

LAKE SHORE BANCORP, INC.
Form 10-K
March 27, 2015

United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

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

Commission File No.: 000-51821

Lake Shore Bancorp, Inc.

(Exact Name of Registrant as Specified in Its Charter)

United States
(State or Other Jurisdiction of Incorporation or Organization) 20-4729288
(I.R.S. Employer Identification No.)

31 East Fourth Street, Dunkirk, NY 14048

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(Address of Principal Executive Offices, including zip code)

(716) 366-4070

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: Common Stock, \$0.01 par value per share

Name of each exchange on which registered: The NASDAQ Stock Market, LLC

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

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

Yes No

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

Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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.

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company) Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2014 was \$22,083,847 based on the per share closing price as of June 30, 2014 on the Nasdaq Global Market for the registrant's common stock, which was \$12.45.

There were 5,995,439 shares of the registrant's common stock, \$.01 par value per share, outstanding at March 23, 2015.

DOCUMENTS INCORPORATED BY REFERENCE:

	Part of 10-K
Portions of the registrant's Proxy Statement for the 2015 Annual Meeting of Stockholders	where incorporated III

LAKE SHORE BANCORP, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2014

TABLE OF CONTENTS

ITEM	<u>PART I</u>	PAGE
1	<u>BUSINESS</u>	1
1A	<u>RISK FACTORS</u>	33
1B	<u>UNRESOLVED STAFF COMMENTS</u>	40
2	<u>PROPERTIES</u>	41
3	<u>LEGAL PROCEEDINGS</u>	42
4	<u>MINE SAFETY DISCLOSURES</u>	42
 <u>PART II</u>		
5	<u>MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	42
6	<u>SELECTED FINANCIAL DATA</u>	44
7	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	46
7A	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	60
8	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	60
9	<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	60
9A	<u>CONTROLS AND PROCEDURES</u>	60
9B	<u>OTHER INFORMATION</u>	61
 <u>PART III</u>		
10	<u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	61
11	<u>EXECUTIVE COMPENSATION</u>	61
12	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	61
13	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	61
14	<u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	61
 <u>PART IV</u>		
15	<u>EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	62
	<u>SIGNATURES</u>	65

PART I

Item 1. Business.

General

Lake Shore Bancorp, Inc. (“Lake Shore Bancorp,” the “Company,” “us,” or “we”) operates as a mid-tier, federally chartered savings and loan holding company of Lake Shore Savings Bank (“Lake Shore Savings” or the “Bank”). A majority of Lake Shore Bancorp’s issued and outstanding common stock (60.7% as of December 31, 2014) is held by Lake Shore, MHC (the “MHC”), a federally chartered mutual holding company, which serves as the parent company to Lake Shore Bancorp. The MHC does not engage in any business activity other than its investment in a majority of the common stock of Lake Shore Bancorp. The Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) is the regulator for the MHC. Federal law and regulations require that as long as the MHC is in existence, it must own at least a majority of Lake Shore Bancorp’s common stock. The remaining common shares of Lake Shore Bancorp are owned by public stockholders and the Lake Shore Savings Bank Employee Stock Ownership Plan (“ESOP”). Our common stock is traded on the Nasdaq Global Market under the symbol “LSBK”. Unless the context otherwise requires, all references herein to Lake Shore Bancorp or Lake Shore Savings include Lake Shore Bancorp and Lake Shore Savings on a consolidated basis.

Lake Shore Bancorp, Inc. was organized in 2006 for the purpose of acting as the savings and loan holding company of Lake Shore Savings Bank in connection with the Company’s initial public stock offering. The Company, a federal corporation, is regulated by the Federal Reserve Board. At December 31, 2014, Lake Shore Bancorp had total consolidated assets of \$487.5 million, of which \$284.9 million was comprised of loans receivable, net and \$138.2 million was comprised of available for sale securities. At December 31, 2014, total consolidated deposits were \$386.9 million and total consolidated stockholders’ equity was \$71.6 million.

Lake Shore Savings Bank was chartered as a New York savings and loan association in 1891. In 2006, the Bank converted from a New York-chartered mutual savings and loan association to a federal savings bank charter. The Bank is subject to the supervision and regulation of the Office of the Comptroller of the Currency (“OCC”).

For over 123 years, the Bank has served the local community of Dunkirk, New York. In 1987, we opened our second office in Fredonia, New York. Since 1993, we have expanded to eleven branch offices. In addition, we have added three administrative office buildings which comprise our corporate headquarters in Dunkirk, New York. Our principal business consists of (1) attracting retail deposits from the general public in the areas surrounding our corporate headquarters and main branch office in Dunkirk, New York and ten other branch offices in Chautauqua and Erie Counties, New York and (2) investing those deposits, together with funds generated from operations, primarily in one-to four-family residential mortgage loans, commercial real estate loans, home equity lines of credit and, to a lesser extent, commercial business loans, consumer loans, and investment securities. Our revenues are principally derived from interest generated from our loans and interest earned and dividends received on our investment securities. Our primary sources of funds for lending and investments are deposits, borrowings, payments of loan principal and interest, payments on mortgage-backed and asset-backed securities, maturities and calls of investment securities and income resulting from operations in prior periods.

Available Information

Lake Shore Bancorp's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are made available free of charge on our website, www.lakeshoresavings.com, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. Such reports are also available on the Securities and Exchange Commission's website at www.sec.gov. Information on our website shall not be considered a part of this Form 10-K.

1

Market Area

Our operations are conducted out of our corporate headquarters and main branch office in Dunkirk, New York and ten other branch offices. Our branches in Chautauqua County, New York are located in Dunkirk, Fredonia, Jamestown, Lakewood and Westfield. In Erie County, New York our branch offices are located in Depew, East Amherst, Hamburg, Kenmore, Orchard Park, and Snyder. Our first branch office in Erie County opened during April 2003 and the most recent branch office opened in April 2014. We also have seven stand-alone ATMs. The opening of six branch offices in Erie County, New York since 2003 demonstrates the implementation of our growth strategy which is focused on expansion within Erie County while preserving our market share in Chautauqua County.

Our geographic market area for loans and deposits is principally located within Chautauqua and Erie Counties, New York. Chautauqua County is located on Lake Erie in the western portion of New York and is approximately 45 miles from Buffalo, New York. Chautauqua County is served by four accredited hospitals and offers higher education opportunities at the State University of New York (SUNY) at Fredonia, a four year liberal arts school, and at SUNY Jamestown, a community college. Chautauqua County features tourist areas near Chautauqua Lake, but it also hosts a broad diversity of industry, commercial establishments and financial institutions as well as a skilled and productive workforce. Jamestown, New York, where we opened the first of two branch offices in 1996, is the most populous city in Chautauqua County.

Erie County is a metropolitan center located on the western border of New York. Located within Erie County is the city of Buffalo, the second largest city in the State of New York. As the city of Buffalo has redeveloped, so too have its suburbs throughout Erie County, which also host the Buffalo Niagara International Airport in Cheektowaga, New York and professional sports franchises. One of the main commercial thorough-fares in Erie County is Transit Road, which has experienced robust development in recent years and is the location of one of our branch offices.

The demographic characteristics of our market area are less attractive than national and state measures. Both Chautauqua and Erie Counties exhibit slower rates of population growth when compared to the United States and New York State averages. In addition, both Chautauqua and Erie Counties have lower per capita income and slower growth in per capita income when compared to the United States and the New York State averages. Since Chautauqua County has historically exhibited less attractive demographic characteristics, we may have limited growth opportunities in Chautauqua County. However, Erie County displays a stronger housing market than Chautauqua County and Erie County's population base is five times larger than Chautauqua County, which offers us an expanded source of new customers in the form of deposit and lending opportunities. Notwithstanding these demographic characteristics, our primary market area has historically been stable, with a diversified base of employers and employment sectors. The local economies that we serve are not dependent on one key employer. Transportation equipment is the largest manufacturing industry in the Buffalo area, as well as production of automobile component parts. The principal employment sectors are service-related, wholesale and retail trade, and durable-goods manufacturing. Most of the job opportunities in Chautauqua and Erie Counties have been in service-related industries, and service jobs now account for the largest portion of the workforce.

The challenging economic conditions that affected the national and global financial markets in 2007 and 2008 did not have a significant effect on the housing prices in our market area. Furthermore, unemployment rates in our market area have decreased since December 2012 from 8.4% to 5.5% in Erie County and from 8.9% to 6.4% in Chautauqua County as of December 31, 2014. New York State's unemployment rate as of December 31, 2014 was 5.8%, the lowest level since September 2008.

Our future growth will be influenced by the strength of our regional economy, other demographic trends and the competitive environment. We believe that we have developed lending products and marketing strategies to address the credit-related needs of the residents and small businesses in our local market area.

2

New York State currently has several incentive programs for businesses to invest in the Western New York region. One example is the “Start-Up NY” program, which offers tax incentives to start, expand or relocate a qualified business to a tax-free areas within the state, primarily near a university or community college campus, in order to access top talent and research facilities. Qualified businesses for this program include advance materials & manufacturing, biotech & life sciences, tech & electronics, and optics & imaging. This program has generated significant interest in Western New York for new business development, due to its proximity to Canada, history of being a strong industrial and manufacturing center, and number of quality colleges and universities in the area.

Furthermore, the Erie County region and the City of Buffalo have recently experienced economic expansion led by major growth in the health care and education sectors, and a resurgence in the central business district, which has led to an influx of private investment in development of hotels and housing in the downtown sector. Major construction projects are currently underway on the waterfront and at the Buffalo Niagara Medical Campus. The Buffalo Niagara Medical Campus has grown significantly with the construction of a new children’s hospital, expansion of an existing cancer/research hospital and construction of a new medical school by the State University of New York at Buffalo. Development on the waterfront has centered around redevelopment of property for mixed use, including public access and private development that includes office space, ice rinks, a hotel and restaurants. The economic development within the region also impacts the small business and middle-market customers that we focus on and we believe we will be able to capitalize on opportunities created by economic growth in this section of our market area.

Competition

We face intense competition both in making loans and attracting deposits. New York State has a high concentration of financial institutions, many of which are branches of large money centers and regional banks which have resulted from the consolidation of the banking industry in New York and surrounding states. Some of these competitors have greater resources than we do and may offer services that we do not provide. For example, we do not offer trust or investment services. Customers who seek “one stop shopping” may be drawn to our competitors who offer such services.

Our competition for loans comes principally from commercial banks, savings banks, mortgage banking companies, credit unions, and other financial service companies. The most direct competition for deposits has historically come from credit unions, commercial banks and savings banks. Specifically, we compete with local financial institutions such as Cattaraugus County Bank and Evans Bank; regional financial institutions such as M&T Bank, Community Bank, NA, and First Niagara Bank; and national financial institutions such as Key Bank and Bank of America. We are significantly smaller than many of these financial institution competitors. We face additional competition for deposits from non-depository competitors such as mutual funds, securities and brokerage firms and insurance companies. We remain very competitive in Chautauqua County, New York and as of June 30, 2014 we had 14.9% of total deposits and ranked 4th out of 11 banks in this market area, according to the Federal Deposit Insurance Corporation (“FDIC”) annual deposit market share report. Our deposit market share in Erie County, New York has steadily increased since we entered this market area in 2003. To remain competitive, we provide superior customer service and are active participants in our local community.

Lending Activities

General. Historically, as a thrift institution, we have primarily originated residential mortgage loans, including home equity loans. In recent years, we have become more focused on originating commercial real estate and commercial business loans to add adjustable rate loans to our portfolio and diversify the risk on our balance sheet, limit interest rate risk and to position ourselves for a rising interest rate environment. At December 31, 2014 we had total gross loans of \$283.8 million. Typically, we retain the loans that we originate. However, we have occasionally sold residential mortgage loans into the secondary market, with retention of servicing rights. In the fourth quarter of 2014,

we began to sell fixed rate, long-term residential mortgage loans with low yields (primarily sold loans with interest rates below 5% and maturities of 30 years) at the time of origination, with servicing retained, in an effort to manage interest rate risk and we plan to continue this

3

practice in the near future. We also purchase a limited number of equipment loans from a third party broker, which are secured by first liens on the new equipment purchases by small businesses located throughout the Northeastern United States.

The interest rates we offer for loans are affected principally by the demand for loans, the supply of money available for lending purposes and the interest rates offered by our competitors. These factors, in turn, are affected by general and local economic conditions and monetary policies of the federal government, including the Federal Reserve Board.

Loan Portfolio. The following table sets forth the composition of our loan portfolio, by type of loan, in dollar amounts and in percentages at the dates indicated. We did not have any loans held for sale as of these dates.

	At December 31, 2014		2013		2012		2011		2010	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)									
Real Estate loans:										
Residential one- to four- family	\$ 167,840	59.14%	\$ 170,793	61.81%						