UNITY BANCORP INC /NJ/
Form 10-Q
August 08, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from ____ to ____.

Commission File Number 1-12431

Unity Bancorp, Inc.
(Exact name of registrant as specified in its charter)

New Jersey	22-3282551
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
64 Old Highway 22, Clinton, NJ	08809
(Address of principal executive offices)	(Zip Code)

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

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

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

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

The number of shares outstanding of each of the registrant’s classes of common equity stock, as of July 31, 2016 common stock, no par value: 8,486,832 shares outstanding.

Table of Contents

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

PART I CONSOLIDATED FINANCIAL INFORMATION
ITEM 1 Consolidated Financial Statements (Unaudited)
Unity Bancorp, Inc.
Consolidated Balance Sheets
(Unaudited)

(In thousands)	June 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$20,169	$22,681
Federal funds sold and interest-bearing deposits	75,908	65,476
Cash and cash equivalents	96,077	88,157
Securities:		
Securities available for sale	45,266	52,865
Securities held to maturity (fair value of $29,333 and $18,607 respectively)	28,728	18,471
Total securities	73,994	71,336
Loans:		
SBA loans held for sale	13,245	13,114
SBA loans held for investment	40,006	39,393
SBA 504 loans	27,038	29,353
Commercial loans	481,713	465,518
Residential mortgage loans	268,774	264,523
Consumer loans	84,267	77,057
Total loans	915,043	888,958
Allowance for loan losses	(12,758)	(12,759)
Net loans	902,285	876,199
Premises and equipment, net	20,397	15,171
Bank owned life insurance ("BOLI")	13,568	13,381
Deferred tax assets	6,223	5,968
Federal Home Loan Bank ("FHLB") stock	5,092	4,600
Accrued interest receivable	3,953	3,884
Other real estate owned ("OREO")	1,702	1,591
Goodwill and other intangibles	1,516	1,516
Other assets	3,563	3,063
Total assets	$1,128,370	$1,084,866
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing demand	$210,024	$185,267
Interest-bearing demand	117,189	130,605
Savings	318,184	301,447
Time, under $100,000	144,394	134,468
Time, $100,000 and over, under $250,000	91,770	104,106
Time, $250,000 and over	30,637	38,600
Total deposits	912,198	894,493
Borrowed funds	114,000	92,000
Subordinated debentures	10,310	15,465
Accrued interest payable	368	461
Accrued expenses and other liabilities	6,527	3,977
Total liabilities	1,043,403	1,006,396

Commitments and contingencies		
Shareholders' equity:		
Common stock	59,844	59,371
Retained earnings	25,916	19,566
Accumulated other comprehensive (loss)	(793)	(467)
Total shareholders' equity	84,967	78,470
Total liabilities and shareholders' equity	$ 1,128,370	$ 1,084,866
Issued and outstanding common shares	8,487	8,436

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

3

Unity Bancorp, Inc.
Consolidated Statements of Income
(Unaudited)

(In thousands, except per share amounts)	For the three months ended June 30, 2016	2015	For the six months ended June 30, 2016	2015
INTEREST INCOME				
Federal funds sold and interest-bearing deposits	$41	$6	$85	$16
FHLB stock	55	38	107	81
Securities:				
Taxable	427	363	791	750
Tax-exempt	55	71	117	143
Total securities	482	434	908	893
Loans:				
SBA loans	788	605	1,509	1,284
SBA 504 loans	344	369	729	715
Commercial loans	5,860	5,276	11,538	10,342
Residential mortgage loans	2,937	2,716	5,878	5,298
Consumer loans	980	774	1,911	1,473
Total loans	10,909	9,740	21,565	19,112
Total interest income	11,487	10,218	22,665	20,102
INTEREST EXPENSE				
Interest-bearing demand deposits	124	103	261	209
Savings deposits	381	271	748	535
Time deposits	954	725	1,904	1,411
Borrowed funds and subordinated debentures	686	750	1,421	1,558
Total interest expense	2,145	1,849	4,334	3,713
Net interest income	9,342	8,369	18,331	16,389
Provision for loan losses	400	—	600	200
Net interest income after provision for loan losses	8,942	8,369	17,731	16,189
NONINTEREST INCOME				
Branch fee income	286	373	619	719
Service and loan fee income	267	466	522	762
Gain on sale of SBA loans held for sale, net	637	—	945	363
Gain on sale of mortgage loans, net	593	687	1,308	1,031
BOLI income	93	95	187	189
Net security gains	81	28	175	28
Gain on repurchase of subordinated debt	—	—	2,264	—
Other income	277	244	494	442
Total noninterest income	2,234	1,893	6,514	3,534
NONINTEREST EXPENSE				
Compensation and benefits	3,709	3,481	7,258	6,952
Occupancy	513	601	1,131	1,273
Processing and communications	600	614	1,198	1,210
Furniture and equipment	395	422	815	795
Professional services	239	242	494	478
Loan costs	59	160	257	382
OREO expenses	82	67	105	103

Deposit insurance	165	150	326	333
Advertising	303	343	544	525
Other expenses	663	572	1,210	1,103
Total noninterest expense	6,728	6,652	13,338	13,154
Income before provision for income taxes	4,448	3,610	10,907	6,569
Provision for income taxes	1,624	1,182	3,878	2,202
Net income	$2,824	$2,428	$7,029	$4,367
Net income per common share - Basic	$0.33	$0.29	$0.83	$0.52
Net income per common share - Diluted	$0.33	$0.28	$0.82	$0.51
Weighted average common shares outstanding - Basic	8,471	8,425	8,465	8,421
Weighted average common shares outstanding - Diluted	8,608	8,524	8,597	8,519

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

4

Unity Bancorp, Inc.
Consolidated Statements of Comprehensive Income
(Unaudited)

	For the three months ended					
	June 30, 2016			June 30, 2015		
(In thousands)	Before tax amount	Income tax expense (benefit)	Net of tax amount	Before tax amount	Income tax expense (benefit)	Net of tax amount
Net income	$4,448	$1,624	$2,824	$3,610	$1,182	$2,428
Other comprehensive income (loss)						
Investment securities available for sale:						
Unrealized holding gains (losses) on securities arising during the period	284	109	175	(201)	(80)	(121)
Less: reclassification adjustment for gains on securities included in net income	81	28	53	28	10	18
Total unrealized gains (losses) on securities available for sale	203	81	122	(229)	(90)	(139)
Adjustments related to defined benefit plan:						
Initial recognition of prior service cost	—	—	—	(830)	(332)	(498)
Amortization of prior service cost	21	7	14	42	17	25
Total adjustments related to defined benefit plan	21	7	14	(788)	(315)	(473)
Net unrealized (losses) from cash flow hedges:						
Unrealized holding loss on cash flow hedges arising during the period	(366)	(138)	(228)	—	—	—
Total unrealized loss on cash flow hedges	(366)	(138)	(228)	—	—	—
Total other comprehensive (loss)	(142)	(50)	(92)	(1,017)	(405)	(612)
Total comprehensive income	$4,306	$1,574	$2,732	$2,593	$777	$1,816

Unity Bancorp, Inc.
Consolidated Statements of Comprehensive Income
(Unaudited)

(In thousands)	For the six months ended June 30, 2016			June 30, 2015		
	Before tax amount	Income tax expense (benefit)	Net of tax amount	Before tax amount	Income tax expense (benefit)	Net of tax amount
Net income	$10,907	$3,878	$7,029	$6,569	$2,202	$4,367
Other comprehensive income (loss)						
Investment securities available for sale:						
Unrealized holding gains (losses) on securities arising during the period	436	164	272	(139)	(55)	(84)
Less: reclassification adjustment for gains on securities included in net income	175	61	114	28	10	18
Total unrealized gains (losses) on securities available for sale	261	103	158	(167)	(65)	(102)
Adjustments related to defined benefit plan:						
Initial recognition of prior service cost	—	—	—	(830)	(332)	(498)
Amortization of prior service cost	41	7	34	42	17	25
Total adjustments related to defined benefit plan	41	7	34	(788)	(315)	(473)
Net unrealized (losses) from cash flow hedges:						
Unrealized holding loss on cash flow hedges arising during the period	(858)	(340)	(518)	—	—	—
Total unrealized loss on cash flow hedges	(858)	(340)	(518)	—	—	—
Total other comprehensive income (loss)	(556)	(230)	(326)	(955)	(380)	(575)
Total comprehensive income	$10,351	$3,648	$6,703	$5,614	$1,822	$3,792

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

Consolidated Statements of Changes in Shareholders’ Equity
For the six months ended June 30, 2016 and 2015
(Unaudited)

(In thousands)	Common stock Shares	Common stock Amount	Retained earnings	Accumulated other comprehensive (loss)	Total shareholders' equity
Balance, December 31, 2015	8,436	$59,371	$19,566	$ (467)	$ 78,470
Net income			7,029		7,029
Other comprehensive loss, net of tax				(326)	(326)
Dividends on common stock ($0.08 per share)		48	(679)		(631)
Common stock issued and related tax effects (1)	51	425			425
Balance, June 30, 2016	8,487	$59,844	$25,916	$ (793)	$ 84,967

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

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

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

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

(In thousands)	For the six months ended June 30, 2016	2015
OPERATING ACTIVITIES:		
Net income	$7,029	$4,367
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	600	200
Net amortization of purchase premiums and discounts on securities	172	279
Depreciation and amortization	504	352
Deferred income tax expense	10	345
Net security gains	(175)	(28)
Gain on sale of subordinated debt	(2,264)	—
Stock compensation expense	271	226
(Loss) gain on sale of OREO	(44)	22
Gain on sale of mortgage loans held for sale, net	(783)	(911)
Gain on sale of SBA loans held for sale, net	(945)	(363)
Origination of mortgage loans held for sale	(51,052)	(42,184)
Origination of SBA loans held for sale	(11,174)	(9,866)
Proceeds from sale of mortgage loans held for sale, net	51,835	43,095
Proceeds from sale of SBA loans held for sale, net	11,563	3,829
BOLI income	(187)	(189)
Net change in other assets and liabilities	1,226	733
Net cash provided by (used in) financing activities	6,586	(93)
INVESTING ACTIVITIES		
Purchases of securities held to maturity	(11,109)	—
Purchases of securities available for sale	(4,249)	(1,002)
Purchases of FHLB stock, at cost	(3,012)	(9,570)
Maturities and principal payments on securities held to maturity	823	1,350
Maturities and principal payments on securities available for sale	5,547	4,414
Proceeds from sales of securities available for sale	6,594	528
Proceeds from redemption of FHLB stock	2,520	9,967
Proceeds from sale of OREO	1,518	1,044
Net increase in loans	(27,585)	(55,953)
Purchases of premises and equipment	(6,001)	(676)
Net cash used in investing activities	(34,954)	(49,898)
FINANCING ACTIVITIES		
Net increase in deposits	17,705	21,086
Proceeds from new borrowings	59,000	50,000
Repayments of borrowings	(37,000)	(60,000)
Repurchase of subordinated debentures	(2,891)	—
Proceeds from exercise of stock options	105	—
Dividends on common stock	(631)	(474)
Net cash provided by financing activities	36,288	10,612
Increase (decrease) in cash and cash equivalents	7,920	(39,379)
Cash and cash equivalents, beginning of period	88,157	129,821
Cash and cash equivalents, end of period	$96,077	$90,442

8

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

	For the six months ended June 30,	
(In thousands)	2016	2015
SUPPLEMENTAL DISCLOSURES		
Cash:		
Interest paid	$4,427	$3,767
Income taxes paid	3,112	1,868
Noncash investing activities:		
Capitalization of servicing rights	835	240
Transfer of loans to OREO	1,473	2,194

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

Unity Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
June 30, 2016

NOTE 1. Significant Accounting Policies

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

The interim unaudited Consolidated Financial Statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission ("SEC") and consist of normal recurring adjustments necessary for the fair presentation of interim results. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, "we" and "us" and "our" refer to Unity Bancorp, Inc., and its consolidated subsidiary, Unity Bank, depending on the context. Certain information and financial disclosures required by U.S. generally accepted accounting principles have been condensed or omitted from interim reporting pursuant to SEC rules. Interim financial statements should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Stock Transactions

Stock Option Plans
The Company has incentive and nonqualified option plans, which allow for the grant of options to officers, employees and members of the Board of Directors. Transactions under the Company's stock option plans for the six months ended June 30, 2016 are summarized in the following table:

	Shares	Weighted average exercise price	Weighted average remaining contractual life in years	Aggregate intrinsic value
Outstanding at December 31, 2015	475,396	$ 7.09	5.1	$2,562,175
Options granted	89,000	11.06		

Options exercised	(18,525)	5.65		
Options forfeited	—	—		
Options expired	—	—		
Outstanding at June 30, 2016	545,871	$ 7.79	5.4	$2,685,821
Exercisable at June 30, 2016	392,042	$ 6.81	3.9	$2,312,616

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of June 30, 2016, 1,920,529 shares have been reserved for issuance upon the exercise of options, 545,871 option grants are outstanding, and 1,271,073 option grants have been exercised, forfeited or expired, leaving 103,585 shares available for grant.

The fair values of the options granted during the three and six months ended June 30, 2016 and 2015 were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Number of options granted	—	—	89,000	40,000
Weighted average exercise price	$ —	$ —	$ 11.06	$ 9.12
Weighted average fair value of options	$ —	$ —	$ 3.50	$ 3.82
Expected life in years (1)	0.00	0.00	6.85	6.69
Expected volatility (2)	—%	— %	31.91 %	46.76 %
Risk-free interest rate (3)	—%	— %	1.79 %	1.80 %
Dividend yield (4)	—%	— %	1.44 %	1.33 %

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

Upon exercise, the Company issues shares from its authorized but unissued common stock to satisfy the options. The following table presents information about options exercised during the three and six months ended June 30, 2016 and 2015:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Number of options exercised	18,525	—	18,525	—
Total intrinsic value of options exercised	$ 116,992	—	$ 116,992	—
Cash received from options exercised	—	—	—	—
Tax deduction realized from options	—	—	—	—

The following table summarizes information about stock options outstanding and exercisable at June 30, 2016:

	Options outstanding			Options exercisable	
Range of exercise prices	Options outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Options exercisable	Weighted average exercise price
$ 0.00 - 4.00	87,000	2.7	$ 3.85	87,000	$ 3.85
4.01 - 8.00	265,425	4.9	6.79	247,593	6.71
8.01 - 12.00	102,551	9.1	9.71	15,554	9.32
12.01 - 16.00	90,895	5.4	12.32	41,895	12.62
Total	545,871	5.4	$ 7.79	392,042	$ 6.81

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 718, "Compensation - Stock Compensation," requires an entity to recognize the fair value of equity awards as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period). Compensation expense related to stock options and the related income tax benefit for the three and six months ended June 30, 2016 and 2015 are detailed in the following table:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Compensation expense	$57,765	$39,072	$113,748	$68,990
Income tax benefit	23,684	15,605	46,466	27,555

As of June 30, 2016, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company's stock option plans totaled approximately $430 thousand. That cost is expected to be recognized over a weighted average period of 2.2 years.

Restricted Stock Awards

Restricted stock is issued under the stock bonus program to reward employees and directors and to retain them by distributing stock over a period of time. The following table summarizes nonvested restricted stock activity for the six months ended June 30, 2016:

	Shares	Average grant date fair value
Nonvested restricted stock at December 31, 2015	80,800	$ 8.50
Granted	30,350	11.21
Cancelled	(2,000)	5.35
Vested	(14,950)	8.26
Nonvested restricted stock at June 30, 2016	94,200	$ 9.48

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value at the time of grant and amortized into salary expense on a straight line basis over the vesting period. As of June 30, 2016, 471,551 shares of restricted stock were reserved for issuance, of which 146,350 shares are available for grant.

Restricted stock awards granted during the three and six months ended June 30, 2016 and 2015 were as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Number of shares granted	—	—	30,350	34,800
Average grant date fair value	$ —	$ —	$11.21	$ 9.27

Compensation expense related to restricted stock for the three and six months ended June 30, 2016 and 2015 is detailed in the following table:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Compensation expense	$81,110	$79,961	$157,229	$157,510
Income tax benefit	32,545	31,937	64,230	62,909

As of June 30, 2016, there was approximately $716 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.7 years.

401(k) Savings Plan

The Bank has a 401(k) savings plan covering substantially all employees. Under the Plan, an employee can contribute up to 80 percent of their salary on a tax deferred basis. The Bank may also make discretionary contributions to the Plan. The Bank contributed $179 thousand and $145 thousand to the Plan during the six months ended June 30, 2016 and 2015, and $90 thousand and $69 thousand during the three months ended June 30, 2016 and 2015, respectively.

Deferred Fee Plan

The Company has a deferred fee plan for Directors and executive management. Directors of the Company have the option to elect to defer up to 100 percent of their respective retainer and Board of Director fees, and each member of executive management has the option to elect to defer 100 percent of their year end cash bonuses. Director and executive deferred fees totaled $31.6 thousand and $26.3 thousand during the six months ended June 30, 2016 and 2015, and $4.9 thousand and $5.4 thousand during the three months ended June 30, 2016 and 2015, respectively. The interest paid on the deferred balances totaled $14.9 thousand and $12.8 thousand during the six months ended June 30, 2016 and 2015, and $7.6 thousand and $6.5 thousand during the three months ended June 30, 2016 and 2015, respectively. No fees were distributed in 2016 and 2015, respectively.

Benefit Plans

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

On June 4, 2015, the Company approved the Supplemental Executive Retirement Plan ("SERP") pursuant to which the President and CEO is entitled to receive certain supplemental nonqualified retirement benefits. Upon separation from service after age 66, the President and CEO will be entitled to an annual benefit in the amount of $156 thousand, payable in fifteen annual installments subject to annual 2% increases. The future payments are estimated to total $2.7 million. A discount rate of 3.84% was used to calculate the present value of the benefit obligation.

The President and CEO commenced vesting to this retirement benefit on January 1, 2014, and vests an additional 3% each year until fully vested on January 1, 2024. In the event that the President and CEO's separation from service from the company were to occur prior to full vesting, the President and CEO would be entitled to and shall be paid the vested portion of the retirement benefit calculated as of the date of separation from service. Notwithstanding the foregoing, upon a Change in Control, and provided that within 6 months following the Change in Control the President and CEO is involuntarily terminated for reasons other than "cause" or the President and CEO resigns for "good reason", as such is defined in the SERP, or the President and CEO voluntarily terminates his employment after being offered continued employment in a position that is not a "Comparable Position", as such is also defined in the SERP, the President and CEO shall become 100% vested in the full retirement benefit.

No contributions or payments have been made during the three and six months ended June 30, 2016. The following table summarizes the components of the net periodic pension cost of the defined benefit plan recognized during the three and six months ended June 30, 2016:

(In thousands)	For the three months ended June 30, 2016	For the six months ended June 30, 2016
Service cost	$ 16	$ 31
Interest cost	9	19
Amortization of prior service cost	21	41
Net periodic benefit cost	$ 46	$ 91

The following table summarizes the changes in benefit obligations of the defined benefit plan during the six months ended June 30, 2016:

(In thousands)	For the six months ended

	June 30, 2016
Benefit obligation, beginning of year	$ 923
Service cost	31
Interest cost	19
Actuarial gain (loss)	—
Benefit obligation, end of period	$ 973

On October 22, 2015, the Company entered into an Executive Incentive Retirement Plan (the “Plan”) with certain key executive officers. The Plan has an effective date of January 1, 2015.

13

The Plan is an unfunded, nonqualified deferred compensation plan. For any Plan Year, a guaranteed annual Deferral Award percentage of seven and one half percent (7.5%) of the participant's annual base salary will be credited to each Participant's Deferred Benefit Account. A discretionary annual Deferral Award equal to seven and one half percent (7.5%) of the participant's annual base salary may be credited to the Participant's account in addition to the guaranteed Deferral Award, if the Bank exceeds the benchmarks set forth in the Annual Executive Bonus Matrix. The total Deferral Award shall never exceed fifteen percent (15%) for any given Plan Year. Each Participant shall be one hundred percent 100% vested in all Deferral Awards as of the date they are awarded.

As of June 30, 2016, the Company had total year to date expenses of $30 thousand related to the Plan. The Plan is reflected on the Company's balance sheet as accrued expenses.

Certain members of management are also enrolled in a split-dollar life insurance plan with a post retirement death benefit of $250 thousand. Total expenses related to this plan were $1 thousand and 2 thousand for the three and six months ended June 30, 2016 and 2015, respectively.

Other-Than-Temporary Impairment

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

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

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

Transfers of Financial Assets

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

Loans

Loans Held for Sale
Loans held for sale represent the guaranteed portion of Small Business Administration (“SBA”) loans and are reflected at the lower of aggregate cost or market value. The Company originates loans to customers under an SBA program that historically has provided for SBA guarantees of up to 90 percent of each loan. The Company generally sells the guaranteed portion of its SBA loans to a third party and retains the servicing, holding the nonguaranteed portion in its portfolio. The net amount of loan origination fees on loans sold is included in the carrying value and in the gain or loss on the sale. When sales of SBA loans do occur, the premium received on the sale and the present value of future cash flows of the servicing assets are recognized in income. All criteria for sale accounting must be met in order for the loan sales to occur; see details under the “Transfers of Financial Assets” heading above.

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

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

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

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

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

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

Troubled debt restructurings ("TDRs") occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider. These concessions typically include reductions in interest rate, extending the maturity of a loan, or a combination of both. Interest income on accruing TDRs is credited to operations primarily based upon the principal amount outstanding, as stated in the paragraphs above.

The Company evaluates its loans for impairment. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company has defined impaired loans to be all TDRs and nonperforming loans individually evaluated for impairment. Impairment is evaluated in total for smaller-balance loans of a similar nature (consumer and residential mortgage loans), and on an individual basis for all other loans. Impairment of a loan is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or as a practical expedient, based on a loan’s observable market price or the fair value of collateral, net of estimated costs to sell, if the loan is collateral-dependent. If the value of the impaired loan is less than the recorded investment in the loan, the Company establishes a valuation allowance, or adjusts existing valuation allowances, with a corresponding charge to the provision for loan losses.

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

Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

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

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

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

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

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

Income Taxes

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

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

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

NOTE 2. Litigation

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

NOTE 3. Net Income per Share

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

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

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

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands, except per share amounts)	2016	2015	2016	2015
Net income	$2,824	$2,428	$7,029	$4,367
Weighted average common shares outstanding - Basic	8,471	8,425	8,465	8,421
Plus: Potential dilutive common stock equivalents	137	99	132	98
Weighted average common shares outstanding - Diluted	8,608	8,524	8,597	8,519
Net income per common share - Basic	$0.33	$0.29	$0.83	$0.52
Net income per common share - Diluted	0.33	0.28	0.82	0.51
Stock options and common stock excluded from the income per share calculation as their effect would have been anti-dilutive	153	141	170	127

NOTE 4. Income Taxes

The Company follows FASB ASC Topic 740, “Income Taxes,” which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes.

For the quarter ended June 30, 2016, the Company reported income tax expense of $1.6 million for an effective tax rate of 36.5 percent, compared to an income tax expense of $1.2 million and an effective tax rate of 32.7 percent for the prior year’s quarter. For the six months ended June 30, 2016, the Company reported income tax expense of $3.9 million for an effective tax rate of 35.6 percent, compared to an income tax expense of $2.2 million and an effective tax rate of 33.5 percent for the six months ended June 30, 2015. The Company did not recognize or accrue any interest or penalties related to income taxes during the three or six months ended June 30, 2016 or 2015. The Company did not have an accrual for uncertain tax positions as of June 30, 2016 or December 31, 2015, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2011 and thereafter are subject to future examination by tax authorities.

NOTE 5. Other Comprehensive (Loss) Income [(a)]

The following tables show the changes in other comprehensive (loss) income for the three and six months ended June 30, 2016 and 2015, net of tax:

	For the three months ended June 30,						
	2016				2015		
(In thousands)	Net unrealized gains on securities	Adjustments related to defined benefit plan	Net unrealized losses from cash flow hedges	Accumulated other comprehensive loss	Net unrealized gains (losses) on securities	Adjustments related to defined benefit plan	Accumulated other comprehensive income (loss)
Balance at March 31,	$34	$ (428)	$ (307)	$ (701)	$180	$ —	$ 180
Other comprehensive (loss) income before reclassification	175	—	(228)	(53)	(121)	(498)	(619)
Less amounts reclassified from accumulated other comprehensive loss	53	(14)	—	39	18	(25)	(7)
Period change	122	14	(228)	(92)	(139)	(473)	(612)
Balance at June 30,	$156	$ (414)	$ (535)				