LAKE SHORE BANCORP, INC.
Form 10-Q
August 10, 2018

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 June 30, 2018

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	20-4729288
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
31 East Fourth Street, Dunkirk, New York	14048

(Address(Zip code)
of
principal
executive
offices)

(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, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [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 6,055,519 shares of the registrant’s common stock, $0.01 par value per share, outstanding at August 8, 2018.

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PART I Financial Information

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	June 30, 2018	December 31, 2017
	(Unaudited)	
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 7,245	$ 7,709
Interest earning deposits	829	6,570
Federal funds sold	35,049	26,634
Cash and Cash Equivalents	43,123	40,913
Securities available for sale	84,926	80,421
Federal Home Loan Bank stock, at cost	1,545	1,631
Loans receivable, net of allowance for loan losses 2018 $3,474; 2017 $3,283	382,319	365,063
Premises and equipment, net	9,368	9,373
Accrued interest receivable	1,828	1,801
Bank owned life insurance	18,247	18,077
Other assets	1,963	1,698
Total Assets	$ 543,319	$ 518,977
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 375,337	$ 350,535
Non-interest bearing	56,974	54,618
Total Deposits	432,311	405,153
Long-term debt	24,650	26,950
Advances from borrowers for taxes and insurance	3,028	3,000
Other liabilities	4,801	5,499
Total Liabilities	$ 464,790	$ 440,602
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,827,741 shares issued and 6,059,714 shares outstanding at June 30, 2018 and 6,827,741 shares issued and 6,098,323 shares outstanding at December 31, 2017	$ 68	$ 68

Additional paid-in capital	30,819	30,719
Treasury stock, at cost (768,027 shares at June 30, 2018 and 729,418 shares at December 31, 2017)	(7,921)	(7,309)
Unearned shares held by ESOP	(1,492)	(1,535)
Unearned shares held by compensation plans	(353)	(540)
Retained earnings	57,509	56,181
Accumulated other comprehensive (loss) income	(101)	791
Total Stockholders' Equity	78,529	78,375
Total Liabilities and Stockholders' Equity	$ 543,319	$ 518,977

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(Unaudited) (Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$ 4,445	$ 4,105	$ 8,817	$ 8,167
Investment securities, taxable	256	198	486	408
Investment securities, tax-exempt	397	423	790	871
Other	169	48	282	86
Total Interest Income	5,267	4,774	10,375	9,532
Interest Expense				
Deposits	701	499	1,318	976
Long-term debt	140	97	279	189
Other	19	21	39	42
Total Interest Expense	860	617	1,636	1,207
Net Interest Income	4,407	4,157	8,739	8,325
Provision for Loan Losses	115	25	190	375
Net Interest Income after Provision for Loan Losses	4,292	4,132	8,549	7,950
Non-Interest Income				
Service charges and fees	463	465	914	912
Earnings on bank owned life insurance	86	90	170	177
Unrealized gain on equity securities	6	-	14	-
Recovery on previously impaired investment securities	68	32	90	71
Gain on sale of securities available for sale	-	197	-	222
Net gain on sale of loans	4	2	6	9
Other	30	21	53	46
Total Non-Interest Income	657	807	1,247	1,437
Non-Interest Expenses				
Salaries and employee benefits	2,034	1,822	4,099	3,712
Occupancy and equipment	561	565	1,148	1,175
Data processing	335	310	663	617
Professional services	255	245	479	472
Advertising	169	145	322	312
Postage and supplies	54	81	118	144
FDIC Insurance	36	37	74	73
Other	338	297	637	574
Total Non-Interest Expenses	3,782	3,502	7,540	7,079
Income before Income Taxes	1,167	1,437	2,256	2,308
Income Tax Expense	161	295	314	450
Net Income	$ 1,006	$ 1,142	$ 1,942	$ 1,858
Basic earnings per common share	$ 0.17	$ 0.19	$ 0.32	$ 0.30
Diluted earnings per common share	$ 0.16	$ 0.19	$ 0.32	$ 0.30
Dividends declared per share	$ 0.10	$ 0.08	$ 0.20	$ 0.16

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended June 30,	
	2018	2017
	(Unaudited) (Dollars in thousands)	
Net Income	$ 1,006	1,142
Other Comprehensive Loss, net of tax benefit:		
Unrealized holding (losses) gains on securities available for sale, net of tax benefit (expense)	(297)	66
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(54)	(21)
Net gain on sale of securities included in net income, net of tax expense	-	(130)
Total Other Comprehensive Loss	(351)	(85)
Total Comprehensive Income	$ 655	$ 1,057

	Six Months Ended June 30,	
	2018	2017
	(Unaudited) (Dollars in thousands)	
Net Income	$ 1,942	$ 1,858
Other Comprehensive Loss, net of tax benefit:		
Unrealized holding (losses) gains on securities available for sale, net of tax benefit (expense)	(977)	26
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(71)	(47)
Net gain on sale of securities included in net income, net of tax expense	-	(146)
Total Other Comprehensive Loss	(1,048)	(167)
Total Comprehensive Income	$ 894	$ 1,691

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

Six Months Ended June 30, 2018 and 2017 (Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by Compensation Plans	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(Dollars in thousands, except share and per share data)							
Balance - January 1, 2017	$ 68	$ 30,532	$ (7,300)	$(1,620)	$(578)	$53,546	$1,382	$76,030
Net income	-	-	-	-	-	1,858	-	1,858
Other comprehensive loss, net of tax benefit of $86	-	-	-	-	-	-	(167)	(167)
ESOP shares earned (3,968 shares)	-	20	-	43	-	-	-	63
Stock based compensation	-	22	-	-	-	-	-	22
Compensation plan shares granted (27,348 shares)	-	-	270	-	(270)	-	-	-
Compensation plan shares forfeited (200 shares)	-	-	(2)	-	2	-	-	-
Compensation plan shares earned (13,321 shares)	-	45	-	-	142	-	-	187
Purchase of treasury stock, at cost (13,500 shares)	-	-	(212)	-	-	-	-	(212)
Cash dividends declared ($0.16 per share)	-	-	-	-	-	(373)	-	(373)
Balance - June 30, 2017	$ 68	$ 30,619	$ (7,244)	$(1,577)	$(704)	$55,031	$1,215	$77,408
Balance - January 1, 2018	$ 68	$ 30,719	$ (7,309)	$(1,535)	$(540)	$56,181	$791	$78,375
Net income	-	-	-	-	-	1,942	-	1,942
Other comprehensive loss, net of tax benefit of $278	-	-	-	-	-	-	(1,048)	(1,048)
Reclassification of the Income Tax Effects of the Tax Cuts and Jobs Act from AOCI	-	-	-	-	-	(156)	156	-
ESOP shares earned (3,968 shares)	-	24	-	43	-	-	-	67
Stock based compensation	-	22	-	-	-	-	-	22
Compensation plan shares granted (5,329 shares)	-	-	51	-	(51)	-	-	-
Compensation plan shares forfeited (9,638 shares)	-	-	(91)	-	91	-	-	-
Compensation plan shares earned (13,942 shares)	-	54	-	-	147	-	-	201
	-	-	(572)	-	-	-	-	(572)

Purchase of treasury stock, at cost (34,300 shares)								
Cash dividends declared ($0.20 per share)	-	-	-	-	-	(458)	-	(458)
Balance - June 30, 2018	$ 68	$ 30,819	$ (7,921)	$(1,492)	$(353)	$57,509	$(101)	$78,529

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Six Months Ended June 30,	
	2018	2017
	(Unaudited) (Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,942	$ 1,858
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	46	61
Net amortization of deferred loan costs	277	287
Provision for loan losses	190	375
Recovery on previously impaired investment securities	(90)	(71)
Unrealized gain on equity securities	(14)	-
Gain on sale of investment securities	-	(222)
Originations of loans held for sale	(434)	(672)
Proceeds from sales of loans held for sale	440	681
Gain on sale of loans	(6)	(9)
Depreciation and amortization	384	441
Increase in bank owned life insurance, net	(170)	(177)
ESOP shares committed to be released	67	63
Stock based compensation expense	223	209
Increase in accrued interest receivable	(27)	(31)
Decrease in other assets	95	105
Decrease in other liabilities	(698)	(279)
Net Cash Provided by Operating Activities	2,225	2,619
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	-	5,445
Maturities, prepayments and calls	4,299	6,764
Purchases	(10,072)	(1,714)
Purchases of Federal Home Loan Bank Stock	(20)	(375)
Redemptions of Federal Home Loan Bank Stock	106	-
Loan origination and principal collections, net	(17,805)	(38,347)
Additions to premises and equipment	(379)	(967)
Net Cash Used in Investing Activities	(23,871)	(29,194)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	27,158	6,787
Net increase (decrease) in advances from borrowers for taxes and insurance	28	(138)
Proceeds from issuance of long-term debt	1,500	9,700
Repayment of long-term debt	(3,800)	(1,700)
Purchase of treasury stock	(572)	(212)
Cash dividends paid	(458)	(373)
Net Cash Provided by Financing Activities	23,856	14,064
Net Increase (Decrease) in Cash and Cash Equivalents	2,210	(12,511)
CASH AND CASH EQUIVALENTS - BEGINNING	40,913	45,479
CASH AND CASH EQUIVALENTS - ENDING	$ 43,123	$ 32,968

SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 1,619	$ 1,202
Income taxes paid	$ 277	$ 440
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Securities purchased and not settled	$ 82	$ 45

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

The interim consolidated financial statements include the accounts of Lake Shore Bancorp, Inc. (the “Company”, “us”, “our”, or “we”) and Lake Shore Savings Bank (the “Bank”), its wholly owned subsidiary. All intercompany accounts and transactions of the consolidated subsidiary have been eliminated in consolidation.

The interim consolidated financial statements included herein as of June 30, 2018 and for the three and six months ended June 30, 2018 and 2017 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, 2017 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, 2017. The consolidated statements of income for the three and six months ended June 30, 2018 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2018.

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 June 30, 2018 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 FASB ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" (ASU 2018-02) on January 1, 2018. ASU 2018-02 was issued to address the income tax accounting treatment of the stranded tax effects within other comprehensive income. This issue came about from the enactment of the Tax Cuts and Jobs Act (the "Tax Act") on December 22, 2017 that changed the Company's tax rate from 34% to 21%. ASU 2018-02 allows an entity to elect a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the Tax Act. The amount of that reclassification should include the effect of tax rate changes on the deferred tax amount, any related valuation allowance and other income tax effects on the items in AOCI. Upon adoption of ASU 2018-02, the Company reclassified the income tax effect of the Tax Act from AOCI to retained earnings. The reclassification increased AOCI and decreased retained earnings by $156,000, with zero net effect on total shareholders' equity. The Company uses the individual security approach for all available for sale securities when releasing income tax effects remaining in AOCI.

Note 3 – Investment Securities

Debt Securities

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

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
Debt Securities				
U.S. Government Agencies	$ 2,012	$ -	$ (94)	$ 1,918
Municipal bonds	45,427	736	(116)	46,047
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	28	-	-	28
Collateralized mortgage obligations-government sponsored entities	33,315	13	(984)	32,344
Government National Mortgage Association	204	8	-	212
Federal National Mortgage Association	2,596	46	(28)	2,614
Federal Home Loan Mortgage Corporation	1,386	14	(21)	1,379
Asset-backed securities-private label	-	296	-	296
Asset-backed securities-government sponsored entities	50	2	-	52
Total Debt Securities	$ 85,018	$ 1,115	$ (1,243)	$ 84,890
Equity Securities	22	14	-	36
Total Securities Available for Sale	$ 85,040	$ 1,129	$ (1,243)	$ 84,926

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
Debt Securities				
U.S. Government Agencies	$ 2,013	$ -	$ (26)	$ 1,987
Municipal bonds	44,256	1,312	(6)	45,562
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	30	-	-	30
Collateralized mortgage obligations-government sponsored entities	28,195	28	(569)	27,654
Government National Mortgage Association	229	16	-	245
Federal National Mortgage Association	2,834	95	-	2,929
Federal Home Loan Mortgage Corporation	1,518	35	-	1,553
Asset-backed securities-private label	69	276	(1)	344
Asset-backed securities-government sponsored entities	57	3	-	60
Total Debt Securities	$ 79,201	$ 1,765	$ (602)	$ 80,364
Equity Securities	22	35	-	57
Total Securities Available for Sale	$ 79,223	$ 1,800	$ (602)	$ 80,421

Debt Securities

All of our collateralized mortgage obligations are backed by one- to four-family residential mortgages.

At June 30, 2018, thirty-two municipal bonds with a cost of $11.0 million and fair value of $11.2 million were pledged under a collateral agreement with the Federal Reserve Bank (“FRB”) of New York for liquidity borrowing. At December 31, 2017, thirty-three municipal bonds with a cost of $11.3 million and fair value of $11.7 million were pledged with the FRB. In addition, at June 30, 2018, twenty-two municipal bonds with a cost and fair value of $5.6 million were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation (“FDIC”) insurance limits. At December 31, 2017, twenty municipal bonds with a cost of $5.1 million and fair value of $5.3 million were pledged as collateral for customer deposits in excess of the FDIC insurance limits.

The following table sets forth the Company's investment in debt 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)					
June 30, 2018						
U.S. Government Agencies	$ 1,918	$ (94)	$ -	$ -	$ 1,918	$ (94)
Municipal bonds	4,597	(112)	561	(4)	5,158	(116)
Mortgage-backed securities	14,508	(275)	15,881	(758)	30,389	(1,033)
	$ 21,023	$ (481)	$ 16,442	$ (762)	$ 37,465	$ (1,243)

December 31, 2017						
U.S. Government Agencies	$ 1,987	$ (26)	$ -	$ -	$ 1,987	$ (26)
Municipal bonds	491	(6)	-	-	491	(6)
Mortgage-backed securities	7,547	(57)	17,602	(512)	25,149	(569)
Asset-backed securities -private label	68	(1)	-	-	68	(1)
	$ 10,093	$ (90)	$ 17,602	$ (512)	$ 27,695	$ (602)

The Company reviews all investment securities on an ongoing basis for the presence of other-than-temporary impairment ("OTTI") with formal reviews performed quarterly.

At June 30, 2018, the Company's investment portfolio included several debt securities in the "unrealized losses less than twelve months" category. The debt securities were not evaluated further for OTTI as the unrealized losses on the individual debt securities were less than 20% of book value, which management deemed to be immaterial, the securities were issued by government sponsored enterprises and management has the intent and ability to hold these securities.

At June 30, 2018, the Company had several debt securities in the "unrealized losses twelve months or more" category. These securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value and management has the intent and ability to hold these securities until unrealized losses have recovered. Management believes 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.

Management completed an OTTI analysis for three private label asset-backed securities, which did not have unrealized losses as of June 30, 2018. Management concluded that there was a limited risk of principal losses for these securities and that additional OTTI charges were not required as of June 30, 2018 on these securities.

The unrealized losses on debt securities shown in the previous tables were recorded as a component of other comprehensive loss, net of tax benefit on the Company's Consolidated Statements of Stockholders' Equity.

The following table presents a summary of the credit-related OTTI charges recognized as components of income:

	For The Six Months Ended June 30,	
	2018	2017
	(Dollars in thousands)	
Beginning balance	$ 435	$ 554
Additions:		
Credit loss not previously recognized	-	-
Reductions:		
Losses realized during the period on OTTI previously recognized	-	-
Receipt of cash flows on previously recorded OTTI	(48)	(71)
Ending balance	$ 387	$ 483

A deterioration in credit quality and/or other factors that may limit the liquidity of a security in our portfolio 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.

During the six months ended June 30, 2018, the Company did not sell any available for sale debt securities. During the six months ended June 30, 2017, the Company sold fourteen municipal bonds for total proceeds of $5.4 million resulting in gross realized gains of $222,000.

Equity Securities

At June 30, 2018 and December 31, 2017, available for sale equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock. During the six months ended June 30, 2018, the Company recognized an unrealized gain of $14,000 on the equity securities, which was recorded in noninterest income in the consolidated statements of income. There were no sales of equity securities during the six months ended June 30, 2018.

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

	Amortized Cost	Fair Value

	(Dollars in thousands)	
June 30, 2018:		
After one year through five years	$ 5,473	$ 5,608
After five years through ten years	22,871	23,273
After ten years	19,095	19,084
Mortgage-backed securities	37,529	36,577
Asset-backed securities	50	348
Equity securities	22	36
	$ 85,040	$ 84,926

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's housing market has consistently demonstrated stability in home prices despite economic conditions. Furthermore, the Company has conservative underwriting standards and its residential lending policies and procedures ensure that its one- to four-family residential mortgage loans generally conform to secondary market guidelines.

- Home Equity - are loans or lines of credit secured by first or second liens on owner-occupied residential real estate primarily held in the Western New York region. 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. The Company does not originate interest only home equity loans.
- 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 relatively large loan balances concentrated with 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 one- to four-family 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. The Company limits its risk during construction as disbursements are not made until the required work for each advance has been completed and an updated lien search is performed. The completion of the construction progress is verified by a Company loan officer or inspections performed by an independent appraisal firm. Construction loans also expose us to the risk of construction delays which may impair the borrower's ability to repay the loan.

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 5 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. Although commercial loans may be collateralized by equipment or other business assets, the liquidation of collateral in the event of a borrower default may be an insufficient source of repayment because the equipment or other business assets may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial loan depends primarily on the credit worthiness of the borrowers (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.
- 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

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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 bank regulators, 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 an amount of loss allowances to these classified loans based on loan grade.

The following tables summarize the activity in the allowance for loan losses for the three and six months ended June 30, 2018 and 2017 and the distribution of the allowance for loan losses and loans receivable by loan portfolio class and impairment method as of June 30, 2018 and December 31, 2017:

	Real Estate Loans				Other Loans			
	One- to Four-Family (2)	Home Equity	Commercial	Construction - Commercial	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
June 30, 2018								
Allowance for Loan Losses:								
Balance – April 1, 2018	$ 476	$ 128	$ 1,705	$ 350	$ 630	$ 30	$ 48	$ 3,367
Charge-offs	-	-	-	-	-	(11)	-	(11)
Recoveries	-	1	-	-	1	1	-	3
Provision (Credit)	(36)	(43)	182	(21)	27	10	(4)	115
Balance – June 30, 2018	$ 440	$ 86	$ 1,887	$ 329	$ 658	$ 30	$ 44	$ 3,474
Balance – January 1, 2018	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Charge-offs	-	-	-	-	-	(23)	-	(23)
Recoveries	18	1	-	-	1	4	-	24
Provision (Credit)	(89)	(37)	224	(18)	113	14	(17)	190
Balance – June 30, 2018	$ 440	$ 86	$ 1,887	$ 329	$ 658	$ 30	$ 44	$ 3,474
Ending balance: individually evaluated for impairment	$ -	$ -	$ 90	$ -	$ -	$ -	$ -	$ 90
Ending balance: collectively	$ 440	$ 86	$ 1,797	$ 329	$ 658	$ 30	$ 44	$ 3,384

evaluated for impairment								
Gross Loans Receivable (1):								
Ending balance	$ 145,415	$ 39,957	$ 136,902	$ 29,248	$ 29,713	$ 1,365	$ -	$ 382,600
Ending balance: individually evaluated for impairment	$ 181	$ 19	$ 2,111	$ -	$ 61	$ -	$ -	$ 2,372
Ending balance: collectively evaluated for impairment	$ 145,234	$ 39,938	$ 134,791	$ 29,248	$ 29,652	$ 1,365	$ -	$ 380,228

(1) Gross Loans Receivable does not include allowance for loan losses of $(3,474) or deferred loan costs of $3,193.
(2) Includes one- to four-family construction loans.

	Real Estate Loans				Other Loans			
	One- to Four-Family (1)	Home Equity	Commercial	Construction - Commercial	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
June 30, 2017								
Allowance for Loan Losses:								
Balance – April 1, 2017	$ 462	$ 117	$ 1,968	$ 191	$ 381	$ 21	$ 58	$ 3,198
Charge-offs	-	(3)	-	-	-	(6)	-	(9)
Recoveries	-	3	-	-	-	6	-	9
Provision (Credit)	9	7	(80)	111	(50)	11	17	25
Balance – June 30, 2017	$ 471	$ 124	$ 1,888	$ 302	$ 331	$ 32	$ 75	$ 3,223
Balance – January 1, 2017	$ 432	$ 114	$ 1,803	$ 149	$ 338	$ 28	$ 18	$ 2,882
Charge-offs	-	(3)	-	-	(18)	(28)	-	(49)
Recoveries	1	3	-	-	1	10	-	15
Provision (Credit)	38	10	85	153	10	22	57	375
Balance – June 30, 2017	$ 471	$ 124	$ 1,888	$ 302	$ 331	$ 32	$ 75	$ 3,223

(1) Includes one– to four- family construction loans.

	Real Estate Loans				Other Loans			
	One- to Four-Family (2)	Home Equity	Commercial	Construction - Commercial	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
December 31, 2017								
Allowance for Loan Losses:								
Balance – December 31, 2017	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Gross Loans Receivable (1):								

Ending Balance	$ 144,614	$ 38,078	$ 122,747	$ 30,802	$ 27,612	$ 1,355	$ -	$ 365,208
Ending balance: individually evaluated for impairment	$ 184	$ 21	$ 1,498	$ -	$ 54	$ -	$ -	$ 1,757
Ending balance: collectively evaluated for impairment	$ 144,430	$ 38,057	$ 121,249	$ 30,802	$ 27,558	$ 1,355	$ -	$ 363,451

(1) Gross Loans Receivable does not include allowance for loan losses of $(3,283) or deferred loan costs of $3,138.
(2) Includes one– to four- family construction loans.

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.

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
				For the Six Months Ended	
	At June 30, 2018			June 30, 2018	
	(Dollars in thousands)				
With no related allowance recorded:					
Residential, one- to four-family	$ 181	$ 181	$ -	$ 182	$ 7
Home equity	19	19	-	20	-
Commercial real estate	411	411	-	414	4
Commercial loans	61	61	-	80	1
Total impaired loans with no related allowance	672	672	-	696	12
With an allowance recorded:					
Commercial real estate	1,700	1,700	90	1,618	9
Total impaired loans with an allowance	1,700	1,700	90	1,618	9
Total of impaired loans:					
Residential, one- to four-family					