Lake Shore Bancorp, Inc.
Form 10-Q
November 14, 2011

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 September 30, 2011

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

Commission file number: 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 Number)
31 East Fourth Street, Dunkirk, New York (Address of principal executive offices)	14048 (Zip code)

(716) 366-4070
(Registrant’s telephone number, including area code)

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, and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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 x No o

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.

Large accelerated filer ¨	Accelerated filer ¨
	Smaller reporting company x

Non-accelerated file ¨ (Do not check if a 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 o No x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practical date:

Common stock ($0.01 par value) 5,939,132 shares outstanding as of November 1, 2011.

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PART I

Item 1. Financial Statements
LAKE SHORE BANCORP, INC. and SUBSIDIARY
Consolidated Statements of Financial Condition

	September 30, 2011	December 31, 2010
	(Unaudited)	
	(Dollars in thousands, except per share information)	
Assets		
Cash and due from banks	$ 8,991	$ 6,457
Interest earning deposits	14,265	16,351
Federal funds sold	6,349	10,706
Cash and Cash Equivalents	29,605	33,514
Securities available for sale	161,789	153,924
Federal Home Loan Bank stock, at cost	2,269	2,401
Loans receivable, net of allowance for loan losses 2011 $1,212; 2010 $953	275,827	263,031
Premises and equipment, net	8,645	8,966
Accrued interest receivable	2,103	1,801
Bank owned life insurance	11,313	11,119
Other assets	2,285	4,291
Total Assets	$ 493,836	$ 479,047
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 350,302	$ 352,799
Non-interest bearing	33,481	22,986
Total Deposits	383,783	375,785
Short-term borrowings	4,650	5,000
Long-term debt	30,590	34,160
Advances from borrowers for taxes and insurance	1,718	3,027
Other liabilities	10,054	5,865
Total Liabilities	430,795	423,837
Commitments and Contingencies	—	—
Stockholders' Equity		

Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,612,500 shares issued and 5,939,132 shares outstanding at September 30, 2011 and 6,612,500 shares issued and 5,957,082 shares outstanding at December 31, 2010	66	66
Additional paid-in capital	27,971	27,920
Treasury stock, at cost (673,368 shares at September 30, 2011 and 655,418 shares at December 31, 2010)	(6,260)	(6,091)
Unearned shares held by ESOP	(2,068)	(2,132)
Unearned shares held by RRP	(644)	(757)
Retained earnings	39,317	36,737
Accumulated other comprehensive income (loss)	4,659	(533)
Total Stockholders' Equity	63,041	55,210
Total Liabilities and Stockholders' Equity	$ 493,836	$ 479,047

See notes to consolidated financial statements.

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(Unaudited) (Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$3,657	$3,415	$10,742	$10,470
Investment securities, taxable	1,086	1,173	3,367	3,464
Investment securities, tax exempt	460	340	1,425	918
Other	9	18	29	40
Total Interest Income	5,212	4,946	15,563	14,892
Interest Expense				
Deposits	1,124	1,197	3,483	3,536
Short-term borrowings	4	3	19	14
Long-term debt	229	375	715	1,104
Other	27	29	83	86
Total Interest Expense	1,384	1,604	4,300	4,740
Net Interest Income	3,828	3,342	11,263	10,152
Provision for loan losses	10	1,725	295	1,975
Net Interest Income after Provision for Loan Losses	3,818	1,617	10,968	8,177
Non-interest income				
Service charges and fees	433	466	1,281	1,412
Earnings on bank owned life insurance	65	75	194	204
Gain on sale of securities available for sale	—	1,057	31	1,057
Recovery on previously impaired investment securities	—	—	57	—
Other	30	34	90	86
Total Non-Interest Income	528	1,632	1,653	2,759
Non-interest expenses				
Salaries and employee benefits	1,444	1,505	4,382	4,595
Occupancy and equipment	449	418	1,344	1,228
Professional services	274	260	851	791
Data processing	144	147	426	422
Advertising	129	82	382	349
FDIC Insurance	15	130	264	373
Postage and Supplies	54	62	187	210
Other	269	232	777	731
Total Non-Interest Expenses	2,778	2,836	8,613	8,699

Income before Income Taxes	1,568	413	4,008	2,237
Income taxes expense (Benefit)	412	(365)	915	89
Net Income	$1,156	$778	$3,093	$2,148
Basic and diluted earnings per common share	$0.20	$0.13	$0.54	$0.37
Dividends declared per share	$0.07	$0.06	$0.21	$0.18

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Nine Months Ended September 30, 2011 and 2010 (unaudited)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by RRP	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(Dollars in thousands, except share and per share data)							
Balance – January 1, 2010	$66	$ 27,838	$(4,467)	$(2,217)	$(987)	$34,224	$ 989	$55,446
Comprehensive income:								
Net income	—	—	—	—	—	2,148	—	2,148
Other comprehensive income	—	—	—	—	—	—	1,745	1,745
Total Comprehensive Income								3,893
ESOP shares earned (5,951 shares)	—	(16)	—	64	—	—	—	48
Stock based compensation	—	111	—	—	—	—	—	111
RRP shares earned (12,842 shares)	—	(34)	—	—	172	—	—	138
Purchase of treasury stock, at cost (160,380 shares)	—	—	(1,297)	—	—	—	—	(1,297)
Cash dividends declared ($0.18 per share)	—	—	—	—	—	(452)	—	(452)
Balance – September 30, 2010	$66	$ 27,899	$(5,764)	$(2,153)	$(815)	$35,920	$ 2,734	$57,887
Balance – January 1, 2011	$66	$ 27,920	$(6,091)	$(2,132)	$(757)	$36,737	$ (533)	$55,210
Comprehensive income:								
Net income	—	—	—	—	—	3,093	—	3,093
Other comprehensive income	—	—	—	—	—	—	5,192	5,192
Total Comprehensive income								8,285
ESOP shares earned (5,952 shares)	—	(3)	—	64	—	—	—	61
Stock based compensation	—	80	—	—	—	—	—	80

RRP shares earned (8,446 shares)	—	(26)	—	—	113	—	—	87
Purchase of treasury stock, at cost (17,950 shares)	—	—	(169)	—	—	—	—	(169)
Cash dividends declared ($0.21 per share)	—	—	—	—	—	(513)	—	(513)
Balance – September 30, 2011	$66	$ 27,971	$(6,260)	$(2,068)	$(644)	$39,317	$ 4,659	$63,041

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS of CASH FLOWS

	Nine Months Ended September 30 2011	2010
	(Unaudited) (Dollars in thousands)	
Cash Flows from Operating Activities		
Net Income	$ 3,093	$ 2,148
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization (accretion) of investment securities	74	(25)
Amortization of deferred loan costs	374	363
Provision for loan losses	295	1,975
Recovery on previously impaired investment securities	(57)	—
Gain on sale of investment securities	(31)	(1,057)
Originations of loans held for sale	(487)	(243)
Proceeds from sales of loans held for sale	487	243
Depreciation and amortization	495	441
Increase in bank owned life insurance, net	(194)	(204)
ESOP shares committed to be released	61	48
Stock based compensation expense	167	249
Increase in accrued interest receivable	(302)	(100)
Decrease (increase) in other assets	806	(665)
Increase in other liabilities	181	217
Net Cash Provided by Operating Activities	4,962	3,390
Cash Flows from Investing Activities		
Activity in available for sale securities:		
Sales	4,673	10,776
Maturities, prepayments and calls	16,676	22,203
Purchases	(18,666)	(55,971)
Purchases of Federal Home Loan Bank Stock	(51)	(354)
Redemptions of Federal Home Loan Bank Stock	183	261
Loan origination and principal collections, net	(13,602)	(229)
Additions to premises and equipment	(171)	(1,302)
Net Cash Used in Investing Activities	(10,958)	(24,616)
Cash Flows from Financing Activities		
Net increase in deposits	7,998	45,424
Net decrease in advances from borrowers for taxes and insurance	(1,309)	(1,427)
Net decrease in short-term borrowings	(350)	(4,500)
Proceeds from issuance of long-term debt	4,100	9,300
Repayment of long-term debt	(7,670)	(3,600)
Purchase of Treasury Stock	(169)	(1,297)
Cash dividends paid	(513)	(452)

Net Cash Provided by Financing Activities		2,087			43,448
Net Increase (Decrease) in Cash and Cash Equivalents		(3,909	)		22,222
Cash and Cash Equivalents – Beginning		33,514			22,064
Cash and Cash Equivalents – Ending	$	29,605		$	44,286
Supplementary Cash Flows Information					
Interest paid	$	4,338		$	4,730
Income taxes paid	$	876		$	1,189
Supplementary Schedule of Noncash Investing and Financing Activities					
Foreclosed real estate acquired in settlement of loans	$	145		$	228
Securities purchased and not settled	$	2,065		$	2,010

See notes to consolidated financial statements.

LAKE SHORE BANCORP, INC. and Subsidiary
Notes to Consolidated Financial Statements (unaudited)

NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Lake Shore Bancorp, Inc. (the "Company") was formed on April 3, 2006 to serve as the stock holding company for Lake Shore Savings Bank ("the Bank") as part of the Bank's conversion and reorganization from a New York-chartered mutual savings and loan association to the federal mutual holding form of organization.

The interim consolidated financial statements include the accounts of the Company and the Bank, its wholly owned subsidiary. All intercompany accounts and transactions of the consolidated subsidiary have been eliminated in consolidation.

The interim financial statements included herein as of September 30, 2011 and for the three and nine months ended September 30, 2011 and 2010 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and therefore, do not include all information or footnotes necessary for a complete presentation of the consolidated statements of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The consolidated balance sheet at December 31, 2010 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information and to make the financial statements not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the audited consolidated financial statements included in the Company's Form 10-K for the year ended December 31, 2010. The consolidated results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2011.

To prepare these consolidated financial statements in conformity with GAAP, management of the Company made a number of estimates and assumptions relating to the reporting of assets and liabilities and the reporting of revenue and expenses. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, securities valuation estimates, evaluation of impairment of securities and income taxes.

The Company has evaluated events and transactions occurring subsequent to the balance sheet as of September 30, 2011 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

NOTE 2 – NEW ACCOUNTING STANDARDS

The Company adopted the section of FASB Accounting Standards Update ("ASU") 2010-20 "Receivables" ("Subtopic 310"): "Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" ("ASU 2010-20") as it relates to troubled debt restructurings, effective September 30, 2011. The adoption of ASU 2010-20, as it relates to troubled debt restructurings, did not have a material impact on the Company's consolidated financial condition or results of operations.

The Company adopted FASB ASU 2011-02, "Receivables ("Subtopic 310"): "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring" ("ASU 2011-02") effective September 30, 2011. ASU 2011-02 provides additional guidance and clarification in determining whether

NOTE 2 – NEW ACCOUNTING STANDARDS (continued)

a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The adoption of this update did not have a material impact on the Company's consolidated financial condition or results of operations.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement ("Subtopic 820"): "Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs" ("ASU 2011-04"). ASU 2011-04 will create common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. ASU 2011-04 will change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend for the amendments in ASU 2011-04 to result in a change to the application of the requirements in Subtopic 820. Some of the amendments clarify the application of existing fair value measurement requirements. Other amendments change a particular principal or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. Management does not expect the adoption of this update to have a material impact on the Company's consolidated financial condition or results of operations.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income ("Subtopic 220"): "Presentation of Comprehensive Income" ("ASU 2011-05"). ASU 2011-05 provides an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The amendments in ASU 2011-05 do not change the items that must be reported; how they are reported in other comprehensive income; or when an item of other comprehensive income must be reclassified to net income. The amendments do not affect how earnings per share is calculated or presented. ASU 2011-05 is effective for interim and annual periods ending after December 15, 2011 and is to be applied retrospectively. Management does not expect the adoption of this update to have a material impact on the Company's consolidated financial condition or results of operations.

NOTE 3 – OTHER COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and other-than-temporary impairment ("OTTI") related to non-credit factors, are reported as a separate component of the stockholders' equity section of the consolidated statements of financial condition, such items, along with net income, are components of other comprehensive income.

NOTE 3 – OTHER COMPREHENSIVE INCOME (continued)

The components of other comprehensive income and related tax effects for the three and nine months ended September 30, 2011 and 2010 are as follows:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
	(Dollars in thousands)			
Unrealized holding gains on securities available for sale	$4,631	$1,326	$8,557	$3,903
Reclassification adjustment related to:				
Net realized gains on sales of securities included in net income	—	(1,057)	(31)	(1,057)
Recovery on previously impaired investment securities	—	—	(57)	—
Changes in Net Unrealized Gains	4,631	269	8,469	2,846
Income tax expense	(1,792)	(105)	(3,277)	(1,101)
Other Comprehensive Income	$2,839	$164	$5,192	$1,745

NOTE 4 – INVESTMENT SECURITIES

The amortized cost and fair value of securities are as follows:

	September 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities Available for Sale:				
U.S. Treasury bonds	$12,945	$2,040	$—	$14,985
Municipal bonds	49,229	2,824	(6)	52,047
Mortgage-backed securities:				
Collateralized mortgage obligations - private label	147	—	(5)	142
Collateralized mortgage obligations - government sponsored entities	59,462	1,774	—	61,236
Government National Mortgage Association	3,351	237	—	3,588
Federal National Mortgage Association	18,640	1,067	—	19,707
Federal Home Loan Mortgage Corporation	4,552	552	—	5,104
Asset-backed securities - private label	5,656	351	(1,236)	4,771
Asset-backed securities - government sponsored entities	185	18	—	203
Equity securities	22	—	(16)	6
	$154,189	$8,863	$(1,263)	$161,789

NOTE 4 – INVESTMENT SECURITIES (continued)

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities Available for Sale:				
U.S. Treasury bonds	$8,961	$170	$(27)	$9,104
Municipal bonds	47,995	292	(2,541)	45,746
Mortgage-backed securities:				
Collateralized mortgage obligations - private label	305	3	(4)	304
Collateralized mortgage obligations - government sponsored entities	71,864	1,726	(194)	73,396
Government National Mortgage Association	2,461	1	(55)	2,407
Federal National Mortgage Association	10,545	454	(133)	10,866
Federal Home Loan Mortgage Corporation	5,817	390	—	6,207
Asset-backed securities - private label	6,586	253	(1,189)	5,650
Asset-backed securities - government sponsored entities	237	—	—	237
Equity securities	22	—	(15)	7
	$154,793	$3,289	$(4,158)	$153,924

All of our collateralized mortgage obligations are backed by residential mortgages.

At September 30, 2011 and December 31, 2010, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock.

At September 30, 2011, thirty-two municipal bonds with a cost of $10.0 million and fair value of $10.9 million were pledged under a collateral agreement with the Federal Reserve Bank of New York for liquidity borrowing. In addition, at September 30, 2011, eleven municipal bonds with a cost of $4.1 million and a fair value of $4.4 million were pledged as collateral for customer deposits in excess of the FDIC insurance limits. At December 31, 2010, twenty-nine municipal bonds with a cost of $9.6 million and fair value of $9.7 million were pledged under a collateral agreement with the Federal Reserve Bank of New York for liquidity borrowing. In addition, at December 31, 2010, nine municipal bonds with a cost and fair value of $3.4 million were pledged as collateral for customer deposits in excess of the FDIC insurance limits.

NOTE 4 – INVESTMENT SECURITIES (continued)

The following table sets forth the Company's investment in securities available for sale with gross unrealized losses of less than twelve months and gross unrealized losses of twelve months or more and associated fair values as of the dates indicated:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars in thousands)					
September 30, 2011:						
Municipal bonds	$ —	$ —	$ 1,007	$ (6)	$ 1,007	$ (6)
Mortgage-backed securities	142	(5)	—	—	142	(5)
Asset-backed securities - private label	—	—	3,956	(1,236)	3,956	(1,236)
Equity securities	—	—	6	(16)	6	(16)
	$ 142	$ (5)	$ 4,969	$ (1,258)	$ 5,111	$ (1,263)
December 31, 2010:						
U.S. Treasury bonds	$ 2,049	$ (27)	$ —	$ —	$ 2,049	$ (27)
Municipal bonds	34,806	(2,476)	533	(65)	35,339	(2,541)
Mortgage-backed securities	14,922	(382)	183	(4)	15,105	(386)
Asset-backed securities - private label	—	—	4,757	(1,189)	4,757	(1,189)
Equity securities	7	(15)	—	—	7	(15)
	$ 51,784	$ (2,900)	$ 5,473	$ (1,258)	$ 57,257	$ (4,158)

The Company reviews investment securities on an ongoing basis for the presence of OTTI with formal reviews performed quarterly.

The Company determines whether the unrealized losses are other-than-temporary in accordance with FASB ASC Topic 320 "Investments - Debt and Equity Securities". The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral and the continuing performance of the securities.

Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which fair value has been less than cost, and near-term prospects of the issuer. The Company uses the cash flow expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the provisions in the applicable bond indenture and other factors, then applies a discounting rate equal to the effective yield of the security. If the present value of the expected cash flows is less than the amortized book value it is considered a credit loss. The fair value of the security is determined using the same expected cash flows; the discount rate is a rate the Company determines from open market and other sources as appropriate for the security. The difference between the fair value and the credit loss is recognized in other comprehensive income, net of taxes.

At September 30, 2011 the Company's investment portfolio included one mortgage-backed security in the less than twelve months category. The mortgage-backed security was not evaluated further for OTTI as the unrealized loss on the individual security was less than 20% of its book value, which management deemed to be immaterial, and the credit ratings remained strong. The Company expects this security to

NOTE 4 – INVESTMENT SECURITIES (continued)

be repaid in full, with no losses realized. Management does not intend to sell this security and it is more likely than not that it will not be required to sell this security.

At September 30, 2011, the Company had one equity security, two municipal bonds and four private-label asset-backed securities in the unrealized loss of twelve months or more category. The Company's investment in equity securities is a requirement of its membership with the FHLMC. These securities were not evaluated further for OTTI, despite the percentage of unrealized losses, due to immateriality. Two municipal bonds and one private label security in this category were not evaluated further for OTTI as the unrealized loss was less than 20% of book value. Furthermore, for the municipal bonds, the credit ratings remained high. The temporary impairments in these securities were due to declines in fair values resulting from changes in interest rates or increased credit/liquidity spreads since the time the securities were purchased. The Company expects these securities to be repaid in full, with no losses realized. Management does not intend to sell these securities and it is more likely than not that it will not be required to sell these securities.

The three remaining private label asset-backed securities in this category were subject to a formal OTTI review as the unrealized losses were greater than 20% of book value for the individual security, or the related credit ratings were below investment grade, or the Company's analysis indicated a possible loss of principal. The following table provides additional information relating to these private-label asset-backed securities as of September 30, 2011 (dollars in thousands):

					Delinquent %			
Security	Book Value	Fair Value	Unrealized Gain/ (Loss)	Lowest Rating	Over 60 days	Over 90 days	Foreclosure/ OREO / Bankruptcy %	OREO%
1	$ 2,000	$ 1,294	$ (706)	CC	41.40 %	39.20 %	13.90 %	2.60 %
2	1,391	1,054	(337)	B-	37.80 %	34.80 %	12.50 %	2.20 %
3	1,000	821	(179)	CCC	22.00 %	20.50 %	12.30 %	0.60 %
Total	$ 4,391	$ 3,169	$ (1,222)					

The three private-label asset-backed securities listed above were evaluated for OTTI under the guidance of FASB ASC Topic 320. The Company believes the unrealized losses on these three private-label asset-backed securities occurred due to the current challenging economic environment, high unemployment rates, a continued decline in housing values in many areas of the country, and increased delinquency trends. It is possible that principal losses may be incurred on the tranches we hold in these specific securities. Management's evaluation of the estimated discounted cash flows in comparison to the amortized book value did not reflect the need to record initial OTTI charges against earnings as of September 30, 2011 as the calculations of the estimated discounted cash flows did not show additional principal losses for these securities under various prepayment and default rate scenarios. Management also concluded that it does not intend to sell the securities and that it is not likely it will be required to sell the securities.

Management also completed an OTTI analysis for two private-label asset backed securities, which did not have unrealized losses as of September 30, 2011. However, an impairment charge had been taken on these securities during 2008. Management reviewed key credit metrics for these securities, including delinquency rates, cumulative default rates, prepayment speeds, foreclosure rates, loan-to-values and credit support levels. Management's calculation of the estimated discounted cash flows did not show additional principal losses for these securities under various prepayment and default rate scenarios. As a result of the stress tests that were performed, management concluded that additional OTTI charges were not required as of September 30, 2011 on these securities. Management also concluded that it does not intend to sell these securities and that it is not likely it will be required to sell these securities.

NOTE 4 – INVESTMENT SECURITIES (continued)

The unrealized losses shown in the above table, were recorded as a component of other comprehensive income, net of tax on the Company's Consolidated Statements of Changes in Stockholders' Equity.

The following table presents a summary of the credit related OTTI charges recognized as components of earnings (dollars in thousands):

	For the Nine Months Ended September 30, 2011	For the Year Ended December 31, 2010
Beginning balance	$ 1,176	$ 1,922
Additions: Credit related OTTI recorded in current period	—	—
Reductions: Realized loss on sale of security	—	(457)
Losses realized during the period on OTTI previously recognized	(31)	(147)
Receipt of cash flows on previously recorded OTTI	(57)	(142)
Ending balance	$ 1,088	$ 1,176

During the year ended December 31, 2010, management sold one private-label asset-backed security on which a credit related OTTI charge of $457,000 had been previously recorded. At the time of sale, an additional realized loss of $108,000 was recognized and recorded in the non-interest income section on the Consolidated Statements of Income.

Further deterioration in credit quality and/or a continuation of the current imbalances in liquidity that exist in the marketplace might adversely affect the fair values of the Company's investment portfolio and may increase the potential that certain unrealized losses will be designated as other than temporary and that the Company may incur additional write-downs in future periods.

Scheduled contractual maturities of available for sale securities are as follows:

	Amortized Cost (Dollars in thousands)	Fair Value
September 30, 2011		
After five years through ten years	$ 15,427	$ 17,255
After ten years	46,747	49,777
Mortgage-backed securities	86,152	89,777
Asset-backed securities	5,841	4,974
Equity securities	22	6
	$ 154,189	$ 161,789

The Company sold available for sale securities during the nine months ended September 30, 2011, for total proceeds of $4.7 million, resulting in gross realized gains of $115,000 and gross realized losses of $84,000.

The Company sold available for sale securities during the nine months ended September 30, 2010, for total proceeds of $10.8 million, resulting in gross realized gains of $1.4 million and gross realized losses of $324,000.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES

Management segregates the loan portfolio into loan types and analyzes the risk level for each loan type when determining its allowance for loan losses. The loan types are as follows:

Real Estate Loans:

One-to Four-Family – are loans secured by first lien collateral on residential real estate primarily held in the Western New York region. These loans can be affected by economic conditions and the value of underlying properties. Western New York has not been impacted as severely as other parts of the country by fluctuating real estate prices. Furthermore, the Company has conservative underwriting standards and does not have any sub-prime loans in its loan portfolio.

Home Equity - are loans or lines of credit secured by second lien collateral on owner-occupied residential real estate primarily held in the Western New York area. These loans can also be affected by economic conditions and the values of underlying properties.

Commercial Real Estate – are loans used to finance the purchase of real property, which generally consists of developed real estate that is held as first lien collateral for the loan. These loans are secured by real estate properties that are primarily held in the Western New York region. Commercial real estate lending involves additional risks compared with one-to four-family residential lending, because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, and/or the collateral value of the commercial real estate securing the loan, and repayment of such loans may be subject to adverse conditions in the real estate market or economic conditions to a greater extent than one-to four-family residential mortgage loans. Also, commercial real estate loans typically involve large loan balances to single borrowers or groups of related borrowers.

Construction – are loans to finance the construction of either one-to four-family owner occupied homes or commercial real estate. At the end of the construction period, the loan automatically converts to either a conventional or commercial mortgage, as applicable. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion compared to the estimated cost of construction.

Other Loans:

Commercial – includes business installment loans, lines of credit, and other commercial loans. Most of our commercial loans have variable interest rates tied to the prime rate, and are for terms generally not in excess of 15 years. Whenever possible, we collateralize these loans with a lien on business assets and equipment and require the personal guarantees from principals of the borrower. Commercial loans generally involve a higher degree of credit risk because the collateral underlying the loans may be in the form of intangible assets and/or inventory subject to market obsolescence. Commercial loans can also involve relatively large loan balances to a single borrower or groups of related borrowers, with the repayment of such loans typically dependent on the successful operation of the commercial businesses and the income stream of the borrower. Such risks can be significantly affected by economic conditions.

Consumer – consist of loans secured by collateral such as an automobile or a deposit account, unsecured loans and lines of credit. Consumer loans tend to have a higher credit risk due to the loans being either unsecured or secured by rapidly depreciable assets. Furthermore, consumer loan payments are dependent on the borrower’s continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (continued)

The allowance for loan losses is a valuation account that reflects the Company's evaluation of the losses inherent in its loan portfolio. In order to determine the adequacy of the allowance for loan losses, the Company estimates losses by loan type using historical loss factors, as well as other environmental factors, such as trends in loan volume and loan type, loan concentrations, changes in the experience, ability and depth of the lending management, and national and local economic conditions. The Company also reviews all loans on which the collectability of principal may not be reasonably assured, by reviewing payment status, financial conditions and estimated value of loan collateral. These loans are assigned an internal loan grade, and the Company assigns the amount of loss components to these classified loans based on loan grade.

The following table summarizes the activity in the allowance for loan losses for the three and nine months ended September 30, 2011 and the distribution of the allowance for loan losses and loans receivable by loan portfolio class and impairment method as of September 30, 2011:

	Real Estate Loans				Other Loans			
	One-to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2011								
Allowance for Loan Losses:								
Balance – July 1, 2011	$373	$90	$ 498	$ —	$228	$ 17	$ —	$1,206
Charge-offs	—	—	—	—	(1)	(3)	—	(4)
Recoveries	—	—	—	—	—	—	—	—
Provision	30	(37)	23	—	(11)	5	—	10
Balance – September 30, 2011	$403	$53	$ 521	$ —	$216	$ 19	$ —	$1,212
Balance – January 1, 2011	$407	$141	$ 278	$ 1	$104	$ 21	$ 1	$953
Charge-offs	—	(29)	—	—	(1)	(13)	—	(43)
Recoveries	4	—	—	—	—	3	—	7
Provision	(8)	(59)	243	(1)	113	8	(1)	295
Balance – September 30, 2011	$403	$53	$ 521	$ —	$216	$ 19	$ —	$1,212
Ending balance: individually evaluated for impairment	$—	$—	$ 23	$ —	$—	$—	$ —	$23
Ending balance: collectively evaluated for	$403	$53	$ 498	$ —	$216	$ 19	$ —	$1,189

impairment								
Gross Loans Receivable (1):								
Ending balance	$186,093	30,435	$ 43,512	$ 531	$11,748	$ 2,006	$ —	$274,325
Ending balance: individually evaluated for impairment	$—	$—	$ 370	$ —	$—	$ —	$ —	$370
Ending balance: collectively evaluated for impairment	$186,093	$30,435	$ 43,142	$ 531	$11,748	$ 2,006	$ —	$273,955

(1) Gross Loans Receivable does not include allowance for loan losses of $(1,212) or deferred loan costs of $2,714.

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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (continued)

The following table summarizes the distribution of the allowance for loan losses and loans receivable by loan portfolio class as of December 31, 2010:

	Real Estate Loans				Other Loans			
	One-to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
December 31, 2010	(Dollars in thousands)							
Allowance for Loan Losses:								
Ending balance	$407	$141	$ 278	$ 1	$104	$21	$ 1	$953
Ending balance: individually evaluated for impairment	$—	$—	$ —	$ —	$—	$—	$ —	$—
Ending balance: collectively evaluated for impairment	$407	$141	$ 278	$ 1	$104	$21	$ 1	$953
Gross Loans Receivable (1):								
Ending balance	$183,929	$30,613	$ 33,782	$ 616	$10,360	$2,224	$ —	$261,524
Ending balance: individually evaluated for impairment	$—	$—	$ 277	$ —	$—	$—	$ —	$277
Ending balance: collectively evaluated for impairment	$183,929	$30,613	$ 33,505	$ 616	$10,360	$2,224	$ —	$261,247

Gross Loans Receivable does not include allowance for loan losses of $(953) or deferred loan costs of $2,460.

Although the allocations noted above are by loan type, the allowance for loan losses is general in nature and is available to offset losses from any loan in the Company's portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will not be able to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered in determining impairment include payment status, collateral value and the probability of collecting scheduled payments when due. Impairment is measured on a loan-by-loan basis for commercial real estate loans and commercial loans. Larger groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer, home equity, or one-to four-family loans for impairment disclosure.

NOTE 5 - ALLOWANCE FOR LOAN LOSSES (continued)

The following is a summary of information pertaining to impaired loans for the periods indicated:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(Dollars in thousands)		
For the nine months ended September 30, 2011					
With no related allowance recorded:					
Commercial real estate	$129	$129	$—	$131	$10
With an allowance recorded:					
Commercial real estate	241	241	23	247	13
Total	$370	$370	$23	$378	$23
For the year ended December 31, 2010					
With no related allowance recorded:					
Commercial real estate	$277	$277	$—	$211	$5
With an allowance recorded:					
Commercial real estate	—	—	—	1,566	56
Commercial loans	—	—	—	147	8
Total	$277	$277	$—	$1,924	$69

The following table provides an analysis of past due loans as of dates indicated:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable
			(Dollars in thousands)			
September 30, 2011:						
Real Estate Loans:						
Residential, One-to Four-Family	$ 827	$ 639	$ 1,390	$ 2,856	$ 183,237	$ 186,093
Home equity	61	36	136	233	30,202	30,435
Commercial	141	—	465	606	42,906	43,512
Construction	—	—	—	—	531	531
Other Loans:						
Commercial	130	50	53	233	11,515	11,748
Consumer	10	1	36	47	1,959	2,006
Total	$ 1,169	$ 726	$ 2,080	$ 3,975	$ 270,350	$ 274,325
December 31, 2010:						
Real Estate Loans:						
	$ 1,435	$ 713	$ 1,490	$ 3,638	$ 180,291	$ 183,929

Residential, One-to Four-Family						
Home equity	188	116	135	439	30,174	30,613
Commercial	45	—	413	458	33,324	33,782
Construction	—	—	—	—	616	616
Other Loans:						
Commercial	300	—	27	327	10,033	10,360
Consumer	13	13	70	96	2,128	2,224
Total	$ 1,981	$ 842	$ 2,135	$ 4,958	$ 256,566	$ 261,524

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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (continued)

The following table is a summary of nonaccrual loans and accruing loans delinquent 90 days or more by loan class for the dates indicated:

	At September 30, 2011		At December 31, 2010	
	(Dollars in thousands)			
Loans past due 90 days or more but still accruing:				
Real Estate Loans:				
Residential, One-to Four-Family	$	290	$	391
Home equity		—		39
Commercial		—		43
Construction		—		—
Other loans:				
Commercial		—		—
Consumer		25		59
Total	$	315	$	532
Loans accounted for on a non-accrual basis:				
Real Estate Loans:				
Residential, One-to Four-Family	$	1,371	$	1,279
Home Equity		211		122
Commercial		465		370
Construction		—		—
Other loans:				
Commercial		78		27
Consumer		11		11
Total	$	2,136	$	1,809

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance. Interest income not recognized on non-accrual loans during the nine month period ended September 30, 2011 and September 30, 2010 was $135,000 and $76,000 respectively.

The Company's policies provide for the classification of loans as follows:

Pass/Performing
Watch/Special Mention – does not currently expose the Company to a sufficient degree of risk but does possess credit deficiencies or potential weaknesses deserving the Company's close attention;
Substandard - has one or more defined weaknesses and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected;
Doubtful - has all the weaknesses inherent in substandard loans with the additional characteristic that the weaknesses present make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss; and
Loss - loan is considered uncollectible and continuance as a loan of the Company is not warranted.

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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (continued)

The Company's Asset Classification Committee is responsible for monitoring risk ratings and making changes as deemed appropriate. Each commercial loan is individually assigned a loan classification. The Company's consumer loans, including residential mortgages and home equity loans, are not individually classified. Instead the Company uses the delinquency status as the credit quality indicator for consumer loans. Unless the loan is well secured and in the process of collection, all consumer loans that are more than 90 days past due are classified.

The following table summarizes the internal loan grades applied to the Company's loan portfolio as of September 30, 2011 and December 31, 2010:

	Pass/ Performing (Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total
September 30, 2011						
Real Estate Loans:						
One-to Four-family	$ 184,203	$ —	$ 1,617	$ 212	$ 61	$ 186,093
Home Equity	30,150	—	285	—	—	30,435
Commercial	39,869	3,096	83	464	—	43,512
Construction	531	—	—	—	—	531
Other Loans:						
Commercial	10,647	795	199	107	—	11,748
Consumer	1,991	—	10	2	3	2,006
Total	$ 267,391	$ 3,891	$ 2,194	$ 785	$ 64	$ 274,325

	Pass/ Performing (Dollars in thousands)	Special Mention	Substandard	Doubtful	Loss	Total
December 31, 2010						
Real Estate Loans:						
One-to Four-family	$ 181,631	$ —	$ 2,243	$ 55	$ —	$ 183,929
Home Equity	30,336	—	248	—	29	30,613
Commercial	32,185	1,184	43	370	—	33,782
Construction	616	—	—	—	—	616
Other Loans:						
Commercial	9,706	351	199	104	—	10,360
Consumer	2,203	—	15	6	—	2,224
Total	$ 256,677	$ 1,535	$ 2,748	$ 535	$ 29	$ 261,524

Troubled debt restructurings ("TDRs") occur when we grant borrowers concessions that we would not otherwise grant but for economic or legal reasons pertaining to the borrower's financial difficulties. A concession is made when the terms of the loan modification are more favorable than the terms the borrower would have received in the current market under similar financial difficulties. These concessions may include, but are not limited to, modifications of the terms of the debt, the transfer of assets or the issuance of an equity interest by the borrower to satisfy all or part of the debt, or the addition of borrower(s). The Company identifies loans for potential TDRs primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management

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NOTE 5 - ALLOWANCE FOR LOAN LOSSES (continued)

will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future. Generally, we will not return a TDR to accrual status until the borrower has demonstrated the ability to make principal and interest payments under the restructured terms for at least six consecutive months.

For the nine months ended September 30, 2011, nine one-to four-family real estate loans with aggregate balances of $945,000 were modified and not classified as TDRs and one home equity loan for $31,000 was modified and classified as a TDR. For the modified loans, not classified as TDRs, the interest rate was lowered due to the lower rate environment in order to maintain the customer lending relationship. The TDR home equity loan was modified due to the borrower’s financial difficulties, in which case past due post petition payments and attorney fees were capitalized as part of the loan balance, increasing the balance to $34,000, and the loan term was extended by 8 years with no change in interest rate. This loan was classified as a substandard loan with no specific reserve established and was current with the modified terms at September 30, 2011. We did not have any TDRs that subsequently defaulted.

NOTE 6 – EARNINGS PER SHARE

Earnings per share was calculated for the three and nine months ended September 30, 2011 and 2010, respectively. Basic earnings per share is based upon the weighted average number of common shares outstanding, exclusive of unearned shares held by the Employee Stock Ownership Plan of Lake Shore Bancorp, Inc. (the “ESOP”) and unearned shares held by the Recognition and Retention Plan (“RRP”). Diluted earnings per share is based upon the weighted average number of common shares outstanding and common share equivalents that would arise from the exercise of dilutive securities. Stock options and unvested restricted stock are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent they would be dilutive and computed using the treasury stock method.

NOTE 6 – EARNINGS PER SHARE (continued)

The calculated basic and diluted earnings per share are as follows:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010
Numerator – net income	$ 1,156,000	$ 778,000
Denominators:		
Basic weighted average shares outstanding	5,692,710	5,776,740
Diluted weighted average shares outstanding(1)		