LAKE SHORE BANCORP, INC.
Form 10-Q
May 13, 2014

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 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 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 [ ]

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 [ ]

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
Non-accelerated filer	(Do not check if a 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 Exchange Act).

Yes [ ] No [X]

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

There were 5,910,835 shares of the registrant's common stock, $.01 par value per share, outstanding at May 1, 2014.

TABLE OF CONTENTS

PART I

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	March 31, 2014 (Unaudited)	December 31, 2013
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 8,447	$ 7,748
Interest earning deposits	7,408	2,321
Federal funds sold	12,251	7,133
Cash and Cash Equivalents	28,106	17,202
Securities available for sale	155,317	157,964
Federal Home Loan Bank stock, at cost	1,535	1,560
Loans receivable, net of allowance for loan losses 2014 $1,780; 2013 $1,813	275,490	277,345
Premises and equipment, net	9,590	9,642
Accrued interest receivable	1,952	1,787
Bank owned life insurance	14,468	14,407
Other assets	1,533	2,260
Total Assets	$ 487,991	$ 482,167
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 358,086	$ 353,915
Non-interest bearing	35,251	34,320
Total Deposits	393,337	388,235
Short-term borrowings	11,900	11,650
Long-term debt	7,050	7,850

Advances from borrowers for taxes and insurance	2,473	3,454
Other liabilities	5,821	5,707
Total Liabilities	$ 420,581	$ 416,896
Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,619,203 shares issued and 5,910,835 shares outstanding at March 31, 2014 and 6,619,203 shares issued and 5,915,835 shares outstanding at December 31, 2013	$ 66	$ 66
Additional paid-in capital	28,047	28,039
Treasury stock, at cost (708,368 shares at March 31, 2014 and 703,368 shares at December 31, 2013)	(6,650)	(6,588)
Unearned shares held by ESOP	(1,855)	(1,876)
Unearned shares held by RRP	(490)	(499)
Retained earnings	46,252	45,624
Accumulated other comprehensive income	2,040	505
Total Stockholders' Equity	67,410	65,271
Total Liabilities and Stockholders' Equity	$ 487,991	$ 482,167

See notes to consolidated financial statements.

1

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended March 31,	
	2014	2013
	(Unaudited) (Dollars in thousands, except per share data)	
Interest Income		
Loans, including fees	$ 3,305	$ 3,479
Investment securities, taxable	702	699
Investment securities, tax-exempt	530	480
Other	1	3
Total Interest Income	4,538	4,661
Interest Expense		
Deposits	757	810
Short-term borrowings	12	13
Long-term debt	32	63
Other	25	26
Total Interest Expense	826	912
Net Interest Income	3,712	3,749
Provision for Loan Losses	-	45
Net Interest Income after Provision for Loan Losses	3,712	3,704
Non-Interest Income		
Service charges and fees	396	393
Earnings on bank owned life insurance	61	78
Loss on sale of securities available for sale	(98)	-
Recovery on previously impaired investment securities	83	-
Other	38	44
Total Non-Interest Income	480	515
Non-Interest Expenses		
Salaries and employee benefits	1,663	1,562
Occupancy and equipment	559	492
Professional services	315	350
Data processing	183	157
Advertising	99	91
FDIC Insurance	71	64
Postage and supplies	67	75
Other	281	312
Total Non-Interest Expenses	3,238	3,103

Income before Income Taxes	954	1,116
Income Tax Expense	179	210
Net Income	$ 775	$ 906
Basic earnings per common share	$ 0.14	$ 0.16
Diluted earnings per common share	$ 0.14	$ 0.16
Dividends declared per share	$ 0.07	$ 0.07

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended March 31, 2014	2013
	(Unaudited) (Dollars in thousands)	
Net Income	$ 775	$ 906
Other Comprehensive Income (Loss), net of tax (expense) benefit		
Unrealized holding gains (losses) on securities available for sale, net of tax (expense) benefit 2014 $(963); 2013 $490	1,526	(776)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense $32	(51)	-
Loss on sale of securities included in net income, net of tax benefit $38	60	-
Total Other Comprehensive Income (Loss)	1,535	(776)
Total Comprehensive Income	$ 2,310	$ 130

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

Three Months Ended March 31, 2014 and 2013 (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	Total
	(In thousands, except share and per share data)							
Balance - January 1, 2013	$ 66	$ 27,973	$ (6,469)	$ (1,961)	$ (553)	$ 42,468	$ 5,461	$ 66,985
Net income	-	-	-	-	-	906	-	906
Other comprehensive loss, net of tax benefit of $490	-	-	-	-	-	-	(776)	(776)
ESOP shares earned (1,984 shares)	-	-	-	21	-	-	-	21
Stock based compensation	-	2	-	-	-	-	-	2
RRP shares earned (994 shares)	-	-	-	-	14	-	-	14
Cash dividends declared ($0.07 per share)	-	-	-	-	-	(159)	-	(159)
Balance - March 31, 2013	$ 66	$ 27,975	$ (6,469)	$ (1,940)	$ (539)	$ 43,215	$ 4,685	$ 66,993
Balance - January 1, 2014	$ 66	$ 28,039	$ (6,588)	$ (1,876)	$ (499)	$ 45,624	$ 505	65,271
Net income	-	-	-	-	-	775	-	775
Other comprehensive income, net of tax expense of $969	-	-	-	-	-	-	1,535	1,535
ESOP shares earned (1,984 shares)	-	3	-	21	-	-	-	24
Stock based compensation	-	1	-	-	-	-	-	1
RRP shares earned (658 shares)	-	4	-	-	9	-	-	13
Purchase of treasury stock, at cost (5,000 shares)	-	-	(62)	-	-	-	-	(62)
Cash dividends declared ($0.07 per share)	-	-	-	-	-	(147)	-	(147)
Balance - March 31, 2014	$ 66	$ 28,047	$ (6,650)	$ (1,855)	$ (490)	$ 46,252	$ 2,040	$ 67,410

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Three Months Ended March 31, 2014	2013
	(Unaudited) (Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 775	$ 906
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	73	153
Amortization of deferred loan costs	116	113
Provision for loan losses	-	45
Recovery on previously impaired investment securities	(83)	-
Loss on sale of investment securities	98	-
Originations of loans held for sale	(112)	(195)
Proceeds from sales of loans held for sale	112	195
Depreciation and amortization	181	166
Increase in bank owned life insurance, net	(61)	(78)
ESOP shares committed to be released	24	21
Stock based compensation expense	14	16
Increase in accrued interest receivable	(165)	(186)
Increase in other assets	(122)	(45)
Increase (decrease) in other liabilities	59	(901)
Net Cash Provided by Operating Activities	909	210
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	1,544	1,410
Maturities, prepayments and calls	3,519	8,491
Purchases	-	(6,592)
Redemptions of Federal Home Loan Bank Stock	25	76
Loan origination and principal collections, net	1,674	513
Additions to premises and equipment	(129)	(379)
Net Cash Provided by Investing Activities	6,633	3,519
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	5,102	5,749
Net decrease in advances from borrowers for taxes and insurance	(981)	(912)
Net increase in short term borrowings	250	2,450
Proceeds from issuance of long-term debt	1,900	1,750
Repayment of long-term debt	(2,700)	(5,900)
Purchase of treasury stock	(62)	-
Cash dividends paid	(147)	(159)
Net Cash Provided by Financing Activities	3,362	2,978

Net Increase in Cash and Cash Equivalents	10,904	6,707
CASH AND CASH EQUIVALENTS - BEGINNING	17,202	19,765
CASH AND CASH EQUIVALENTS - ENDING	$ 28,106	$ 26,472
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 840	$ 934
Income taxes paid	$ 85	$ 371
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	$ 79	$ 168
Securities purchased and not settled	$ -	$ 4,065

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", "us," "our", or "we") 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 company 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 March 31, 2014 and for the three months ended March 31, 2014 and 2013 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 statement of financial condition at December 31, 2013 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated 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 Annual Report on Form 10-K for the year ended December 31, 2013. The consolidated results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2014.

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 statement of financial condition as of March 31, 2014 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 Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2013-11, Income Taxes ("Topic 740"): "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." ("ASU 2013-11"). ASU 2013-11 amends existing guidance on the financial statement presentation of an unrecognized tax benefit, when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 requires an entity to present these types of unrecognized tax benefits, or a portion of these types of unrecognized tax benefits in the financial statements as a reduction to a deferred tax asset with certain exceptions. The amendments in ASU 2013-11 do not require new recurring disclosures. This guidance is effective for all interim and annual reporting periods beginning after December 15, 2013. The adoption of ASU 2013-11 did not have a material impact on the Company's consolidated financial condition or results of operations.

Note 3 – Investment Securities

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

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,847	$ 1,178	$ -	$ 14,025
Municipal bonds	57,188	2,261	(210)	59,239
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	72	5	-	77
Collateralized mortgage obligations-government sponsored entities	61,136	340	(1,128)	60,348
Government National Mortgage Association	2,095	89	-	2,184
Federal National Mortgage Association	11,080	362	(94)	11,348
Federal Home Loan Mortgage Corporation	5,620	145	(41)	5,724
Asset-backed securities-private label	1,804	494	(142)	2,156
Asset-backed securities-government sponsored entities	126	4	-	130
Equity securities	22	64	-	86
	$ 151,990	$ 4,942	$ (1,615)	$ 155,317

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,857	$ 991	$ -	$ 13,848
Municipal bonds	57,199	1,385	(540)	58,044
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	77	4	-	81
Collateralized mortgage obligations-government sponsored entities	63,840	362	(1,577)	62,625
Government National Mortgage Association	2,153	66	-	2,219
Federal National Mortgage Association	11,452	318	(136)	11,634
Federal Home Loan Mortgage Corporation	5,774	117	(75)	5,816
Asset-backed securities-private label	3,637	618	(757)	3,498
Asset-backed securities-government sponsored entities	130	4	-	134
Equity securities	22	43	-	65
	$ 157,141	$ 3,908	$ (3,085)	$ 157,964

7

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

At March 31, 2014 and at December 31, 2013, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock.

At March 31, 2014 and December 31, 2013, thirty-one municipal bonds with a cost of $10.6 million and fair value of $11.2 million and $11.1 million, respectively, were pledged under a collateral agreement with the Federal Reserve Bank of New York for liquidity borrowing. In addition, at March 31, 2014 and December 31, 2013, five municipal bonds with a cost and fair value of $1.1 million, were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") insurance limits.

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)					
March 31, 2014						
Municipal bonds	$ 4,573	$ (210)	$ -	$ -	$ 4,573	$ (210)
Mortgage-backed securities	31,149	(823)	11,135	(440)	42,284	(1,263)
Asset-backed securities -private label	-	-	1,635	(142)	1,635	(142)
	$ 35,722	$ (1,033)	$ 12,770	$ (582)	$ 48,492	$ (1,615)

	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)					
December 31, 2013						
Municipal bonds	$ 14,052	$ (540)	$ -	$ -	$ 14,052	$ (540)
Mortgage backed securities	41,094	(1,267)	12,768	(521)	53,862	(1,788)
Asset-backed securities -private label	-	-	2,794	(757)	2,794	(757)
	$ 55,146	$ (1,807)	$ 15,562	$ (1,278)	$ 70,708	$ (3,085)

The Company reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment ("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 March 31, 2014, the Company's investment portfolio included seventeen municipal bonds and twenty mortgage-backed securities in the "unrealized losses less than twelve months" category. The municipal bonds and mortgage-backed securities were not evaluated further for OTTI as the unrealized losses on the individual securities were less than 20% of book value, which management deemed to be immaterial, and the mortgage-backed securities were issued by government sponsored enterprises. 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.

At March 31, 2014, the Company had fourteen mortgage-backed securities and two private label asset-backed securities in the "unrealized losses twelve months or more" category.

The fourteen mortgage-backed securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value. The temporary impairments were due to declines in fair value resulting from changes in interest rates and/or increased credit liquidity spreads since 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 two private label asset-backed securities in this category were evaluated further for OTTI, as the unrealized loss was greater than 20% of book value for the individual security, the probability of default is high, 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 March 31, 2014 (dollars in thousands):

Security	Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Over 90 days	Foreclosure/ OREO/ Bankruptcy %	OREO%
1	$ 1,017	914	$ (103)	CCC	24.50%	23.40%	10.50%	0.50%
2	760	721	(39)	CCC	20.00%	18.60%	6.10%	1.00%
Total	$ 1,777	$ 1,635	$ (142)					

The two 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 two private label asset-backed securities occurred due to the current challenging economic environment, high unemployment rates, stressed 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 for the securities listed above did not reflect the need to record an OTTI charge against earnings during the three months ended March 31, 2014. The estimated discounted cash flows for these securities did not show an additional principal loss under various prepayment and default rate scenarios. Management concluded that it does not intend to sell these securities and that it is not likely it will be required to sell these securities.

Management also completed an OTTI analysis for two private label asset-backed securities, which did not have unrealized losses as of March 31, 2014. Management reviewed key credit metrics for these securities, including delinquency rates, cumulative default rates, prepayment speeds, foreclosure rates, loan-to-value ratios 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 March 31, 2014 on these securities. Management also concluded that it does not intend to sell the securities and that it is not likely it will be required to sell these securities.

The unrealized losses shown in the previous table, were recorded as a component of other comprehensive income (loss), 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:

	For The Three Months Ended March 31, 2014	For The Three Months Ended March 31, 2013
	(Dollars in thousands)	
Beginning balance	$ 1,318	$ 1,155
Additions:		
Credit loss not previously recognized	-	-
Reductions:		
Realized loss on sale of security on OTTI previously recognized	(282)	-
Losses realized during the period on OTTI previously recognized	(2)	(7)
Receipt of cash flows on previously recorded OTTI	(83)	-
Ending balance	$ 951	$ 1,148

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	Fair Value
	(Dollars in thousands)	
March 31, 2014:		
After one year through five years	$ 327	$ 355
After five years through ten years	24,058	25,674
After ten years	45,650	47,235
Mortgage-backed securities	80,003	79,681
Asset-backed securities	1,930	2,286
Equity securities	22	86

$ 151,990	$ 155,317

The Company sold one private-label asset-backed security during the three months ended March 31, 2014, for total proceeds of $1.5 million, resulting in gross realized losses of $98,000. During the three months ended March 31, 2013, the Company did not sell any securities available for sale. During the three months ended March 31, 2013, the Company received a $1.4 million settlement related to the sale of available for sale securities in the fourth quarter of 2012.

Note 4 - 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. Home equity loans may have increased risk of loss if the Company does not hold the first mortgage resulting in the Company being in a secondary position in the event of collateral liquidation.
- 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 actual cost of construction.

Other Loans:

- Commercial – includes business installment loans, lines of credit, and other commercial loans. Most of our commercial loans have fixed interest rates, and are for terms generally not in excess of 10 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 business 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.

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 Company’s lending management, and national and local economic conditions. The Company's determination as to the classification of loans and the amount of loss allowances are subject to review by regulatory agencies, which can require the establishment of additional loss allowances.

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 tables summarize the activity in the allowance for loan losses for the three months ended March 31, 2014 and 2013 and the distribution of the allowance for loan losses and loan receivable by loan portfolio class and impairment method as of March 31, 2014.

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
March 31, 2013 Allowance for Loan Losses:								
Balance – January 1, 2013	$ 393	$ 79	$ 1,118	$ -	$ 202	$ 14	$ -	$ 1,806
Charge-offs	-	-	-	-	(20)	(4)	-	(24)
Recoveries	-	-	5	-	2	-	-	7
Provision (Credit)	134	(6)	(134)	-	37	11	3	45
Balance – March 31, 2013	$ 527	$ 73	$ 989	$ -	$ 221	$ 21	$ 3	$ 1,834

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
March 31, 2014 Allowance for Loan Losses:								
Balance – January 1, 2014	$ 355	$ 80	$ 1,104	$ -	$ 218	$ 9	$ 47	$ 1,813
Charge-offs	(17)	(13)	-	-	(4)	(7)	-	(41)
Recoveries	-	-	-	-	-	8	-	8
Provision (Credit)	22	32	(52)	-	(19)	11	6	-
Balance – March 31, 2014	$ 360	$ 99	$ 1,052	$ -	$ 195	$ 21	$ 53	$ 1,780

Ending balance: individually evaluated for impairment	$ -	-	125	-	2	-	-	$ 127
Ending balance: collectively evaluated for impairment	$ 360	$ 99	$ 927	$ -	$ 193	$ 21	$ 53	$ 1,653
Gross Loans Receivable (1):								
Ending balance	$ 169,172	$ 31,209	$ 58,239	$ 1,401	$ 13,059	$ 1,395	$ -	$ 274,475
Ending balance: individually evaluated for impairment	$ 173	$ 4	$ 2,538	$ -	$ 7	$ -	$ -	$ 2,722
Ending balance: collectively evaluated for impairment	$ 168,999	$ 31,205	$ 55,701	$ 1,401	$ 13,052	$ 1,395	$ -	$ 271,753

(1) Gross Loans Receivable does not include allowance for loan losses of $(1,780) or deferred loan costs of $2,795.

12

The following table summarizes the distribution of the allowance for loan losses and loans receivable by loan portfolio class as of December 31, 2013:

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
December 31, 2013								
Allowance for Loan Losses:								
Balance – December 31, 2013	$ 355	$ 80	$ 1,104	$ -	$ 218	$ 9	$ 47	$ 1,813
Ending balance: individually evaluated for impairment	$ -	-	125	-	-	-	-	$ 125
Ending balance: collectively evaluated for impairment	$ 355	$ 80	$ 979	$ -	$ 218	$ 9	$ 47	$ 1,688
Gross Loans Receivable (1):								
Ending Balance	$ 170,793	$ 31,675	$ 58,746	$ 936	$ 12,645	$ 1,517	$ -	$ 276,312
Ending balance: individually evaluated for impairment	$ 177	$ 4	$ 2,458	$ -	$ 9	$ -	$ -	$ 2,648
Ending balance: collectively evaluated for impairment	$ 170,616	$ 31,671	$ 56,288	$ 936	$ 12,636	$ 1,517	$ -	$ 273,664

(1) Gross Loans Receivable does not include allowance for loan losses of $(1,813) or deferred loan costs of $2,846.

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. The unallocated component of the allowance for loan losses reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for existing specific and general losses in the 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, unless they are subject to a troubled debt restructuring.

13

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			For the Three Months Ended	
	At March 31, 2014			March 31, 2014	
With no related allowance recorded:					
Residential, one- to four-family	$ 173	$ 173	$ -	$ 175	$ 3
Home equity	4	4	-	4	-
Commercial real estate	1,911	1,911	-	1,911	-
Commercial loans	5	5	-	38	-
With an allowance recorded:					
Commercial real estate	627	627	125	548	15
Commercial loans	2	2	2	2	-
Total	$ 2,722	$ 2,722	$ 127	$ 2,678	$ 18

	At December 31, 2013			For the Year Ended December 31, 2013	
With no related allowance recorded:					
Residential, one- to four-family	$ 177	$ 177	$ -	$ 189	$ 11
Home equity	4	4	-	5	-
Commercial real estate	1,911				