Lake Shore Bancorp, Inc.
Form 10-Q
August 14, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

¨ **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	**20-4729288**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**
125 East Fourth Street, Dunkirk, New York	**14048**
(Address of principal executive offices)	**(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 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	x

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:

Common stock ($0.01 par value) 6,352,698 outstanding shares as of July 31, 2008.

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PART I

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

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	June 30, 2008	December 31, 2007
	(Unaudited)	
	(In Thousands, except per share data)	
ASSETS		
Cash and due from banks	**$ 6,155**	$ 7,379
Interest bearing deposits	**2,917**	2,671
Federal funds sold	**17,267**	41
Cash and Cash Equivalents	**26,339**	10,091
Securities available for sale	**108,662**	105,922
Federal Home Loan Bank stock, at cost	**3,034**	3,081
Loans receivable, net of allowance for loan losses 2008 $1,280; 2007 $1,226	**227,903**	218,711
Premises and equipment, net	**6,915**	6,923
Accrued interest receivable	**1,547**	1,494
Bank owned life insurance	**10,370**	10,166
Other assets	**2,775**	1,413
Total Assets	**$ 387,545**	$ 357,801
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Deposits:		
Interest bearing	**$ 250,312**	$ 221,507
Non-interest bearing	**20,420**	19,321
Total Deposits	**270,732**	240,828
Short-term borrowings	**4,055**	18,505
Long-term debt	**51,100**	37,940
Advances from borrowers for taxes and insurance	**2,713**	2,669
Other liabilities	**6,388**	4,394
Total Liabilities	**$ 334,988**	$ 304,336
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,612,500 shares issued and 6,367,698 outstanding at June 30, 2008 and 6,612,500 shares issued and 6,423,671 outstanding at December 31, 2007, respectively	**$ 66**	$ 66
Additional paid-in capital	**27,705**	27,653
Treasury stock, at cost (244,802 shares at June 30, 2008 and 188,829 shares at December 31, 2007)	**(2,774)**	(2,215)
Unearned shares held by ESOP	**(2,345)**	(2,388)
Unearned shares held by RRP	**(1,279)**	(1,367)
Retained earnings	**31,026**	31,534

Accumulated other comprehensive income		**158**		182
Total Stockholders Equity		**52,557**		53,465
Total Liabilities and Stockholders Equity	**$**	**387,545**	$	357,801

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
	(Unaudited)			
	(In Thousands, except per share data)			
INTEREST INCOME				
Loans, including fees	**$ 3,214**	$ 3,124	**$ 6,962**	$ 6,326
Investment securities, taxable	**1,185**	1,172	**2,321**	2,323
Investment securities, tax-exempt	**122**	89	**235**	163
Other	**85**	41	**129**	111
Total Interest Income	**4,606**	4,426	**9,647**	8,923
INTEREST EXPENSE				
Deposits	**1,632**	1,753	**3,277**	3,476
Short-term borrowings	**48**	145	**182**	294
Long-term debt	**491**	320	**961**	639
Other	**30**	30	**60**	60
Total Interest Expense	**2,201**	2,248	**4,480**	4,469
Net Interest Income	**2,405**	2,178	**5,167**	4,454
PROVISION FOR LOAN LOSSES	**150**		**150**	45
Net Interest Income after Provision for Loan Losses	**2,255**	2,178	**5,017**	4,409
NON-INTEREST INCOME				
Impairment charge on investment securities	**(1,732)**		**(1,732)**	
Service charges and fees	**519**	360	**967**	701
Earnings on bank owned life insurance	**101**	103	**204**	205
Other	**27**	29	**66**	55
Total Non-Interest Income (Loss)	**(1,085)**	492	**(495)**	961
NON-INTEREST EXPENSES				
Salaries and employee benefits	**1,192**	1,199	**2,540**	2,503
Occupancy and equipment	**354**	319	**695**	668
Professional services	**309**	346	**596**	605
Data processing	**141**	126	**277**	239
Advertising	**84**	67	**186**	108
Postage and supplies	**61**	58	**128**	126
Other	**191**	182	**398**	388
Total Non-Interest Expenses	**2,332**	2,297	**4,820**	4,637
Income (Loss) before Income Taxes	**(1,162)**	373	**(298)**	733
INCOME TAXES	**(236)**	71	**(30)**	133

Net Income (Loss)	**$ (926)**	$ 302	**$ (268)**	$ 600
Basic earnings (loss) per common share	**$ (0.15)**	$ 0.05	**$ (0.04)**	$ 0.10
Diluted earnings (loss) per common share	**$ (0.15)**	$ 0.05	**$ (0.04)**	$ 0.10
Dividends declared per share	**$ 0.05**	$ 0.03	**$ 0.09**	$ 0.06

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, 2008 and 2007 (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
				(In Thousands, except per share data)				
Balance December 31, 2006	$ 66	$ 27,537	$	$ (2,473)	$ (1,565)	$ 30,063	$ 119	$ 53,747
Comprehensive income:								
Net income						600		600
Other comprehensive loss							(501)	(501)
Total Comprehensive Income								99
ESOP shares earned (3,968 shares)		6		43				49
Stock based compensation		69						69
RRP shares earned (7,321 shares)		(14)			98			84
Purchase of treasury stock, at cost (148,781 shares)			(1,852)					(1,852)
Cash dividends declared ($0.06 per share)						(164)		(164)
Balance June 30, 2007	**$ 66**	**$ 27,598**	**$ (1,852)**	**$ (2,430)**	**$ (1,467)**	**$ 30,499**	**$ (382)**	**$ 52,032**
Balance December 31, 2007	$ 66	$ 27,653	$ (2,215)	$ (2,388)	$ (1,367)	$ 31,534	$ 182	$ 53,465
Comprehensive loss:								
Net loss						(268)		(268)
Other comprehensive loss							(24)	(24)
Total Comprehensive Loss								(292)
ESOP shares earned (3,968 shares)		(5)		43				38
Stock based compensation		69						69
RRP shares earned (6,599 shares)		(12)			88			76
Purchase of treasury stock, at cost (55,973 shares)			(559)					(559)
Cash dividends declared ($ 0.09 per share)						(240)		(240)
Balance June 30, 2008	**$ 66**	**$ 27,705**	**$ (2,774)**	**$ (2,345)**	**$ (1,279)**	**$ 31,026**	**$ 158**	**$ 52,557**

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2008	2007
	(Unaudited)	
	(In Thousands)	
Cash Flows from Operating Activities		
Net income (loss)	**$ (268)**	$ 600
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net amortization (accretion) of investment securities	**(58)**	2
Provision for loan losses	**150**	45
Impairment of investment securities	**1,732**	
Depreciation and amortization	**266**	272
Earnings on bank owned life insurance	**(204)**	(205)
ESOP shares committed to be released	**38**	49
Stock based compensation expense	**145**	153
Increase in accrued interest receivable	**(53)**	(32)
(Increase) decrease in other assets	**(1,017)**	140
Increase (decrease) in other liabilities	**1,002**	(394)
Net Cash Provided by Operating Activities	**1,733**	630
Cash Flows from Investing Activities		
Activity in available for sale securities:		
Maturities, prepayments and calls	**9,837**	8,531
Purchases	**(13,298)**	(7,923)
Purchases of Federal Home Loan Bank Stock	**(749)**	(326)
Redemptions of Federal Home Loan Bank Stock	**796**	344
Proceeds from sales of loans	**2**	32
Loan origination and principal collections, net	**(9,674)**	(3,466)
Additions to premises and equipment	**(258)**	(214)
Net Cash Used in Investing Activities	**(13,344)**	(3,022)
Cash Flows from Financing Activities		
Net increase (decrease) in deposits	**29,904**	(2,152)
Net increase (decrease) in advances from borrowers for taxes and insurance	**44**	(176)
Net increase (decrease) in short-term borrowings	**(14,450)**	620
Proceeds from issuance of long-term debt	**18,900**	
Repayment of long-term debt	**(5,740)**	(1,260)
Purchase of Treasury Stock	**(559)**	(1,852)
Cash dividends paid	**(240)**	(164)
Net Cash Provided by (Used in) Financing Activities	**27,859**	(4,984)
Net Increase (Decrease) in Cash and Cash Equivalents	**16,248**	(7,376)
Cash and Cash Equivalents Beginning	**10,091**	18,682
Cash and Cash Equivalents Ending	**$ 26,339**	$ 11,306

Supplementary Cash Flows Information				
Interest paid	**$**	**4,496**	$	4,562
Income taxes paid	**$**	**143**	$	632
Supplementary Schedule of Noncash Investing and Financing Activities				
Foreclosed real estate acquired in settlement of loans	**$**	**422**	$	34

See notes to consolidated financial statements.

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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 company form of organization.

The interim financial statements included herein as of June 30, 2008 and for the three and six months ended June 30, 2008 and 2007 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), and therefore, do not include all information or footnotes necessary for a complete presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. The balance sheet at December 31, 2007 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. These interim 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, 2007. The results of operations for the three and six months ended June 30, 2008 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2008.

To prepare these financial statements in conformity with generally accepted accounting principles, 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, and income taxes.

NOTE 2 DERIVATIVE INSTRUMENTS

In August 2006, the Company entered into a derivative contract as part of its risk management strategy to protect against market fluctuations in interest rates. An interest rate floor was purchased for $221,000 to protect against a decline in the prime rate earned on a $10 million notional amount of adjustable rate loans within our loan portfolio. The term of the interest rate floor product is 60 months. The Company follows Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, to account for this transaction. SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives must be recognized in earnings when they occur, unless the derivatives qualify as a hedge. If a derivative qualifies as a hedge, a company can elect to use hedge accounting to eliminate or reduce income statement volatility that would arise from reporting changes in a derivative s fair value in income. The Company did not elect to use hedge accounting for this transaction. The interest rate floor is recorded in Other Assets on the Consolidated Statement of Financial Condition and the change in fair value is recorded in Loan Interest Income on the Consolidated Statement of Income. As of June 30, 2008 and 2007, the fair market value of the interest rate floor was $583,000 and $119,000, respectively, resulting in $64,000 of interest income for the six months ended June 30, 2008 and $101,000 of interest expense for the six months ended June 30, 2007. During the quarter ended June 30, 2008 and 2007, $262,000 and $110,000, respectively, of interest expense was recorded for the decline in the fair market value of the interest rate floor.

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NOTE 3 ADOPTION OF NEW ACCOUNTING STANDARDS

The Company adopted FASB Statement No. 157 Fair Value Measurements (SFAS 157) effective January 1, 2008, for financial assets and liabilities that are measured and reported at fair value. There was no impact from the adoption of SFAS 157 on the amounts reported in the consolidated financial statements. The primary impact of SFAS 157 on the Company was to expand required disclosures pertaining to the methods used to determine fair values. See Note 9 for further details.

NOTE 4 RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 was effective as of January 1, 2008. The Company adopted this statement, but did not elect the fair value option for any financial assets or financial liabilities.

In March 2007, the FASB ratified EITF Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. There was no impact on adopting EITF 06-11 on the Company s consolidated financial statements.

FASB Statement No. 160 Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 151 was issued on December 31, 2007. This statement establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. The guidance will become effective as of the beginning of a company s fiscal year beginning after December 15, 2008. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In February 2008, the FASB issued a FASB Staff Position (FSP) FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This FSP addresses the issue of whether or not these transactions should be viewed as two separate transactions or as one linked transaction. The FSP includes a rebuttable presumption that presumes linkage of the two transactions unless the presumption can be overcome by meeting certain criteria. The FSP will be effective for fiscal years beginning after November 15, 2008 and will apply only to original transfers made after that date; early adoption will not be allowed. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (Statement 161). Statement 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 has been applied, and the impact that hedges have on an entity s financial position, financial performance, and cash flows. Statement 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

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In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets (SFAS 142). The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, and other GAAP. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This Statement is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP clarifies that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. This FSP is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

NOTE 5 OTHER COMPREHENSIVE LOSS

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, are reported as a separate component of the stockholders equity section of the consolidated statement of financial condition, such items, along with net income, are components of comprehensive income.

The components of other comprehensive loss and related tax effects for the three and six months ended June 30, 2008 and 2007 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(In Thousands)			
Unrealized holding losses on securities available for sale	$ (2,510)	$ (910)	$ (1,770)	$ (794)
Reclassification adjustment related to impairment charge for losses included in net loss	1,732		1,732	
Net Unrealized Losses	(778)	(910)	(38)	(794)
Income tax benefit	288	337	14	293
Other Comprehensive Loss	$ (490)	$ (573)	$ (24)	$ (501)

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NOTE 6 EARNINGS (LOSS) PER SHARE

Earnings (loss) per share is calculated for the three and six month periods ended June 30, 2008 and 2007, respectively. Basic net income (loss) per share is based upon the weighted average number of common shares outstanding, while diluted net income (loss) 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.

The difference between the common shares issued and the common shares outstanding, for the purposes of calculating basic earnings (loss) per share, is a result of the unallocated shares held by the Company s employee stock ownership plan (the ESOP), restricted stock shares, and treasury stock. The Company utilized $2.6 million to extend a loan to the ESOP and as of June 30, 2008, the ESOP used such proceeds to purchase 238,050 shares of stock on the open market at an average price of $10.70 per share, plus commission expenses. As a result of the purchase of shares by the ESOP, total stockholders equity of the Company was reduced by $2.6 million.

Basic and diluted earnings (loss) per share was calculated as follows:

	Three Months ended June 30, 2008	Three Months ended June 30, 2007
Numerator net income (loss)	$ (926,000)	$ 302,000
Denominators:		
Basic weighted average shares outstanding	6,070,730	6,263,852
Increase in weighted average shares outstanding due to: (1)		
Stock options		
Unvested restricted stock awards		2,487
Diluted shares outstanding	6,070,730	6,266,339
Earnings (loss) per share:		
Basic	$ (0.15)	$ 0.05
Diluted	$ (0.15)	$ 0.05

	Six Months ended June 30, 2008	Six Months ended June 30, 2007
Numerator net income (loss)	$ (268,000)	$ 600,000
Denominators:		
Basic weighted average shares outstanding	6,080,724	6,270,889
Increase in weighted average shares outstanding due to: (1)		
Stock options		
Unvested restricted stock awards		1,331
Diluted shares outstanding	6,080,724	6,272,220
Earnings (loss) per share:		
Basic	$ (0.04)	$ 0.10
Diluted	$ (0.04)	$ 0.10

(1) Stock options to purchase 219,289 shares under the Stock Option Plan at $11.50 and to purchase restricted unvested shares of 95,761 under the RRP plan were outstanding during the six month period ended June 30, 2008, but were not included in the

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calculation of diluted earnings (loss) per share because to do so would have been anti-dilutive. Stock options to purchase 241,546 shares under the Stock Option Plan at $11.50 were outstanding during the six month period ended June 30, 2007, but were not included in the calculation of diluted earnings (loss) per share because to do so would have been anti-dilutive. No RRP plan shares were anti-dilutive in 2007.

NOTE 7 COMMITMENTS TO EXTEND CREDIT

The Company has commitments to extend credit with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition.

The Company s exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

The following commitments to extend credit were outstanding:

	Contract Amount	
	June 30, 2008	**December 31, 2007**
	(In Thousands)	
Commitments to grant loans	**$ 15,412**	$ 5,037
Unfunded commitments under lines of credit	**$ 22,393**	$ 21,256

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management s credit evaluation of the customer. At June 30, 2008 and December 31, 2007, the Company s fixed rate loan commitments totaled $13.1 million and $3.7 million, respectively. The range of interest rates on these fixed rate commitments was 5.25% to 8.50% at June 30, 2008.

NOTE 8 STOCK-BASED COMPENSATION

As of June 30, 2008, the Company had three stock-based compensation plans, which are described below. The Company accounts for the fair value of its grants under those plans in accordance with SFAS 123R, Share Based Payment. The compensation cost that has been charged under salary and benefits expense in the other non-interest expense section of the consolidated statements of operations for these plans was $87,000 for the three months ended June 30, 2008 and $101,000 for the three months ended June 30, 2007. The compensation cost that has been charged under salary and benefits expense in the other non-interest expense section of the consolidated statements of operations for these plans for the six month periods ended June 30, 2008 and June 30, 2007 was $183,000 and $202,000, respectively.

Stock Option Plan

The Company s 2006 Stock Option Plan (the Stock Option Plan), which was approved by the Company s shareholders, permits the grant of options to its employees and non-employee directors for up to 297,562 shares of common stock. On November 15, 2006, the Board of Directors granted stock options exercisable into 241,546 shares of common stock to members of management and non-employee directors. Both incentive stock options and non-qualified stock options may be granted under the Stock Option Plan. The exercise price of each stock option equals the market price of the Company s stock on the date of grant and the maximum term is ten years. The stock options generally vest over a five year period.

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 1.04%; expected volatility of 9.64%; risk-free interest rate of 4.617%; and expected life of 10 years.

A summary of the status of the Stock Option Plan as of June 30, 2008 and 2007 is presented below:

	June 30, 2008			June 30, 2007		
	Options	Exercise Price	Remaining Contractual Life	Options	Exercise Price	Remaining Contractual Life
Outstanding at beginning of year	241,546	$ 11.50		241,546	$ 11.50	
Granted						
Forfeited	22,257	$ 11.50				
Outstanding at end of quarter	219,289	$ 11.50	8 years	241,546	$ 11.50	9 years
Options exercisable at end of quarter	48,319	$ 11.50				
Fair value of options granted	$ 3.27			$ 3.27		

At June 30, 2008, stock options outstanding did not have an intrinsic value (as the stock price on that date was below the exercise price) and 78,273 options remain available for grant under the stock option plan. Compensation expense amounted to $33,000 for the three months ended June 30, 2008 and $35,000 for the three months ended June 30, 2007 based on the vesting of 10,092 and 10,669 stock options earned respectively, through those dates. Compensation expense amounted to $69,000 for the six months ended June 30, 2008 and 2007 based on the vesting of 21,257 and 21,224 stock options, respectively, through those dates. At June 30, 2008, $489,000 of unrecognized compensation cost related to stock options is expected to be recognized over a period of 42 months.

Recognition and Retention Plan

The Company s 2006 Recognition and Retention Plan (the RRP), which was approved by the Company s shareholders, permits the grant of restricted stock awards to employees and non-employee directors for up to 119,025 shares of common stock. On November 15, 2006, the Board of Directors granted awards for an aggregate of 83,305 shares under the RRP to members of management and non-employee directors. Awards vest at a rate of 20% per year with the first vesting period ended December 31, 2007. The fair value of the awards on the grant date was $11.50. As of June 30, 2008, there were 16,665 shares vested and distributed to eligible participants. Compensation expense amounted to $35,000 for the three months ended June 30, 2008 and $42,000 for the three months ended June 30, 2007 based on the vesting of 3,047 and 3,679 shares, respectively. Compensation expense amounted to $76,000 for the six months ended June 30, 2008, based on the vesting of 6,599 shares and $84,000 for the six months ended June 30, 2007 based on the vesting of 7,321 shares earned, respectively through those dates. At June 30, 2008, $534,000 of unrecognized compensation cost related to the RRP is expected to be recognized over a period of 42 months.

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Employee Stock Ownership Plan

The Company established the ESOP for the benefit of eligible employees of the Company and Bank. All Company and Bank employees meeting certain age and service requirements are eligible to participate in the ESOP. Participants benefits become fully vested after five years of service. As of June 30, 2008, there were 15,870 allocated shares and 222,180 unallocated shares compared to 7,935 allocated shares and 230,115 unallocated shares at June 30, 2007. The ESOP compensation expense was $19,000 for the three months ended June 30, 2008 and $24,000 for the three months ended June 30, 2007 based on 1,984 shares that were earned in the three month periods ended June 30, 2008 and 2007. The ESOP compensation expense was $38,000 for the six months ended June 30, 2008 and $49,000 for the six months ended June 30, 2007 based on 3,968 shares that were earned in the six month periods ended June 30, 2008 and 2007.

NOTE 9 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In addition, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in these estimates.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument, including judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates as provided by the company s custody agent and investment advisor. Prices obtained from these sources include market quotations.

As discussed in Note 3, the Company adopted SFAS 157 effective January 1, 2008. SFAS 157 established a fair value hierarchy that prioritized the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The three levels of the fair value hierarchy under SFAS 157 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date of identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows:

		Fair Value Measurements at June 30, 2008		
	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
		(In Thousands)		
Securities available for sale	$ 108,662	$	$ 108,662	$
Interest rate floor	583		583	
Total	$ 109,245	$	$ 109,245	$

Nonrecurring Fair Value Changes

We may be required to measure certain other financial assets at fair value on a nonrecurring basis. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The Level 3 disclosures shown below represent the carrying value of loans for which adjustments are primarily based on the appraised value of collateral or the present value of expected future cash flows, which often results in significant management assumptions and input with respect to the determination of fair value. There were no realized or unrealized gains or losses relating to Level 3 financial assets and liabilities measured on a nonrecurring basis for the six months ended June 30, 2008.

		Fair Value Measurements Nonrecurring at June 30, 2008		
	June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
		(In Thousands)		
Impaired loans	$ 79	$	$	$ 79

Impaired loans, which are measured using the fair value of the collateral for collateral-dependent loans, had a carrying amount of $107,000, with a valuation allowance of $28,000, resulting in additional provision for loan losses of $7,000 for the six months ended June 30, 2008.

The Company s adoption of SFAS 157 applies only to its financial instruments required to be reported at fair value. The adoption did not apply to those non-financial assets and non-financial liabilities for which the adoption was delayed until January 1, 2009 in accordance with FSP FAS 157-2.

Fair value methods and assumptions are set forth below for each type of financial instrument.

Securities available for sale

Fair value on available for sale securities were based upon a market approach. Securities which are fixed income instruments that are not quoted on an exchange, but are traded in active markets, are valued using prices obtained from our custodian, which used third party data service providers.

Management evaluated the Company s investment portfolio and determined that a $1.7 million other than temporary impairment existed on four non-agency, asset-backed securities. The impairment of these securities was considered to be other than temporary due to recent developments in the financial condition and near-term prospects of the issuers or insurers backing the securities, a downturn of economic conditions in the financial services industry and deteriorating book values of these securities.

The impairment charge represents a write down of these securities to their fair market value as of June 30, 2008 and was recognized in earnings during the second quarter of 2008. Management will continue to evaluate the value of these investments and make any necessary adjustments as conditions dictate.

Interest rate floor

The carrying amount of the interest rate floor approximates fair value. Fair value of the interest rate floor is provided by a third party and is derived from proprietary models based upon well recognized financial principles and reasonable estimates about relevant future market conditions. Interest rate floor products are not actively traded, and fair market values do not indicate potential amount received if sold.

Impaired loans

Fair value on impaired loans is based on recent appraisal of related collateral and current market conditions.

NOTE 10 TREASURY STOCK

During the three months ended June 30, 2008, the Company repurchased 26,073 shares of common stock at an average cost of $9.83 per share pursuant to the Company s publicly announced common stock repurchase program. As of June 30, 2008, there were 49,445 shares remaining to be repurchased under the existing stock repurchase program.

NOTE 11 SUBSEQUENT EVENTS

On July 23, 2008, the Board of Directors declared a quarterly dividend of $0.05 per share on the Company s common stock, payable on August 15, 2008 to shareholders of record as of August 4, 2008. Lake Shore, MHC, which owns 57.1% of the Company s outstanding common stock elected to waive its right to receive cash dividends of approximately $182,000 for the three month period ended June 30, 2008 and $327,000 for the six month period ended June 30, 2008. Cumulatively, Lake Shore, MHC has waived approximately $908,000 of cash dividends as of June 30, 2008. The dividends waived by Lake Shore, MHC are considered a restriction on the retained earnings of the Company.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements may be identified by words such as believe, will, expect, project, may, could, anticipate, estimate, ir targets and similar expressions. These statements are based upon our current beliefs and expectations and are subject to significant risks and uncertainties. Actual results may differ materially from those set forth in the forward-looking statements as a result of numerous factors.

The following factors, including the factors set forth in Part I, Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2007, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements:

- general and local economic conditions;
- changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values and competition;
- the ability of our customers to make loan payments;
- our ability to continue to control costs and expenses;
- our ability to effectively deploy the capital raised in our April 2006 initial public offering;
- changes in accounting principles, policies or guidelines;
- our success in managing the risks involved in our business;
- inflation, and market and monetary fluctuations;
- changes in legislation or regulation; and
- other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may differ from actual outcomes. They can be affected by inaccurate assumptions we might make or known or unknown risks and uncertainties. Consequently, no forward-looking statements can be guaranteed. We undertake no obligation to publicly update any forward looking statement, whether as a result of new information, future events or otherwise.

Overview

The following discussion and analysis is presented to assist in the understanding and evaluation of our consolidated financial condition and results of operations. It is intended to complement the unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q and should be read in conjunction therewith. The detailed discussion focuses on our consolidated financial condition as of June 30, 2008 compared to the financial condition as of December 31, 2007 and the consolidated results of operations for the three and six months ended June 30, 2008 and 2007.

Our results of operations depend primarily on our net interest income, which is the difference between the interest income we earn on loans and investments and the interest we pay on deposits and other interest-bearing liabilities. Net interest income is affected by the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates we earn or pay on these balances.

Our operations are also affected by non-interest income, such as service fees and gains and losses on the sales of securities and loans, our provision for loan losses and non-interest expenses, which include salaries and employee benefits, occupancy costs, and other general and administrative expenses.

Financial institutions like us are significantly affected by economic conditions, competition, and the monetary and fiscal policies of the federal government. Lending activities are influenced by the demand for and supply of housing, competition among lenders, interest rate conditions, and funds availability. Our operations and lending are principally concentrated in the Western New York area, and our operations and earnings are influenced by local economic conditions. Deposit balances and cost of funds are influenced by prevailing market rates on competing investments, customer preferences, and levels of personal income and savings in our primary market area.

Management Strategy

Our Reputation. With more than 115 years of service to our community, our primary management strategy has been to maintain our reputation as one of the most respected and recognized community banks in Western New York. We strive to accomplish this goal by continuing to emphasize our high quality customer service and financial strength. We are one of the largest lenders in market share of residential mortgages in Chautauqua County.

Branching. In 2003, we opened branch offices in Orchard Park and East Amherst, New York. These offices have generated deposits of $31.7 million and $23.6 million as of June 30, 2008, respectively. We also opened a branch office in Hamburg, New York in December 2005, which has generated deposits of $14.2 million as of June 30, 2008. Our offices are located in Dunkirk, Fredonia, Jamestown, Lakewood and Westfield, in Chautauqua County, New York and in East Amherst, Hamburg and Orchard Park in Erie County, New York. Saturation of the market in Chautauqua County led to our expansion plan in Erie County, which is a critical component of our future profitability and growth.

Our People. A large part of our success is related to customer service and customer satisfaction. Having employees who understand and value our clientele and their business is a key component to our success. We believe that our employees constitute one of our competitive strengths. Thus, the retention of such persons and our ability to continue to attract high quality personnel are high priorities.

Residential Mortgage and Other Lending. Historically, our lending portfolio has been composed predominantly of residential mortgage loans. At June 30, 2008 and December 31, 2007, we held $166.3 million and $157.8 million of residential mortgage loans, respectively, which constituted 73.2% and 72.4% of our total loan portfolio, at such respective dates. We also originate commercial real estate loans to finance the purchase of real property, which generally consists of developed real estate. At June 30, 2008 and December 31, 2007, our commercial real estate loan portfolio consisted of loans totaling $19.9 million and $20.4 million respectively, or 8.8% and 9.4%, respectively, of total loans. In addition to commercial real estate loans, we also engage in small business commercial lending, including business installment loans, lines of credit, and other commercial loans. At June 30, 2008 and December 31, 2007, our commercial loan portfolio consisted of loans totaling $10.2 million and $8.2 million respectively, or 4.5% and 3.8%, respectively, of total loans. Other loan products offered to our customers include home equity loans, construction loans and consumer loans, including auto loans, overdraft lines of credit and share loans. We will sell loans when appropriate and will retain servicing rights to those loans. We will invest excess funds in permissible investments such as mortgage-backed securities and asset-backed securities, when such investment opportunities are prudent. Residential mortgage loans will continue to be the dominant type of loan in our lending portfolio.

Investment Strategy. Our investment policy is designed primarily to manage the interest rate sensitivity of our assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity within established guidelines. At June 30, 2008 and December 31, 2007, our investment securities totaled $111.7 million and $109.0 million, respectively.

Treasury Yield Curve. As with all community banks, we face a challenge in monitoring our interest rate risk. Banks generate revenue on the difference between the interest earned on loans, which are generally for longer terms, and the interest paid on deposits, which are generally for shorter terms. This mismatch between shorter term deposits and longer term loans usually produces a positive contribution to earnings because the yield curve is normally positively sloped. As of December 31, 2006, the treasury yield curve was inverted, with the federal funds rate and short-term treasury bill rates higher than rates on long-term treasury bills. On July 1, 2007, the yield curve was virtually flat at 5%. During the remainder of 2007 and in 2008, the Federal Reserve cut the federal funds rate further and as of June 30, 2008, the federal funds rate was 2.47%. The additional reductions in the federal funds rate, continued weakness in the housing market, credit concerns over sub-prime loan defaults, and concern over downgrades to bond insurers has caused the treasury yield curve to shift. Rates on short-term treasury bills and rates on intermediate-term treasury bills have dropped significantly. As a result, the yield curve now has a positive slope. For example, the yield on the two year Treasury note declined from 4.87% as of June 30, 2007 to 2.63% as of June 30, 2008. The yield on the 10 year Treasury note declined from 5.03% as of June 30, 2007 to 3.99% as of June 30, 2008. However, because of credit concerns over mortgage related securities, the yield spread for mortgage securities widened over Treasury bonds. For example, on June 30, 2007, we offered a 30 year fixed rate mortgage at 6.00%. On June 30, 2008, the rate we offered on this loan type was 5.875%, a decline of only 12.5 basis points. Given the changes to the treasury yield curve and spread relationships, our net interest margin could improve if our funding costs decline and if interest rates on loans remain relatively unchanged.

The changes to the yield curve in 2007 carried over into 2008 and will allow us to re-price some of our short term borrowings to lower interest rates and allow us to reduce the interest rates we offer on our certificates of deposit, which may increase our net interest margin. If we reduce rates on our deposit products, our deposit balances may decrease, which may require us to utilize other funding sources.

Interest Rate Risk. Our strategy to improve interest income was to increase our interest rate risk exposure. To mitigate the risk of falling interest rates on our adjustable rate home equity and commercial loans, we purchased an interest rate floor product during August 2006 on a notional principal amount of $10 million. This product allows us to receive payments if the prime rate drops below 8%. The prime rate as of June 30, 2008 was 5.00%. As a result, we now receive payments on the interest rate floor product, which will partially offset the expected reduction in loan interest income on adjustable rate loans that are tied to the prime rate. The interest rate floor expires on August 11, 2011. Refer to Note 2 in the Notes to our Consolidated Financial Statements for more information.

We believe that the cumulative impact of the strategies we elected to pursue have protected us from having a more severe exposure to credit risk. We believe that our current capital position and success in the core banking services of lending and deposits will result in sustained earnings going forward.

We employ a third party financial advisor to assist us in managing our investment portfolio and developing balance sheet strategies. At June 30, 2008 and December 31, 2007, we had $108.7 and $105.9 million, respectively, invested in securities available for sale, the majority of which are mortgage-backed, collaterized mortgage obligations (CMOs) and municipal securities. We do not own any collateralized debt obligations (CDOs) or structured investment vehicles (SIVs).

Critical Accounting Policies

It is management s opinion that accounting estimates covering certain aspects of our business have more significance than others due to the relative importance of those areas to overall performance, or the level of subjectivity required in making such estimates. Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance for loan losses required for probable credit losses and the material effect that such judgments can have on the results of operations. Management s quarterly evaluation of the adequacy of the allowance considers our historical loan loss experience, review of specific loans, current economic conditions, and such other factors considered appropriate to estimate loan losses. Management uses presently available information to estimate probable losses on loans; however, future additions to the allowance may be necessary based on changes in estimates, assumptions, or economic conditions. Significant factors that could give rise to changes in these estimates include, but are not limited to, changes in economic conditions in the local area, concentrations of risk and decline in local property values.

Our evaluation of risk in maintaining the allowance for loan losses includes the review of all loans on which the collectibility of principal may not be reasonably assured. We consider the following factors as part of this evaluation: historical loan loss experience, payment status, the estimated value of the underlying collateral, loans originated in areas outside of the historic market area for loan activity, trends in loan volume, and national and local economic conditions. There may be other factors that may warrant consideration in maintaining an allowance at a level sufficient to provide for probable loan losses. Although our management believes that it has established and maintained the allowance for loan losses to reflect losses inherent in our loan portfolio, based on its evaluation of the factors noted above, future additions may be necessary if economic and other conditions differ substantially from the current operating environment.

The allowance consists of allocated, general and unallocated components. The allocated component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value for that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management also considers the accounting policy relating to the evaluation of impairment of investments to be a critical accounting policy due to the subjectivity and judgment involved and the material effect an impairment loss could have on the results of operations. A decline in the fair value of investments below cost deemed to be other than temporary is charged to earnings resulting in the establishment of a new cost basis for an asset. Management continually reviews the current value of its investments for evidence of other than temporary impairment.

These critical policies and their application are reviewed periodically by our Audit Committee and our Board of Directors. All accounting policies are important, and as such, we encourage the reader to review each of the policies included in the notes to the consolidated financial statements of our audited consolidated financial statements included in Form 10-K for the year ended December 31, 2007 to better understand how our financial performance is reported.

Other than Temporary Impairment

Despite our attempts to manage credit risk, we found it necessary to write down four asset-backed securities in our investment portfolio during the second quarter of 2008. The write-down resulted in a pre-tax loss of $1.7 million ($1.3 million, net of tax), which

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was recorded in the Other Non-interest Income section of the consolidated statements of operations. The securities were rated AAA by the rating agencies when we purchased them. Three of the securities are collateralized by second lien home equity loans to prime borrowers. Since the collateral was on a second lien position, these securities were wrapped by an insurance guarantee held by Financial Guaranty Insurance Co. (FGIC). FGIC also wrapped other mortgage-backed and asset-backed securities. As a result of FGIC s exposure to the sub-prime housing market, the major rating agencies downgraded FGIC as the insurance company does not appear to have sufficient resources to pay expected losses. The effect of the rating downgrade on FGIC caused the market to price securities guaranteed by FGIC as if the insurance was no longer available. As a result, the major rating agencies downgraded the ratings on these securities and the fair market value of these securities experienced significant declines. The fourth security is backed by first lien residential mortgages by sub-prime borrowers. The security is not insured and a majority of the mortgages are adjustable rate loans. The security has retained its AAA rating, but the fair market value of the security has declined significantly as a result of the sub-prime mortgage and credit crisis. The price declines, current accounting rules and associated SEC guidance contributed to management s determination that the impairment on these securities was other-than-temporary . It should be noted that these securities continue to make payments in accordance with their terms.

Analysis of Net Interest Income

Net interest income represents the difference between the interest we earn on our interest-earning assets, such as mortgage loans and investment securities, and the expense we pay on interest-bearing liabilities, such as time deposits. Net interest income depends on both the volume of our interest-earning assets and interest-bearing liabilities and the interest rates we earn or pay on them.

Average Balances, Interest and Average Yields. The following table sets forth certain information relating to our average balance sheets and reflects the average yield on interest-earnings assets and average cost of interest-bearing liabilities, interest earned and interest paid for the periods indicated. Such yields and costs are derived by dividing annualized income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods presented. Average balances are derived from daily balances over the periods indicated. The average balances for loans are net of allowance for loan losses, but include non-accrual loans. Interest income on securities does not include a tax equivalent adjustment for bank qualified municipals.

	At June 30, 2008		For the Three Months ended June 30, 2008			For the Three Months ended June 30, 2007		
	Actual Balance	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
				(Dollars in thousands)				
Interest-earning assets:								
Federal funds sold & other interest-bearing deposits	$ 20,184	1.28%	$ 15,189	$ 85	2.24%	$ 4,697	$ 41	3.49%
Securities	111,696	4.58%	110,404	1,307	4.74%	110,181	1,261	4.58%
Loans	227,903	6.11%	224,526	3,214	5.73%	206,846	3,124	6.04%
Total interest-earning assets	359,783	5.36%	350,119	4,606	5.26%	321,724	4,426	5.50%
Other assets	27,762		26,340			25,654		
Total assets	$ 387,545		$ 376,459			$ 347,378		
Interest-bearing liabilities:								
Demand and NOW accounts	$ 37,537	0.45%	$ 36,884	$ 36	0.39%	$ 37,347	$ 62	0.66%
Money market accounts	23,902	1.03%	23,920	56	0.94%	25,474	87	1.37%
Savings accounts	31,544	0.48%	28,864	43	0.60%	27,073	34	0.50%
Time deposits	157,329	3.81%	150,348	1,497	3.98%	140,340	1,570	4.47%
Borrowed funds	55,155	4.14%	55,920	539	3.86%	42,153	465	4.41%
Other interest-bearing liabilities	1,371	8.75%	1,374	30	8.73%	1,396	30	8.60%
Total interest bearing liabilities	306,838	2.92%	297,310	2,201	2.96%	273,783	2,248	3.28%
Other non-interest bearing liabilities	28,150		25,307			20,239		
Stockholders equity	52,557		53,842			53,356		
Total liabilities and stockholders equity	$ 387,545		$ 376,459			$ 347,378		
Net interest income				$ 2,405			$ 2,178	
Interest rate spread					2.30%			2.22%
Net interest margin					2.75%			2.71%

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	At June 30, 2008		For the Six Months ended June 30, 2008			For the Six Months ended June 30, 2007		
	Actual Balance	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
			(Dollars in thousands)					
Interest-earning assets:								
Federal funds sold & other interest-bearing deposits	$ 20,184	1.28%	$ 10,355	$ 129	2.49%	$ 5,746	$ 111	3.86%
Securities	111,696	4.58%	109,423	2,556	4.67%	110,104	2,486	4.52%
Loans	227,903	6.11%	222,171	6,962	6.27%	206,136	6,326	6.14%
Total interest-earning assets	359,783	5.36%	341,949	9,647	5.64%	321,986	8,923	5.54%
Other assets	27,762		26,125			25,738		
Total assets	$ 387,545		$ 368,074			$ 347,724		
Interest-bearing liabilities:								
Demand and NOW accounts	$ 37,537	0.45%	$ 35,919	$ 84	0.47%	$ 37,058	$ 123	0.66%
Money market accounts	23,902	1.03%	23,509	123	1.05%	25,191	168	1.33%
Savings accounts	31,544	0.48%	27,155	75	0.55%	26,607	66	0.50%
Time deposits	157,329	3.81%	144,444	2,995	4.15%	141,189	3,119	4.42%
Borrowed funds	55,155	4.14%	57,246	1,143	3.99%	42,517	933	4.39%
Other interest-bearing liabilities	1,371	8.75%	1,377	60	8.71%	1,399	60	8.58%
Total interest bearing liabilities	306,838	2.92%	289,650	4,480	3.09%	273,961	4,469	3.26%
Other non-interest bearing liabilities	28,150		24,423			19,792		
Stockholders equity	52,557		54,001			53,971		
Total liabilities and stockholders equity	$ 387,545		$ 368,074			$ 347,724		
Net interest income				$ 5,167			$ 4,454	
Interest rate spread					2.55%			2.28%
Net interest margin					3.02%			2.77%

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Rate Volume Analysis. The following table analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. The table shows the amount of the change in interest income or expense caused by either changes in outstanding balances (volume) or changes in interest rates. The effect of a change in volume is measured by applying the average rate during the first period to the volume change between the two periods. The effect of changes in rate is measured by applying the change in rate between the two periods to the average volume during the first period. Changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to the absolute value of the change due to volume and the change due to rate.

	Three Months Ended June 30, 2008 Compared to Three Months Ended June 30, 2007		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest-earning assets:			
Federal funds sold and other interest-bearing deposits	$ (19)	$ 63	$ 44
Securities	43	3	46
Loans	(198)	288	90
Total interest-earning assets	(174)	354	180
Interest-bearing liabilities:			
Demand and NOW accounts	(25)	(1)	(26)
Money market accounts	(26)	(5)	(31)
Savings accounts	7	2	9
Time deposits	(179)	106	(73)
Total deposits	(223)	102	(121)
Borrowed funds and other	(64)	138	74
Total interest-bearing liabilities	(287)	240	(47)
Net change in interest income	$ 113	$ 114	$ 227

	Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest-earning assets:			
Federal funds sold and other interest-bearing deposits	$ (49)	$ 67	$ 18
Securities	85	(15)	70
Loans	136	500	636
Total interest-earning assets	172	552	724
Interest-bearing liabilities:			
Demand and NOW accounts	(35)	(4)	(39)
Money market accounts	(34)	(11)	(45)
Savings accounts	8	1	9
Time deposits	(195)	71	(124)
Total deposits	(256)	57	(199)

Borrowed funds and other	(90)	300	210
Total interest-bearing liabilities	(346)	357	11
Net change in interest income	$ 518	$ 195	$ 713

Our earnings may be adversely impacted by an increase in interest rates because the majority of our interest-earning assets are long-term, fixed rate mortgage-related assets that will not reprice as long-term interest rates increase. Conversely, a majority of our interest-bearing liabilities have much shorter contractual maturities and are expected to reprice. A significant portion of our deposits have no contractual maturities and are likely to reprice quickly as short-term interest rates increase. Therefore, in an increasing rate environment, our cost of funds is expected to increase more rapidly than the yields earned on our loan portfolio and securities portfolio. An increasing rate environment is expected to cause a further narrowing of our net interest rate spread and a decrease in our earnings.

However, beginning September 2007, interest rates began to decrease. In a decreasing interest rate environment, our earnings may increase if long-term interest-earning assets do not reprice and interest rates on short-term deposits begin to decrease.

For the three months ended June 30, 2008, the average yield on our loan and investment portfolios was 5.73% and 4.74%, respectively, in comparison to rates of 6.04% and 4.58%, respectively, for the three months ended June 30, 2007. The decrease in yield on our loan portfolio during the three months ended June 30, 2008 is primarily due to a $262,000 loss incurred on our interest rate floor product during the quarter ended June 30, 2008 as compared to a $110,000 loss during the quarter ended June 30, 2007. This loss is recorded as a deduction to loan interest income. Overall, the average yield on our interest earning assets decreased by 0.24% for the three months ended June 30, 2008 in comparison to the three months ended June 30, 2007. For the three months ended June 30, 2008, the average rate that we were paying on deposit products decreased by 0.33% in comparison to the same period in the prior year. Furthermore, the interest paid on our borrowings decreased from 4.41% for the three months ended June 30, 2007 to 3.86% for the three months ended June 30, 2008. Our interest rate spread for the three months ended June 30, 2008 was 2.30%, which was a 0.08% increase in comparison to the three months ended June 30, 2007. Our net interest margin was 2.75% and 2.71% for the three months ended June 30, 2008 and 2007, respectively.

For the six months ended June 30, 2008, the average yield on our loan and investment portfolios was 6.27% and 4.67%, respectively, in comparison to rates of 6.14% and 4.52%, respectively, for the six months ended June 30, 2007. Overall, the average yield on our interest earning assets increased by 0.10% for the six months ended June 30, 2008 in comparison to the six months ended June 30, 2007. For the six months ended June 30, 2008 the average rate we were paying on our deposit products decreased by 0.19% in comparison with the same period in the prior year. Furthermore, the interest paid on our borrowings decreased from 4.39% for the six months ended June 30, 2007 to 3.99% for the six months ended June 30, 2008. Our interest rate spread for the six months ended June 30, 2008 was 2.55%, which was a 0.27% increase in comparison to the six months ended June 30, 2007. Our net interest margin was 3.02% and 2.77% for the six months ended June 30, 2008 and 2007, respectively.

Comparison of Financial Condition at June 30, 2008 and December 31, 2007

Total assets at June 30, 2008 were $387.5 million, an increase of $29.7 million, from $357.8 million at December 31, 2007. The increase in total assets from December 31, 2007 is attributable to an increase of $16.2 million in cash and cash equivalents, an increase of $9.2 million in loans receivable, net, and an increase of $2.8 million in securities available for sale.

Cash and cash equivalents increased by $16.2 million, from $10.1 million as of December 31, 2007 to $26.3 million as of June 30, 2008. The increase is attributable to a $17.2 million increase in federal funds sold resulting from an increase in total deposits of $29.9 million from December 31, 2007 to June 30, 2008. As of June 30, 2008 a portion of the deposit growth had not yet been utilized for loan proceeds or invested in available for sale securities.

Securities available for sale increased by $2.8 million to $108.7 million at June 30, 2008 from $105.9 million at December 31, 2007. The increase is attributable to $14.3 million of new security purchases offset by a $9.8 million reduction due to the receipt of principal payments and a $1.7 million other than temporary impairment write-down. Management determined that four non-agency asset-backed securities were other than temporarily impaired during the second quarter of 2008 which resulted in a $1.7 million write-down before taxes ($1.3 million, net of tax). See Other than Temporary Impairment above.

Loans receivable, net increased by $9.2 million, or 4.2%, to $227.9 million at June 30, 2008 from $218.7 million at December 31, 2007. The table below shows the changes in loan volume by loan type between December 31, 2007 and June 30, 2008:

	June 30, 2008	December 31, 2007 (in thousands)	Change $	Change %
Real Estate Loans:				
Residential, 1-4 Family	$ 166,253	$ 157,834	$ 8,419	5.3%
Home Equity	26,570	26,569	1	0.0%
Commercial	19,939	20,394	(455)	(2.2)%
Construction	1,853	2,775	(922)	(33.2)%
Total Real Estate Loans	214,615	207,572	7,043	3.4%
Commercial Loans	10,185	8,246	1,939	23.5%
Consumer Loans	2,369	2,306	63	2.7%
Total Gross Loans	227,169	218,124	9,045	4.1%
Allowance for Loan Losses	(1,280)	(1,226)	(54)	(4.4)%
Net deferred loan costs	2,014	1,813	201	11.1%
Loans receivable, net	$ 227,903	$ 218,711	$ 9,192	4.2%

The increase in commercial loans is attributable to our efforts to focus on commercial loan originations within our market areas. During 2008, we hired two additional commercial loan officers to strengthen our presence in Erie County, New York and assist us in increasing our commercial loan portfolio. The increase in residential mortgage lending is attributable to an increase in loan applications received and approved for construction or purchase of new and existing homes. Residential mortgage loans and commercial real estate loans represented 73.2% and 8.8%, respectively, of the loan portfolio at June 30, 2008. We do not carry any sub-prime loans in our loan portfolio.

The table below shows changes in deposit volumes by type of deposit between December 31, 2007 and June 30, 2008:

	June 30, 2008	December 31, 2007 (in thousands)	Change $	Change %
Demand Deposits:				
Non-interest bearing	$ 20,420	$ 19,321	$ 1,099	5.7%
Interest bearing	37,537	37,934	(397)	(1.0)%
Money market	23,902	23,202	700	3.0%
Savings	31,544	25,282	6,262	24.8%
Time deposits	157,329	135,089	22,240	16.5%
Total Deposits	$ 270,732	$ 240,828	$ 29,904	12.4%

The overall increase in savings accounts is primarily attributed to new commercial customers. The increase in time deposits is attributed to our ability to offer or match competitive rates in our market area.

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Our borrowings, consisting of advances from the Federal Home Loan Bank of New York, decreased to $55.2 million as of June 30, 2008 from $56.4 million at December 31, 2007. Short-term borrowings decreased $14.5 million, from $18.5 million at December 31, 2007, to $4.1 million at June 30, 2008, while long-term debt increased $13.2 million, from $37.9 million at December 31, 2007, to $51.1 million at June 30, 2008. The Company shifted certain short-term borrowings to long-term debt to lower our borrowing costs, by taking advantage of the drop in interest rates.

Total stockholders equity decreased by $908,000, from $53.5 million at December 31, 2007, to $52.6 million at June 30, 2008. The decrease in total stockholders equity was primarily due to the overall net loss of $268,000 recorded for the six months ended June 30, 2008 and the purchase of $559,000 in outstanding common stock under our stock repurchase plan during this same time period. Stockholders equity was also affected by a decrease in the net of tax unrealized losses on securities available for sale of $24,000 in the six months ended June 30, 2008. Dividends declared and paid in the six months ended June 30, 2008 reduced stockholders equity by $240,000 and stock-based compensation expenses increased stockholders equity by $183,000.

Comparison of Results of Operations for the Three Months Ended June 30, 2008 and 2007

General. A net loss of $926,000 was recorded for the three months ended June 30, 2008, compared to net income of $302,000 for the three months ended June 30, 2007. Earnings in the 2008 quarter were negatively impacted by a non-cash, pretax, impairment charge of $1.7 million related to write downs of the Company s investments in four non-agency asset-backed securities. See Other than Temporary Impairment above. Excluding the impairment charge, the Company would have recorded net income for the quarter of $384,000, an increase of $82,000, or 27.2%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Earnings (loss) per diluted share decreased $0.20 per diluted share from $0.05 for the three months ended June 30, 2007 to ($0.15) per diluted share for the three months ended June 30, 2008. Excluding the impairment charge, earnings per diluted share would have been $0.06 per diluted share for the quarter ended June 30, 2008, which was an increase of $0.01 per share, or 20.0%, in comparison to the quarter ended June 30, 2007.

Interest Income. Interest income increased $180,000, or 4.1%, from $4.4 million for the three months ended June 30, 2007, to $4.6 million for the three months ended June 30, 2008. Loan interest increase increased by $90,000, from $3.1 million for the three months ended June 30, 2007, to $3.2 million for the three months ended June 30, 2008. The average balance on our loan portfolio increased $17.7 million, from an average balance of $206.8 million in 2007, to an average balance of $224.5 million in 2008. The average yield on our portfolio decreased from 6.04% for the three months ended June 30, 2007 to 5.73% for the three months ended June 30, 2008. Interest income on our loan portfolio for the three months ended June 30, 2008 was reduced by a $262,000 loss on the fair value of our interest rate floor derivative product during the quarter. For the three months ended June 30, 2007, this loss was $110,000. Interest income on investment securities was $1.3 million for the three months ended June 30, 2008 and 2007. The investment portfolio had an average yield of 4.74% for the three months ended June 30, 2008 compared to an average yield of 4.58% for the three months ended June 30, 2007. Other interest income increased by $44,000, from $41,000 for the three months ended June 30, 2007, to $85,000 for the three months ended June 30, 2008. The average balance of Fed Funds and other interest bearing deposits was $15.2 million in 2008, an increase of $10.5 million from $4.7 million in 2007. The average yield on other interest bearing assets was 2.24% for the three months ended June 30, 2008 compared to an average yield of 3.49% for the three months ended June 30, 2007.

Interest Expense. Interest expense decreased by $47,000, or 2.1%, from $2.3 million for the three months ended June 30, 2007 to $2.2 million for the three months ended June 30, 2008. The interest paid on deposits decreased by $121,000, from $1.8 million for the three months ended June 30, 2007, to $1.6 million for the three months ended June 30, 2008. This was due to a decrease in the average rate paid on interest-bearing deposits, from 3.05% for the three months ended June 30, 2007, to 2.72% for the three months ended June 30, 2008. The interest expense related to advances from the Federal Home Loan Bank of New York increased by $74,000, from $465,000 for the three months ended June 30, 2007, to $539,000 for the three months ended June 30, 2008. While the average rate on these borrowings decreased from 4.41% for the three months ended June 30, 2007 to 3.86% for the three months ended June 30, 2008, the average balance increased from $42.2 million for the three months ended June 30, 2007 to $55.9 million for the three month period ended June 30, 2008.

Provision for Loan Losses. For the three months ended June 30, 2008 and 2007, a provision for loan losses of $150,000 and $0 was recorded, respectively. Management deemed an increase was necessary due to a $9.2 million increase in net loans since December 31, 2007 and due to a slight increase in non-performing loans as a percent of total net loans as of June 30, 2008 to 0.83% compared to 0.75% as of December 31, 2007.

We establish provisions for loan losses, which are charged to operations, in order to maintain the allowance for loan losses at a level management considers necessary to absorb probable incurred credit losses in the loan portfolio. The amount of allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or later events occur. Management assesses the allowance for loan losses on a quarterly basis and makes provisions for loan losses in order to maintain the adequacy of the allowance.

Non-interest Income (Loss). For the three months ended June 30, 2008, non-interest income (loss) was $(1.1) million for the quarter ended June 30, 2008 compared to non-interest income of $492,000 for the same period in 2007. The decrease in non-interest income (loss) was due to a pre-tax $1.7 million other than temporary impairment charge recorded on certain non-agency asset-backed securities. See Other than Temporary Impairment above. Excluding the impairment charge, the Company would have recorded non-interest income for the quarter ended June 30, 2008 of $647,000, a 31.5% increase over the quarter ended June 30, 2007, mainly due to an increase in service fees implemented in July 2007 and the implementation of a new fee-based service in February 2008.

Non-interest Expense. Non-interest expense was $2.3 million for the three month period ended June 30, 2008 and 2007. Non-interest expense includes the expense of salaries and employee benefits, occupancy and equipment, data processing and other items not related to expenses on deposits or borrowings. Occupancy and equipment increased by $35,000 for the three months ended June 30, 2008 compared to the three month period ended June 30, 2007. The increase is attributed to an increase in maintenance contracts, taxes, costs for equipment maintenance and repairs, equipment purchases and utilities. Advertising expense increased by $17,000 from $67,000 for the three month period ended June 30, 2007 to $84,000 for the three month period ended June 30, 2008, primarily due to the costs incurred to create television advertising for our Erie County market area. Data processing increased by $15,000 primarily due to an increase in ATM and debit card transaction expenses. These increases were partially offset by a decrease in professional services of $37,000 from $346,000 for the three month period ended June 30, 2007 to $309,000 for the three month period ended June 30, 2008. Professional service expenses decreased primarily due to a decrease in consulting and legal fees.

Income Tax Expense (Benefit). Income tax expense decreased by $307,000, from $71,000 for the three month period ended June 30, 2007, to an income tax benefit of $236,000 for the three month period ended June 30, 2008. The decrease in income tax expense is largely attributed to the impact of the pre-tax impairment charge described above as well as an increase in tax exempt income on our municipal bond portfolio. As a result, our projected mix of tax-exempt income derived from our municipal bond portfolio and bank-owned life insurance increased significantly as it related to our projection of pre-tax book income for the year, causing our effective tax rate estimate to decrease to 10.0%. This decrease combined with the impact on our effective tax rate recognized for the quarter ended March 31, 2008, resulted in our effective tax rate increasing from 19.0% for the quarter ended June 30, 2007 to 20.3% for the quarter ended June 30, 2008.

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Comparison of Results of Operations for the Six Months Ended June 30, 2008 and 2007

General. A net loss of $268,000 was recorded for the six months ended June 30, 2008 compared to net income of $600,000 for the six months ended June 30, 2007. The decrease in net income is primarily attributed to the Company recording a $1.7 million other than temporary impairment write-down associated with four non-agency, asset-backed securities. See Other than Temporary Impairment above. Excluding the impairment charge, the Company would have had net income of $1.0 million for the six months ended June 30, 2008, an increase of $400,000, or 66.7%, in comparison to the same period in the prior year. Earnings (loss) per diluted share decreased $0.14 per share, from $0.10 per diluted share for the six months ended June 30, 2007, to $(0.04) per diluted share for the six months ended June 30, 2008. Excluding the impairment charge, earnings per diluted share would have been $0.17 per diluted share for the six months ended June 30, 2008, an increase of $0.07 per diluted share compared to the six month period ended June 30, 2007.

Interest Income. Interest income increased $724,000, or 8.1%, from $8.9 million for the six months ended June 30, 2007, to $9.6 million for the six months ended June 30, 2008. Loan interest income increased by $636,000, or 10.1%, for the six months ended June 30, 2007 to $7.0 million for the six months ended June 30, 2008. The increase in loan interest income is primarily due to an increase in average balance and average yield on our loan portfolio. The average balance on our loan portfolio increased $16.1 million, from an average balance of $206.1 million in 2007, to $222.2 million in 2008. The average yield on our loan portfolio was 6.27% and 6.14% for the six months ended June 30, 2008 and 2007, respectively. During the six months ended June 30, 2008, a $64,000 gain on the fair value of our interest rate floor derivative product was recorded in loan interest income, compared to a $102,000 loss recorded for the six months ended June 30, 2007. Investment interest income increased by $70,000, or 2.8%, during the six month period ended June 30, 2008 compared to the same period in the prior year. The investment portfolio had an average balance of $109.4 million and an average yield of 4.67% for the six months ended June 30, 2008 compared to an average balance of $110.1 million and an average yield of 4.52% for the six month period ended June 30, 2007. Interest income on fed funds and other interest bearing deposits increased $18,000, or 16.2%, for the period ended June 30, 2008 compared to the six months ended June 30, 2007. The average balance of Fed Funds and other interest bearing deposits was $10.3 million and the average yield was 2.49% for the six months ended June 30, 2008 compared to an average balance of $5.7 million and average yield of 3.86% for the six months ended June 30, 2007.

Interest Expense. Interest expense increased by $11,000 for the six month period ended June 30, 2008 compared to the six month period ended June 30, 2007. Interest expense on deposits decreased by $199,000, or 5.7%, from $3.5 million for the period ended June 30, 2007, to $3.2 million for the period ended June 30, 2008. The average rate on deposits decreased from 3.02% for the six months ended June 30, 2007 to 2.84% for the six months ended June 30, 2008. The average balance on deposits increased by $982,000 to $231.0 million for the period ended June 30, 2008 compared to an average balance of $230.0 million for the six month period ended June 30, 2007. The interest expense related to advances from the Federal Home Loan Bank of New York increased by $210,000, or 22.5%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. While the average rate on these borrowings decreased from 4.39% for the six month period ended June 30, 2007 to 3.99% for the six months ended June 30, 2008, the average balance increased from $42.5 million to $57.2 million for the same periods.

Provision for Loan Losses. For the six months ended June 30, 2008 and 2007, a provision for loan losses of $150,000 and $45,000 was recorded, respectively. Management deemed an increase was necessary due to a $9.2 million increase in net loans since December 31, 2007 and due to a slight increase in non-performing loans as a percent of total net loans as of June 30, 2008 to 0.83% compared to 0.75% as of December 31, 2007.

We establish provisions for loan losses, which are charged to operations, in order to maintain the allowance for loan losses at a level management considers necessary to absorb probable incurred credit losses in the loan portfolio. The amount of allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or later events occur. Management assesses the allowance for loan losses on a quarterly basis and makes provisions for loan losses in order to maintain the adequacy of the allowance.

***Non-interest Income (Loss)*.** For the six months ended June 30, 2008, non-interest income (loss) was $(495,000) compared to non-interest income of $1.0 million for the same period in 2007. The decrease in non-interest income was due to a pre-tax $1.7 million other than temporarily impairment charge recorded on certain non-agency asset-backed securities. See Other than Temporary Impairment above. Excluding the impairment charge, the Company would have recorded non-interest income for the six months ended June 30, 2008 of $1.2 million, a 28.7% increase over the six months ended June 30, 2007, mainly due to an increase in service fees during July 2007 and the implementation of a new fee-based service in February 2008.

***Non-interest Expense*.** Non-interest expense increased $183,000, or 3.9%, to $4.8 million for the six months ended June 30, 2008 compared to $4.6 million for the same period in 2007. Salaries and benefits expense increased by $37,000, or 1.5%, for the six months ended June 30, 2008 compared to the comparable period in 2007 due to annual salary increases and the addition of two lending officers offset by decreases in benefit costs due to employee and director retirements. Advertising expense increased by $78,000 for the six months ended June 30, 2008 compared with the six months ended June 30, 2007 primarily due to costs incurred in 2008 to create television ads for our Erie County market. Data processing expenses increased by $38,000 for the six months ended June 30, 2008 compared to the comparable period in 2007 due to increased transactions and expense for ATM and debit card transactions. Occupancy expense increased by $27,000 for the six months ended June 30, 2008 compared to the comparable period in 2007 due to increased costs for property taxes, utilities, equipment maintenance contracts and property maintenance.

***Income Tax Expense (Benefit)*.** Income taxes decreased by $163,000, or 122.6%, from a tax expense of $133,000 for the six months ended June 30, 2007 to a tax benefit of $30,000 for the six months ended June 30, 2008. The decrease in income tax expense is largely attributed to impact of the pre-tax impairment charge discussed above as well as an increase in our tax-exempt income on our municipal bond portfolio. As a result, our projected mix of tax-exempt income derived from our municipal bond portfolio and bank-owned life insurance increased significantly as it related to our projection of pre-tax book income for the year, causing our effective tax rate estimate to decrease from 18.1% for the six months ended June 30, 2007 to 10.0% for the six months ended June 30, 2008.

Liquidity and Capital Resources

Liquidity describes our ability to meet the financial obligations that arise during the ordinary course of business. Liquidity is primarily needed to meet the lending and deposit withdrawal requirements of our customers and to fund current and planned expenditures. Our primary sources of funds consist of deposits, scheduled amortization and prepayments of loans and mortgage-backed and asset-backed securities, maturities and sales of other investments, interest bearing deposits at other financial institutions and funds provided from operations. We have written agreements with the Federal Home Loan Bank of New York, which as of July 31, 2007 allowed us to borrow up to $31.5 million on an overnight line of credit and $31.5 million on a one-month overnight repricing line of credit. We had no borrowings through either of these agreements as of June 30, 2008 and 2007. We also have a third agreement to obtain advances from the Federal Home Loan Bank collateralized by a pledge of our mortgage loans. At June 30, 2008, we had outstanding advances on this agreement totaling $55.2 million.

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Loan repayments and maturing investment securities are a relatively predictable source of funds. However, deposit flows, calls of investment securities, and prepayments of loans and mortgage-backed securities are strongly influenced by interest rates, general and local economic conditions, and competition in the marketplace. These factors reduce the predictability of the timing of these sources of funds.

Our primary investing activities include the origination of loans and, to a lesser extent, the purchase of investment securities. For the six months ended June 30, 2008 and 2007, we originated loans of approximately $30.9 million and $20.0 million, respectively. Purchases of investment securities totaled $14.3 million in the six months ended June 30, 2008 and $7.9 million in the six months ended June 30, 2007.

At June 30, 2008, we had loan commitments to borrowers of approximately $15.4 million and overdraft lines of protection and unused home equity lines of credit of approximately $22.4 million.

Total deposits were $270.7 million at June 30, 2008, as compared to $240.8 million at December 31, 2007. Time deposit accounts scheduled to mature within one year were $109.1 million at June 30, 2008. The increase in total deposits occurred as a result of offering and matching competitive rates in our market area. We anticipate that a significant portion of the time deposits that are scheduled to mature within one year will remain with us.

We are committed to maintaining a strong liquidity position; therefore, we monitor our liquidity position on a daily basis. We anticipate that we will have sufficient funds to meet our current funding commitments. The marginal cost of new funding, however, whether from deposits or borrowings from the Federal Home Loan Bank, will be carefully considered as we monitor our liquidity needs. Therefore, in order to minimize our cost of funds, we may consider additional borrowings from the Federal Home Loan Bank in the future.

Loans Past Due and Non-performing Assets. We define non-performing loans as loans that are either non-accruing or accruing whose payments are 90 days or more past due. Non-performing assets, including non-performing loans and foreclosed real estate, totaled $2.2 million at June 30, 2008 and $1.7 million at December 31, 2007.

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The following table presents information regarding our non-accrual loans, accruing loans delinquent 90 days or more, and foreclosed real estate as of the dates indicated.

	At June 30, 2008	At December 31, 2007
	(Dollars in thousands)	
Loans past due 90 days or more but still accruing interest:		
Mortgage loans on real estate:		
One-to-four family	$ 482	$ 209
Construction		
Commercial real estate	305	208
Home equity loans and lines of credit	205	65
Other loans:		
Commercial loans		85
Consumer loans	6	
Total	$ 998	$ 567
Loans accounted for on a nonaccrual basis:		
Mortgage loans on real estate:		
One-to-four family	$ 699	$ 918
Construction		
Commercial real estate	150	107
Home equity loans and lines of credit	24	42
Other loans:		
Commercial loans	17	
Consumer loans	2	10
Total non-accrual loans	892	1,077
Total nonperforming loans	1,890	1,644
Foreclosed real estate	310	61
Restructured loans		
Total nonperforming assets	$ 2,200	$ 1,705
Ratios:		
Nonperforming loans as a percent of total net loans:	0.83%	0.75%
Nonperforming assets as a percent of total assets:	0.57%	0.48%

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The following table sets forth activity in our allowance for loan losses and other ratios for the dates indicated.

	For the Six Months Ended June 30, 2008	For the Year Ended December 31, 2007
	(Dollars in thousands)	
Balance at beginning of period:	$ 1,226	$ 1,257
Provision for loan losses	150	105
Charge-offs:		
Mortgage loans on real estate:		
One-to-four family	91	25
Construction loans		
Commercial real estate		
Home equity loans and lines of credit		80
Other loans:		
Commercial loans	2	19
Consumer loans	6	15
Total charge-offs	99	139
Recoveries:		
Mortgage loans on real estate:		
One-to-four family		
Construction		
Commercial real estate		
Home equity loans and lines of credit		
Other loans:		
Commercial loans	2	
Consumer loans	1	3
Total recoveries	3	3
Net charge-offs	96	136
Balance at end of period	$ 1,280	$ 1,226
Average loans outstanding	$ 222,171	$ 210,610
Ratio of net charge-offs to average loans outstanding	0.04%	0.06%

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Off-Balance Sheet Arrangements

Other than loan commitments, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors. Refer to Note 7 of the Notes to Consolidated Financial Statements for a summary of loan commitments outstanding as of June 30, 2008.

Item 3. Quantitative and Qualitative Disclosures about Market Risk
Management of Market Risk

There have been no material changes in information regarding quantitative and qualitative disclosures about market risk at June 30, 2008 from the information presented in the Company s Form 10-K for the year ended December 31, 2007.

Item 4T. Controls and Procedures.
Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective, as of June 30, 2008, to ensure that information relating to us, which is required to be disclosed in the reports we file with the SEC under the Exchange Act, is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

There has been no change in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table reports information regarding repurchases by the Company of its common stock in each month of the quarter ended June 30, 2008:

COMPANY PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (1)
April 1, 2008 through April 30, 2008				75,518
May 1, 2008 through May 31, 2008	10,000	$ 10.05	10,000	65,518
June 1, 2008 through June 30, 2008	16,073	$ 9.70	16,073	49,445
Total	26,073	$ 9.83	26,073	49,445

(1) On November 16, 2007, the Company announced that the Board of Directors had approved it s second stock repurchase plan pursuant to which the Company could repurchase up to 141,342 shares of its outstanding common stock. This amount represented 5% of the Company s outstanding stock not owned by Lake Shore, MHC. The repurchase plan does not have an expiration date.

Item 4. Submission of Matters to a Vote of Security Holders.

An annual meeting of shareholders of Lake Shore Bancorp, Inc. was held on May 21, 2008. The proposal submitted to shareholders and the tabulation of votes for this proposal was as follows:

Election of Directors:

	Number of Votes For	Number of Votes Withheld
To serve two-year term:		
Paul Kolkmeyer	6,038,037	81,047
To serve three-year terms:		
Reginald S. Corsi	5,925,362	193,722
James P. Foley, DDS	5,911,530	207,554
Daniel P. Reininga	5,915,237	203,847

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In addition to the foregoing, the following directors will continue to serve:

Directors whose terms expire in 2010: Sharon E. Brautigam and Michael E. Brunecz

Directors whose terms expire in 2009: David C. Mancuso, Gary W. Winger and Nancy L. Yocum.

Item 6. Exhibits

3.1	Charter of Lake Shore Bancorp, Inc.[1]
3.2	Amended and Restated Bylaws of Lake Shore Bancorp, Inc.[2]
31.1	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes- Oxley Act of 2002*
32.1	Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*

* Filed herewith

1 Incorporated herein by reference to the Exhibits to the Registration Statement on Form S-1, filed with the Securities and Exchange Commission on November 4, 2005 (Registration No. 333-129439).

2 Incorporated herein by reference to Exhibit 3.2 to Form 8-K, filed with the Securities and Exchange Commission on April 2, 2008.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	LAKE SHORE BANCORP, INC. (Registrant)
	/s/ David C. Mancuso
August 14, 2008	By: David C. Mancuso President and Chief Executive Officer (Principal Executive Officer)
	/s/ Rachel A. Foley
August 14, 2008	By: Rachel A. Foley Chief Financial Officer (Principal Financial and Accounting Officer)