UNITY BANCORP INC /NJ/
Form 10-K
March 05, 2019

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

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

(Mark One)
(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
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

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

| Common Stock, no par value | NASDAQ |
|---|---|
| (Title of Each Class) | (Name of Exchange on Which Registered) |

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T §232.405 of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K §229.405 of this chapter is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging Growth Company

If an emerging growth company, indicate by checkmark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the aggregate market value of the registrant’s Common Stock, no par value per share, held by non-affiliates of the registrant was $175,312,497 and 7,706,044 shares of the Common Stock were outstanding to non-affiliates. As of February 28, 2019, 10,798,718 shares of the registrant’s Common Stock were outstanding.

Documents incorporated by reference:

- Portions of Unity Bancorp’s Proxy Statement for the Annual Meeting of Shareholders to be filed no later than 120 days from December 31, 2018 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

Item 1. Business:

a)General

Unity Bancorp, Inc., ("we", "us", "our", the "Company" or "Registrant"), is a bank holding company incorporated under the laws of the State of New Jersey to serve as a holding company for Unity Bank (the “Bank”). The Company has also elected to become a financial holding company pursuant to regulations of the Board of Governors of the Federal Reserve system (the "FRB"). The Company was organized at the direction of the Board of Directors of the Bank for the purpose of acquiring all of the capital stock of the Bank. Pursuant to the New Jersey Banking Act of 1948 (the "Banking Act"), and pursuant to approval of the shareholders of the Bank, the Company acquired the Bank and became its holding company on December 1, 1994. The primary activity of the Company is ownership and supervision of the Bank. The Company also owns 100% of the common equity of Unity (NJ) Statutory Trust II. The trust has issued $10.3 million of preferred securities to investors. The Company serves as a holding company for its wholly-owned subsidiary, Unity Risk Management, Inc. Unity Risk Management, Inc. is a captive insurance company that insures risks to the Bank and the Company not provided by the traditional commercial insurance market.

The Bank received its charter from the New Jersey Department of Banking and Insurance on September 13, 1991 and opened for business on September 16, 1991. The Bank is a full-service commercial bank, providing a wide range of business and consumer financial services through its main office in Clinton, New Jersey and sixteen additional New Jersey branches located in Edison, Emerson, Flemington, Highland Park, Linden, Middlesex, North Plainfield, Phillipsburg, Scotch Plains, Somerset, Somerville, South Plainfield, Ramsey, Union, Washington and Whitehouse. In addition, the Bank has two Pennsylvania branches located in Bethlehem and Forks Township. The Bank's primary service area encompasses the Route 22/Route 78 corridors between the Bethlehem, Pennsylvania office and its Linden, New Jersey branch, as well as Bergen County, New Jersey.

The principal executive offices of the Company are located at 64 Old Highway 22, Clinton, New Jersey 08809, and the telephone number is (800) 618-2265. The Company’s website address is www.unitybank.com.

Business of the Company

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

Service Areas

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

Bethlehem offices serve Northampton County, Pennsylvania.

Competition

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

Employees

At December 31, 2018, the Company employed 192 full-time and 15 part-time employees. None of the Company's employees are represented by any collective bargaining units. The Company believes that its relations with its employees are good.

SUPERVISION AND REGULATION

General Supervision and Regulation

Bank holding companies and banks are extensively regulated under both federal and state law, and these laws are subject to change. As an example, in the summer of 2010, Congress passed, and the President signed, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) (discussed below). These laws and regulations are intended to protect depositors, not stockholders. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in the applicable law or regulation may have a material effect on the business and prospects of the Company and the Bank. Management of the Company is unable to predict, at this time, the impact of future changes to laws and regulations.

General Bank Holding Company Regulation

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

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

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

The BHCA was substantially amended through the Modernization Act. The Modernization Act permits bank holding companies and banks, which meet certain capital, management and Community Reinvestment Act standards, to engage in a broader range of non-banking activities. In addition, bank holding companies, which elect to become financial holding companies, may engage in certain banking and non-banking activities without prior FRB approval. Finally, the Modernization Act imposes certain privacy requirements on all financial institutions and their treatment of consumer information. The Company has elected to become a financial holding company. See "Financial Holding Company Status" below.

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

Capital Adequacy Guidelines

In December 2010 and January 2011, the Basel Committee on Banking Supervision (the “Basel Committee”) published the final reforms on capital and liquidity generally referred to as “Basel III.” In July 2013, the FRB, the FDIC and the Comptroller of the Currency adopted final rules (the “New Rules”), which implement certain provisions of Basel III and the Dodd-Frank Act. The New Rules replaced the existing general risk-based capital rules of the various banking agencies with a single, integrated regulatory capital framework. The New Rules require higher capital cushions and more stringent criteria for what qualifies as regulatory capital. The New Rules were effective for the Bank and the Company on January 1, 2015.

Under the New Rules, the Company and the Bank are required to maintain the following minimum capital ratios, expressed as a percentage of risk-weighted assets:

•Common Equity Tier 1 Capital Ratio of 4.5% (the “CET1”);
•Tier 1 Capital Ratio (CET1 capital plus “Additional Tier 1 capital”) of 6.0%; and
•Total Capital Ratio (Tier 1 capital plus Tier 2 capital) of 8.0%.

In addition, the Company and the Bank are subject to a leverage ratio of 4% (calculated as Tier 1 capital to average consolidated assets as reported on the consolidated financial statements).

The New Rules also require a “capital conservation buffer.” As of January 1 2019, the Company and the Bank are required to maintain a 2.5% capital conservation buffer, which is composed entirely of CET1, on top of the minimum risk-weighted asset ratios described above, resulting in the following minimum capital ratios:

•CET1 of 7%;
•Tier 1 Capital Ratio of 8.5%; and
•Total Capital Ratio of 10.5%.

The purpose of the capital conservation buffer is to absorb losses during periods of economic stress. Banking institutions with a CET1, Tier 1 Capital Ratio and Total Capital Ratio above the minimum set forth above but below the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers, based on the amount of the shortfall.

The New Rules provide for several deductions from and adjustments to CET1. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in common equity issued by nonconsolidated financial entities must be deducted from CET1 to the extent that any one of those categories exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Under the New Rules, banking organizations such as the Company and the Bank may make a one-time permanent election regarding the treatment of accumulated other comprehensive income items in determining regulatory capital

ratios. Effective as of January 1, 2015, the Company and the Bank elected to exclude accumulated other comprehensive income items for purposes of determining regulatory capital.

While the New Rules generally require the phase-out of non-qualifying capital instruments such as trust preferred securities and cumulative perpetual preferred stock, holding companies with less than $15 billion in total consolidated assets as of December 31, 2009, such as the Company, may permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in Additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

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The New Rules prescribe a standardized approach for calculating risk-weighted assets. Depending on the nature of the assets, the risk categories generally range from 0% for U.S. Government and agency securities, to 600% for certain equity exposures, and result in higher risk weights for a variety of asset categories. In addition, the New Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

Consistent with the Dodd-Frank Act, the New Rules adopt alternatives to credit ratings for calculating the risk-weighting for certain assets.

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), each federal banking agency has promulgated regulations, specifying the levels at which an insured depository institution such as the Bank would be considered “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” or “critically undercapitalized,” and providing for certain mandatory and discretionary supervisory actions based on the capital level of the institution. To qualify to engage in financial activities under the Gramm-Leach-Bliley Act, all depository institutions must be “well capitalized.”

The New Rules also revised the regulations implementing these provisions of FDICIA, to change the capital levels applicable to each designation. Under the New Rules, an institution will be classified as “well capitalized” if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a Tier 1 leverage ratio of at least 5.0 percent, (iv) has a common equity Tier 1 capital ratio of at least 6.5 percent, and (v) meets certain other requirements. An institution will be classified as “adequately capitalized” if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a Tier 1 leverage ratio of at least 4.0 percent, (iv) has a common equity Tier 1 capital ratio of at least 4.5 percent, and (v) does not meet the definition of “well capitalized.” An institution will be classified as “undercapitalized” if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a Tier 1 leverage ratio of less than 4.0 percent, or (iv) has a common equity Tier 1 capital ratio of less than 4.5 percent. An institution will be classified as “significantly undercapitalized” if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a Tier 1 leverage ratio of less than 3.0 percent, or (iv) has a common equity Tier 1 capital ratio of less 3.0 percent. An institution will be classified as “critically undercapitalized” if it has a tangible equity to total assets ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating.

General Bank Regulation

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

Insurance of Deposits: The Dodd-Frank Act has caused significant changes in the FDIC’s insurance of deposit accounts. Among other things, the Dodd-Frank Act permanently increased the FDIC deposit insurance limit to $250 thousand per depositor.

On February 7, 2011 the FDIC announced the approval of the assessment system mandated by the Dodd-Frank Act. Dodd-Frank required that the base on which deposit insurance assessments are charged be revised from one based on domestic deposits to one based on assets. The FDIC’s rule to base the assessment on average total consolidated assets minus average tangible equity instead of domestic deposits lowered assessments for many

community banks with less than $10 billion in assets and reduced the Company’s costs.

Dividend Rights: Under the Banking Act, a bank may declare and pay dividends only if, after payment of the dividend, the capital stock of the bank will be unimpaired and either the bank will have a surplus of not less than 50% of its capital stock or the payment of the dividend will not reduce the bank's surplus. Unless and until the Company develops other lines of business, payments of dividends from the Bank will remain the Company’s primary source of income and the primary source of funds for dividend payments to the shareholders of the Company.

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Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), enacted on July 21, 2010, significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of insured depository institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations. The Dodd-Frank Act, among other things:

- capped debit card interchange fees for institutions with $10 billion in assets or more at $0.21 plus 5 basis points times the transaction amount, a substantially lower rate than the average rate in effect prior to adoption of the Dodd-Frank Act;
- provided for an increase in the FDIC assessment for depository institutions with assets of $10 billion or more, increases in the minimum reserve ratio for the Deposit Insurance Fund ("DIF") from 1.15% to 1.35% and changes the basis for determining FDIC premiums from deposits to assets;
- permanently increased the deposit insurance coverage to $250 thousand and allowed depository institutions to pay interest on checking accounts;
- created a new Consumer Financial Protection Bureau (“CFPB”) that has rulemaking authority for a wide range of consumer financial protection laws that apply to all banks and has broad authority to enforce these laws;
- provided for new disclosure and other requirements relating to executive compensation and corporate governance;
- changed standards for Federal preemption of state laws related to federally-chartered institutions and their subsidiaries;
- provided mortgage reform provisions regarding a customer’s ability to repay, restricting variable rate lending by requiring the ability to repay to be determined for variable rate loans by using the maximum rate that will apply during the first five years of a variable rate loan term, and making more loans subject to provisions for higher cost loans, new disclosures, and certain other revisions; and
- created a financial stability oversight council that will recommend to the FRB increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

The Dodd-Frank Act also imposes new obligations on originators of residential mortgage loans, such as the Bank. Among other things, the Dodd-Frank Act requires originators to make a reasonable and good faith determination based on documented information that a borrower has a reasonable ability to repay a particular mortgage loan over the long term. If the originator cannot meet this standard, the mortgage may be unenforceable. The Dodd-Frank Act contains an exception from this ability-to-repay rule for “Qualified Mortgages”. The CFPB has established specific underwriting criteria for a loan to qualify as a Qualified Mortgage. The criteria generally exclude loans that (1) are interest-only, (2) have excessive upfront points or fees, or (3) have negative amortization features, balloon payments, or terms in excess of 30 years. The underwriting criteria also impose a maximum debt to income ratio of 43%, based upon documented and verifiable information. If a loan meets these criteria and is not a “higher priced loan” as defined in FRB regulations, the CFPB rule establishes a safe harbor preventing a consumer from asserting the failure of the originator to establish the consumer’s ability to repay. However, a consumer may assert the lender’s failure to comply with the ability-to-repay rule for all residential mortgage loans other than Qualified Mortgages, and may challenge whether a loan in fact qualified as a Qualified Mortgage.

Although the majority of residential mortgages historically originated by the Bank would be considered Qualified Mortgages, the Bank has and may continue to make residential mortgage loans that would not qualify. As a result of such rules, the Bank might experience increased compliance costs, loan losses, litigation related expenses and delays in taking title to real estate collateral, if these loans do not perform and borrowers challenge whether the Bank satisfied the ability-to-repay rule upon originating the loan.

The requirements of the Dodd-Frank Act and other regulatory reforms continue to be implemented. It is difficult to predict at this time what specific impact certain provisions and yet-to-be-finalized rules and regulations will have on us, including any regulations promulgated by the CFPB. Financial reform legislation and rules could have adverse implications on the financial industry, the competitive environment, and our ability to conduct business. Management will have to apply resources to ensure compliance with all applicable provisions of regulatory reforms, including the

Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

Financial Holding Company Status

The Company has elected to become a financial holding company. Financial holding companies may engage in a broader scope of activities than a bank holding company. In addition, financial holding companies may undertake certain activities without prior FRB approval.

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A financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. "Financial in nature" activities include:

- securities underwriting, dealing and market making;
- sponsoring, mutual funds and investment companies;
- insurance underwriting and insurance agency activities;
- merchant banking; and
- activities that the FRB determines to be financial in nature or incidental to a financial activity or which is complementary to a financial activity and does not pose a safety and soundness risk.

A financial holding company that desires to engage in activities that are financial in nature or incidental to a financial activity but not previously authorized by the FRB must obtain approval from the FRB before engaging in such activity. Also, a financial holding company may seek FRB approval to engage in an activity that is complementary to a financial activity, if it shows, among other things, that the activity does not pose a substantial risk to the safety and soundness of its insured depository institutions or the financial system.

A financial holding company generally may acquire a company (other than a bank holding company, bank or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature without prior approval from the FRB. Prior FRB approval is required, however, before the financial holding company may acquire control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank or savings association. In addition, under the FRB's merchant banking regulations, a financial holding company is authorized to invest in companies that engage in activities that are not financial in nature, as long as the financial holding company makes its investment with the intention of limiting the duration of the investment, does not manage the company on a day-to-day basis, and the company does not cross-market its products or services with any of the financial holding company's controlled depository institutions.

If any subsidiary bank of a financial holding company ceases to be "well-capitalized" or "well-managed" and fails to correct its condition within the time period that the FRB specifies, the FRB has authority to order the financial holding company to divest its subsidiary banks. Alternatively, the financial holding company may elect to limit its activities and the activities of its subsidiaries to those permissible for a bank holding company that is not a financial holding company. If any subsidiary bank of a financial holding company receives a rating under the CRA of less than "satisfactory", then the financial holding company is prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations until the rating is raised to "satisfactory" or better.

Item 1A. Risk Factors:

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

We have been and may continue to be adversely affected by national financial markets and economic conditions, as well as local conditions.

Our business and results of operations are affected by the financial markets and general economic conditions in the United States, including factors such as the level and volatility of interest rates, inflation, home prices, unemployment and under-employment levels, bankruptcies, household income, consumer spending, investor confidence and the strength of the U.S. economy. The deterioration of any of these conditions can adversely affect our securities and loan portfolios, our level of charge-offs and provision for credit losses, our capital levels, liquidity and our results of operations.

In addition, we are affected by the economic conditions within our New Jersey and Pennsylvania trade areas. Unlike larger banks that are more geographically diversified, we provide banking and financial services primarily to customers in the seven counties in the New Jersey market and one county in Pennsylvania in which we have branches, so any decline in the economy of New Jersey or eastern Pennsylvania could have an adverse impact on us.

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

Partial or complete shutdown of the federal government may adversely effect our SBA lending business and otherwise negatively affect our results of operations.

We have historically been an active participant in SBA lending programs. Through interest on SBA loans, gains on sale of SBA loans and SBA loan servicing income, our participation in SBA lending has a material impact on our results of operations. However, during periods of partial or complete shut downs of the federal government due to failure of Congress and the President to agree on budget legislation, the SBA has been and will be unable to function, and this will disrupt our SBA loan origination activities. If any future shutdowns last for a prolonged period of time, the disruption in our SBA loan origination activities may have a material adverse effect on our results of operations. In addition, a number of our customers provide services to the federal government and its agencies, and the businesses of these customers may also be adversely affected by any future partial or total shut down of the federal government, thereby making it more difficult for these customers to comply with the terms of their credit agreements with us. Defaults on loans by customers whose business is adversely affected by government shut downs may negatively affect our results of operations.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2018, approximately 94 percent of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. Weakness in the real estate market in our primary market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the

collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. Any future declines in home prices in the New Jersey and Pennsylvania markets we serve also may result in increases in delinquencies and losses in our loan portfolios. Stress in the real estate market, combined with any weakness in economic conditions and any future elevated unemployment levels could drive losses beyond that which is provided for in our allowance for loan losses. In that event, our earnings could be adversely affected.

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

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

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

The risk of nonpayment (or deferred or delayed payment) of loans is inherent in commercial banking. Such nonpayment, or delayed or deferred payment of loans to the Company, if they occur, may have a material adverse effect on our earnings and overall financial condition. Additionally, in compliance with applicable banking laws and regulations, the Company maintains an allowance for loan losses created through charges against earnings. As of December 31, 2018, the Company's allowance for loan losses was $15.5 million, or 1.19 percent of our total loan portfolio and 225.35 percent of our nonperforming loans. The Company's marketing focus on small to medium size businesses may result in the assumption by the Company of certain lending risks that are different from or greater than those which would apply to loans made to larger companies. We seek to minimize our credit risk exposure through credit controls, which include evaluation of potential borrowers' available collateral, liquidity and cash flow. However, there can be no assurance that such procedures will actually reduce loan losses.

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

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

We are subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Net interest income, the difference between interest earned on our interest-earning assets and interest paid on interest-bearing liabilities, represents a significant portion of our earnings. Both increases and decreases in the interest rate environment may reduce our profits. Interest rates are subject to factors which are beyond our control, including general economic conditions, competition and policies of various governmental and regulatory agencies, such as the FRB. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investment securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, including the held to maturity and available for sale securities portfolios, and (iii) the average duration of our interest-earning assets. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rate indexes underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk).

The banking business is subject to significant government regulations.

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

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For example, the Dodd-Frank Act has resulted in substantial new compliance costs, and may restrict certain sources of revenue. The Dodd-Frank Act was signed into law on July 21, 2011. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law, many of which will not become effective until various Federal regulatory agencies have promulgated rules implementing the statutory provisions. Uncertainty remains as to the ultimate impact of the Dodd-Frank Act, which could have a material adverse impact either on the financial services industry as a whole, or on our business, results of operations and financial condition. The Dodd-Frank Act, among other things:

- capped debit card interchange fees for institutions with $10 billion in assets or more at $0.21 plus 5 basis points times the transaction amount, a substantially lower rate than the average rate in effect prior to adoption of the Dodd-Frank Act;
- provided for an increase in the FDIC assessment for depository institutions with assets of $10 billion or more, increases the minimum reserve ratio for the DIF from 1.15% to 1.35% and changes the basis for determining FDIC premiums from deposits to assets;
- permanently increased the deposit insurance coverage to $250 thousand and allowed depository institutions to pay interest on checking accounts;
- created a new CFPB that has rule making authority for a wide range of consumer financial protection laws that apply to all banks and has broad authority to enforce these laws;
- provided for new disclosure and other requirements relating to executive compensation and corporate governance;
- changed standards for Federal preemption of state laws related to federally-chartered institutions and their subsidiaries;
- provided mortgage reform provisions regarding a customer’s ability to repay, restricting variable rate lending by requiring the ability to repay to be determined for variable rate loans by using the maximum rate that will apply during the first five years of a variable rate loan term, and making more loans subject to provisions for higher cost loans, new disclosures, and certain other revisions; and
- created a financial stability oversight council that will recommend to the FRB increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

In addition, in order to implement Basel III and certain additional capital changes required by the Dodd-Frank Act, on July 9, 2013, the FRB approved, as an interim final rule, the regulatory capital requirements for U.S. bank holding companies, such as us, substantially similar to final rules issued by the FDIC and the Office of the Comptroller of the Currency. These new requirements are likely to increase our capital requirements in future periods. See “Supervisions and Regulation – Capital Adequacy Guidelines.”

These provisions, as well as any other aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, may impact the profitability of our business activities and may change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans, and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations in order to comply, and could therefore also materially and adversely affect our business, financial condition and results of operations.

Our management is actively reviewing the provisions of the Dodd-Frank Act and Basel III, many of which are to be phased-in over the next several years, and assessing the probable impact on our operations. However, the ultimate effect of these changes on the financial services industry in general, and us in particular, is uncertain at this time.

We are subject to changes in accounting policies or accounting standards.

Understanding our accounting policies is fundamental to understanding our financial results. Some of these policies require the use of estimates and assumptions that may affect the value of assets or liabilities and financial results. We

have identified our accounting policies regarding the allowance for loan losses, security valuations and impairments, goodwill and income taxes to be critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain. Under each of these policies, it is possible that materially different amounts would be reported under different conditions, using different assumptions, or as new information becomes available.

From time to time, the FASB and the SEC change their guidance governing the form and content of our external financial statements. In addition, accounting standard setters and those who interpret U.S. generally accepted accounting principles (“U.S. GAAP”), such as the FASB, SEC, banking regulators and our outside auditors, may change or even reverse their previous interpretations or positions on how these standards should be applied. Such changes are expected to continue. Changes in U.S. GAAP and changes in current interpretations are beyond our control, can be hard to predict and could materially impact how we report our financial results and condition. In certain cases, we could be required to apply a new or revised guidance retroactively or apply existing guidance differently (also retroactively) which may result in our restating prior period financial statements for material amounts. Additionally, significant changes to U.S. GAAP may require costly technology changes, additional training and personnel, and other expenses that will negatively impact our results of operations.

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Declines in value may adversely impact the investment portfolio.

As of December 31, 2018, we had approximately $46.7 million, $14.9 million and $2.1 million in available for sale, held to maturity and equity investment securities, respectively. We may be required to record impairment charges in earnings related to credit losses on our investment securities if they suffer a decline in value that is considered other-than-temporary. Additionally, (a) if we intend to sell a security or (b) it is more likely than not that we will be required to sell the security prior to recovery of its amortized cost basis, we will be required to recognize an other-than-temporary impairment charge in the statement of income equal to the full amount of the decline in fair value below amortized cost. Factors, including lack of liquidity, absence of reliable pricing information, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect on our investment portfolio and may result in other-than-temporary impairment on our investment securities in future periods.

Liquidity risk.

Liquidity risk is the potential that we will be unable to meet our obligations as they come due because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances.

Liquidity is required to fund various obligations, including credit commitments to borrowers, mortgage and other loan originations, withdrawals by depositors, repayment of borrowings, dividends to shareholders, operating expenses and capital expenditures.

Liquidity is derived primarily from retail deposit growth and retention; principal and interest payments on loans; principal and interest payments on investment securities; sale, maturity and prepayment of investment securities; net cash provided from operations and access to other funding sources.

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to persistent weakness, or downturn, in the economy or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not necessarily specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

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

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

The Company has also been active in competing for New Jersey governmental and municipal deposits. At December 31, 2018, the Company held approximately $121.9 million in governmental and municipal deposits. The newly elected governor of New Jersey has proposed that the state form and own a bank in which governmental and municipal entities would deposit their excess funds, with the state owned bank then financing small businesses and municipal projects in New Jersey. Although this proposal is in the very early stages and no legislation has been introduced in the state legislature, should this proposal be adopted and a state owned bank formed, it could impede the Company's ability to attract and retain governmental and municipal deposits, thereby impairing the Company's liquidity.

Future offerings of common stock may adversely affect the market price of our stock.

In the future, if our or the Bank’s capital ratios fall below the prevailing regulatory required minimums, we or the Bank could be forced to raise additional capital by making additional offerings of common stock or preferred stock. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both.

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

The financial services market, including banking services, is increasingly affected by advances in technology, including developments in:
•telecommunications;
•data processing;
•automation;
•Internet-based banking;
•Tele-banking; and
•debit cards/smart cards

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

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

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer-relationship management, general ledger, deposit, loan and other systems.

We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as us) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. We maintain a system of comprehensive policies and a control framework designed to monitor vendor risks including, among other things, (i) changes in the vendor's organizational structure or internal controls, (ii) changes in the vendor's financial condition, (iii) changes in the vendor's support for existing products and services and (iv) changes in the vendor's strategic focus. In addition we maintain cyber liability insurance to mitigate against any loss incurred.

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

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

We expect to continue to experience growth in the scope of our operations and, correspondingly, in the number of our employees and customers. We may not be able to successfully manage our business as a result of the strain on our management and operations that may result from this growth. Our ability to manage this growth will depend upon our ability to continue to attract, hire and retain skilled employees. Our success will also depend on the ability of our officers and key employees to continue to implement and improve our operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage our employees.

Hurricanes or other adverse weather events could negatively affect our local economies or disrupt our operations, which would have an adverse effect on our business or results of operations.

Hurricanes and other weather events can disrupt our operations, result in damage to our properties and negatively affect the local economies in which we operate. In addition, these weather events may result in a decline in value or destruction of properties securing our loans and an increase in delinquencies, foreclosures and loan losses.

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The Company may be adversely affected by recent changes in U.S. tax laws.

Changes in tax laws contained in the Tax Cuts and Jobs Act ("Tax Act"), enacted in December 2017, include a number of provisions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. Changes include (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense and (iv) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the tax laws may have an adverse effect on the market for, and valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, such as New Jersey. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in the loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in the provision for loan losses, which would reduce profitability and could have a material adverse effect on the Company’s business, financial condition and results of operations.

Recent New Jersey legislative changes may increase our tax expense.

In connection with adopting the 2019 fiscal year budget, the New Jersey legislature adopted, and the Governor signed, legislation that will increase our state income tax liability and could increase our overall tax expense. The legislation imposes a temporary surtax on corporations earning New Jersey allocated income in excess of $1 million at a rate of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and at 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey’s current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. Although regulations implementing the legislative changes have not yet been issued, and so we cannot yet fully evaluate the impact of the legislation on our overall tax expense, it is likely that the Company may lose the benefit of at least some of the Company’s tax management strategies, and as a result our total tax expense will increase.

Item 1B. Unresolved Staff Comments: None

Item 2. Properties:

The Company presently conducts its business through its main office located at 64 Old Highway 22, Clinton, New Jersey, and its nineteen branch offices. The Company is currently leasing additional back office space in Clinton, New Jersey, in a building adjacent to its main office. The Company's facilities are adequate to meet its needs.

The following table sets forth certain information regarding the Company's properties from which it conducts business as of December 31, 2018.

| Location | Leased or Owned | Date Leased or Acquired | Lease Expiration | 2018 Annual Rental Fee |
|---|---|---|---|---|
| North Plainfield, NJ | Owned | 1991 | — | — |
| Linden, NJ | Owned | 1997 | — | — |
| Whitehouse, NJ | Owned | 1998 | — | — |
| Union, NJ | Owned | 2002 | — | — |
| Scotch Plains, NJ | Owned | 2004 | — | — |
| Flemington, NJ | Owned | 2005 | — | — |
| Forks Township, PA | Leased | 2006 | 2019 | 62,262 |
| Middlesex, NJ | Owned | 2007 | — | — |
| Somerset, NJ | Leased | 2012 | 2023 | 125,751 |
| Washington, NJ | Owned | 2012 | — | — |
| Highland Park, NJ | Owned | 2013 | — | — |
| South Plainfield, NJ | Owned | 2013 | — | — |
| Edison, NJ | Owned | 2013 | — | — |
| Clinton, NJ | Owned | 2016 | — | — |
| Somerville, NJ | Owned | 2016 | — | — |
| Emerson, NJ | Owned | 2016 | — | — |
| Ramsey, NJ | Leased | 2017 | 2021 | 59,500 |
| Phillipsburg, NJ | Leased | 2017 | 2022 | 60,000 |
| Clinton, NJ | Leased | 2018 | 2019 | 27,600 |
| Bethlehem, PA | Leased | 2018 | 2028 | 75,000 |

Item 3. Legal Proceedings:

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

Item 4. Mine Safety Disclosures: N/A

Item 4A. Executive Officers of the Registrant:

The following table sets forth certain information as of December 31, 2018, regarding each executive officer of the Company who is not also a director.

| Name, Age and Position | Officer Since | Principal Occupation During Past Five Years |
|---|---|---|

| | | |
|---|---|---|
| John Kauchak, 65, Chief Operating Officer and Executive Vice President of the Company and Bank | 2002 | Previously, Mr. Kauchak was the head of Deposit Operations for Unity Bank from 1996 to 2002. |
| Alan J. Bedner, 47, Chief Financial Officer and Executive Vice President of the Company and Bank | 2003 | Previously, Mr. Bedner was Controller for Unity Bank from 2001 to 2003. |
| Janice Bolomey, 50, Chief Administrative Officer and Executive Vice President of the Company and Bank | 2013 | Previously, Ms. Bolomey was Director of Sales for Unity Bank from 2002 to 2013. |

PART II

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

(a)Market Information

The Company’s Common Stock is quoted on the NASDAQ Global Market under the symbol “UNTY.”

(b) Repurchase Plan

On October 21, 2002, the Company authorized the repurchase of up to 10 percent of its outstanding common stock. The amount and timing of purchases is dependent upon a number of factors, including the price and availability of the Company’s shares, general market conditions and competing alternate uses of funds. As of December 31, 2018, the Company had repurchased a total of 556 thousand shares, of which 131 thousand shares have been retired, leaving 153 thousand shares remaining to be repurchased under the plan. There were no shares repurchased during 2018 or 2017.

Item 6. Selected Financial Data:

The following selected financial data should be read in conjunction with the Company's consolidated financial statements and notes presented herein in response to Item 8 of this Annual Report.

Non-GAAP Financial Measures

In addition to the results presented in accordance with GAAP, this Annual Report on Form 10-K contains certain non-GAAP financial measures. The Company believes that providing these non-GAAP financial measures provides investors with information useful in understanding the Company’s financial performance, performance trends, and financial position. While the Company uses these non-GAAP measures in its analysis of the Company’s performance, this information should not be considered an alternative to measurements required by GAAP. The following table provides a reconciliation of certain GAAP financial measures to non-GAAP financial measures.

| | For the years ended December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | | 2016 | | |
| (In thousands, except percentages) | GAAP | Non-GAAP | GAAP | Tax Act Adjustment | Non-GAAP | GAAP | Nonrecurring Gain Adjustment | Non-GAAP |
| Federal and state income tax expense | $5,388 | $5,388 | $9,540 | $(1,733) | $7,807 | $7,257 | $(781) | $6,476 |
| Net income | $21,919 | $21,919 | $12,893 | $1,733 | $14,626 | $13,209 | $(1,483) | $11,726 |
| Basic earnings per share | $2.04 | $2.04 | $1.22 | $0.16 | $1.38 | $1.40 | $(0.15) | $1.25 |
| Diluted earnings per share | $2.01 | $2.01 | $1.20 | $0.16 | $1.36 | $1.38 | $(0.15) | $1.23 |
| Return on average assets | 1.53 % | 1.53 % | 1.02 % | 0.13 % | 1.15 % | 1.17 % | (0.13)% | 1.04 % |
| Return on average equity | 17.10 % | 17.10 % | 11.47 % | 1.55 % | 13.02 % | 15.37 % | (1.72)% | 13.65 % |
| Effective tax rate | 19.70 % | 19.70 % | 42.50 % | (7.70)% | 34.80 % | 35.50 % | (7.30)% | 28.20 % |

There were no non-GAAP adjustments in 2018. The reconciling items between the GAAP and non-GAAP financial measures above include the impact of the Tax Act in 2017 and the gain on subordinated debentures in 2016. During the first quarter of 2016, the Company repurchased $5.2 million of its outstanding subordinated debentures, resulting in a pre-tax gain of $2.3 million on the transaction. This gain is included in noninterest income on the income statement. On December 22, 2017, the Tax Act was signed, which lowered the corporate tax rate from 35% to 21%. This adjustment resulted in a $1.7 million increase in income tax expense and is reflected in our tax provision on the income statement. The Company believes the financial results are more comparable excluding the impact of the revaluation of the net deferred tax asset.

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Basic earnings per share is calculated by dividing net income by average outstanding shares and diluted earnings per share is calculated by dividing net income by diluted average outstanding shares. The one-time net tax expense of $1.7 million in 2017 and the one-time gain on subordinated debentures of $2.3 million in 2016 were included in determining income for both the GAAP basic earnings per share and the GAAP diluted earnings per share. Conversely, the one-time net tax expense of $1.7 million in 2017 and the one-time gain on subordinated debentures of $2.3 million in 2016 were excluded in determining income for both the non-GAAP basic earnings per share and the non-GAAP diluted earnings per share. Average outstanding shares of 10,726,000,10,558,000 and 9,416,000 were used in the GAAP and non-GAAP basic earnings per share for the years ended December 31, 2018, December 31, 2017 and December 31, 2016, respectively. Diluted average outstanding shares of 10,916,000, 10,749,000 and 9,572,000 were used in the GAAP and non-GAAP diluted earnings per share for the year ended December 31, 2018, December 31, 2017 and December 31, 2016.

The return on average assets ratio is calculated by dividing net income by average assets and the return on average equity ratio is calculated by dividing net income by average equity. The one-time net tax expense of $1.7 million in 2017 and the one-time gain of subordinated debentures of $2.3 million in 2016 were included in determining income for both the GAAP return on average assets and the GAAP return on average equity. Conversely, the one-time net tax expense of $1.7 million and the one-time gain on subordinated debentures of $2.3 million in 2016 were excluded in determining income for both the non-GAAP return on average assets and the non-GAAP return on average equity. Average assets of $1.4 billion, $1.3 billion and $1.1 billion were used in the GAAP and non-GAAP return on average assets ratios for the years ended December 31, 2018, December 31, 2017 and December 31, 2016. Average equity of $128.2 million, $113.0 million and $85.9 million were used in the GAAP and non-GAAP return on average equity ratios for the years ended December 31, 2018, December 31, 2017 and December 31, 2016.

The effective tax rate is calculated by dividing federal and state income tax expense by income before income taxes. The non-GAAP effective tax rate uses the non-GAAP federal and state income tax expense of $5.4 million, $7.8 million and $6.5 million for 2018, 2017 and 2016, respectively, for calculating the rate.

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Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations:

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing the Company's results of
operations for each of the past three years and financial condition for each of the past two years. In order to fully appreciate this
analysis, the reader is encouraged to review the consolidated financial statements and accompanying notes thereto appearing under
Item 8 of this report, and statistical data presented in this document.

Overview

Unity Bancorp, Inc. (the “Parent Company”) is a bank holding company incorporated in New Jersey and is registered under the Bank Holding Company Act of 1956, as amended. Its wholly-owned subsidiary, Unity Bank (the “Bank” or, when consolidated with the Parent Company, the “Company”) is chartered by the New Jersey Department of Banking and Insurance. The Bank provides a full range of commercial and retail banking services through the Internet and its nineteen branch offices located in Bergen, Hunterdon, Middlesex, Somerset, Union and Warren counties in New Jersey, and Northampton County in Pennsylvania. These services include the acceptance of demand, savings, and time deposits and the extension of consumer, real estate, Small Business Administration (“SBA”) and other commercial credits.

Results of Operations

Net income totaled $21.9 million, or $2.01 per diluted share for the year ended December 31, 2018, compared to $12.9 million, or $1.20 per diluted share for the year ended December 31, 2017.

Highlights for the year include:

- Net income before tax increased 21.7 percent to $27.3 million from $22.4 million in the prior year.
- Net interest income increased $7.9 million or 17.2 percent to $53.7 million from $45.9 million in the prior year, primarily due to strong loan growth and an increased net interest margin.
- Net interest margin expanded 14 basis points to 3.97 percent compared to 3.83 percent in the prior year due to the benefit of a rising rate environment.
- Noninterest income was $9.0 million, a $761 thousand increase compared to $8.3 million in the prior year. This increase was primarily due to increased BOLI income and gains on sales of mortgages.
- Noninterest expense totaled $33.4 million, an increase of $3.4 million when compared to $30.0 million in the prior year. The increase was primarily the result of expansion costs from two additional branches and increased headcount which resulted in higher compensation, benefits, occupancy and equipment expenses.
- The effective tax rate declined to 19.7 percent compared to 42.5 percent in the prior year, as a result of the Tax Act, which was enacted December 22, 2017, and lowered the federal corporate tax rate.
- An 11.4 percent increase in total loans driven by a 19.4 percent increase in residential mortgages loans, a 12.8 percent increase in consumer loans and a 10.4 percent increase in commercial loans.
- A 15.8 percent increase in total deposits with a 12.6 percent increase in interest-bearing demand deposits and a 5.5 percent increase in noninterest-bearing deposits.

The Company's performance ratios for the past three years are listed in the following table:

| | For the years ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |

| | | | |
|---|---|---|---|
| Net income per common share - Basic (1) | $2.04 | $1.22 | $1.40 |
| Net income per common share - Diluted (2) | $2.01 | $1.20 | $1.38 |
| Return on average assets | 1.53 % | 1.02 % | 1.17 % |
| Return on average equity (3) | 17.10 % | 11.47 % | 15.37 % |
| Efficiency ratio (4) | 53.07 % | 55.57 % | 56.51 % |

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

(2) Defined as net income divided by the sum of weighted average shares and the potential dilutive impact of the exercise of outstanding options.

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

(4) The efficiency ratio is a non-GAAP measure of operational performance. It is defined as noninterest expense divided by the sum of net interest income plus noninterest income less any gains or losses on securities.

Net income presented above includes the impact of the Tax Act in 2017, which lowered the corporate tax rate from 35% to 21%, and the gain on subordinated debentures in 2016. During the first quarter of 2016, the Company repurchased $5.2 million of its outstanding subordinated debentures, resulting in a pre-tax gain of $2.3 million on the transaction. This gain is included in noninterest income on the income statement. For additional information on the impact of the Tax Act and the Company's non-GAAP performance ratios, see the "Non-GAAP Financial Measures" section in "Item 6. Selected Financial Data".

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 checking, savings and time deposits, Federal Home Loan Bank ("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.

2018 compared to 2017

Tax-equivalent net interest income amounted to $53.8 million in 2018, an increase of $7.9 million from $45.9 million in 2017. The Company's net interest margin increased 14 basis points to 3.97 percent in 2018, compared to 3.83 percent in 2017. The net interest spread was 3.65 percent, an increase of 8 basis points from 3.57 percent in 2017. This was due to strong loan growth and the rising interest rate environment.

During 2018, tax-equivalent interest income was $67.3 million, an increase of $11.9 million or 21.5 percent when compared to 2017. This increase was driven primarily by the increase in the average volume of loans:

- Of the $11.9 million increase in interest income on a tax-equivalent basis, $8.8 million of the increase was due primarily to the increased volume of earning assets and $3.1 million of the increase was due to an increase in yields on average interest-earning assets due to the rising interest rate environment.
- The yield on interest-earning assets increased 36 basis points to 4.97 percent in 2018 when compared to 2017.
- The average volume of interest-earning assets increased $153.9 million to $1.4 billion in 2018 compared to $1.2 billion in 2017. This was due primarily to a $189.2 million increase in average loans, primarily commercial, residential mortgage and consumer loans, partially offset by a $29.4 million decrease in average federal funds, interest-bearing deposits and repos and a $6.5 million decrease in average investment securities.

Total interest expense was $13.5 million in 2018, an increase of $4.1 million or 43.0 percent compared to 2017. This increase was driven by the increased rates on interest-bearing deposits and volume of time deposits, partially offset by decreased rates on borrowed funds and subordinated debentures compared to a year ago:

- Of the $4.1 million increase in interest expense, $2.3 million was due to increased rates on interest-bearing liabilities and $1.7 million was due to an increase in the volume of average interest-bearing liabilities.
- The average cost of interest-bearing liabilities increased 28 basis points to 1.32 percent in 2018 when compared to 2017. While the cost of interest-bearing deposits increased 37 basis points to 1.23 percent in 2018, the cost of borrowed funds and subordinated debentures decreased 15 basis points to 1.89 percent.
-

Interest-bearing liabilities averaged $1.0 billion in 2018, an increase of $118.1 million or 12.9 percent, compared to 2017. The increase in interest-bearing liabilities was primarily due to an increase in average time deposits.

2017 compared to 2016

Tax-equivalent net interest income amounted to $45.9 million in 2017, an increase of $7.6 million from $38.4 million in 2016. The
Company's net interest margin increased 25 basis points to 3.83 percent in 2017, compared to 3.58 percent in 2016. The net interest
spread was 3.57 percent, an increase of 21 basis points from 3.36 percent in 2016. This was due to strong loan growth, the rising
interest rate environment and a stable cost of funds.

During 2017, tax-equivalent interest income was $55.4 million, an increase of $8.2 million or 17.5 percent when compared to
2016. This increase was driven primarily by the increase in the average volume of loans:

- Of the $8.2 million increase in interest income on a tax-equivalent basis, $6.3 million of the increase was due primarily to the increased volume of earning assets and $2.0 million of the increase was due to an increase in yields on average interest earning assets due to the rising interest rate environment.
- The yield on interest-earning assets increased 21 basis points to 4.61 percent in 2017 when compared to 2016.
- The average volume of interest-earning assets increased $130.5 million to $1.2 billion in 2017 compared to $1.1 billion in 2016. This was due primarily to a $127.0 million increase in average loans, primarily commercial, residential mortgage, consumer and SBA loans and a $3.6 million increase in average investment securities, partially offset by a $3.5 million decrease in SBA 504 loans.

Total interest expense was $9.5 million in 2017, an increase of $686 thousand or 7.8 percent compared to 2016. This increase was driven by the increased volume in savings deposits, partially offset by a decrease in the volume of time deposits and decreased rates on borrowed funds and subordinated debentures compared to a year ago:

- Of the $686 thousand increase in interest expense, $366 thousand was due to an increase in the volume of average interest- bearing liabilities and $320 thousand was due to increased rates on these liabilities.
- The average cost of interest-bearing liabilities remained flat at 1.04 percent in 2017 and 2016. While the cost of interest-bearing deposits increased 4 basis points to 0.86 percent in 2017, the cost of borrowed funds and subordinated debentures decreased 41 basis points to 2.04 percent.
- Interest-bearing liabilities averaged $912.5 million in 2017, an increase of $74.7 million or 8.9 percent, compared to 2016. The increase in interest-bearing liabilities was primarily due to an increase in average savings deposits.

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 21 percent in 2018 and 35 percent in prior years.

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

| For the years ended December 31, | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Average balance | Interest | Rate/Yield | Average balance | Interest | Rate/Yield |
| ASSETS | | | | | | |
| Interest-earning assets: | | | | | | |
| Federal funds sold, interest-bearing deposits and repos | $40,700 | $773 | 1.90 % | $70,139 | $851 | 1.21 % |
| Federal Home Loan Bank ("FHLB") stock | 6,786 | 462 | 6.81 | 6,230 | 370 | 5.94 |
| Securities: | | | | | | |
| Taxable | 60,734 | 1,907 | 3.14 | 66,107 | 2,029 | 3.07 |
| Tax-exempt | 5,104 | 145 | 2.84 | 6,225 | 240 | 3.86 |
| Total securities (A) | 65,838 | 2,052 | 3.12 | 72,332 | 2,269 | 3.14 |
| Loans, net of unearned discount: | | | | | | |
| SBA loans | 60,321 | 4,338 | 7.19 | 59,293 | 3,805 | 6.42 |
| Commercial loans | 668,144 | 33,886 | 5.07 | 571,001 | 28,150 | 4.93 |
| Residential mortgage loans | 396,731 | 18,837 | 4.75 | 319,074 | 14,650 | 4.59 |
| Consumer loans | 116,311 | 6,943 | 5.97 | 102,898 | 5,296 | 5.15 |
| Total loans (B) | 1,241,507 | 64,004 | 5.16 | 1,052,266 | 51,901 | 4.93 |
| Total interest-earning assets | $1,354,831 | $67,291 | 4.97 % | $1,200,967 | $55,391 | 4.61 % |
| | | | | | | |
| Noninterest-earning assets: | | | | | | |
| Cash and due from banks | 24,598 | | | 23,321 | | |
| Allowance for loan losses | (14,640 ) | | | (13,033 ) | | |
| Other assets | 65,770 | | | 58,481 | | |
| Total noninterest-earning assets | 75,728 | | | 68,769 | | |
| Total assets | $1,430,559 | | | $1,269,736 | | |
| | | | | | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing demand deposits | $177,022 | $1,202 | 0.68 % | $159,642 | $665 | 0.42 % |
| Savings deposits | 404,613 | 3,871 | 0.96 | 397,250 | 2,738 | 0.69 |
| Time deposits | 314,224 | 5,903 | 1.88 | 219,847 | 3,278 | 1.49 |
| Total interest-bearing deposits | 895,859 | 10,976 | 1.23 | 776,739 | 6,681 | 0.86 |
| Borrowed funds and subordinated debentures | 134,664 | 2,540 | 1.89 | 135,730 | 2,772 | 2.04 |
| Total interest-bearing liabilities | $1,030,523 | $13,516 | 1.32 % | $912,469 | $9,453 | 1.04 % |
| | | | | | | |
| Noninterest-bearing liabilities: | | | | | | |
| Noninterest-bearing demand deposits | 261,976 | | | 237,207 | | |
| Other liabilities | 9,903 | | | 7,090 | | |
| Total noninterest-bearing liabilities | 271,879 | | | 244,297 | | |
| Total shareholders' equity | 128,157 | | | 112,970 | | |
| Total liabilities and shareholders' equity | $1,430,559 | | | $1,269,736 | | |
| | | | | | | |
| Net interest spread | | $53,775 | 3.65 % | | $45,938 | 3.57 % |
| Tax-equivalent basis adjustment | | (28 ) | | | (81 ) | |
| Net interest income | | $53,747 | | | $45,857 | |

| | | | | |
|---|---|---|---|---|
| Net interest margin | 3.97 | % | 3.83 | % |

(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 21 percent in 2018 and 35 percent in prior years 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.

| 2016 Average balance | Interest | | Rate/Yield | | 2015 Average balance | Interest | | Rate/Yield | | 2014 Average balance | Interest | Rate/Yield | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $71,265 | $214 | | 0.30 | % | $34,883 | $39 | | 0.11 | % | $44,900 | $44 | 0.10 | % |
| 5,241 | 245 | | 4.67 | | 3,695 | 155 | | 4.19 | | 3,972 | 165 | 4.15 | |
| 61,053 | 1,698 | | 2.78 | | 62,937 | 1,459 | | 2.32 | | 81,334 | 2,183 | 2.68 | |
| 7,649 | 307 | | 4.01 | | 11,739 | 421 | | 3.59 | | 14,493 | 526 | 3.63 | |
| 68,702 | 2,005 | | 2.92 | | 74,676 | 1,880 | | 2.52 | | 95,827 | 2,709 | 2.83 | |
| 56,834 | 3,181 | | 5.60 | | 50,997 | 2,693 | | 5.28 | | 53,232 | 2,467 | 4.63 | |
| 510,614 | 25,256 | | 4.95 | | 459,068 | 22,771 | | 4.96 | | 413,081 | 21,005 | 5.08 | |
| 273,612 | 12,205 | | 4.46 | | 246,278 | 11,048 | | 4.49 | | 196,333 | 8,898 | 4.53 | |
| 84,222 | 4,021 | | 4.77 | | 69,580 | 3,202 | | 4.60 | | 51,188 | 2,301 | 4.50 | |
| 925,282 | 44,663 | | 4.83 | | 825,923 | 39,714 | | 4.81 | | 713,834 | 34,671 | 4.86 | |
| $1,070,490 | $47,127 | 41,788 | 4.40 | % | $939,177 | $41,788 | 41,788 | 4.45 | % | $858,533 | $37,589 | 4.38 | % |
| 24,409 | | | | | 25,952 | | | | | 27,021 | | | |
| (12,841) | | | | | (12,638) | | | | | (13,124) | | | |
| 50,103 | | | | | 43,742 | | | | | 44,312 | | | |
| 61,671 | | | | | 57,056 | | | | | 58,209 | | | |
| $1,132,161 | | | | | $996,233 | | | | | $916,742 | | | |
| $133,212 | $537 | | 0.40 | % | $126,876 | $438 | | 0.35 | % | $125,706 | $430 | 0.34 | % |
| 328,486 | 1,742 | | 0.53 | | 290,848 | 1,088 | | 0.37 | | 274,395 | 856 | 0.31 | |
| 261,225 | 3,670 | | 1.40 | | 240,132 | 3,160 | | 1.32 | | 214,984 | 2,777 | 1.29 | |
| 722,923 | 5,949 | | 0.82 | | 657,856 | 4,686 | | 0.71 | | 615,085 | 4,063 | 0.66 | |
| 114,853 | 2,818 | | 2.45 | | 87,652 | 2,974 | | 3.39 | | 91,230 | 3,243 | 3.55 | |
| $837,776 | $8,767 | | 1.04 | % | $745,508 | $7,660 | | 1.03 | % | $706,315 | $7,306 | 1.03 | % |
| 199,554 | | | | | 172,172 | | | | | 144,310 | | | |
| 8,895 | | | | | 4,611 | | | | | 3,764 | | | |
| 208,449 | | | | | 176,783 | | | | | 148,074 | | | |
| 85,936 | | | | | 73,942 | | | | | 62,353 | | | |
| $1,132,161 | | | | | $996,233 | | | | | $916,742 | | | |
| | $38,360 | | 3.36 | % | | $34,128 | | 3.42 | % | | $30,283 | 3.35 | % |
| | (103) | | | | | (137) | | | | | (171) | | |
| | $38,257 | | | | | $33,991 | | | | | $30,112 | | |
| | | | 3.58 | % | | | | 3.63 | % | | | 3.53 | % |

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 solely 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 21 percent in 2018 and 35 percent in 2017 and 2016.

| | For the years ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 versus 2017 | | | 2017 versus 2016 | | |
| | Increase (decrease) due to change in: | | | Increase (decrease) due to change in: | | |
| (In thousands on a tax-equivalent basis) | Volume | Rate | Net | Volume | Rate | Net |
| Interest income: | | | | | | |
| Federal funds sold, interest-bearing deposits and repos | $(443) | $365 | $(78) | $(3) | $640 | $637 |
| Federal Home Loan Bank stock | 35 | 57 | 92 | 51 | 74 | 125 |
| Securities | (206) | (11) | (217) | 91 | 173 | 264 |
| Net loans | 9,386 | 2,717 | 12,103 | 6,109 | 1,129 | 7,238 |
| Total interest income | $8,772 | $3,128 | $11,900 | $6,248 | $2,016 | $8,264 |
| Interest expense: | | | | | | |
| Interest-bearing demand deposits | $80 | $457 | $537 | $102 | $26 | $128 |
| Savings deposits | 51 | 1,082 | 1,133 | 407 | 589 | 996 |
| Time deposits | 1,631 | 994 | 2,625 | (613) | 221 | (392) |
| Total interest-bearing deposits | 1,762 | 2,533 | 4,295 | (104) | 836 | 732 |
| Borrowed funds and subordinated debentures | (23) | (209) | (232) | 470 | (516) | (46) |
| Total interest expense | 1,739 | 2,324 | 4,063 | 366 | 320 | 686 |
| Net interest income - fully tax-equivalent | $7,033 | $804 | $7,837 | $5,882 | $1,696 | $7,578 |
| Decrease in tax-equivalent adjustment | | | 53 | | | 22 |
| Net interest income | | | $7,890 | | | $7,600 |

Provision for Loan Losses

The provision for loan losses totaled $2.1 million for 2018, an increase of $400 thousand and $900 thousand compared to $1.7 million and $1.2 million for 2017 and 2016. 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 Unfunded Loan Commitments." The current provision is considered appropriate based upon 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 past three years:

| | For the years ended December 31, | | |
|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2016 |
| Branch fee income | $1,519 | $1,384 | $1,269 |
| Service and loan fee income | 2,130 | 2,100 | 1,020 |
| Gain on sale of SBA loans held for sale, net | 1,680 | 1,617 | 2,099 |
| Gain on sale of mortgage loans, net | 1,719 | 1,530 | 2,621 |

| | | | |
|---|---|---|---|
| BOLI income | 975 | 469 | 378 |
| Net security (losses) gains | (199 ) | 62 | 424 |
| Gain on repurchase of subordinated debt | — | — | 2,264 |
| Other income | 1,207 | 1,108 | 985 |
| Total noninterest income | $9,031 | $8,270 | $11,060 |

2018 compared to 2017

Noninterest income was $9.0 million for 2018, a $761 thousand increase compared to $8.3 million for 2017. This increase was primarily due to increased BOLI income and gains on sales of mortgages.

Changes in noninterest income reflect:

- Branch fee income increased $135 thousand from the prior year primarily due to increased check printing income and higher levels of service charges from commercial checking accounts.
- Service and loan fee income, which consists of prepayment fees, application fees and servicing fees, increased $30 thousand in 2018.
- Net gains on the sale of SBA loans increased $63 thousand to $1.7 million in 2018 due to an increase in the volume of SBA loans sales. In 2018, $22.3 million in SBA loans were sold compared to $19.4 million in the prior year. SBA loan sales in 2018 averaged a lower bid rate compared to 2017, which resulted in lower gains per sale.
- During the year, $80.7 million in residential mortgage loans were sold at a gain of $1.7 million compared to $82.1 million in loans sold at a gain of $1.5 million during the prior year. The increased gain was a result of portfolio sales of $13.3 million in 2018 vs $3.5 million in 2017.
- BOLI income increased $506 thousand from prior year, primarily due to a $291 thousand death benefit in the third quarter of 2018, and the increase in income related to the purchase of a $10.0 million Separate Account BOLI policy during the third quarter of 2017.
- There were net losses on the sales of securities totaling $4 thousand in 2018 compared to gains of $62 thousand in 2017. Due to the adoption of ASU 2016-01 in January of 2018, there was an unrealized loss of $195 thousand recognized during the year resulting from a decrease in the market value of equity securities.
- Other income, which includes check card related income and miscellaneous service charges, totaled $1.2 million and $1.1 million in 2018 and 2017, respectively. The increase was primarily due to increases in Visa check card interchange fees and wire transfer fees.

2017 compared to 2016

Noninterest income was $8.3 million for 2017, a $2.8 million decrease compared to $11.1 million for 2016. This decrease was
primarily due to a nonrecurring gain on the repurchase of subordinated debentures in 2016. The Company repurchased $5.2 million of
its outstanding debentures on February 26, 2016. The subordinated debentures were repurchased at a price of $0.5475 per dollar,
resulting in a 2016 pre-tax gain of $2.3 million on the transaction. Excluding the nonrecurring gain, noninterest income decreased
$526 thousand to $8.3 million primarily due to lower gains on the sale of mortgage and SBA loans and securities, partially offset by an
increase in branch fee income.

Changes in noninterest income reflect:

- Branch fee income increased $115 thousand from the prior year due to higher levels of overdraft fees and service charges from commercial checking accounts and paper statement fees.
- Service and loan fee income increased $1.1 million in 2017 primarily due to increased loan interest rate swap program fees and loan and mortgage servicing income.
-

- Net gains on the sale of SBA loans decreased $482 thousand to $1.6 million in 2017 due to a decrease in the volume of SBA loans sales. In 2017, $19.4 million in SBA loans were sold compared to $24.7 million in the prior year.
- During the year, $82.1 million in residential mortgage loans were sold at a gain of $1.5 million compared to $108.1 million in loans sold at a gain of $2.6 million during the prior year. The decrease was by design as management elected to hold more residential mortgages in portfolio for long term investment.
- BOLI income increased $91 thousand from prior year, primarily due to the purchase of a $10.0 million Separate Account BOLI policy.
- Net gains on the sale of securities totaled $62 thousand and $424 thousand in 2017 and 2016, respectively.
- Other income, which includes check card related income and miscellaneous service charges, totaled $1.1 million and $985 thousand in 2017 and 2016, respectively. The increase was primarily due to increases in Visa check card interchange fees and rental income.

Noninterest Expense

The following table presents a breakdown of noninterest expense for the past three years:

| | For the years ended December 31, | | |
|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2016 |
| Compensation and benefits | $20,119 | $17,117 | $14,952 |
| Occupancy | 2,739 | 2,381 | 2,360 |
| Processing and communications | 2,788 | 2,551 | 2,628 |
| Furniture and equipment | 2,348 | 2,079 | 1,700 |
| Professional services | 934 | 1,022 | 976 |
| Loan collection and OREO (recoveries) expenses | (288) | 463 | 654 |
| Other loan expenses | 135 | 186 | 152 |
| Deposit insurance | 782 | 546 | 713 |
| Advertising | 1,411 | 1,179 | 1,095 |
| Director fees | 671 | 637 | 559 |
| Other expenses | 1,782 | 1,883 | 1,842 |
| Total noninterest expense | $33,421 | $30,044 | $27,631 |

2018 compared to 2017

Noninterest expense totaled $33.4 million for the year ended December 31, 2018, an increase of $3.4 million when compared to $30.0 million in 2017. The majority of this increase is attributed to expansion costs from two additional branches and increased headcount which resulted in higher compensation, benefits, occupancy and equipment expenses.

Changes in noninterest expense reflect:

- Compensation and benefits expense, the largest component of noninterest expense, increased $3.0 million for the year ended December 31, 2018, when compared to 2017. Expenses have risen as we expanded our branch network, lending and support staff. This additional headcount has resulted in higher salary, commission and benefit expense. In addition, benefits expense for 2018 included a $1.1 million supplemental executive retirement plan expense.
- Occupancy expense increased $358 thousand in 2018 primarily due to the addition of branches in Ramsey, New Jersey, and in Bethlehem, Pennsylvania.
- Processing and communications increased $237 thousand for the year ended December 31, 2018 when compared to 2017, primarily due to increased bank services from the addition of new branches.
- Furniture and equipment expense increased $269 thousand in 2018, due to investment in our technology infrastructure through network and software upgrades that will improve our efficiency and help keep our data secure.
- Professional service fees decreased $88 thousand in 2018, primarily due to lower consulting expenses, partially offset by increased loan review, legal and external audit and tax expenses.
- Loan collection and OREO expenses decreased $751 thousand in 2018, primarily due to a $317 thousand recovery on an OREO property in 2018, compared to a loss of $253 thousand on a sale in 2017.
- Other loan expenses, which consist of expenses such as appraisals, filings and credit reports, decreased $51 thousand in 2018, when compared to 2017.
- Deposit insurance expense increased $236 thousand in 2018 when compared to 2017 due to asset growth.
- Advertising expenses increased $232 thousand for the year ended December 31, 2018 in support of our retail and lending sales as well as branch expansions and retail promotions.
- Director fees increased $34 thousand in 2018 when compared to 2017.

- Other expenses decreased $101 thousand in 2018, primarily due to a decreased provision for loan commitments.

2017 compared to 2016

Noninterest expense totaled $30.0 million for the year ended December 31, 2017, an increase of $2.4 million when compared to $27.6
million in 2016. The majority of this increase may be attributed to costs of expanding our retail branch and lending networks which
resulted in higher compensation and benefits expenses.

Changes in noninterest expense reflect:

- Compensation and benefits expense, the largest component of noninterest expense, increased $2.2 million for the year ended December 31, 2017, when compared to 2016. Expenses have risen as we expanded our branch network, lending and support staff. This additional headcount has resulted in higher salary, commission and benefit expense.
- Occupancy expense remained relatively flat with expenses of $2.4 million in 2017 and 2016.
- Processing and communications remained relatively flat with expenses of $2.6 million in 2017 and 2016.
- Furniture and equipment expense increased $379 thousand in 2017, due to investment in our technology infrastructure through equipment, network and software upgrades that will improve our efficiency and keep our data secure.
- Professional service fees increased $46 thousand in 2017, primarily due to increased consulting expenses, partially offset by decreased loan review and legal expenses.
- Loan collection and OREO expenses decreased $191 thousand in 2017, primarily due to lower legal and property tax expense.
- Other loan expenses increased $34 thousand in 2017, when compared to 2016, primarily due to an increase in loan appraisal expenses, partially offset by decreases in site visits, inspections and tax service fees.
- Deposit insurance expense decreased $167 thousand in 2017 when compared to 2016 as a result of a drop in our assessment rate due to the capital raise in December 2016.
- Advertising expenses increased $84 thousand for the year ended December 31, 2017 in support of our retail and lending sales as well as the branch expansion.
- Director fees increased $78 thousand in 2017 when compared to 2016.
- Other expenses increased $41 thousand in 2017, primarily due to increased officer and employee training and provision for commitments.

Income Tax Expense

For 2018, the Company reported income tax expense of $5.4 million for an effective tax rate of 19.7%, compared to an income tax expense of $9.5 million and an effective tax rate of 42.5% in 2017 and an income tax expense of $7.3 million and an effective tax rate of 35.5% in 2016. This decrease was due to the Tax Act, which lowered the corporate tax rate from 35% to 21% starting in 2018. Under ASC 740, Income Taxes, we were required to adjust our deferred income tax balances as of the enactment date, December 22, 2017, to reflect the lower tax rate of 21%. This adjustment resulted in a $1.7 million increase in income tax expense and an effective tax rate of 42.5% for the year. Excluding this, our income tax expense was $7.8 million with an effective tax rate of 34.8% for the year ended December 31, 2017. For additional information on the revaluation of the deferred tax asset and the effective tax rate, see the "Non-GAAP Financial Measures" section in "Item 6. Selected Financial Data".

On July 1, 2018, New Jersey's Assembly Bill 4202 was signed into law. The new bill, effective January 1, 2018, imposed a temporary surtax on corporations earning New Jersey allocated income in excess of $1 million at a rate of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and at a rate of 1.5% for years beginning on or after January 1, 2020, through December 31, 2021. In addition, effective for periods on or after January 1, 2019, New Jersey is adopting mandatory unitary combined reporting for its Corporation Business Tax.

For additional information on income taxes, see Note 15 to the Consolidated Financial Statements.

Financial Condition

Total assets increased $123.7 million or 8.5 percent, to $1.6 billion at December 31, 2018, compared to $1.5 billion at December 31, 2017.  This increase was primarily due to increases of $132.0 million in net loans, with strong residential, commercial and consumer loan growth.

Total deposits increased $164.5 million, primarily due to increases of $131.6 million in time deposits, $20.8 million in interest-bearing demand deposits, and $14.0 million in noninterest-bearing demand deposits, partially offset by a decrease of $1.8 million in saving deposits. Borrowed funds decreased $65.0 million to $210.0 million at December 31, 2018 primarily due to the call of several FHLB borrowings and the maturity of repurchase borrowings.

Total shareholders' equity increased $20.4 million from year end 2017, primarily due to net income from operations, less dividends paid on our common stock. Net income was $21.9 million for the year ended December 31, 2018, an increase of $9.0 million from the prior year. Other changes in shareholders' equity included stock-based transactions of $1.6 million, offset by an other comprehensive loss net of tax of $328 thousand and common stock dividends of $2.8 million paid in 2018.

These fluctuations are discussed in further detail in the sections that follow.

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Securities

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

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

AFS securities totaled $46.7 million at December 31, 2018, a decrease of $5.6 million or 10.7%, compared to $52.3 million at December 31, 2017. This net decrease was the result of:

- $5.4 million in principal payments, maturities and called bonds,
- $572 thousand of depreciation in the market value of the portfolio. At December 31, 2018, the portfolio had a net unrealized loss of $1.0 million compared to a net unrealized loss of $476 thousand at December 31, 2017. These net unrealized losses are reflected net of tax in shareholders' equity as accumulated other comprehensive income, and
- $181 thousand in net amortization of premiums, partially offset by
- $579 thousand from the purchase of one corporate bond.

The weighted average life of AFS securities, adjusted for prepayments, amounted to 6.2 years at both December 31, 2018 and 2017.

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

HTM securities were $14.9 million at December 31, 2018, a decrease of $1.4 million or 8.8 percent, from year end 2017. This net decrease was the result of:

- $1.4 million in principal payments and maturities and
- $39 thousand in net amortization of premiums.

The weighted average life of HTM securities, adjusted for prepayments, amounted to 5.4 years and 5.9 years at December 31, 2018 and 2017, respectively. As of December 31, 2018 and December 31, 2017, the fair value of HTM securities was $14.8 million and $16.3 million, respectively.

Equity 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. Equity securities consist of Community Reinvestment Act ("CRA") investments and the company's current other equity holdings. These securities were transferred from available for sale and reclassified into equity securities on the balance sheet as a result of the adoption of ASU 2016-01 in January 2018.

Equity securities totaled $2.1 million at December 31, 2018, an increase of $938 thousand or 77.8%, compared to $1.2 million at December 31, 2017. This net increase was the result of:

- $1.1 million from the purchase of six community bank holdings, partially offset by
- $195 thousand in market value adjustments throughout the year.

The average balance of taxable securities amounted to $60.7 million in 2018 compared to $66.1 million in 2017. The average yield earned on taxable securities increased 7 basis points to 3.14 percent in 2018, from 3.07 percent in 2017. The average balance of tax-exempt securities amounted to $5.1 million in 2018 compared to $6.2 million in 2017. The average yield earned on tax-exempt securities decreased 102 basis points to 2.84 percent in 2018, from 3.86 percent in 2017.

Securities with a carrying value of $4.3 million and $20.8 million at December 31, 2018 and December 31, 2017, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law.

Approximately 80 percent of the total investment portfolio had a fixed rate of interest at December 31, 2018, compared to 82 percent in 2017.

For additional information on securities, see Note 3 to the Consolidated Financial Statements.

Loans

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, commercial, residential mortgage and consumer loans. Each of these segments is subject to differing levels of credit and interest rate risk.

Total loans increased $133.9 million or 11.4 percent to $1.3 billion at December 31, 2018, compared to $1.2 billion at year end 2017. Residential mortgages, commercial loans, and consumer loans increased $70.9 million, $65.2 million, and $14.0 million, respectively, partially offset by a decrease of $16.3 million in SBA loans.

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

| | 2018 | | 2017 | | 2016 | | 2015 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|
| (In thousands, except percentages) | Amount | % of total | Amount | % of total | Amount | % of total | Amount | % of total | Amount | % of total |
| Ending balance: | | | | | | | | | | |
| SBA loans held for investment | $39,333 | 3.0 % | $43,999 | 3.8 % | $42,492 | 4.4 % | $39,393 | 4.4 % | $40,401 | 5.3 % |
| Commercial loans | 694,102 | 53.2 | 628,865 | 53.7 | 535,515 | 55.0 | 494,871 | 55.6 | 436,271 | 57.2 |
| Residential mortgage loans | 436,056 | 33.4 | 365,145 | 31.2 | 289,093 | 29.7 | 264,523 | 29.8 | 220,878 | 29.0 |
| Consumer loans | 123,904 | 9.5 | 109,855 | 9.4 | 91,541 | 9.4 | 77,057 | 8.7 | 59,096 | 7.8 |
| Total loans held for investment | 1,293,395 | 99.1 | 1,147,864 | 98.1 | 958,641 | 98.5 | 875,844 | 98.5 | 756,646 | 99.3 |
| SBA loans held for sale | 11,171 | 0.9 | 22,810 | 1.9 | 14,773 | 1.5 | 13,114 | 1.5 | 5,179 | 0.7 |
| Total loans | $1,304,566 | 100.0% | $1,170,674 | 100.0% | $973,414 | 100.0% | $888,958 | 100.0% | $761,825 | 100.0% |

Average loans increased $189.2 million or 18.0 percent from $1.1 billion in 2017, to $1.2 billion in 2018. The increase in average loans was due to increases in commercial loans, residential mortgages, consumer and SBA 7(a) loans. The yield on the overall loan portfolio increased 23 basis points to 5.16 percent for the year ended December 31, 2018, compared to 4.93 percent for the prior year.

SBA 7(a) loans, on which the SBA historically has 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. These loans are made for the purposes of providing working capital, financing the purchase of equipment, inventory or commercial real estate. Generally, an SBA 7(a) loan has a deficiency in its credit profile that would not allow the borrower to qualify for a traditional commercial loan, which is why the SBA provides the guarantee. The deficiency may be a higher loan to value ("LTV") ratio, lower debt service coverage ("DSC") ratio or weak personal financial guarantees. In addition, many SBA 7(a) loans are for start up businesses where there is no historical financial information. Finally, many SBA

borrowers do not have an ongoing and continuous banking relationship with the Bank, but merely work with the Bank on a single transaction. 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 7(a) loans held for sale, carried at the lower of cost or market, amounted to $11.2 million at December 31, 2018, a decrease of $11.6 million from $22.8 million at December 31, 2017. SBA 7(a) loans held for investment amounted to $39.3 million at December 31, 2018, a decrease of $4.7 million from $44.0 million at December 31, 2017. The yield on SBA 7(a) loans, which are generally floating and adjust quarterly to the Prime Rate, was 7.19 percent for the year ended December 31, 2018, compared to 6.42 percent in the prior year.

The guarantee rates on SBA 7(a) loans range from 50 percent to 90 percent, with the majority of the portfolio having a guarantee rate of 75 percent at origination. The guarantee rates are determined by the SBA and can vary from year to year depending on government funding and the goals of the SBA program. The carrying value of SBA loans held for sale represents the guaranteed portion to be sold into the secondary market. The carrying value of SBA loans held for investment represents the unguaranteed portion, which is the Company's portion of SBA loans originated, reduced by the guaranteed portion that is sold into the secondary market. Approximately $101.1 million and $97.5 million in SBA loans were sold but serviced by the Company at December 31, 2018 and December 31, 2017,

respectively, and are not included on the Company's balance sheet. There is no direct relationship or correlation between the guarantee percentages and the level of charge-offs and recoveries on the Company's SBA 7(a) loans. Charge-offs taken on SBA 7(a) loans effect the unguaranteed portion of the loan. SBA loans are underwritten to the same credit standards irrespective of the guarantee percentage.

Commercial loans are generally made in the Company's marketplace for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. These loans amounted to $694.1 million at December 31, 2018, an increase of $65.2 million from year end 2017. The yield on commercial loans was 5.07 percent for the 2018, compared to 4.93 percent for the same period in 2017. The SBA 504 program, which consists of real estate backed commercial mortgages where the Company has the first mortgage and the SBA has the second mortgage on the property, is included in the Commercial loan portfolio. Generally, the Company has a 50 percent LTV ratio on SBA 504 program loans at origination.

Residential mortgage loans consist of loans secured by 1 to 4 family residential properties. These loans amounted to $436.1 million at December 31, 2018, an increase of $70.9 million from year end 2017. Sales of mortgage loans totaled $80.7 million for 2018. Approximately $13.3 million of the loans sold were from portfolio, with the remainder consisting of new production. Approximately $42.5 million and $34.6 million in residential loans were sold but serviced by the Company at December 31, 2018 and December 31, 2017, respectively, and are not included on the Company's balance sheet. The yield on residential mortgages was 4.75 percent for 2018, compared to 4.59 percent for 2017. Residential mortgage loans maintained in portfolio are generally to individuals that do not qualify for conventional financing. In extending credit to this category of borrowers, the Bank considers other mitigating factors such as credit history, equity and liquid reserves of the borrower. As a result, the residential mortgage loan portfolio of the Bank includes fixed and adjustable rate mortgages with rates that exceed the rates on conventional fixed-rate mortgage loan products but are not considered high priced mortgages.

Consumer loans consist of home equity loans, construction loans and loans for the purpose of financing the purchase of consumer goods, home improvements, and other personal needs, and are generally secured by the personal property being purchased. These loans amounted to $123.9 million at December 31, 2018, an increase of $14.0 million from December 31, 2017. This increase was generated primarily by consumer construction loans, a product the Company first offered in 2014. The yield on consumer loans was 5.97 percent for 2018, compared to 5.15 percent for 2017.

There are no concentrations of loans to any borrowers or group of borrowers exceeding 10 percent of the total loan portfolio and no foreign loans in the portfolio.

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

The following table shows the maturity distribution or repricing of the loan portfolio and the allocation of fixed and floating interest rates at December 31, 2018:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| (In thousands) | One year or less | One to five years | Over five years | Total |
| SBA loans | $44,745 | $4,004 | $1,755 | $50,504 |
| Commercial loans | | | | |

| | | | | |
|---|---|---|---|---|
| SBA 504 loans | 12,363 | 13,909 | 2,883 | 29,155 |
| Commercial other | 17,416 | 42,093 | 45,078 | 104,587 |
| Commercial real estate | 61,624 | 362,157 | 86,589 | 510,370 |
| Commercial real estate construction | 13,059 | 23,771 | 13,160 | 49,990 |
| Total | $149,207 | $445,934 | $149,465 | $744,606 |
| Amount of loans with maturities or repricing dates greater than one year: | | | | |
| Fixed interest rates | | | | $179,660 |
| Floating or adjustable interest rates | | | | 415,739 |
| Total | | | | $595,399 |

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

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Troubled Debt Restructurings

Troubled debt restructurings ("TDRs") occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider. These concessions typically include reductions in interest rate, extending the maturity of a loan, other modifications of payment terms, or a combination of modifications. When the Company modifies a loan, management evaluates the loan 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 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.

At December 31, 2018, there was one loan totaling $745 thousand that was classified as a TDR and deemed impaired, compared to one such loan totaling $786 thousand at December 31, 2017. The TDR was a commercial real estate loan which was modified in 2017 to reduce the principal balance. The loan remains in accrual status since it continues to perform in accordance with the restructured terms. Restructured loans that are placed in nonaccrual status may be removed after six months of contractual payments and the borrower showing the ability to service the debt going forward.

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

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Asset Quality

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

The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market.

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

The following table sets forth information concerning nonperforming assets and loans past due 90 days or more and still accruing interest at December 31st for the past five years:

| (In thousands, except percentages) | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Nonperforming by category: | | | | | |
| SBA loans held for investment (1) | $1,560 | $632 | $1,168 | $1,764 | $3,348 |
| Commercial loans | 1,076 | 68 | 939 | 2,682 | 6,830 |
| Residential mortgage loans | 4,211 | 1,669 | 2,672 | 2,224 | 645 |
| Consumer loans | 26 | 625 | 2,458 | 590 | 545 |
| Total nonperforming loans (2) | $6,873 | $2,994 | $7,237 | $7,260 | $11,368 |
| OREO | 56 | 426 | 1,050 | 1,591 | 1,162 |
| Total nonperforming assets | $6,929 | $3,420 | $8,287 | $8,851 | $12,530 |
| Past due 90 days or more and still accruing interest: | | | | | |
| SBA loans held for investment | $— | $— | $— | $— | $161 |
| Commercial loans | — | 60 | — | — | 7 |
| Residential mortgage loans | 98 | — | — | — | 722 |
| Total past due 90 days or more and still accruing interest | $98 | $60 | $— | $— | $890 |
| Nonperforming loans to total loans | 0.53 % | 0.26 % | 0.74 % | 0.82 % | 1.49 % |
| Nonperforming loans and TDRs to total loans (3) | 0.58 | 0.32 | 0.74 | 1.16 | 1.96 |
| Nonperforming assets to total loans and OREO | 0.53 | 0.29 | 0.85 | 0.99 | 1.64 |
| Nonperforming assets to total assets | 0.44 | 0.23 | 0.70 | 0.82 | 1.24 |
| (1) Guaranteed SBA loans included above | $89 | $27 | $60 | $288 | $1,569 |

| | | | | | |
|---|---|---|---|---|---|
| (2) Nonperforming TDRs included above | — | — | 153 | 293 | 2,960 |
| (3) Performing TDRs | 745 | 786 | — | 3,015 | 3,548 |

Nonperforming loans were $6.9 million at December 31, 2018, a $3.9 million increase from $3.0 million at year end 2017. Since year end 2017, nonperforming loans in the residential, commercial and SBA segments increased, partially offset by a decrease in the consumer segment. Included in nonperforming loans at December 31, 2018 are approximately $89 thousand of loans guaranteed by the SBA, compared to $27 thousand at December 31, 2017. In addition, there were $98 thousand in loans past due 90 days or more and still accruing interest at December 31, 2018, compared to $60 thousand at December 31, 2017.

OREO properties totaled $56 thousand at December 31, 2018, a decrease of $370 thousand from $426 thousand at year end 2017. During 2018, the Company took title to two new properties valued at $127 thousand that resulted in a charge to the allowance of $197 thousand. The Company sold two OREO properties, resulting in net recoveries of $22 thousand.

The Company also monitors potential problem loans. Potential problem loans are those loans where information about possible credit problems of borrowers causes management to have doubts as to the ability of such borrowers to comply with loan repayment terms. These loans are not included in nonperforming loans as they continue to perform. Potential problem loans totaled $4.5 million at December 31, 2018, an increase of $569 thousand from $4.0 million at December 31, 2017. The increase is due to the addition of five loans totaling $3.7 million offset by the deletion of nine loans totaling $3.1 million.

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

Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

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

When calculating the five-year historical net charge-off rate, the Company weights the past three years more heavily as it believes they are 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. The factors are evaluated separately for each type of loan. For example, commercial loans are broken down further into commercial and industrial loans, commercial mortgages, construction loans, etc. Each type of loan is risk weighted for each environmental factor based on its individual characteristics.

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

The allowance for loan losses totaled $15.5 million at December 31, 2018, compared to $13.6 million at December 31, 2017, with resulting allowance to total loan ratios of 1.19 percent and 1.16 percent, respectively. Net charge-offs amounted to $118 thousand for 2018, compared to $673 thousand for 2017. The following table is a summary of the changes to the allowance for loan losses for the past five years, including net charge-offs to average loan ratios for each major loan category:

| | For the years ended December 31, | | | | |
|---|---|---|---|---|---|
| (In thousands, except percentages) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Balance, beginning of year | $13,556 | $12,579 | $12,759 | $12,551 | $13,141 |
| Provision charged to expense | 2,050 | 1,650 | 1,220 | 500 | 2,550 |
| Charge-offs: | | | | | |
| SBA loans held for investment | 354 | 293 | 557 | 370 | 1,053 |

| | | | | | |
|---|---|---|---|---|---|
| Commercial loans | 10 | 227 | 775 | 898 | 1,129 |
| Residential mortgage loans | — | 55 | 101 | 50 | 740 |
| Consumer loans | 22 | 336 | 30 | 130 | 593 |
| Total charge-offs | 386 | 911 | 1,463 | 1,448 | 3,515 |
| Recoveries: | | | | | |
| SBA loans held for investment | 72 | 121 | 33 | 54 | 140 |
| Commercial loans | 30 | 102 | 29 | 1,052 | 166 |
| Residential mortgage loans | 13 | 12 | — | 49 | 60 |
| Consumer loans | 153 | 3 | 1 | 1 | 9 |
| Total recoveries | 268 | 238 | 63 | 1,156 | 375 |
| Total net charge-offs | 118 | 673 | 1,400 | 292 | 3,140 |
| Balance, end of year | $15,488 | $13,556 | $12,579 | $12,759 | $12,551 |
| Selected loan quality ratios: | | | | | |
| Net charge-offs/recoveries to average loans: | | | | | |
| SBA loans held for investment | 0.47 % | 0.29 % | 0.92 % | 0.62 % | 1.72 % |
| Commercial loans | — | 0.02 | 0.15 | (0.04 ) | 0.26 |
| Residential mortgage loans | — | 0.01 | 0.04 | — | 0.35 |
| Consumer loans | (0.11 ) | 0.32 | 0.03 | 0.19 | 1.14 |
| Total loans | 0.01 | 0.06 | 0.15 | 0.04 | 0.44 |
| Allowance to total loans | 1.19 | 1.16 | 1.29 | 1.44 | 1.65 |
| Allowance to nonperforming loans | 225.35 | 452.77 | 173.82 | 175.74 | 110.41 |

The following table sets forth, for each of the major lending categories, the amount of the allowance for loan losses allocated to each category and the percentage of total loans represented by such category, as of December 31st of the past five years. 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.

| (In thousands, except percentages) | 2018 Reserve amount | 2018 % of loans to total loans | 2017 Reserve amount | 2017 % of loans to total loans | 2016 Reserve amount | 2016 % of loans to total loans | 2015 Reserve amount | 2015 % of loans to total loans | 2014 Reserve amount | 2014 % of loans to total loans |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance applicable to: | | | | | | | | | | |
| SBA loans held for investment | $1,655 | 3.0 % | $1,471 | 3.8 % | $1,576 | 4.4 % | $1,961 | 4.4 % | $1,883 | 5.3 % |
| Commercial loans | 8,705 | 53.2 | 7,825 | 53.7 | 7,302 | 55.0 | 7,050 | 55.6 | 7,607 | 57.2 |
| Residential mortgage loans | 3,900 | 33.4 | 3,130 | 31.2 | 2,593 | 29.7 | 2,769 | 29.8 | 2,289 | 29.0 |
| Consumer loans | 1,228 | 9.5 | 1,130 | 9.4 | 925 | 9.4 | 817 | 8.7 | 667 | 7.8 |
| Unallocated | — | — | — | — | 183 | — | 162 | — | 105 | — |
| Total loans held for investment | 15,488 | 99.1 | 13,556 | 98.1 | 12,579 | 98.5 | 12,759 | 98.5 | 12,551 | 99.3 |
| SBA loans held for sale | — | 0.9 | — | 1.9 | — | 1.5 | — | 1.5 | — | 0.7 |
| Total loans | $15,488 | 100.0% | $13,556 | 100.0% | $12,579 | 100.0% | $12,759 | 100.0% | $12,551 | 100.0% |

In addition to the allowance for loan losses, the Company maintains a reserve for unfunded loan commitments that is maintained 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 maintained in other liabilities. At December 31, 2018, a $290 thousand commitment reserve was reported on the balance sheet as an "other liability", compared to a $292 thousand commitment reserve at December 31, 2017.

For additional information on the allowance for loan losses and reserve for unfunded loan commitments, see Note 5 to the Consolidated Financial Statements.

Deposits

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

The following table shows period-end deposits and the concentration of each category of deposits for the past three years:

| (In thousands, except percentages) | 2018 Amount | 2018 % of total | 2017 Amount | 2017 % of total | 2016 Amount | 2016 % of total |
|---|---|---|---|---|---|---|
| Ending balance: | | | | | | |
| Noninterest-bearing demand deposits | $270,152 | 22.4 % | $256,119 | 24.6 % | $215,963 | 22.8 % |
| Interest-bearing demand deposits | 185,792 | 15.4 | 164,997 | 15.8 | 145,654 | 15.4 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Savings deposits | 394,727 | 32.6 | 396,557 | 38.0 | 363,462 | 38.5 |
| Time deposits | 357,016 | 29.6 | 225,464 | 21.6 | 220,644 | 23.3 |
| Total deposits | $1,207,687 | 100.0% | $1,043,137 | 100.0% | $945,723 | 100.0% |

Total deposits increased $164.6 million to $1.2 billion at December 31, 2018, from $1.0 billion at December 31, 2017. This increase in deposits was due to increases of $131.6 million, $20.8 million and $14.0 million in time deposits, interest-bearing demand deposits and noninterest-bearing demand deposits, partially offset by a decrease of $1.8 million in savings deposits.

The Company's deposit composition at December 31, 2018, consisted of 32.6 percent savings deposits, 29.6 percent time deposits, 22.4 percent noninterest-bearing demand deposits and 15.4 percent interest-bearing demand deposits. The change in the composition of the portfolio from December 31, 2017 reflects a 8.0 percent increase in time deposits, offset by a 5.4 percent decrease in savings deposits, 2.2 percent decrease in noninterest-bearing demand deposits and a 0.4 percent decrease in interest-bearing demand deposits.

The increase in noninterest-bearing demand deposits is attributable to growth in commercial customer relationships.

The following table shows average deposits and the concentration of each category of deposits for the past three years:

| | For the years ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| (In thousands, except percentages) | Amount | % of total | Amount | % of total | Amount | % of total |
| Average balance: | | | | | | |
| Noninterest-bearing demand deposits | $261,976 | 22.6 % | $237,207 | 21.6 % | $199,554 | 21.6 % |
| Interest-bearing demand deposits | 177,022 | 15.3 | 159,642 | 14.4 | 133,212 | 14.4 |
| Savings deposits | 404,613 | 35.0 | 397,250 | 35.7 | 328,486 | 35.7 |
| Time deposits | 314,224 | 27.1 | 219,847 | 28.3 | 261,225 | 28.3 |
| Total deposits | $1,157,835 | 100.0% | $1,013,946 | 100.0% | $922,477 | 100.0% |

For additional information on deposits, see Note 8 to the Consolidated Financial Statements.

Borrowed Funds and Subordinated Debentures

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

Borrowed funds and subordinated debentures totaled $220.3 million and $285.3 million at December 31, 2018 and December 31, 2017, respectively, and are broken down in the following table:

| (In thousands) | December 31, 2018 | December 31, 2017 |
|---|---|---|
| FHLB borrowings: | | |
| Fixed rate advances | $ — | $ 40,000 |
| Adjustable rate advances | 50,000 | 50,000 |
| Overnight advances | 160,000 | 170,000 |
| Other repurchase agreements | — | 15,000 |
| Subordinated debentures | 10,310 | 10,310 |
| Total borrowed funds and subordinated debentures | $ 220,310 | $ 285,310 |

Borrowed funds decreased $65.0 million from prior year-end due to a $40.0 million decrease in FHLB fixed rate advances, a $15.0 million decrease in other repurchase agreements and a $10.0 million decrease in FHLB overnight borrowings during the year ended December 31, 2018.

FHLB Borrowings

At December 31, 2018, the Company had no fixed rate advances, compared to $40.0 million at December 31, 2017. The decrease was a result of the FHLB exercising its option to put each of the advances as a result of the rising interest rate environment. The borrowings had a weighted average rate of 2.016%.

At December 31, 2018 and December 31, 2017, the $50.0 million FHLB adjustable rate ("ARC") advances consisted of two $20.0 million advances and one $10.0 million advance. These ARC advances roll over every six months. The Company has opted to use swap instruments to control rates in the rising environment. Each ARC advance has a swap

instrument which modifies the borrowing to a 5 year fixed rate borrowing. The terms of these transactions are as follows:

- The $160.0 million FHLB overnight line of credit advance issued on December 31, 2018 was at a rate of 2.60% and was repaid on January 2, 2019.
- The $20.0 million FHLB advance that was issued on December 7, 2018 has an adjustable interest rate equal to 3 month LIBOR plus 5.0 basis points and matures on June 7, 2019. This borrowing was swapped to a 5 year fixed rate borrowing at 1.730%.

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- The $10.0 million FHLB advance that was issued on August 16, 2018 has an adjustable interest rate equal to 3 month LIBOR plus 8.5 basis points and matures on February 19, 2019. This borrowing was swapped to a 5 year fixed rate borrowing at 1.103%.
- The $20.0 million FHLB advance that was issued on July 5, 2018 has an adjustable interest rate equal to LIBOR minus 1.0 basis points and matures on January 7, 2019. This borrowing was swapped to a 5 year fixed rate borrowing at 1.048%.

At December 31, 2018, there were FHLB overnight borrowings of $160.0 million at a rate of 2.600%, compared to $170.0 million at a rate of 1.530% at December 31, 2017.

In December 2018, the FHLB issued a $22.0 million municipal deposit letter of credit in the name of Unity Bank naming the NJ Department of Banking and Insurance as beneficiary, to secure municipal deposits as required under New Jersey law.

At December 31, 2018, the Company had $262.5 million of additional credit available at the FHLB. Pledging additional collateral in the form of 1 to 4 family residential mortgages, commercial loans and investment securities can increase the line with the FHLB.

Repurchase Agreements

At December 31, 2017, the Company was party to a $15.0 million repurchase agreement that was entered into in February 2008, with a rate of 3.670%. The borrowing matured on February 28, 2018.

Subordinated Debentures

On July 24, 2006, Unity (NJ) Statutory Trust II, a statutory business trust and wholly-owned subsidiary of the Parent Company, issued $10.0 million of floating rate capital trust pass through securities to investors due on July 24, 2036. The subordinated debentures are redeemable in whole or part, prior to maturity but after July 24, 2011. The floating interest rate on the subordinated debentures is three-month LIBOR plus 159 basis points and reprices quarterly. The floating interest rate was 4.414% at December 31, 2018 and 3.265% at December 31, 2017. This has been swapped to a 3 year fixed rate borrowing at 0.885%.

For additional information on borrowed funds and subordinated debentures, see Note 9 to the Consolidated Financial Statements.

Market Risk

Based on the Company's business, the two largest risks facing the Company are market risk and credit risk. Market risk for the Company is primarily limited to interest rate risk, which is the impact that changes in interest rates would have on future earnings. The Company's Risk Management Committee ("RMC") manages this risk. The principal objectives of RMC are to establish prudent risk management guidelines, evaluate and control the level of interest rate risk in balance sheet accounts, determine the level of appropriate risk given the business focus, operating environment, capital, and liquidity requirements, and actively manage risk within Board-approved guidelines. The RMC reviews the maturities and repricing of loans, investments, deposits and borrowings, cash flow needs, current market conditions, and interest rate levels.

The Company uses various techniques to evaluate risk levels on both a short and long-term basis. One of the monitoring tools is the "gap" ratio. A gap ratio, as a percentage of assets, is calculated to determine the maturity and repricing mismatch between interest rate-sensitive assets and interest rate-sensitive liabilities. A gap is considered

positive when the amount of interest rate-sensitive assets repricing exceeds the amount of interest rate-sensitive liabilities repricing in a designated time period. A positive gap should result in higher net interest income with rising interest rates, as the amount of the assets repricing exceeds the amount of liabilities repricing. Conversely, a gap is considered negative when the amount of interest rate-sensitive liabilities exceeds interest rate-sensitive assets, and lower rates should result in higher net interest income.

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

The following table sets forth the gap ratio at December 31, 2018. Assumptions regarding the repricing characteristics of certain assets and liabilities are critical in determining the projected level of rate sensitivity. Certain savings and interest checking accounts are less sensitive to market interest rate changes than other interest-bearing sources of funds. Core deposits such as interest-bearing demand, savings and money market deposits are allocated based on their expected repricing in relation to changes in market interest rates.

| (In thousands, except percentages) | Under six months | Six months through one year | More than one year through three years | More than three years through five years | More than five years through ten years | More than ten years and not repricing | Total |
|---|---|---|---|---|---|---|---|
| Assets: | | | | | | | |
| Cash and due from banks | $— | $— | $— | $— | $— | $20,028 | $20,028 |
| Federal funds sold, interest-bearing deposits and repos | 124,017 | — | 1,470 | — | — | — | 125,487 |
| Federal Home Loan Bank stock | — | — | — | — | — | 10,795 | 10,795 |
| Securities | 6,017 | 2,776 | 18,920 | 14,532 | 12,266 | 9,221 | 63,732 |
| Loans | 395,168 | 145,266 | 372,771 | 298,960 | 71,226 | 21,175 | 1,304,566 |
| Allowance for loan losses | — | — | — | — | — | (15,488 ) | (15,488 ) |
| Other assets | — | — | — | — | — | 70,037 | 70,037 |
| Total assets | $525,202 | $148,042 | $393,161 | $313,492 | $83,492 | $115,768 | $1,579,157 |
| Liabilities and shareholders' equity: | | | | | | | |
| Noninterest-bearing demand deposits | $— | $— | $— | $— | $— | $270,152 | $270,152 |
| Savings and interest-bearing demand deposits | 284,062 | — | 75,142 | 111,775 | 109,540 | — | 580,519 |
| Time deposits | 110,368 | 71,082 | 155,355 | 19,821 | 390 | — | 357,016 |
| Borrowed funds and subordinated debentures | 170,000 | — | 50,000 | — | — | 310 | 220,310 |
| Other liabilities | — | — | — | — | — | 12,672 | 12,672 |
| Shareholders' equity | — | — | — | — | — | 138,488 | 138,488 |
| Total liabilities and shareholders' equity | $564,430 | $71,082 | $280,497 | $131,596 | $109,930 | $421,622 | $1,579,157 |
| Gap | (39,228 ) | 76,960 | 112,664 | 181,896 | (26,438 ) | (305,854 ) | |
| Cumulative gap | (39,228 ) | 37,732 | 150,396 | 332,292 | 305,854 | — | |
| Cumulative gap to total assets | (2.5 )% | 2.4 % | 9.5 % | 21.0 % | 19.4 % | — | |

At December 31, 2018, there was a six-month liability-sensitive gap of $39.2 million and a one-year asset-sensitive gap of $37.7 million, as compared to a six-month liability-sensitive gap of $833 thousand and a one-year asset-sensitive gap of $33.6 million at December 31, 2017. The six-month and one-year cumulative gap to total assets ratios were within the Board-approved guidelines of +/- 20 percent.

Other models are also used in conjunction with the static gap table, which is not able to capture the risk of changing spread relationships over time, the effects of projected growth in the balance sheet or dynamic decisions such as the modification of investment maturities as a rate environment unfolds. For these reasons, a simulation model is used, where numerous interest rate scenarios and balance sheets are combined to produce a range of potential income

results.  Net interest income is managed within guideline ranges for interest rates rising or falling by 200 basis points.  Results outside of guidelines require action by the RMC to correct the imbalance.  Simulations are typically created over a 12 to 24 month time horizon.  At December 31, 2018, these simulations show that with a 200 basis point rate increase over a 12 month period, net interest income would decrease by approximately $720 thousand, or 1.3 percent.  A 200 basis point rate decline over a 12 month period would decrease net interest income by approximately $1.9 million or 3.4 percent.  These variances in net interest income are within the Board-approved guidelines of +/- 10 percent.

Finally, to measure the impact of longer-term asset and liability mismatches beyond two years, the Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity ("EVPE") models. The modified duration of equity measures the potential price risk of equity to changes in interest rates. A longer modified duration of equity indicates a greater degree of risk to rising interest rates. Because of balance sheet optionality, an EVPE analysis is also used to dynamically model the present value of asset and liability cash flows, with rate shocks of 200 basis points. The economic value of equity is likely to be different as interest rates change. Results falling outside prescribed ranges require action by the RMC. The Company's variance in the economic value of equity with rate shocks of 200 basis points is a decline of 6.0 percent in a rising rate environment and a decrease of 2.9 percent in a falling rate environment at December 31, 2018. At December 31, 2017, the Company's variance in the economic value of equity with rate shocks of 200 basis points is a decline of 7.2 percent in a rising rate environment and a decrease of 1.4 percent in a falling rate environment. The variance in the EVPE at December 31, 2018 and 2017 were within the Board-approved guidelines in place at the time of +/- 20 percent.

Liquidity

Consolidated Bank Liquidity

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. A bank's liquidity reflects its ability to meet loan demand, to accommodate possible outflows in deposits and to take advantage of interest rate opportunities in the marketplace. The Company's liquidity is monitored by management and the Board of Directors through the RMC, which reviews historical funding requirements, the current liquidity position, sources and stability of funding, marketability of assets, options for attracting additional funds, and anticipated future funding needs, including the level of unfunded commitments. The goal is to maintain sufficient asset-based liquidity to cover potential funding requirements in order to minimize dependence on volatile and potentially unstable funding markets.

The principal sources of funds at the Bank are deposits, scheduled amortization and prepayments of investment and loan principal, sales and maturities of investment securities, additional borrowings and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit inflows and outflows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Consolidated Statement of Cash Flows provides detail on the Company's sources and uses of cash, as well as an indication of the Company's ability to maintain an adequate level of liquidity. As the Consolidated Bank comprises the majority of the assets of the Company, this Consolidated Statement of Cash Flows is indicative of the Consolidated Bank's activity. At December 31, 2018, the balance of cash and cash equivalents was $145.5 million, a decrease of $4.7 million from December 31, 2017. A discussion of the cash provided by and used in operating, investing and financing activities follows.

Operating activities provided $38.6 million and $14.4 million in net cash for the years ended December 31, 2018 and 2017. The primary sources of funds were net income from operations and adjustments to net income, such as the proceeds from the sale of mortgage and SBA loans held for sale, partially offset by originations of mortgage and SBA loans held for sale.

Investing activities used $140.7 million and $219.6 million in net cash for the years ended December 31, 2018 and 2017, respectively. Cash was primarily used to fund new loans, purchase FHLB stock, securities and premises and equipment, partially offset by cash inflows from proceeds from the redemption of FHLB stock and maturities and pay downs on securities.

- Securities. The Consolidated Bank's available for sale investment portfolio amounted to $46.7 million and $53.2 million at December 31, 2018 and December 31, 2017, respectively. This excludes the Parent Company's securities discussed under the heading "Parent Company Liquidity" below. Projected cash flows from securities over the next

twelve months are $6.0 million.

- Loans. The SBA loans held for sale portfolio amounted to $11.2 million and $22.8 million at December 31, 2018 and December 31, 2017, respectively. Sales of these loans provide an additional source of liquidity for the Company.

- Outstanding Commitments. The Company was committed to advance approximately $289.9 million to its borrowers as of December 31, 2018, compared to $291.9 million at December 31, 2017. At December 31, 2018, $161.1 million of these commitments expire within one year, compared to $209.3 million at December 31, 2017. The Company had $5.7 million and $5.6 million in standby letters of credit at December 31, 2018 and December 31, 2017, respectively, which are included in the commitments amount noted above. The estimated fair value of these guarantees is not significant. The Company believes it has the necessary liquidity to honor all commitments. Many of these commitments will expire and never be funded.

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Financing activities provided $97.3 million and $249.5 million in net cash for the years ended December 31, 2018 and 2017, respectively, primarily due to an increase in the Company's borrowings and deposits, partially offset by the Company's repayment of borrowings.

- Deposits. As of December 31, 2018, deposits included $121.9 million of Government deposits, as compared to $99.6 million at year end 2017. These deposits are generally short in duration and are very sensitive to price competition. The Company believes that the current level of these types of deposits is appropriate. Included in the portfolio were $116.6 million of deposits from fourteen municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.
- Borrowed Funds. Total FHLB borrowings amounted to $210.0 million and $260.0 million as of December 31, 2018 and 2017, respectively. There were no third party repurchase agreements as of December 31, 2018, compared to a total of $15.0 million as of December 31, 2017. As a member of the Federal Home Loan Bank of New York, the Company can borrow additional funds based on the market value of collateral pledged. At December 31, 2018, pledging provided an additional $221.9 million in borrowing potential from the FHLB. In addition, the Company can pledge additional collateral in the form of 1 to 4 family residential mortgages, commercial loans or investment securities to increase this line with the FHLB.

Parent Company Liquidity

The Parent Company's cash needs are funded by dividends paid and rental payments on corporate headquarters by the Bank. Other than its investment in the Bank, Unity Risk Management Inc., and Unity Statutory Trust II, the Parent Company does not actively engage in other transactions or business. Only expenses specifically for the benefit of the Parent Company are paid using its cash, which typically includes the payment of operating expenses, cash dividends on common stock and payments on trust preferred debt.

At December 31, 2018, the Parent Company had $1.2 million in cash and cash equivalents and $1.2 million in investment securities valued at fair market value, compared to $1.6 million in cash and cash equivalents and $278 thousand in investment securities at December 31, 2017.

Off-Balance Sheet Arrangements and Contractual Obligations

The following table shows the amounts and expected maturities or payment periods of off-balance sheet arrangements and contractual obligations as of December 31, 2018:

| (In thousands) | One year or less | One to three years | Three to five years | Over five years | Total |
|---|---|---|---|---|---|
| Off-balance sheet arrangements: | | | | | |
| Standby letters of credit | $4,720 | $166 | $— | $799 | $5,685 |
| Contractual obligations: | | | | | |
| Time deposits | 181,450 | 155,355 | 19,821 | 390 | 357,016 |
| Borrowed funds and subordinated debentures | 210,000 | — | — | 10,310 | 220,310 |
| Operating lease obligations | 383 | 675 | 446 | 376 | 1,880 |
| Purchase obligations | 1,959 | 3,919 | 2,123 | — | 8,001 |
| Total off-balance sheet arrangements and contractual obligations | $398,512 | $160,115 | $22,390 | $11,875 | $592,892 |

Standby letters of credit represent guarantees of payment issued by the Bank on behalf of a client that is used as "payment of last resort" should the client fail to fulfill a contractual commitment with a third party. Standby letters of credit are typically short-term in duration, maturing in one year or less.

Time deposits have stated maturity dates. For additional information on time deposits, see Note 8 to the Consolidated Financial Statements.

Borrowed funds and subordinated debentures include adjustable rate borrowings from the Federal Home Loan Bank and subordinated debentures. The borrowings have defined terms and under certain circumstances are callable at the option of the lender. For additional information on borrowed funds and subordinated debentures, see Note 9 to the Consolidated Financial Statements.

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Operating leases represent obligations entered into by the Company for the use of land and premises. The leases generally have escalation terms based upon certain defined indexes. For additional information on the Company's operating leases, see Note 10 to the Consolidated Financial Statements.

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

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Capital Adequacy

A significant measure of the strength of a financial institution is its capital base. Shareholders' equity increased $20.4 million to $138.5 million at December 31, 2018 compared to $118.1 million at December 31, 2017, primarily due to net income of $21.9 million. Other items impacting shareholders' equity included $2.8 million in dividends paid on common stock, $386 thousand in unrealized losses net of tax on available for sale securities, $1.6 million from the issuance of common stock under employee benefit plans, $148 thousand in unrealized gains net of tax on cash flow hedges and $90 thousand in adjustments related to the defined benefit plan. The issuance of common stock under employee benefit plans includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

For additional information on shareholders' equity, see Note 12 to the Consolidated Financial Statements.

Federal regulators have classified and defined capital into the following components: (1) tier 1 capital, which includes tangible shareholders' equity for common stock, qualifying preferred stock and certain qualifying hybrid instruments, and (2) tier 2 capital, which includes a portion of the allowance for loan losses, certain qualifying long-term debt, preferred stock and hybrid instruments which do not qualify as tier 1 capital. Minimum capital levels are regulated by risk-based capital adequacy guidelines, which require the Company and the Bank to maintain certain capital as a percent of assets and certain off-balance sheet items adjusted for predefined credit risk factors (risk-weighted assets). A bank is required to maintain, at a minimum, tier 1 capital as a percentage of risk-weighted assets of 4 percent and combined tier 1 and tier 2 capital as a percentage of risk-weighted assets of 8 percent. In addition, banks are required to meet a leverage capital requirement, which measures tier 1 capital against average assets. Banks which are highly rated and not experiencing significant growth are required to maintain a leverage ratio of 3 percent while all other banks are expected to maintain a leverage ratio 1 to 2 percentage points higher. Finally, the Bank is required to maintain a ratio of common equity tier 1 capital, consisting solely of common equity, to risk-weighted assets of at least 4.5%. The Company is subject to similar requirements on a consolidated basis.

The following table summarizes the Company's and the Bank's regulatory capital ratios at December 31, 2018 and 2017, as well as the minimum regulatory capital ratios required for the Bank to be deemed "well-capitalized." The Company's capital amounts and ratios reflect the capital decreases described above.

| | At December 31, 2018 | | Required for capital adequacy purposes effective | | To be well-capitalized under prompt corrective action regulations |
|---|---|---|---|---|---|
| | Company | Bank | January 1, 2018 | January 1, 2019 | Bank |
| Leverage ratio | 9.90 % | 9.52 % | 4.000% | 4.00 % | 5.00 % |
| CET1 | 11.40% | 11.80% | 6.375% (1) | 7.00 % (2) | 6.50 % |
| Tier I risk-based capital ratio | 12.24% | 11.80% | 7.875% (1) | 8.50 % (2) | 8.00 % |
| Total risk-based capital ratio | 13.49% | 13.05% | 9.875% (1) | 10.50% (2) | 10.00 % |

(1) Includes 1.875% capital conservation buffer.
(2) Includes 2.5% capital conservation buffer.

| | At December 31, 2017 | Required for capital | To be well-capitalized |
|---|---|---|---|

| | | | adequacy purposes effective | | | under prompt corrective action regulations |
|---|---|---|---|---|---|---|
| | Company | Bank | January 1, 2017 | | January 1, 2019 | Bank |
| Leverage ratio | 9.37 % | 9.03 % | 4.000 % | | 4.00 % | 5.00 % |
| CET1 | 10.81 % | 11.33 % | 5.750 % | (3) | 7.00 % (4) | 6.50 % |
| Tier I risk-based capital ratio | 11.75 % | 11.33 % | 7.250 % | (3) | 8.50 % (4) | 8.00 % |
| Total risk-based capital ratio | 12.87 % | 12.50 % | 9.250 % | (3) | 10.50 % (4) | 10.00 % |

(3) Includes 1.25% capital conservation buffer.
(4) Includes 2.5% capital conservation buffer.

For additional information on regulatory capital, see Note 17 to the Consolidated Financial Statements.

## Forward-Looking Statements

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

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

Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations" is based upon the Company's Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company's Audited Consolidated Financial Statements for the year ended December 31, 2018, contains a summary of the Company's significant accounting policies. Management believes the Company's policies with respect to the methodology for the determination of the other-than-temporary impairment on securities, servicing assets, allowance for loan losses, and income taxes involve a higher degree of complexity and require management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies are periodically reviewed with the Audit Committee and the Board of Directors.

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, the intent to sell a security or whether it is more likely than not the security will be required to be sold before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, the 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.

For additional information on other-than-temporary impairment, see Note 3 to the Consolidated Financial Statements.

Servicing Assets

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.

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

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Allowance for Loan Losses and Unfunded Loan Commitments

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

The level of the allowance is based on management's evaluation of probable losses in the loan portfolio, after consideration of prevailing economic conditions in the Company's market area, the volume and composition of the loan portfolio, and historical loan loss experience. The allowance for loan losses consists of specific reserves for individually impaired credits and TDRs and 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 judgments about information available at the time of the 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 5 to the Consolidated Financial Statements.

Income Taxes

The Company accounts for income taxes according to the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. If tax reform results in a decline in the corporate tax rates the Company would have to write-down its deferred tax asset.

Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

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

of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits would be recognized in income tax expense on the income statement.

For additional information on income taxes, see Note 15 to the Consolidated Financial Statements.

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

For information regarding Quantitative and Qualitative Disclosures about Market Risk, see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk."

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Item 8. Financial Statements and Supplementary Data:

Consolidated Balance Sheets

| (In thousands) | December 31, 2018 | December 31, 2017 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 20,028 | $ 23,701 |
| Federal funds sold, interest-bearing deposits and repos | 125,487 | 126,553 |
| Cash and cash equivalents | 145,515 | 150,254 |
| Securities: | | |
| Securities available for sale (amortized cost of $47,762 and $52,763 in 2018 and 2017, respectively) | 46,713 | 52,287 |
| Securities held to maturity (fair value of $14,802 and $16,346 in 2018 and 2017, respectively) | 14,875 | 16,307 |
| Equity securities (amortized cost of $2,394 and $1,262 in 2018 and 2017, respectively) | 2,144 | 1,206 |
| Total securities | 63,732 | 69,800 |
| Loans: | | |
| SBA loans held for sale | 11,171 | 22,810 |
| SBA loans held for investment | 39,333 | 43,999 |
| Commercial loans | 694,102 | 628,865 |
| Residential mortgage loans | 436,056 | 365,145 |
| Consumer loans | 123,904 | 109,855 |
| Total loans | 1,304,566 | 1,170,674 |
| Allowance for loan losses | (15,488 ) | (13,556 ) |
| Net loans | 1,289,078 | 1,157,118 |
| Premises and equipment, net | 23,371 | 23,470 |
| Bank owned life insurance ("BOLI") | 24,710 | 24,227 |
| Deferred tax assets | 5,350 | 4,017 |
| Federal Home Loan Bank ("FHLB") stock | 10,795 | 12,863 |
| Accrued interest receivable | 6,399 | 5,447 |
| Other real estate owned ("OREO") | 56 | 426 |
| Goodwill | 1,516 | 1,516 |
| Prepaid expenses and other assets | 8,635 | 6,358 |
| Total assets | $ 1,579,157 | $ 1,455,496 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing demand | $ 270,152 | $ 256,119 |
| Interest-bearing demand | 185,792 | 164,997 |
| Savings | 394,727 | 396,557 |
| Time, under $100,000 | 184,022 | 133,881 |
| Time, $100,000 to $250,000 | 116,147 | 71,480 |
| Time, $250,000 and over | 56,847 | 20,103 |
| Total deposits | 1,207,687 | 1,043,137 |
| Borrowed funds | 210,000 | 275,000 |
| Subordinated debentures | 10,310 | 10,310 |
| Accrued interest payable | 406 | 436 |
| Accrued expenses and other liabilities | 12,266 | 8,508 |
| Total liabilities | 1,440,669 | 1,337,391 |

| | | |
|---|---|---|
| Shareholders' equity: | | |
| Common stock, no par value, 12,500 shares authorized, 10,780 shares issued and outstanding in 2018; 10,615 shares issued and outstanding in 2017 | 88,484 | 86,782 |
| Retained earnings | 50,161 | 31,117 |
| Accumulated other comprehensive (loss) income | (157) | 206 |
| Total shareholders' equity | 138,488 | 118,105 |
| Total liabilities and shareholders' equity | $ 1,579,157 | $ 1,455,496 |

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

Consolidated Statements of Income

| (In thousands, except per share amounts) | For the years ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| INTEREST INCOME | | | |
| Federal funds sold, interest-bearing deposits and repos | $773 | $851 | $214 |
| FHLB stock | 462 | 370 | 245 |
| Securities: | | | |
| Taxable | 1,907 | 2,029 | 1,698 |
| Tax-exempt | 117 | 159 | 204 |
| Total securities | 2,024 | 2,188 | 1,902 |
| Loans: | | | |
| SBA loans | 4,338 | 3,805 | 3,181 |
| Commercial loans | 33,886 | 28,150 | 25,256 |
| Residential mortgage loans | 18,837 | 14,650 | 12,205 |
| Consumer loans | 6,943 | 5,296 | 4,021 |
| Total loans | 64,004 | 51,901 | 44,663 |
| Total interest income | 67,263 | 55,310 | 47,024 |
| INTEREST EXPENSE | | | |
| Interest-bearing demand deposits | 1,202 | 665 | 537 |
| Savings deposits | 3,871 | 2,738 | 1,742 |
| Time deposits | 5,903 | 3,278 | 3,670 |
| Borrowed funds and subordinated debentures | 2,540 | 2,772 | 2,818 |
| Total interest expense | 13,516 | 9,453 | 8,767 |
| Net interest income | 53,747 | 45,857 | 38,257 |
| Provision for loan losses | 2,050 | 1,650 | 1,220 |
| Net interest income after provision for loan losses | 51,697 | 44,207 | 37,037 |
| NONINTEREST INCOME | | | |
| Branch fee income | 1,519 | 1,384 | 1,269 |
| Service and loan fee income | 2,130 | 2,100 | 1,020 |
| Gain on sale of SBA loans held for sale, net | 1,680 | 1,617 | 2,099 |
| Gain on sale of mortgage loans, net | 1,719 | 1,530 | 2,621 |
| BOLI income | 975 | 469 | 378 |
| Net security (losses) gains | (199) | 62 | 424 |
| Gain on repurchase of subordinated debt | — | — | 2,264 |
| Other income | 1,207 | 1,108 | 985 |
| Total noninterest income | 9,031 | 8,270 | 11,060 |
| NONINTEREST EXPENSE | | | |
| Compensation and benefits | 20,119 | 17,117 | 14,952 |
| Occupancy | 2,739 | 2,381 | 2,360 |
| Processing and communications | 2,788 | 2,551 | 2,628 |
| Furniture and equipment | 2,348 | 2,079 | 1,700 |
| Professional services | 934 | 1,022 | 976 |
| Loan collection and OREO (recoveries) expenses | (288) | 463 | 654 |
| Other loan expenses | 135 | 186 | 152 |
| Deposit insurance | 782 | 546 | 713 |
| Advertising | 1,411 | 1,179 | 1,095 |
| Director fees | 671 | 637 | 559 |
| Other expenses | 1,782 | 1,883 | 1,842 |

| | | | |
|---|---|---|---|
| Total noninterest expense | 33,421 | 30,044 | 27,631 |
| Income before provision for income taxes | 27,307 | 22,433 | 20,466 |
| Provision for income taxes | 5,388 | 9,540 | 7,257 |
| Net income | $21,919 | $12,893 | $13,209 |
| Net income per common share - Basic | $2.04 | $1.22 | $1.40 |
| Net income per common share - Diluted | $2.01 | $1.20 | $1.38 |
| Weighted average common shares outstanding - Basic | 10,726 | 10,558 | 9,416 |
| Weighted average common shares outstanding - Diluted | 10,916 | 10,749 | 9,572 |

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

Consolidated Statements of Comprehensive Income

| (In thousands) | For the year ended December 31, 2018 | | |
|---|---|---|---|
| | Before tax amount | Income tax expense (benefit) | Net of tax amount |
| Net income | $27,307 | $5,388 | $21,919 |
| Other comprehensive loss | | | |
| Investment securities available for sale: | | | |
| Unrealized holding losses on securities arising during the period | (756) | (225) | (531) |
| Less: reclassification adjustment for losses on securities included in net income | (183) | (38) | (145) |
| Total unrealized losses on securities available for sale | (573) | (187) | (386) |
| Adjustments related to defined benefit plan: | | | |
| Amortization of prior service cost | 83 | 173 | (90) |
| Total adjustments related to defined benefit plan | 83 | 173 | (90) |
| Net unrealized gains from cash flow hedges: | | | |
| Unrealized holding gains on cash flow hedges arising during the period | 25 | (123) | 148 |
| Total unrealized gains on cash flow hedges | 25 | (123) | 148 |
| Total other comprehensive loss | (465) | (137) | (328) |
| Total comprehensive income | $26,842 | $5,251 | $21,591 |

| (In thousands) | For the year ended December 31, 2017 | | |
|---|---|---|---|
| | Before tax amount | Income tax expense (benefit) | Net of tax amount |
| Net income | $22,433 | $9,540 | $12,893 |
| Other comprehensive income | | | |
| Investment securities available for sale: | | | |
| Unrealized holding losses on securities arising during the period | (152) | (18) | (134) |
| Less: reclassification adjustment for gains on securities included in net income | 62 | 22 | 40 |
| Total unrealized losses on securities available for sale | (214) | (40) | (174) |
| Adjustments related to defined benefit plan: | | | |
| Amortization of prior service cost | 83 | 33 | 50 |
| Total adjustments related to defined benefit plan | 83 | 33 | 50 |
| Net unrealized gains from cash flow hedges: | | | |
| Unrealized holding gains on cash flow hedges arising during the period | 204 | 34 | 170 |
| Total unrealized gains on cash flow hedges | 204 | 34 | 170 |
| Total other comprehensive income | 73 | 27 | 46 |
| Total comprehensive income | $22,506 | $9,567 | $12,939 |

| (In thousands) | For the year ended December 31, 2016 | | |
|---|---|---|---|
| | Before tax amount | Income tax expense (benefit) | Net of tax amount |
| Net income | $20,466 | $7,257 | $13,209 |
| Other comprehensive income | | | |
| Investment securities available for sale: | | | |
| Unrealized holding gains on securities arising during the period | 157 | 41 | 116 |
| Less: reclassification adjustment for gains on securities included in net income | 424 | 149 | 275 |
| Total unrealized losses on securities available for sale | (267) | (108) | (159) |
| Adjustments related to defined benefit plan: | | | |
| Amortization of prior service cost | 83 | 26 | 57 |
| Total adjustments related to defined benefit plan | 83 | 26 | 57 |
| Net unrealized gains from cash flow hedges: | | | |
| Unrealized holding gains on cash flow hedges arising during the period | 1,232 | 503 | 729 |
| Total unrealized gains on cash flow hedges | 1,232 | 503 | 729 |
| Total other comprehensive income | 1,048 | 421 | 627 |
| Total comprehensive income | $21,514 | $7,678 | $13,836 |

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

Consolidated Statements of Changes in Shareholders’ Equity

| (In thousands, except per share amounts) | Common stock Shares | Amount | Retained earnings (3) | Accumulated other comprehensive income (loss) | Total Shareholders' equity |
|---|---|---|---|---|---|
| Balance, December 31, 2015 | 9,279 | $59,371 | $19,566 | $ (467) | $ 78,470 |
| Net income | | | 13,209 | | 13,209 |
| Other comprehensive income, net of tax | | | | $ 627 | 627 |
| Dividend on common stock ($0.18 per share) | | 109 | (1,633) | | (1,524) |
| 10% stock dividend payable September 30, 2016 | | 10,394 | (10,394) | | — |
| Common stock issued and related tax effects (1) | 130 | 1,097 | | | 1,097 |
| Proceeds from rights offering (2) | 1,068 | 14,412 | | | 14,412 |
| Balance, December 31, 2016 | 10,477 | 85,383 | 20,748 | 160 | 106,291 |
| Net income | | | 12,893 | | 12,893 |
| Other comprehensive income, net of tax | | | | 46 | 46 |
| Dividends on common stock ($0.23 per share) | | 144 | (2,524) | | (2,380) |
| Common stock issued and related tax effects (1) | 138 | 1,255 | | | 1,255 |
| Balance, December 31, 2017 | 10,615 | 86,782 | 31,117 | 206 | 118,105 |
| Net income | | | 21,919 | | 21,919 |
| Other comprehensive loss, net of tax | | | | (328) | (328) |
| Dividends on common stock ($0.27 per share) | | 107 | (2,910) | | (2,802) |
| Common stock issued and related tax effects (1) | 165 | 1,595 | | | 1,595 |
| Balance, Retained earnings impact due to adoption of ASU 2016-01 (4) | | | (40) | 40 | — |
| Balance, Tax Rate adjustment to AOCI (5) | | | 75 | (75) | — |
| Balance, December 31, 2018 | 10,780 | $88,484 | $50,161 | $ (157) | $ 138,488 |

(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.
(2) Represents gross proceeds of $14.6 million reduced by legal, accounting and other filing feeds of approximately $213 thousand.
(3) 2017 includes the impact of implementing ASU 2016-09, “Compensation - Stock Compensation (Topic 718),” which resulted in a cumulative-effect adjustment of $498 thousand to retained earnings.
(4) As a result of ASU 2016-01, "Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities", the Company reclassed $40 thousand of losses on available for sale equity securities sitting in accumulated other comprehensive income to retained earnings.
(5) As a result of ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income", the Company reclassed $75 thousand from accumulated other comprehensive income to retained earnings.

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

Consolidated Statements of Cash Flows

| | For the twelve months ended December 31, | | |
|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2016 |
| OPERATING ACTIVITIES: | | | |
| Net income | $21,919 | $12,893 | $13,209 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | 2,050 | 1,650 | 1,220 |
| Net amortization of purchase premiums and discounts on securities | 220 | 290 | 346 |
| Depreciation and amortization | 1,937 | 1,238 | 734 |
| Deferred income tax expense | (1,262) | 1,546 | 110 |
| Net security losses (gains) | 4 | (62) | (424) |
| Gains on repurchase of subordinated debentures | — | — | (2,264) |
| Stock compensation expense | 1,053 | 746 | 545 |
| Loss (gain) on sale of OREO | (169) | 245 | (71) |
| Valuation writedowns on OREO | — | 151 | 300 |
| Gain on sale of mortgage loans held for sale, net | (1,390) | (1,699) | (1,610) |
| Gain on sale of SBA loans held for sale, net | (1,680) | (1,617) | (2,099) |
| Origination of mortgage loans held for sale | (80,729) | (82,088) | (108,120) |
| Origination of SBA loans held for sale | (9,510) | (24,394) | (29,916) |
| Proceeds from sale of mortgage loans held for sale, net | 82,119 | 83,787 | 109,730 |
| Proceeds from sale of SBA loans held for sale, net | 23,939 | 20,998 | 26,837 |
| BOLI income | (975) | (469) | (378) |
| Net change in other assets and liabilities | 1,064 | 1,234 | 639 |
| Net cash provided by operating activities | 38,590 | 14,449 | 8,788 |
| INVESTING ACTIVITIES | | | |
| Purchases of securities held to maturity | — | (163) | (11,322) |
| Purchase of equity securities | (1,133) | — | — |
| Purchases of securities available for sale | (579) | (29,382) | (9,339) |
| Purchases of FHLB stock, at cost | (72,115) | (17,408) | (4,182) |
| Maturities and principal payments on securities held to maturity | 1,393 | 4,278 | 2,201 |
| Maturities and principal payments on securities available for sale | 5,396 | 13,220 | 8,927 |
| Proceeds from sales of securities held to maturity | — | 529 | 6,661 |
| Proceeds from sales of securities available for sale | — | 2,777 | 12,472 |
| Proceeds from redemption of FHLB stock | 74,183 | 10,583 | 2,745 |
| Proceeds from sale of OREO | 440 | 1,034 | 2,302 |
| Net increase in loans | (147,223) | (193,592) | (82,697) |
| Proceeds from BOLI | 492 | — | — |
| Purchase of BOLI | — | (10,000) | — |
| Purchases of premises and equipment | (1,507) | (1,509) | (9,595) |
| Net cash used in investing activities | (140,653) | (219,633) | (81,827) |
| FINANCING ACTIVITIES | | | |
| Net increase in deposits | 164,550 | 97,414 | 51,230 |
| Proceeds from new borrowings | 210,000 | 220,000 | 76,000 |
| Repayments of borrowings | (275,000) | (66,000) | (47,000) |
| Repurchase of subordinated debentures | — | — | (2,891) |
| Proceeds from exercise of stock options | 576 | 509 | 550 |
| Dividends on common stock | (2,802) | (2,380) | (1,524) |
| Proceeds from capital offering | — | — | 14,412 |

| | | | |
|---|---|---|---|
| Net cash provided by financing activities | 97,324 | 249,543 | 90,777 |

| | | | |
|---|---|---|---|
| (Decrease) increase in cash and cash equivalents | (4,739 ) | 44,359 | 17,738 |
| Cash and cash equivalents, beginning of year | 150,254 | 105,895 | 88,157 |
| Cash and cash equivalents, end of year | $145,515 | $150,254 | $105,895 |
| SUPPLEMENTAL DISCLOSURES | | | |
| Cash: | | | |
| Interest paid | $13,546 | $9,447 | $8,798 |
| Income taxes paid | 5,941 | 7,002 | 7,592 |
| Noncash investing activities: | | | |
| Transfer of SBA loans held for sale to held to maturity | — | 13 | — |
| Capitalization of servicing rights | 938 | 172 | 1,472 |
| Transfer of loans to OREO | 127 | 872 | 1,990 |

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

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Overview

The accompanying Consolidated Financial Statements include the accounts of Unity Bancorp, Inc. (the "Parent Company") and its wholly-owned subsidiary, Unity Bank (the "Bank" or when consolidated with the Parent Company, the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

Unity Bancorp, Inc. is a bank holding company incorporated in New Jersey and registered under the Bank Holding Company Act of 1956, as amended. Its wholly-owned subsidiary, the Bank, is chartered by the New Jersey Department of Banking and Insurance. The Bank provides a full range of commercial and retail banking services through nineteen branch offices located in Bergen, Hunterdon, Middlesex, Somerset, Union and Warren counties in New Jersey and Northampton County in Pennsylvania. These services include the acceptance of demand, savings, and time deposits and the extension of consumer, real estate, Small Business Administration ("SBA") and other commercial credits.

Unity Bank has nine wholly-owned subsidiaries: Unity Investment Services, Inc., AJB Residential Realty Enterprises, Inc., AJB Commercial Realty, Inc., MKCD Commercial, Inc., JAH Commercial, Inc., UB Commercial LLC, ASBC Holdings LLC, Unity Property Holdings 1, Inc., and Unity Property Holdings 2, Inc. Unity Investment Services, Inc. is used to hold and administer part of the Bank's investment portfolio. The other subsidiaries hold, administer and maintain the Bank's other real estate owned ("OREO") properties. Unity Investment Services, Inc. has one subsidiary, Unity Delaware Investment 2, Inc., which has one subsidiary, Unity NJ REIT, Inc. Unity NJ REIT, Inc. was formed in 2013 to hold loans.

The Company has two wholly-owned subsidiaries: Unity (NJ) Statutory Trust II and Unity Risk Management, Inc. For additional information on Unity (NJ) Statutory Trust II, see Note 9 to the Consolidated Financial Statements. Unity Risk Management, Inc. is the Company's captive insurance company that insures risks to the Bank not insured by the traditional commercial insurance market.

Use of Estimates in the Preparation of Financial Statements

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

Cash and Cash Equivalents

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

Securities

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

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

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

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

Equity 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. These securities were transferred from available for sale and reclassified into equity securities on the balance sheet as a result of the adoption of ASU 2016-01 in January 2018. Periodic net gains and losses on equity investments are recognized in the income statement as realized gains and losses.

For additional information on securities, see Note 3 to the Consolidated Financial Statements.

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, the intent to sell a security or whether it is more likely than not the Company will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity.

For debt securities that are considered other-than-temporarily impaired where management has no intent to sell and the Company has 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 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 generally 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.

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

Loans Held for Investment

Loans held for investment 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 delinquent 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. 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 4 to the Consolidated Financial Statements.

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 adjusted for 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 judgments about information available at the time of the examination.

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 expenses and applied to the reserve which is classified as other liabilities.

For additional information on the allowance for loan losses and reserve for unfunded loan commitments, see Note 5 to the Consolidated Financial Statements.

Premises and Equipment

Land is carried at cost. All other fixed assets are carried at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The useful life of buildings is not to exceed 30 years; furniture and fixtures is generally 10 years or less, and equipment is 3 to 5 years. Leasehold improvements are depreciated over the life of the underlying lease.

For additional information on premises and equipment, see Note 6 to the Consolidated Financial Statements.

Bank Owned Life Insurance

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

Federal Home Loan Bank Stock

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

Other Real Estate Owned

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

Appraisals

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 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. Subsequent to receiving the third party results, the Company will discount the value 6 to 10 percent for selling and closing costs.

Income Taxes

The Company follows Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 740, “Income Taxes,” which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

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

penalties that would be payable to the taxing authorities upon examination.

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

For additional information on income taxes, see Note 15 to the Consolidated Financial Statements.

Net Income Per Share

Basic net income per common share is calculated as net income available to common shareholders 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. However, when a net loss rather than net income is recognized, diluted earnings per share equals basic earnings per share.

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For additional information on net income per share, see Note 16 to the Consolidated Financial Statements.

Stock-Based Compensation

The Company accounts for its stock-based compensation awards in accordance with FASB ASC Topic 718, “Compensation – Stock Compensation,” which requires recognition of compensation expense related to stock-based compensation awards over the period during which an employee is required to provide service for the award. Compensation expense is equal to the fair value of the award, net of estimated forfeitures, and is recognized over the vesting period of such awards.

For additional information on the Company’s stock-based compensation, see Note 18 to the Consolidated Financial Statements.

Fair Value

The Company follows FASB ASC Topic 820, “Fair Value Measurement and Disclosures,” which provides a framework for measuring fair value under generally accepted accounting principles.

For additional information on the fair value of the Company’s financial instruments, see Note 19 to the Consolidated Financial Statements.

Other Comprehensive Income

Other comprehensive income consists of the change in unrealized gains (losses) on SERP, securities available for sale and swap related items that were reported as a component of shareholders’ equity, net of tax.

For additional information on other comprehensive income, see Note 11 to the Consolidated Financial Statements.

Advertising

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

Dividend Restrictions

Banking regulations require maintaining certain capital levels that may limit the dividends paid by the Bank to the holding company or by the holding company to the shareholders.

Operating Segments

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

Recent Accounting Pronouncements

ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 replaced almost all existing revenue recognition guidance in current U.S. GAAP. The Company’s main source of revenue is comprised of net interest income on interest earning assets and liabilities and non-interest income. The scope of the guidance explicitly

excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives.

Under previous U.S. GAAP, when full consideration is not expected and financing is required by the buyer to purchase the property, there are very prescriptive requirements in determining when foreclosed real estate property sold by an institution should be derecognized and a gain or loss be recognized. The new guidance that was applied to these sales is more principles based. For example, as it pertains to the criteria for determining how a contract should be accounted for under the new guidance, judgment will need to be exercised in evaluating if: (a) a commitment on the buyer's part exists, (b) collection is probable in circumstances where the initial investment is minimal and (c) the buyer has obtained control of the asset, including the significant risks and rewards of the ownership. If there is no commitment on the buyer's part, collection is not probable or the buyer has not obtained control of the asset, then a gain cannot be recognized under the new guidance. The initial investment requirement for the buyer along with the various methods for profit recognition are no longer applicable.

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For deposit-related fees, considering the straightforward nature of the arrangements with the Company’s deposits customers, the Company's recognition and measurement outcomes of deposit-related fees was not significant differently under the new guidance compared to previous U.S. GAAP.

ASU 2014-09 was to be effective for interim and annual periods beginning after December 15, 2016 and was to be applied on either a modified retrospective or full retrospective basis. In August 2015, the FASB issued ASU 2015-14 which defers the original effective date for all entities by one year. Public business entities should apply the guidance in ASU 2015-14 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company applied this change on January 1, 2018 and the impact of the adoption of ASU 2014-09 on its consolidated financial statements was immaterial.

ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This eliminates the available for sale classification of accounting for equity securities and adjusts the fair value disclosures for financial instruments carried at amortized cost such that the disclosed fair values represent an exit price as opposed to an entry price. This update requires that equity securities be carried at fair value on the balance sheet and any periodic changes in value will be adjusted through the income statement. A practical expedient is provided for equity securities without a readily determinable fair value, such that these securities can be carried at cost less any impairment. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has adopted this standard as of January 1, 2018. As of December 31, 2018, $195 thousand in unrealized losses on equity securities were reclassified to net income.

ASU 2016-02, “Leases (Topic 842)”. ASU 2016-02 was issued in three parts: (a) Section A, “Leases: Amendments to the FASB Accounting Standards Codification®,” (b) Section B, “Conforming Amendments Related to Leases: Amendments to the FASB Accounting Standards Codification®,” and (c) Section C, “Background Information and Basis for Conclusions.” While both lessees and lessors are affected by the new guidance, the effects on lessees are much more significant. The update states that a lessee should recognize the assets and liabilities that arise from all leases with a term greater than 12 months. The core principle requires the lessee to recognize a liability to make lease payments and a "right-of-use" asset. The standards update also requires expanded qualitative and quantitative disclosures. For public business entities, ASC 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018. ASC 2016-02 mandates a modified retrospective transition for all entities. In January 2018, FASB issued ASU 2018-01, " Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842." ASU 2018-01 was issued to facilitate the implementation of ASU 2016-02. ASU 2018-01 would give entities the option to apply ASC 842 as of the effective date, rather than as of the beginning of the earliest period presented. The effective date and transition requirements for the amendment are the same as the effective date and transition requirements in ASU 2016-02. The standard will have a material impact on the Company's consolidated balance sheets, but will not have an impact on its consolidated income statements. The most significant impact will be the recognition of right-of-use ("ROU") assets and lease liabilities for operating leases, while the accounting for finance leases will remain substantially unchanged. As of December 31, 2018, the Company is expecting the addition of $3.0 million in right-of-use assets and lease liabilities to be added its consolidated balance sheets.

ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." ASU 2016-13 was issued to replace the incurred loss impairment methodology in current GAAP with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit impaired loans will receive an allowance account at the

acquisition date that represents a component of the purchase price allocation. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses, with such allowance limited to the amount by which fair value is below amortized cost. For public business entities, ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the impact of the adoption of ASU 2016-13 on its consolidated financial statements.

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ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 was issued to address diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments in this update provide guidance on the following eight specific cash flow issues:

- Debt Prepayment or Debt Extinguishment Costs
- Settlement of Zero-Coupon Debt Instruments or Other Debt Instruments with Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate of the Borrowing
- Contingent Consideration Payments Made after a Business Combination
- Proceeds from the Settlement of Insurance Claims
- Proceeds from the Settlement of Corporate-Owned Life Insurance Policies, include Bank-Owned Life Insurance Policies
- Distributions Received from Equity Method Investees
- Beneficial Interest in Securitization Transactions
- Separately Identifiable Cash Flows and Application of the Predominance Principle

The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company has applied this change and the impact of the adoption of ASU 2016-15 on its consolidated financial statements was immaterial.

ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash." ASU 2016-18 was issued to address divergence in the way restricted cash is classified and presented. The amendments in the update require that a statement of cash flows explain the change during a reporting period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. The amendments in this update apply to entities that have restricted cash or restricted cash equivalents and are required to present a statement of cash flows under Topic 230. The amendment says that transfers between cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are not part of the entity's operating, investing, and financing activities. For public business entities, ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company has applied this change and the impact of the adoption of ASU 2016-18 on its consolidated financial statements was immaterial.

ASU 2017-04, "Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." ASU 2017-04 was issued in an effort to simplify accounting in a new standard. The amendments in this update require that an entity perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. The amendment states that an entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, but the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. For public business entities, ASU 2017-04 is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performing on testing dates after January 1, 2017. The Company does not expect this ASU to have a material impact on the Company's consolidated financial statements since the fair values of our reporting units were not lower than their respective carrying amounts at the time of our goodwill impairment analysis for 2018.

ASU 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 was issued to enhance the accounting for the amortization of premiums for purchased callable debt securities. This amendment requires that the amortization premium be shortened to the earliest call date. For public business entities, ASU 2017-08 is effective for fiscal years after December 15, 2018, and interim periods within those fiscal years. The Company has applied this change and the impact of the adoption of ASU 2017-08 on its consolidated financial statements was immaterial.

ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 was issued to ease the burden associated with assessing hedge effectiveness and to promote better financial statement alignment of the recognition and presentation of the effects of the hedging instrument and the hedged item. This guidance requires entities to present the earnings effect of the hedging instrument in the same income statement line item with the earnings effect on the hedged item. In October 2018, FASB issued ASU 2018-16, "Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financial Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes." ASU 2018-16 was issued to expand the list of benchmark interest rates for hedge accounting. The effective date for the amendment is the same as the effective date for ASU 2017-12. For public business entities, ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. ASU 2017-12 and ASU 2018-16 are not expected to have a significant impact on the consolidated financial statements.

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ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." ASU 2018-02 allows a reclassification from accumulated other comprehensive income (loss) ("AOCI") to retained earnings for the stranded tax effects caused by the revaluation of deferred taxes resulting from the newly enacted corporate tax rate in the Tax Cuts and Jobs Act. The ASU is effective in years beginning after December 15, 2018, but permits early adoption in a period for which financial statements have not yet been issued. The Company has elected to early adopt the ASU as of January 1, 2018. The adoption of the guidance resulted in a $75 thousand cumulative-effect adjustment that increased retained earnings and decreased AOCI in the first quarter of 2018.

Goodwill

The Company accounts for goodwill and other intangible assets in accordance with FASB ASC Topic 350, “Intangibles – Goodwill and Other,” which allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Based on a qualitative assessment, management determined that the Company’s recorded goodwill totaling $1.5 million, which resulted from the 2005 acquisition of its Phillipsburg, New Jersey branch, is not impaired as of December 31, 2018.

Subsequent Events

The Company has evaluated all events or transactions that occurred through the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

Revenue Recognition

ASC 606, Revenue from Contracts with Customers ("ASC 606"), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, derivatives and investment securities, as well as revenue related to our mortgage servicing activities, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of our revenue-generating activities that are within the scope of ASC 606, which are presented in our income statements as components of non-interest income are as follows:

- Service charges on deposit accounts - these represent general service fees for monthly account maintenance and activity- or transaction based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.
- Other non-interest income primarily includes items such as letter of credit fees, bank owned life insurance income, dividends on FHLB and FRB stock and other general operating income, none of which are subject to the requirements of ASC 606.

2. Restrictions on Cash

Federal law requires depository institutions to hold reserves in the form of vault cash or, if vault cash is insufficient, in the form of a deposit maintained with a Federal Reserve Bank. The dollar amount of a depository institution's reserve requirement is determined by applying the reserve ratios specified in the FRB’s Regulation D to an institution's reservable liabilities. As of December 31, 2018 and December 31, 2017, the Company required $23.1 million of additional reserves to meet its reserve requirements.

In addition, the Company’s contract with its current electronic funds transfer (“EFT”) provider requires a predetermined balance be maintained in a settlement account controlled by the provider equal to the Company’s average daily net settlement position multiplied by four days. The required balance was $156 thousand as of December 31, 2018 and 2017. This balance can be adjusted periodically to reflect actual transaction volume and seasonal factors.

As of December 31, 2018, Unity Risk Management, Inc. had a total cash balance of $1.7 million, compared to $1.3 million at December 31, 2017.

3. Securities

This table provides the major components of securities available for sale ("AFS") and held to maturity ("HTM") at amortized cost and estimated fair value at December 31, 2018 and December 31, 2017:

| (In thousands) | December 31, 2018 Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value | December 31, 2017 Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
|---|---|---|---|---|---|---|---|---|
| Available for sale: | | | | | | | | |
| U.S. Government sponsored entities | $5,758 | $ — | $(116) | $5,642 | $5,765 | $ — | $(74) | $5,691 |
| State and political subdivisions | 4,614 | 4 | (120) | 4,498 | 5,227 | 21 | (56) | 5,192 |
| Residential mortgage-backed securities | 27,159 | 74 | (620) | 26,613 | 32,111 | 153 | (386) | 31,878 |
| Corporate and other securities | 10,231 | 123 | (394) | 9,960 | 9,660 | 9 | (143) | 9,526 |
| Total securities available for sale | $47,762 | $ 201 | $(1,250) | $46,713 | $52,763 | $ 183 | $(659) | $52,287 |
| Held to maturity: | | | | | | | | |
| U.S. Government sponsored entities | $2,527 | $ — | $(94) | $2,433 | $3,026 | $ — | $(93) | $2,933 |
| State and political subdivisions | 951 | 110 | — | 1,061 | 1,113 | 144 | — | 1,257 |
| Residential mortgage-backed securities | 3,312 | 17 | (52) | 3,277 | 3,958 | 59 | (18) | 3,999 |
| Commercial mortgage-backed securities | 3,570 | — | (138) | 3,432 | 3,685 | — | (142) | 3,543 |
| Corporate and other securities | 4,515 | 84 | — | 4,599 | 4,525 | 89 | — | 4,614 |
| Total securities held to maturity | $14,875 | $ 211 | $(284) | $14,802 | $16,307 | $ 292 | $(253) | $16,346 |
| Equity securities: | | | | | | | | |
| Total equity securities | $2,394 | $ — | $(250) | $2,144 | $1,262 | $ 15 | $(71) | $1,206 |

This table provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at December 31, 2018 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.

| | 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 | $— | — % | $3,678 | 1.61% | $1,964 | 2.17% | $— | — % | $5,642 | 1.80% |
| State and political subdivisions | 184 | 2.43 | 796 | 3.89 | 2,200 | 2.44 | 1,318 | 2.74 | 4,498 | 2.78 |
| Residential mortgage-backed securities | — | — | 572 | 2.00 | 2,742 | 2.39 | 23,299 | 2.93 | 26,613 | 2.85 |
| Corporate and other securities | — | — | 3,715 | 3.48 | 6,245 | 4.62 | — | — | 9,960 | 4.19 |
| Total securities available for sale | $184 | 2.43% | $8,761 | 2.64% | $13,151 | 3.42% | $24,617 | 2.92% | $46,713 | 3.01% |
| Held to maturity at cost: | | | | | | | | | | |
| U.S. Government sponsored entities | $— | — % | $— | — % | $— | — % | $2,527 | 1.98% | $2,527 | 1.98% |
| State and political subdivisions | — | — | — | — | 494 | 5.07 | 457 | 5.84 | 951 | 5.44 |
| Residential mortgage-backed securities | — | — | 50 | 5.22 | 442 | 3.13 | 2,820 | 3.60 | 3,312 | 3.57 |
| Commercial mortgage-backed securities | — | — | — | — | — | — | 3,570 | 2.72 | 3,570 | 2.72 |
| Corporate and other securities | — | — | — | — | 4,515 | 5.73 | — | — | 4,515 | 5.73 |
| Total securities held to maturity | $— | — % | $50 | 5.22% | $5,451 | 5.46% | $9,374 | 2.94% | $14,875 | 3.87% |
| Equity securities at fair value: | | | | | | | | | | |
| Total equity securities | $— | — % | $— | — % | $— | — % | $2,144 | 1.26% | $2,144 | 1.26% |

The fair value of securities with unrealized losses by length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2018 and December 31, 2017 are as follows:

| | December 31, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | Less than 12 months | | 12 months and greater | | Total | |
| (In thousands, except number in a loss position) | Total number in a loss position | Estimated fair value | Unrealized loss | Estimated fair value | Unrealized loss | Estimated fair value | Unrealized loss |
| Available for sale: | | | | | | | |
| U.S. Government sponsored entities | 5 | $— | $ — | $5,642 | $(116) | $5,642 | $(116) |
| State and political subdivisions | 4 | — | — | 3,129 | (120) | 3,129 | (120) |
| Residential mortgage-backed securities | 31 | 4,445 | (23) | 20,480 | (597) | 24,925 | (620) |
| Corporate and other securities | 5 | 971 | (30) | 5,787 | (364) | 6,758 | (394) |
| Total temporarily impaired securities | 45 | $5,416 | $ (53) | $35,038 | $(1,197) | $40,454 | $(1,250) |
| Held to maturity: | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| U.S. Government sponsored entities | 2 | $— | $ — | $2,434 | $(94) | $2,434 | $(94) |
| Residential mortgage-backed securities | 5 | 1,277 | (15) | 821 | (37) | 2,098 | (52) |
| Commercial mortgage-backed securities | 2 | — | — | 3,432 | (138) | 3,432 | (138) |
| Total temporarily impaired securities | 9 | $1,277 | $ (15) | $6,687 | $(269) | $7,964 | $(284) |

| (In thousands, except number in a loss position) | December 31, 2017<br>Total number in a loss position | Less than 12 months<br>Estimated fair value | <br>Unrealized loss | 12 months and greater<br>Estimated fair value | <br>Unrealized loss | Total<br>Estimated fair value | <br>Unrealized loss |
|---|---|---|---|---|---|---|---|
| Available for sale: | | | | | | | |
| U.S. Government sponsored entities | 5 | $3,732 | $ (40 ) | $1,958 | $ (34 ) | $5,690 | $ (74 ) |
| State and political subdivisions | 2 | 476 | (6 ) | 1,792 | (50 ) | 2,268 | (56 ) |
| Residential mortgage-backed securities | 22 | 20,646 | (218 ) | 4,028 | (168 ) | 24,674 | (386 ) |
| Corporate and other securities | 7 | 4,563 | (30 ) | 2,803 | (184 ) | 7,366 | (214 ) |
| Total temporarily impaired securities | 36 | $29,417 | $ (294 ) | $10,581 | $ (436 ) | $39,998 | $ (730 ) |
| Held to maturity: | | | | | | | |
| U.S. Government sponsored entities | 2 | $— | $ — | $2,933 | $ (93 ) | $2,993 | $ (93 ) |
| Residential mortgage-backed securities | 2 | — | — | 979 | (18 ) | 979 | (18 ) |
| Commercial mortgage-backed securities | 2 | — | — | 3,543 | (142 ) | 3,543 | (142 ) |
| Total temporarily impaired securities | 6 | $— | $ — | $7,455 | $ (253 ) | $7,455 | $ (253 ) |

The Company sold one held to maturity security due to a significant deterioration in the creditworthiness of the bond in 2017. Investments in debt securities may be classified as held-to-maturity and measured at amortized cost in the statement of financial position only if the reporting enterprise has the positive intent and ability to hold those securities to maturity. Evidence of a significant deterioration in the issuer's creditworthiness is a circumstance in which the enterprise may change its intent to hold a certain security to maturity without calling into question its intent to hold other debt securities to maturity in the future. This event was isolated, nonrecurring, and unusual for the Company.

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 December 31, 2018.  There was no other-than-temporary impairment on these securities at December 31, 2017.

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 Federal National Mortgage Association (FNMA), the Government National Mortgage Association (GNMA) and the Federal Home Loan Mortgage Corporation (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 December 31, 2018 or December 31, 2017.

Corporate and other securities: Included in this category are corporate debt securities, Community Reinvestment Act (“CRA”) investments, asset-backed securities, and trust preferred securities. 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 prices of the shares. 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 December 31, 2018 or December 31, 2017. The contractual terms do not allow the securities to be settled at a price less than the par value. Because the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before recovery of its amortized cost basis, which may be at maturity, the Company did not consider these securities to be other-than-temporarily impaired as of December 31, 2018 or December 31, 2017.

Realized Gains and Losses

Gross realized gains and losses on securities for the past three years are detailed in the table below:

| | For the years ended December 31, | | |
|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2016 |
| Available for sale: | | | |
| Realized gains | $— | $89 | $302 |
| Realized losses | (4 ) | (61 ) | (1 ) |
| Total securities available for sale | (4 ) | 28 | 301 |
| Held to maturity: | | | |
| Realized gains | — | 38 | 123 |
| Realized losses | — | (4 ) | — |
| Total securities held to maturity | — | 34 | 123 |
| Net (losses) gains on sales of securities | $(4) | $62 | $424 |

The net realized gains are included in noninterest income in the Consolidated Statements of Income as net security gains. There were no gross realized gains in 2018, compared to gross realized gains of $127 thousand in 2017 and $425 thousand in 2016. There was a $4 thousand gross realized loss in 2018, compared to a $65 thousand loss in 2017 and $1 thousand in 2016.

- The net loss during 2018 is attributed to the partial call of one tax-exempt municipal security with a book value of$174 thousand which resulted in a loss of $4 thousand.
- The net gains during 2017 are attributed to the sale of three mortgage-backed securities with a total book value of $1.2 million and resulting gains of $71 thousand, the sale of one taxable municipal security with a book value of $529 thousand and resulting gains of $38 thousand, the call of two asset-backed securities totaling $3.5 million in book value, resulting in gains of $3 thousand, and the call of four municipal tax-exempt securities with a total book value of $500 thousand and resulting gains of $15 thousand, partially offset by the sale of two mortgage-backed securities with a book value of $1.6 million which resulted in a loss of $58 thousand, and the call of two corporate bonds with a book value of $3.0 million and resulting losses of $7 thousand.
- The net gains during 2016 are attributed to the sale of fifteen municipal securities with a total book value of $6.4 million and resulting gains of $112 thousand, the sale of two SBA securities with a book value of $2.5 million and resulting gains of $12 thousand, the sale of thirteen equity securities totaling $515 thousand in book value, resulting in pre-tax gains of approximately $177 thousand, and the sale of five corporate bonds with a total book value of $8.5 million and resulting gains of $124 thousand, partially offset by the sale of one SBA security with a book value of $753 thousand resulting in a loss of $1 thousand.

Equity Securities

Included in this category are Community Reinvestment Act ("CRA") investments and the Company's current other equity holdings. Equity securities are defined to include (a) preferred, common and other ownership interests in entities including partnerships, joint ventures and limited liability companies and (b) rights to acquire or dispose of ownership interest in entities at fixed or determinable prices.

The company follows ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities," which aims to simplify accounting for financial instruments and to converge the guidance between U.S. GAAP and IFRS. ASU 2016-01 also includes guidance on how entities account for equity investments, present and disclose financial instruments, and measure the valuation

allowance on deferred tax assets related to available-for-sale debt securities. The guidance in ASU 2016-01 requires an entity to disaggregate the net gains and losses on the equity investments recognized in the income statement during a reporting period into realized and unrealized gains and losses. As a result, equity securities are no longer carried at fair value through other comprehensive income (OCI) or by applying the cost method to those equity securities that do not have readily determinable values. Equity securities are generally required to be measured at fair value with market value adjustments being reflected in net income. The Company adopted this standard as of January 1, 2018.

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The following is a summary of the realized gains and losses recognized in net income on equity securities during the year:

| (In thousands) | For the year ended December 31, 2018 |
|---|---|
| Net losses recognized during the period on equity securities | (195 ) |
| Less: Net (losses) gains recognized during the period on equity securities sold during the period | — |
| Unrealized losses recognized during the reporting period on equity securities still held at the reporting date | (195 ) |

Pledged Securities

Securities with a carrying value of $4.3 million and $20.8 million at December 31, 2018 and December 31, 2017, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law.

4. Loans

The following table sets forth the classification of loans by class, including unearned fees, deferred costs and excluding the allowance for loan losses for the past two years:

| (In thousands) | December 31, 2018 | December 31, 2017 |
|---|---|---|
| SBA loans held for investment | $ 39,333 | $ 43,999 |
| Commercial loans | | |
| SBA 504 loans | 29,155 | 21,871 |
| Commercial other | 104,587 | 82,825 |
| Commercial real estate | 510,370 | 469,696 |
| Commercial real estate construction | 49,990 | 54,473 |
| Residential mortgage loans | 436,056 | 365,145 |
| Consumer loans | | |
| Home equity | 59,887 | 55,817 |
| Consumer other | 64,017 | 54,038 |
| Total loans held for investment | $ 1,293,395 | $ 1,147,864 |
| SBA loans held for sale | 11,171 | 22,810 |
| Total loans | $ 1,304,566 | $ 1,170,674 |

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, excluding SBA loans, 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 lending area. However, during late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area. 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.

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. 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. 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. Generally, the Company has a 50 percent loan to value ratio on SBA 504 program loans at origination.

Residential Mortgage and Consumer Loans: The Company originates mortgage and consumer loans including principally residential real estate, home equity lines and loans and consumer construction lines. The Company originates qualified mortgages which are generally sold in the secondary market and nonqualified mortgages which are generally held for investment. Each loan type is evaluated on debt to income, type of collateral and loan to collateral value, credit history and Company 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 the Company initiates contact regarding a loan with a borrower. Documentation, including a borrower's credit history, materials establishing the value and liquidity of potential collateral, the purpose of the loan, the source of funds for repayment of the loan, and other factors, are analyzed before a loan is submitted for approval. The loan portfolio is then subject to on-going internal reviews for credit quality, as well as independent credit reviews by an outside firm.

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

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 start up 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".

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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 delinquent for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. These credit quality indicators are updated on an ongoing basis, as a loan is placed on nonaccrual status as soon as management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan.

The tables below detail the Company's loan portfolio by class according to their credit quality indicators discussed in the paragraphs above as of December 31, 2018:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | SBA & Commercial loans - Internal risk ratings | | | |
| (In thousands) | Pass | Special mention | Substandard | Total |
| SBA loans held for investment | $37,198 | $601 | $ 1,534 | $39,333 |
| Commercial loans | | | | |
| SBA 504 loans | 28,105 | — | 1,050 | 29,155 |
| Commercial other | 103,806 | 322 | 459 | 104,587 |
| Commercial real estate | 504,022 | 2,879 | 3,469 | 510,370 |
| Commercial real estate construction | 49,990 | — | — | 49,990 |
| Total commercial loans | 685,923 | 3,201 | 4,978 | 694,102 |
| Total SBA and commercial loans | $723,121 | $3,802 | $ 6,512 | $733,435 |

| | Residential mortgage & Consumer loans - Performing/Nonperforming | | |
|---|---|---|---|
| (In thousands) | Performing | Nonperforming | Total |
| Residential mortgage loans | $431,845 | $ 4,211 | $436,056 |
| Consumer loans | | | |
| Home equity | 59,861 | 26 | 59,887 |
| Consumer other | 64,017 | — | 64,017 |
| Total consumer loans | 123,878 | 26 | 123,904 |
| Total residential mortgage and consumer loans | $555,723 | $ 4,237 | $559,960 |

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, 2017:

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | SBA & Commercial loans - Internal risk ratings | | | |
| (In thousands) | Pass | Special mention | Substandard | Total |
| SBA loans held for investment | $42,415 | $ 373 | $ 1,211 | $43,999 |
| Commercial loans | | | | |
| SBA 504 loans | 20,751 | 1,024 | 96 | 21,871 |
| Commercial other | 82,201 | 599 | 25 | 82,825 |
| Commercial real estate | 464,589 | 3,047 | 2,060 | 469,696 |
| Commercial real estate construction | 54,473 | — | — | 54,473 |
| Total commercial loans | 622,014 | 4,670 | 2,181 | 628,865 |
| Total SBA and commercial loans | $664,429 | $ 5,043 | $ 3,392 | $672,864 |

| | Residential mortgage & Consumer loans - Performing/Nonperforming | | |
|---|---|---|---|
| (In thousands) | Performing | Nonperforming | Total |
| Residential mortgage loans | $ 363,476 | $ 1,669 | $365,145 |
| Consumer loans | | | |
| Home equity | 55,192 | 625 | 55,817 |
| Consumer other | 54,038 | — | 54,038 |
| Total consumer loans | 109,230 | 625 | 109,855 |
| Total residential mortgage and consumer loans | $ 472,706 | $ 2,294 | $475,000 |

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 delinquent 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 secured and in process of collection. 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. In response to the credit risk in its portfolio, the Company has increased staffing in its credit monitoring department and increased efforts in the collection and analysis of borrowers' financial statements and tax returns.

The following tables set forth an aging analysis of past due and nonaccrual loans as of December 31, 2018 and December 31, 2017:

| | December 31, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| (In thousands) | 30-59 days past due | 60-89 days past due | 90+ days and still accruing | Nonaccrual (1) | Total past due | Current | Total loans |
| SBA loans held for investment | $— | $— | $ — | $ 1,560 | $1,560 | $37,773 | $39,333 |
| Commercial loans | | | | | | | |
| SBA 504 loans | — | — | — | — | — | 29,155 | 29,155 |
| Commercial other | — | — | — | 30 | 30 | 104,557 | 104,587 |
| Commercial real estate | 301 | — | — | 1,046 | 1,347 | 509,023 | 510,370 |
| Commercial real estate construction | — | — | — | — | — | 49,990 | 49,990 |
| Residential mortgage loans | 3,801 | 1,204 | 98 | 4,211 | 9,314 | 426,742 | 436,056 |
| Consumer loans | | | | | | | |
| Home equity | 396 | — | — | 26 | 422 | 59,465 | 59,887 |
| Consumer other | 300 | — | — | — | 300 | 63,717 | 64,017 |
| Total loans held for investment | $4,798 | $1,204 | $ 98 | $ 6,873 | $12,973 | $1,280,422 | $1,293,395 |
| SBA loans held for sale | — | — | — | — | — | 11,171 | 11,171 |
| Total loans | $4,798 | $1,204 | $ 98 | $ 6,873 | $12,973 | $1,291,593 | $1,304,566 |

(1) At December 31, 2018, nonaccrual loans included $89 thousand of loans guaranteed by the SBA.

| | December 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| (In thousands) | 30-59 days past due | 60-89 days past due | 90+ days and still accruing | Nonaccrual (1) | Total past due | Current | Total loans |
| SBA loans held for investment | $240 | $313 | $ — | $ 632 | $1,185 | $42,814 | $43,999 |
| Commercial loans | | | | | | | |
| SBA 504 loans | — | — | — | — | — | 21,871 | 21,871 |
| Commercial other | 23 | — | 60 | 25 | 108 | 82,717 | 82,825 |
| Commercial real estate | 558 | 1,073 | — | 43 | 1,674 | 468,022 | 469,696 |
| Commercial real estate construction | — | — | — | — | — | 54,473 | 54,473 |
| Residential mortgage loans | 1,830 | 958 | — | 1,669 | 4,457 | 360,688 | 365,145 |
| Consumer loans | | | | | | | |
| Home equity | 51 | 205 | — | 625 | 881 | 54,936 | 55,817 |
| Consumer other | 3 | — | — | — | 3 | 54,035 | 54,038 |
| Total loans held for investment | $2,705 | $2,549 | $ 60 | $ 2,994 | $8,308 | $1,139,556 | $1,147,864 |
| SBA loans held for sale | — | — | — | — | — | 22,810 | 22,810 |
| Total loans | $2,705 | $2,549 | $ 60 | $ 2,994 | $8,308 | $1,162,366 | $1,170,674 |

(1) At December 31, 2017, nonaccrual loans included $27 thousand of loans guaranteed by the SBA.

Impaired Loans

The Company has defined impaired loans to be all nonperforming loans and troubled debt restructurings. 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.

The following tables provide detail on the Company's loans individually evaluated for impairment with the associated allowance amount, if applicable, as of December 31, 2018 and December 31, 2017:

| | December 31, 2018 | | |
|---|---|---|---|
| (In thousands) | Unpaid principal balance | Recorded investment | Specific reserves |
| With no related allowance: | | | |
| SBA loans held for investment (1) | $359 | $ 353 | $ — |
| Commercial loans | | | |
| Commercial real estate | 1,046 | 1,046 | — |
| Total commercial loans | 1,046 | 1,046 | — |
| Total impaired loans with no related allowance | 1,405 | 1,399 | — |
| With an allowance: | | | |
| SBA loans held for investment (1) | 1,257 | 1,118 | 540 |
| Commercial loans | | | |
| Commercial other | 30 | 30 | 30 |
| Commercial real estate | 745 | 745 | 97 |
| Total commercial loans | 775 | 775 | 127 |
| Total impaired loans with a related allowance | 2,032 | 1,893 | 667 |
| Total individually evaluated impaired loans: | | | |
| SBA loans held for investment (1) | 1,616 | 1,471 | 540 |
| Commercial loans | | | |
| Commercial other | 30 | 30 | 30 |
| Commercial real estate | 1,791 | 1,791 | 97 |
| Total commercial loans | 1,821 | 1,821 | 127 |
| Total individually evaluated impaired loans | $3,437 | $ 3,292 | $ 667 |

(1) Balances are reduced by amount guaranteed by the SBA of $89 thousand at December 31, 2018.

| (In thousands) | December 31, 2017 Unpaid principal balance | Recorded investment | Specific reserves |
|---|---|---|---|
| With no related allowance: | | | |
| SBA loans held for investment (1) | $135 | $ 52 | $ — |
| Commercial loans | | | |
| Commercial other | 25 | 25 | — |
| Commercial real estate | 43 | 43 | — |
| Total commercial loans | 68 | 68 | — |
| Total impaired loans with no related allowance | 203 | 120 | — |
| With an allowance: | | | |
| SBA loans held for investment (1) | 748 | 553 | 194 |
| Commercial loans | | | |
| Commercial real estate | 786 | 786 | 138 |
| Total commercial loans | 786 | 786 | 138 |
| Total impaired loans with a related allowance | 1,534 | 1,339 | 332 |
| Total individually evaluated impaired loans: | | | |
| SBA loans held for investment (1) | 883 | 605 | 194 |
| Commercial loans | | | |
| Commercial other | 25 | 25 | — |
| Commercial real estate | 829 | 829 | 138 |
| Total commercial loans | 854 | 854 | 138 |
| Total individually evaluated impaired loans | $1,737 | $ 1,459 | $ 332 |

(1) Balances are reduced by amount guaranteed by the SBA of $27 thousand at December 31, 2017.

The following table presents 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 years ended December 31, 2018, 2017 and 2016. 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, therefore no interest income is recognized. The interest recognized on impaired loans noted below represents accruing troubled debt restructurings only and nominal amounts of income recognized on a cash basis for well-collateralized impaired loans.

| | For the years ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| (In thousands) | Average recorded investment | Interest income recognized on impaired loans | Average recorded investment | Interest income recognized on impaired loans | Average recorded investment | Interest income recognized on impaired loans |
| SBA loans held for investment (1) | $1,063 | $ 3 | $668 | $ 47 | $1,535 | $ 14 |
| Commercial loans | | | | | | |
| SBA 504 loans | — | — | 82 | — | 798 | — |
| Commercial other | 12 | — | 25 | — | 607 | 38 |
| Commercial real estate | 2,092 | 100 | 685 | 43 | 1,198 | 59 |
| Commercial real estate construction | — | — | — | — | 272 | — |
| Total | $3,167 | $ 103 | $1,460 | $ 90 | $ | |