repo borrowing during the six months ended June 30, 2015. There were no changes to subordinated debentures. Total shareholders’ equity increased \$3.6 million over year-end 2014, primarily due to earnings less the dividends paid for the six months ended June 30, 2015. These fluctuations are discussed in further detail in the paragraphs that follow.

Securities Portfolio

The Company's securities portfolio consists of AFS and HTM investments. Management determines the appropriate security classification of AFS and HTM 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 obligations of U.S. Government sponsored entities, obligations of state and political subdivisions, mortgage-backed securities, and corporate and other securities.

AFS securities totaled \$55.8 million at June 30, 2015, a decrease of \$4.3 million or 7.2 percent, compared to \$60.1 million at December 31, 2014. This net decrease was the result of:

- \$4.4 million in principal payments and maturities,
- \$500 thousand on the sale of a corporate bond, net of gain,
- \$228 thousand in net amortization of premiums,
- \$167 thousand of depreciation in the market value of the portfolio. At June 30, 2015, the portfolio had net unrealized gains of \$68 thousand compared to net unrealized gains of \$235 thousand at December 31, 2014. These net unrealized gains are reflected net of tax in shareholders' equity as accumulated other comprehensive gains, partially offset by
- \$1.0 million for the purchase of one agency security.

The weighted average life of AFS securities, adjusted for prepayments, amounted to 4.2 years at June 30, 2015 and 4.0 years at December 31, 2014.

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 primarily of U.S. Government sponsored entities, obligations of state and political subdivisions, mortgage-backed securities, and corporate and other securities.

HTM securities were \$18.6 million at June 30, 2015, a decrease of \$1.4 million or 7.0 percent, from year-end 2014. This decrease was the result of:

- \$1.3 million in principal payments and maturities and
- \$51 thousand in net amortization of premiums

The weighted average life of HTM securities, adjusted for prepayments, amounted to 6.8 years and 6.4 years at June 30, 2015 and December 31, 2014, respectively. As of June 30, 2015 and December 31, 2014, the fair value of HTM securities was \$18.7 million and \$20.3 million, respectively.

The average balance of taxable securities amounted to \$65.4 million for the six months ended June 30, 2015, compared to \$89.2 million for the same period in 2014. The average yield earned on taxable securities decreased 56 basis points, to 2.31 percent for the six months ended June 30, 2015, from 2.87 percent for the same period in the prior year. This decrease was due to paydowns and maturities of higher yielding securities. The average balance of tax-exempt securities amounted to \$11.9 million for the six months ended June 30, 2015, compared to \$15.7 million for the same period in 2014. The average yield earned on tax-exempt securities decreased 9 basis points, to 3.59 percent for the six months ended June 30, 2015, from 3.68 percent for the same period in 2014.

Securities with a carrying value of \$19.5 million and \$50.4 million at June 30, 2015 and December 31, 2014, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law. The decrease in pledged securities was due to the FHLB issuing a letter of credit in the name of Unity Bank naming the NJ Dept. of Banking and Insurance as beneficiary. For additional information on amounts pledged to secure Government deposits at June 30, 2015, see section titled "Borrowed Funds and Subordinated Debentures" under Item 2. Management Discussion and Analysis.

Approximately 87 percent of the total investment portfolio had a fixed rate of interest at June 30, 2015.

See Note 7 to the accompanying Consolidated Financial Statements for more information regarding Securities.

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. Each of these segments is subject to differing levels of credit and interest rate risk.

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Total loans increased \$59.9 million or 7.9 percent to \$821.7 million at June 30, 2015, compared to \$761.8 million at year-end 2014. Commercial loans, residential mortgages, consumer loans, and SBA loans increased \$26.4 million, \$22.4 million, \$10.8 million, and \$5.5 million, respectively, partially offset by a decline of \$5.2 million in SBA 504 loans.

The following table sets forth the classification of loans by major category, including unearned fees and deferred costs and excluding the allowance for loan losses as of June 30, 2015 and December 31, 2014:

	June 30, 2015			December 31, 2014	
	Amount	% of total		Amount	% of total
(In thousands, except percentages)					
SBA loans held for investment	\$ 39,663	4.8	%	\$ 40,401	5.3
SBA 504 loans	29,125	3.5		34,322	4.5
Commercial loans	428,371	52.2		401,949	52.7
Residential mortgage loans	243,259	29.6			