LAKE SHORE BANCORP, INC.
Form 10-Q
November 14, 2017

United States
Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2017

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

Commission File No.: 000-51821

LAKE SHORE BANCORP, INC.
(Exact name of registrant as specified in its charter)

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

(Address(Zip code)
of
principal
executive
offices)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes [X]No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X]No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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

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

Yes [ ] No [X]

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

There were 6,097,818 shares of the registrant's common stock, $0.01 par value per share, outstanding at November 6, 2017.

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PART I Financial Information

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	September 30, 2017	December 31, 2016
	(Unaudited)	
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 7,220	$ 8,089
Interest earning deposits	12,520	6,889
Federal funds sold	24,633	30,501
Cash and Cash Equivalents	44,373	45,479
Securities available for sale	73,108	86,335
Federal Home Loan Bank stock, at cost	1,631	1,340
Loans receivable, net of allowance for loan losses 2017 $3,217; 2016 $2,882	362,408	326,365
Premises and equipment, net	9,391	8,747
Accrued interest receivable	1,834	1,600
Bank owned life insurance	17,987	17,719
Other assets	2,029	1,589
Total Assets	$ 512,761	$ 489,174
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 342,240	$ 330,004
Non-interest bearing	58,683	55,889
Total Deposits	400,923	385,893
Long-term debt	26,950	18,950
Advances from borrowers for taxes and insurance	1,708	3,183
Other liabilities	5,019	5,118
Total Liabilities	$ 434,600	$ 413,144
Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,827,236 shares issued and 6,097,818 shares outstanding at September 30, 2017 and 6,827,236 shares issued	$ 68	$ 68

and 6,088,674 shares outstanding at December 31, 2016		
Additional paid-in capital	30,667	30,532
Treasury stock, at cost (729,418 shares at September 30, 2017 and 738,562 shares at December 31, 2016)	(7,309)	(7,300)
Unearned shares held by ESOP	(1,556)	(1,620)
Unearned shares held by compensation plans	(618)	(578)
Retained earnings	55,785	53,546
Accumulated other comprehensive income	1,124	1,382
Total Stockholders' Equity	78,161	76,030
Total Liabilities and Stockholders' Equity	$ 512,761	$ 489,174

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(Unaudited)			
	(Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$ 4,289	$ 3,681	$ 12,456	$ 10,797
Investment securities, taxable	189	237	597	879
Investment securities, tax-exempt	388	449	1,259	1,351
Other	81	30	167	81
Total Interest Income	4,947	4,397	14,479	13,108
Interest Expense				
Deposits	523	449	1,499	1,373
Long-term debt	139	93	328	280
Other	20	23	62	69
Total Interest Expense	682	565	1,889	1,722
Net Interest Income	4,265	3,832	12,590	11,386
Provision for Loan Losses	75	125	450	310
Net Interest Income after Provision for Loan Losses	4,190	3,707	12,140	11,076
Non-Interest Income				
Service charges and fees	441	461	1,353	1,326
Earnings on bank owned life insurance	91	70	268	207
Recovery on previously impaired investment securities	25	39	96	107
Gain on sale of securities available for sale	22	-	244	1,636
Net gain on sale of loans	1	56	10	117
Other	37	32	83	78
Total Non-Interest Income	617	658	2,054	3,471
Non-Interest Expenses				
Salaries and employee benefits	1,898	1,803	5,610	5,388
Occupancy and equipment	565	549	1,740	1,707
Data processing	320	289	937	815
Professional services	231	257	703	784
Advertising	127	81	439	383
Postage and supplies	53	69	197	179
FDIC Insurance	38	68	111	192
Other	381	304	955	865
Total Non-Interest Expenses	3,613	3,420	10,692	10,313
Income before Income Taxes	1,194	945	3,502	4,234
Income Tax Expense	254	188	704	859
Net Income	$ 940	$ 757	$ 2,798	$ 3,375
Basic and diluted earnings per common share	$ 0.15	$ 0.13	$ 0.46	$ 0.56
Dividends declared per share	$ 0.08	$ 0.07	$ 0.24	$ 0.21

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended September 30,	
	2017	2016
	(Unaudited) (Dollars in thousands)	
Net Income	$ 940	$ 757
Other Comprehensive loss, net of tax benefit:		
Unrealized holding losses on securities available for sale, net of tax benefit	(60)	(451)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(16)	(26)
Net gain on sale of securities included in net income, net of tax expense	(15)	-
Total Other Comprehensive Loss	(91)	(477)
Total Comprehensive Income	$ 849	$ 280

	Nine Months Ended September 30,	
	2017	2016
	(Unaudited) (Dollars in thousands)	
Net Income	$ 2,798	$ 3,375
Other Comprehensive loss, net of tax benefit:		
Unrealized holding (losses) gains on securities available for sale, net of tax benefit (expense)	(34)	875
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(63)	(71)
Net gain on sale of securities included in net income, net of tax expense	(161)	(1,080)

Total Other Comprehensive Loss	(258)	(276)
Total Comprehensive Income	$ 2,540	$ 3,099

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

Nine Months Ended September 30, 2017 and 2016 (Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by Compensation Plans	Retained Earnings	Accumulated Other Comprehensive Income	Total
	(Dollars in thousands, except share and per share data)							
Balance - January 1, 2016	$ 67	$ 29,359	$ (7,026)	$ (1,706)	$ (580)	$ 50,919	$ 2,843	$ 73,876
Net income	-	-	-	-	-	3,375	-	3,375
Other comprehensive loss, net of tax benefit of $142	-	-	-	-	-	-	(276)	(276)
Stock options exercised (98,986 shares)	1	1,108	-	-	-	-	-	1,109
ESOP shares earned (5,951 shares)	-	15	-	64	-	-	-	79
Compensation plan shares granted (20,354 shares)	-	-	197	-	(197)	-	-	-
Compensation plan shares earned (17,833 shares)	-	42	-	-	186	-	-	228
Purchase of treasury stock, at cost (25,000 shares)	-	-	(338)	-	-	-	-	(338)
Cash dividends declared ($0.21 per share)	-	-	-	-	-	(727)	-	(727)
Balance - September 30, 2016	$ 68	$ 30,524	$ (7,167)	$ (1,642)	$ (591)	$ 53,567	$ 2,567	$ 77,326
Balance - January 1, 2017	$ 68	$ 30,532	$ (7,300)	$ (1,620)	$ (578)	$ 53,546	$ 1,382	$ 76,030
Net income	-	-	-	-	-	2,798	-	2,798
Other comprehensive loss, net of tax benefit of $133	-	-	-	-	-	-	(258)	(258)
ESOP shares earned (5,951 shares)	-	30	-	64	-	-	-	94
	-	33	-	-	-	-	-	33

Stock based compensation								
Compensation plan shares granted (27,348 shares)	-	-	270	-	(270)	-	-	-
Compensation plan shares forfeited (1,104 shares)	-	-	(10)	-	10	-	-	-
Compensation plan shares earned (20,569 shares)	-	72	-	-	220	-	-	292
Purchase of treasury stock, at cost (17,100 shares)	-	-	(269)	-	-	-	-	(269)
Cash dividends declared ($0.24 per share)	-	-	-	-	-	(559)	-	(559)
Balance - September 30, 2017	$ 68	$ 30,667	$ (7,309)	$ (1,556)	$ (618)	$ 55,785	$ 1,124	$ 78,161

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2017	2016
	(Unaudited)	
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,798	$ 3,375
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	88	138
Net amortization of deferred loan costs	425	412
Provision for loan losses	450	310
Recovery on previously impaired investment securities	(96)	(107)
Gain on sale of investment securities	(244)	(1,636)
Originations of loans held for sale	(796)	(4,628)
Proceeds from sales of loans held for sale	806	4,745
Gain on sale of loans	(10)	(117)
Depreciation and amortization	648	646
Increase in bank owned life insurance, net	(268)	(207)
ESOP shares committed to be released	94	79
Stock based compensation expense	325	228
Increase in accrued interest receivable	(234)	(84)
Decrease in other assets	161	326
(Decrease) increase in other liabilities	(99)	65
Net Cash Provided by Operating Activities	4,048	3,545
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	6,510	14,406
Maturities, prepayments and calls	8,980	8,947
Purchases	(2,402)	-
Purchases of Federal Home Loan Bank Stock	(375)	(3)
Redemptions of Federal Home Loan Bank Stock	84	117
Loan origination and principal collections, net	(37,384)	(24,237)
Additions to premises and equipment	(1,294)	(240)
Net Cash Used in Investing Activities	(25,881)	(1,010)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	15,030	5,311
Net decrease in advances from borrowers for taxes and insurance	(1,475)	(1,438)
Proceeds from issuance of long-term debt	9,700	-
Repayment of long-term debt	(1,700)	(2,200)
Proceeds from stock options exercised	-	1,109
Purchase of treasury stock	(269)	(338)
Cash dividends paid	(559)	(727)
Net Cash Provided by Financing Activities	20,727	1,717
Net (Decrease) Increase in Cash and Cash Equivalents	(1,106)	4,252
CASH AND CASH EQUIVALENTS - BEGINNING	45,479	34,227
CASH AND CASH EQUIVALENTS - ENDING	$ 44,373	$ 38,479

SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 1,869	$ 1,728
Income taxes paid	$ 750	$ 760
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	$ 554	$ 199

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

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

The interim consolidated financial statements included herein as of September 30, 2017 and for the three and nine months ended September 30, 2017 and 2016 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and therefore, do not include all information or footnotes necessary for a complete presentation of the consolidated statements of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The consolidated statement of financial condition at December 31, 2016 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information and to make the financial statements not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. The consolidated statements of income for the three and nine months ended September 30, 2017 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2017.

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

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition as of September 30, 2017 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Note 2 – New Accounting Standards

The following are new accounting standards that have been previously disclosed but not yet adopted, which includes additional information on the impact the adoption of the standard will have on the Company's consolidated financial statements:

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-09 "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605 "Revenue Recognition", and most industry-specific guidance throughout the industry topics of Codification. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017. The Company's revenue is primarily comprised of interest income on financial instruments, including investment securities and loans, which are excluded from the scope of ASU 2014-09. The Company does not expect the guidance to have a material impact on the Company's consolidated financial statements. The most significant impact of the update for the Company may be additional disclosure requirements relating to non-interest income, specifically service charges and fees.

In January 2016, the FASB issued ASU 2016-01 "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The update enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by updating certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Among other changes, the update requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, and clarifies that entities should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entities' other deferred tax assets. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017, and is to be applied on a modified retrospective basis. Upon the effective date, the fair value of the Company's financial instruments will be presented using an exit price method and this will be disclosed. It is not expected that the use of the exit price method will have a material impact on the Company's consolidated financial statements. At the effective date, the Company does not expect any impact on the valuation allowance of deferred tax assets related to available for sale securities as a result of the adoption of ASU 2016-01.

In February 2016, the FASB issued ASU 2016-02 "Leases" (Topic 842) ("ASU 2016-02"). The guidance in the update supersedes the requirements in ASC Topic 840, Leases. The guidance is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for leases with lease terms of more than 12 months. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2018, and is to be applied on a modified retrospective basis. The Company currently has one operating lease for its branch office located in Depew, NY as well as several operating leases for five off-site ATMs, land on which one branch office is situated, and for parking lot space, that will result in recognition of lease assets and lease liabilities on the consolidated balance sheets. The amount of assets and liabilities added to the balance sheet are not expected to have a material impact on the Company's consolidated financial statements per preliminary estimates.

Note 3 – Investment Securities

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

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
Municipal bonds	$ 42,307	$ 1,495	$ (1)	$ 43,801
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	34	-	-	34
Collateralized mortgage obligations-government sponsored entities	24,025	45	(363)	23,707
Government National Mortgage Association	246	19	-	265
Federal National Mortgage Association	2,975	117	-	3,092
Federal Home Loan Mortgage Corporation	1,591	50	-	1,641
Asset-backed securities-private label	147	298	(3)	442
Asset-backed securities-government sponsored entities	58	4	-	62
Equity securities	22	42	-	64
	$ 71,405	$ 2,070	$ (367)	$ 73,108

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	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
Municipal bonds	$ 48,869	$ 1,847	$ (18)	$ 50,698
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	37	-	-	37
Collateralized mortgage obligations-government sponsored entities	29,170	83	(423)	28,830
Government National Mortgage Association	306	23	-	329
Federal National Mortgage Association	3,457	128	(3)	3,582
Federal Home Loan Mortgage Corporation	1,825	42	-	1,867
Asset-backed securities-private label	484	362	(14)	832
Asset-backed securities-government sponsored entities	71	5	-	76
Equity securities	22	62	-	84
	$ 84,241	$ 2,552	$ (458)	$ 86,335

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

At September 30, 2017 and at December 31, 2016, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation (“FHLMC”) common stock.

At September 30, 2017 thirty municipal bonds with a cost of $10.3 million and fair value of $10.7 million, were pledged under a collateral agreement with the Federal Reserve Bank (“FRB”) of New York for liquidity borrowing. At December 31, 2016 thirty-four municipal bonds with a cost of $11.1 million and fair value of $11.5 million were pledged under a collateral agreement with the FRB of New York for liquidity borrowing. In addition at September 30, 2017 nineteen municipal bonds with a cost and fair value of $5.0 million and $5.1 million, respectively, were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation (“FDIC”) insurance limits. At December 31, 2016 fourteen municipal bonds with a cost and fair value of $3.6 million and $3.7 million, respectively, were pledged as collateral for customer deposits in excess of “FDIC” insurance limits.

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

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars In thousands)					
September 30, 2017						
Municipal bonds	$ 453	$ (1)	$ -	$ -	$ 453	$ (1)
Mortgage-backed securities	4,976	(43)	15,095	(320)	20,071	(363)
Asset-backed securities -private label	144	(3)	-	-	144	(3)
	$ 5,573	$ (47)	$ 15,095	$ (320)	$ 20,668	$ (367)
December 31, 2016						
Municipal bonds	$ 1,430	$ (18)	$ -	$ -	$ 1,430	$ (18)
Mortgage-backed securities	13,902	(197)	9,220	(229)	23,122	(426)
Asset-backed securities -private label	470	(14)	-	-	470	(14)
	$ 15,802	$ (229)	$ 9,220	$ (229)	$ 25,022	$ (458)

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

At September 30, 2017, the Company's investment portfolio included several securities, including one private label asset-backed security, in the "unrealized losses less than twelve months" category. With the exception of the private label asset-backed security, the securities were not evaluated further for OTTI as the unrealized losses on the individual securities were less than 20% of book value, which management deemed to be immaterial, and the securities were issued by government sponsored enterprises.

At September 30, 2017, the Company had several securities in the "unrealized losses twelve months or more" category. These securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value. The temporary impairments were due to declines in fair value resulting from changes in interest rates and/or increased credit liquidity spreads since the securities were purchased.

Any private label asset-backed security with unrealized losses is evaluated further for OTTI, if the probability of default is high and the Company's analysis indicates a possible loss of principal. The following tables provide additional information relating to the private label asset-backed securities that were further evaluated as of September 30, 2017 and December 31, 2016 (dollars in thousands):

At September 30, 2017

Security	Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Delinquent % Over 90 days	Foreclosure%	OREO%
1	$ 147	$ 144	$ (3)	B-	17.80%	15.40%	5.50%	0.70%
Total	$ 147	$ 144	$ (3)					

At December 31, 2016

Security		Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Delinquent % Over 90 days	Foreclosure%	OREO%
1		$ 355	$ 342	$ (13)	B-	15.90%	14.90%	7.00%	0.30%
2	*	129	128	(1)	B-	12.70%	11.70%	4.50%	1.10%
Total		$ 484	$ 470	$ (14)					

*This security was paid in full during the second quarter of 2017.

Management's evaluation of the estimated discounted cash flows in comparison to the amortized book value for the security listed above did not reflect the need to record an OTTI charge against earnings as of September 30, 2017. The estimated discounted cash flows for this security did not show an additional principal loss under various prepayment and default rate scenarios.

Management also completed an OTTI analysis for two private label asset-backed securities, which did not have unrealized losses as of September 30, 2017. Management's calculation of the estimated discounted cash flows did not show additional principal losses for these securities under various prepayment and default rate scenarios. As a result of the stress tests that were performed, management concluded that additional OTTI charges were not required as of September 30, 2017 on these securities.

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

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

	For The Nine Months Ended September 30,	
	2017	2016
	(Dollars in thousands)	
Beginning balance	$ 554	$ 696
Additions:		
Credit loss not previously recognized	-	-
Reductions:		
Losses realized during the period on OTTI previously recognized	-	-
Receipt of cash flows on previously recorded OTTI	(96)	(107)
Ending balance	$ 458	$ 589

A deterioration in credit quality and/or other factors that may limit the liquidity of a security in our portfolio might adversely affect the fair values of the Company's investment portfolio and may increase the potential that certain unrealized losses will be designated as "other-than-temporary" and that the Company may incur additional write-downs in future periods.

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

	Amortized Cost	Fair Value
	(Dollars in thousands)	
September 30, 2017:		

After one year through five years	$ 3,452	$ 3,616
After five years through ten years	23,726	24,573
After ten years	15,129	15,612
Mortgage-backed securities	28,871	28,739
Asset-backed securities	205	504
Equity securities	22	64
	$ 71,405	$ 73,108

During the nine months ended September 30, 2017, the Company sold eighteen municipal bonds for total proceeds of $6.5 million resulting in realized gains of $244,000. During the nine months ended September 30, 2016, the Company sold nine U.S. treasury bonds for total proceeds of $14.4 million resulting in realized gains of $1.6 million.

Note 4 - Allowance for Loan Losses

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

Real Estate Loans:

· One- to Four-Family – are loans secured by first lien collateral on residential real estate primarily held in the Western New York region. These loans can be affected by economic conditions and the value of underlying properties. Western New York's housing market has consistently demonstrated stability in home prices despite economic conditions. Furthermore, the Company has conservative underwriting standards and its residential lending policies and procedures ensure that its one- to four-family residential mortgage loans generally conform to secondary market guidelines.
· Home Equity - are loans or lines of credit secured by first or second liens on owner-occupied residential real estate primarily held in the Western New York region. These loans can also be affected by economic conditions and the values of underlying properties. Home equity loans may have increased risk of loss if the Company does not hold the first mortgage resulting in the Company being in a secondary position in the event of collateral liquidation. The Company does not originate interest only home equity loans.
· Commercial Real Estate – are loans used to finance the purchase of real property, which generally consists of developed real estate that is held as first lien collateral for the loan. These loans are secured by real estate properties that are primarily held in the Western New York region. Commercial real estate lending involves additional risks compared with one- to four-family residential lending, because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, and/or the collateral value of the commercial real estate securing the loan, and repayment of such loans may be subject to adverse conditions in the real estate market or economic conditions to a greater extent than one- to four-family residential mortgage loans. Also, commercial real estate loans typically involve relatively large loan balances concentrated with single borrowers or groups of related borrowers.
· Construction – are loans to finance the construction of either one- to four-family owner occupied homes or commercial real estate. At the end of the construction period, the loan automatically converts to either a one- to four-family or commercial mortgage, as applicable. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion compared to the actual cost of construction. The Company limits its risk during construction as disbursements are not made until the required work for each advance has been completed and an updated lien search is performed. The completion of the construction progress is verified by a Company loan officer or inspections performed by an independent appraisal firm. Construction loans also expose us to the risk of construction delays which may impair the borrower's ability to repay the loan.

Other Loans:

· Commercial – includes business installment loans, lines of credit, and other commercial loans. Most of our commercial loans have fixed interest rates, and are for terms generally not in excess of 5 years. Whenever possible, we collateralize these loans with a lien on business assets and equipment and require the personal guarantees from principals of the borrower. Commercial loans generally involve a higher degree of credit risk because the collateral underlying the loans may be in the form of intangible assets and/or inventory subject to market obsolescence. Commercial loans can also involve relatively large loan balances to a single borrower or groups of related borrowers, with the repayment of such loans typically dependent on the successful operation of the commercial business and the income stream of the borrower. Such risks can be significantly affected by economic conditions. Although commercial loans may be collateralized by equipment or other business assets, the liquidation of collateral in the event of a borrower default may be an insufficient source of repayment because the equipment or other business assets may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial loan depends primarily on the credit worthiness of the borrowers (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

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

The allowance for loan losses is a valuation account that reflects the Company’s evaluation of the losses inherent in its loan portfolio. In order to determine the adequacy of the allowance for loan losses, the Company estimates losses by loan type using historical loss factors, as well as other environmental factors, such as trends in loan volume and loan type, loan concentrations, changes in the experience, ability and depth of the Company’s lending management, and national and local economic conditions. The Company's determination as to the classification of loans and the amount of loss allowances are subject to review by bank regulators, which can require the establishment of additional loss allowances.

The Company also reviews all loans on which the collectability of principal may not be reasonably assured, by reviewing payment status, financial conditions and estimated value of loan collateral. These loans are assigned an internal loan grade, and the Company assigns an amount of loss allowances to these classified loans based on loan grade.

The following tables summarize the activity in the allowance for loan losses for the three and nine months ended September 30, 2017 and 2016 and the distribution of the allowance for loan losses and loans receivable by loan portfolio class and impairment method as of September 30, 2017 and December 31, 2016:

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2017								
Allowance for Loan Losses:								
Balance – July 1, 2017	$ 470	$ 124	$ 1,888	$ 303	$ 331	$ 32	$ 75	$ 3,223
Charge-offs	-	-	(75)	-	(2)	(8)	-	(85)
Recoveries	1	1	-	-	-	2	-	4
Provision (Credit)	53	10	(145)	16	167	5	(31)	75
Balance – September 30, 2017	$ 524	$ 135	$ 1,668	$ 319	$ 496	$ 31	$ 44	$ 3,217
Balance – January 1, 2017	$ 431	$ 114	$ 1,803	$ 150	$ 338	$ 28	$ 18	$ 2,882
Charge-offs	-	(3)	(75)	-	(20)	(36)	-	(134)
Recoveries	2	4	-	-	1	12	-	19
Provision (Credit)	91	20	(60)	169	177	27	26	450
Balance – September 30, 2017	$ 524	$ 135	$ 1,668	$ 319	$ 496	$ 31	$ 44	$ 3,217
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 524	$ 135	$ 1,668	$ 319	$ 496	$ 31	$ 44	$ 3,217
Gross Loans Receivable (1):								
Ending balance	$ 147,850	$ 37,661	$ 123,079	$ 29,233	$ 23,355	$ 1,326	$ -	$ 362,504
Ending balance: individually evaluated for impairment	$ 156	$ 21	$ 1,442	$ -	$ 54	$ -	$ -	$ 1,673
Ending balance: collectively evaluated for impairment	$ 147,694	$ 37,640	$ 121,637	$ 29,233	$ 23,301	$ 1,326	$ -	$ 360,831

(1) Gross Loans Receivable does not include allowance for loan losses of $(3,217) or deferred loan costs of $3,121.

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2016								
Allowance for Loan Losses:								
Balance – July 1, 2016	$ 424	$ 129	$ 1,064	$ 129	$ 275	$ 22	$ 17	$ 2,060
Charge-offs	(16)	-	-	-	(46)	(8)	-	(70)
Recoveries	1	-	-	-	-	4	-	5
Provision (Credit)	12	(13)	50	-	72	12	(8)	125
Balance – September 30, 2016	$ 421	$ 116	$ 1,114	$ 129	$ 301	$ 30	$ 9	$ 2,120
Balance – January 1, 2016	$ 351	$ 120	$ 1,204	$ 59	$ 197	$ 22	$ 32	$ 1,985
Charge-offs	(65)	(18)	(1)	-	(76)	(40)	-	(200)
Recoveries	11	1	-	-	1	12	-	25
Provision (Credit)	124	13	(89)	70	179	36	(23)	310
Balance – September 30, 2016	$ 421	$ 116	$ 1,114	$ 129	$ 301	$ 30	$ 9	$ 2,120

The following table summarizes the distribution of the allowance for loan losses and loans receivable by loan portfolio class as of December 31, 2016:

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
December 31, 2016								
Allowance for Loan Losses:								
Balance – December 31, 2016	$ 431	$ 114	$ 1,803	$ 150	$ 338	$ 28	$ 18	$ 2,882
Ending balance: individually evaluated for impairment	$ -	$ -	$ 390	$ -	$ 10	$ -	$ -	$ 400
Ending balance: collectively	$ 431	$ 114	$ 1,413	$ 150	$ 328	$ 28	$ 18	$ 2,482

evaluated for impairment								
Gross Loans Receivable (1):								
Ending Balance	$ 149,333	$ 35,534	$ 107,243	$ 12,361	$ 20,447	$ 1,313	$ -	$ 326,231
Ending balance: individually evaluated for impairment	$ 190	$ 22	$ 3,162	$ -	$ 163	$ -	$ -	$ 3,537
Ending balance: collectively evaluated for impairment	$ 149,143	$ 35,512	$ 104,081	$ 12,361	$ 20,284	$ 1,313	$ -	$ 322,694

(1) Gross Loans Receivable does not include allowance for loan losses of $(2,882) or deferred loan costs of $3,016.

Although the allocations noted above are by loan type, the allowance for loan losses is general in nature and is available to offset losses from any loan in the Company's portfolio. The unallocated component of the allowance for loan losses reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for existing specific and general losses in the portfolio.

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

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	At September 30, 2017			For the Nine Months Ended September 30, 2017	
	(Dollars in thousands)				
With no related allowance recorded:					
Residential, one- to four-family	$ 156	$ 156	$ -	$ 171	$ 10
Home equity	21	21	-	22	-
Commercial real estate	1,442	1,442	-	1,674	217
Commercial loans	54	54	-	54	-
Total impaired loans with no related allowance	1,673	1,673	-	1,921	227
With an allowance recorded:					
Commercial real estate(1)	-	-	-	308	-
Commercial loans(2)	-	-	-	66	6
Total impaired loans with an allowance	-	-	-	374	6
Total of impaired loans:					
Residential, one- to four-family	156	156	-	171	10
Home equity	21	21	-	22	-
Commercial real estate	1,442	1,442	-	1,982	217
Commercial loans	54	54	-	120	6
Total impaired loans	$ 1,673	$ 1,673	$ -	$ 2,295	$ 233

(1)This loan was foreclosed upon during the nine months ended September 30, 2017 and was recorded in other assets at September 30, 2017.

(2)This loan was paid off in full during the nine months ended September 30, 2017.

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	At December 31, 2016 (Dollars in thousands)			For the Year Ended December 31, 2016	
With no related allowance recorded:					
Residential, one- to four-family	$ 190	$ 190	$ -	$ 224	$ 14
Home equity	22	22	-	24	1
Commercial real estate	2,148	2,148	-	2,299	29
Commercial loans	54	54	-	71	-
Total impaired loans with no related allowance	2,414	2,414	-	2,618	44
With an allowance recorded:					
Commercial real estate	1,014	1,014	390	1,011	31
Commercial loans	109	109	10	135	5
Total impaired loans with an allowance	1,123	1,123	400	1,146	36
Total of impaired loans:					
Residential, one- to four-family	190	190	-	224	14
Home equity	22	22	-	24	1
Commercial real estate	3,162	3,162	390	3,310	60
Commercial loans	163	163	10	206	5
Total impaired loans	$ 3,537	$ 3,537	$ 400	$ 3,764	$ 80

The following table provides an analysis of past due loans and non-accruing loans as of the dates indicated:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Due	Total Loans Receivable	Loans on Non-Accrual
	(Dollars in thousands)						
September 30, 2017:							
Real Estate Loans:							
Residential, one- to four-family	$ 1,471	$ 778	$ 1,167	$ 3,416	$ 144,434	$ 147,850	$ 2,088
Home equity	85	59	209	353	37,308	37,661	323
Commercial	-	-	1,264	1,264	121,815	123,079	1,264
Construction	-	-	-	-	29,233	29,233	-
Other Loans:							
Commercial	1	21	54	76	23,279	23,355	54
Consumer	1	-	21	22	1,304	1,326	5
Total	$ 1,558	$ 858	$ 2,715	$ 5,131	$ 357,373	$ 362,504	$ 3,734

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Due	Total Loans Receivable	Loans on Non-Accrual
	(Dollars in thousands)						
December 31, 2016:							
Real Estate Loans:							
Residential, one- to four-family	$ 1,192	$ 782	$ 1,038	$ 3,012	$ 146,321	$ 149,333	$ 2,165
Home equity	141	206	158	505	35,029	35,534	329
Commercial	-	-	2,977	2,977	104,266	107,243	2,977
Construction	-	-	-	-	12,361	12,361	-
Other Loans:							
Commercial	-	19	56	75	20,372	20,447	205
Consumer	31	-	28	59	1,254	1,313	28
Total	$ 1,364	$ 1,007	$ 4,257	$ 6,628	$ 319,603	$ 326,231	$ 5,704

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. A loan does not have to be 90 days delinquent in order to be classified as non-accrual. When interest accrual is discontinued, all unpaid accrued interest is reversed. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance. Interest income not recognized on non-accrual loans during the nine month periods ended September 30, 2017 and 2016 was $209,000 and $257,000 for each period.

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

- Pass/Performing;
- Special Mention – does not currently expose the Company to a sufficient degree of risk but does possess credit deficiencies or potential weaknesses deserving the Company's close attention;
- Substandard – has one or more well-defined weaknesses and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. A substandard asset would be one inadequately protected by the current net worth and paying capacity of the obligor or pledged collateral, if applicable;
- Doubtful – has all the weaknesses inherent in substandard loans with the additional characteristic that the weaknesses present make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss; and
- Loss – loan is considered uncollectible and continuance without the establishment of a specific valuation reserve is not warranted.

The Company's Asset Classification Committee is responsible for monitoring risk ratings and making changes as deemed appropriate. Each commercial loan is individually assigned a loan classification. The Company's consumer loans, including residential one- to four-family loans and home equity loans, are not classified as described above. Instead, the Company uses the delinquency status as the basis for classifying these loans. Generally, all consumer loans more than 90 days past due are classified and placed in non-accrual. Such loans that are well-secured and in the process of collection will remain in accrual status.

The following table summarizes the internal loan grades applied to the Company's loan portfolio as of September 30, 2017 and December 31, 2016:

	Pass/Performing	Special Mention	Substandard	Doubtful	Loss	Total
	(Dollars in thousands)					
September 30, 2017						
Real Estate Loans:						
Residential, one- to four-family	$ 144,993	$ -	$ 2,857	$ -	$ -	$ 147,850
Home equity	37,052	-	609	-	-	37,661
Commercial	119,406	810	2,863	-	-	123,079
Construction	29,233	-	-	-	-	29,233
Other Loans:						
Commercial	21,879	1,122	354	-	-	23,355
Consumer	1,316	-	8	-	2	1,326
Total	$ 353,879	$ 1,932	$ 6,691	$ -	$ 2	$ 362,504

	Pass/Performing	Special Mention	Substandard	Doubtful	Loss	Total
	(Dollars in thousands)					
December 31, 2016						
Real Estate Loans:						
Residential, one- to four-family	$ 146,333	$ -	$ 3,000	$ -	$ -	$ 149,333
Home equity	35,025	-	509	-	-	35,534
Commercial	102,216	1,759	3,268	-	-	107,243
Construction	12,361	-	-	-	-	12,361
Other Loans:						
Commercial	19,865	297	270	15	-	20,447
Consumer	1,306	-	6	-	1	1,313
Total	$ 317,106	$ 2,056	$ 7,053	$ 15	$ 1	$ 326,231

Troubled debt restructurings ("TDRs") occur when we grant borrowers concessions that we would not otherwise grant but for economic or legal reasons pertaining to the borrower's financial difficulties. A concession is made when the terms of the loan modification are more favorable than the terms the borrower would have received in the current market under similar financial difficulties. These concessions may include, but are not limited to, modifications of the terms of the debt, the transfer of assets or the issuance of an equity interest by the borrower to satisfy all or part of the debt, or the addition of borrower(s). The Company identifies loans for potential TDRs primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future. Generally, we will not return a TDR to accrual status until the borrower has demonstrated the ability to make principal and interest payments under the restructured terms for at least six consecutive months. The Company's TDRs are impaired loans, which may result in specific allocations and subsequent charge-offs if appropriate.

The following table summarizes the loans that were classified as TDRs as of the dates indicated:

			Non-Accruing		Accruing		TDRs That Have Defaulted on Modified Terms Year to Date	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
	(Dollars in thousands)							
At September 30, 2017								
Real Estate Loans:								
Residential, one- to four-family	4	$ 156	-	$ -	4	$ 156	-	$ -
Home equity	2	21	1	19	1	2	-	-
Total	6	$ 177	1	$ 19	5	$ 158	-	$ -
At December 31, 2016								
Real Estate Loans:								
Residential, one- to four-family	5	$ 190	-	$ -	5	$ 190	-	$ -
Home equity	2	22	1	19	1	3	-	-
Other Loans:								
Commercial	1	109	1	109	-	-	-	-
Total	8	$ 321	2	$ 128	6	$ 193	-	$ -

No additional loan commitments were outstanding to these borrowers at September 30, 2017 and December 31, 2016.

There were no loans restructured and classified as TDRs during the three and nine months ended September 30, 2017.

The following table details the activity in loans which were first deemed to be TDRs during the three and nine months ended September 30, 2016:

For The Three Months Ended September 30, 2016		
Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment

	(Dollars in thousands)		
Real Estate Loans:			
Residential, one- to four-family	-	$ -	$ -
Other Loans:			
Commercial	1	118	118
Total	1	$ 118	$ 118

	For The Nine Months Ended September 30, 2016		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)		
Real Estate Loans:			
Residential, one- to four-family	1	$ 31	$ 31
Other Loans:	-	-	-
Commercial	1	118	118
Total	2	$ 149	$ 149

The loans above were deemed to be TDRs due to the borrower's financial difficulties or due to modifications of the terms of the debt related to the bankruptcy of the borrower.

Some loan modifications classified as TDRs may not ultimately result in full collection of principal and interest, as modified, which may result in potential losses. These potential losses have been factored into our overall estimate of the allowance for loan losses.

Foreclosed real estate consists of property acquired in settlement of loans which is carried at its fair value less estimated selling costs. Write-downs from cost to fair value less estimated selling costs are recorded at the date of acquisition or repossession and are charged to the allowance for loan losses. Foreclosed real estate was $513,000 and $412,000 at September 30, 2017 and December 31, 2016, respectively, and was included as a component of other assets on the consolidated statements of financial condition. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction was $1.0 million and $767,000 at September 30, 2017 and December 31, 2016, respectively.

Note 5 – Earnings per Share

Earnings per share was calculated for the three and nine months ended September 30, 2017 and 2016, respectively. Basic earnings per share is based upon the weighted average number of common shares outstanding, exclusive of unearned shares held by the Employee Stock Ownership Plan of Lake Shore Bancorp, Inc. (the "ESOP"), unearned shares held by the Lake Shore Bancorp, Inc. 2006 Recognition and Retention Plan ("RRP"), and unearned shares held by the Lake Shore Bancorp, Inc. 2012 Equity Incentive Plan ("EIP"). Diluted earnings per share is based upon the weighted average number of common shares outstanding and common share equivalents that would arise from the exercise of dilutive securities. Stock options are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent they would be dilutive and computed using the treasury stock method.

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

	Three Months Ended September 30,	
	2017	2016
Numerator – net income	$ 940,000	$ 757,000
Denominator:		
Basic weighted average shares outstanding	6,115,140	6,036,026
Increase in weighted average shares outstanding due to:		
Stock options	9,113	7,575
Diluted weighted average shares outstanding (1)	6,124,253	6,043,601
Earnings per share:		
Basic	$ 0.15	$ 0.13
Diluted	$ 0.15	$ 0.13

	Nine Months Ended September 30,	
	2017	2016
Numerator – net income	$ 2,798,000	$ 3,375,000
Denominator:		
Basic weighted average shares outstanding	6,109,468	6,000,501
Increase in weighted average shares outstanding due to:		
Stock options	9,093	7,607
Diluted weighted average shares outstanding (1)	6,118,561	6,008,108
Earnings per share:		
Basic	$ 0.46	$ 0.56
Diluted	$ 0.46	$ 0.56

(1) Stock options to purchase 64,547 shares under the Company’s 2006 Stock Option Plan and 20,000 shares under the EIP at $14.38 under each plan were outstanding during the three and nine month periods ended September 30, 2017, but were not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive.

Note 6 – 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. There were no loss reserves associated with these commitments at September 30, 2017 and December 31, 2016. 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 as of the dates specified:

	Contract Amount	
	September 30, 2017	December 31, 2016
	(Dollars in thousands)	
Commitments to grant loans	$ 19,910	$ 24,707
Unfunded commitments under lines of credit	$ 38,184	$ 35,356

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 September 30, 2017 and December 31, 2016, the Company’s loan commitments that have fixed interest rates for the next five years totaled $9.7 million and $12.0 million, respectively. The range of interest rates on these fixed rate commitments was 3.75% to 6.25% at September 30, 2017.

Note 7 – Stock-based Compensation

As of September 30, 2017, the Company had four stock-based compensation plans, which are described below. The compensation cost that has been recorded under salary and benefits expense in the non-interest expense section of the consolidated statements of income for these plans was $146,000 and $110,000 for the three months ended September 30, 2017 and 2016, respectively. The compensation cost that has been recorded for these plans for the nine months ended September 30, 2017 and 2016 was $418,000 and $309,000, respectively.

2006 Stock Option Plan

The Company’s 2006 Stock Option Plan (the “Stock Option Plan”), which was approved by the Company’s stockholders, permitted the grant of options to its employees and non-employee directors for up to 297,562 shares of common stock. The Stock Option Plan expired on October 24, 2016, and grants of options can no longer be awarded.

Both incentive stock options and non-qualified stock options have been granted under the Stock Option Plan. The exercise price of each stock option equals the market price of the Company’s common stock on the date of grant and an option’s maximum term is ten years. The stock options generally vest over a five year period.

A summary of the status of the Stock Option Plan during the nine months ended September 30, 2017 and 2016 is presented below:

:

	September 30, 2017			September 30, 2016		
	Options	Exercise Price	Remaining Contractual Life	Options	Exercise Price	Remaining Contractual Life
Outstanding at beginning of year	82,826	$ 12.95		118,087	$ 10.68	
Granted	-	-		-	-	
Exercised	-	-		(98,986)	11.19	
Forfeited	-	-		-	-	
Outstanding at end of period	82,826	$ 12.95	7.6 years	19,101	$ 8.04	3.2 years
Options exercisable at end of period	18,279	$ 7.88	7.6 years	19,101	$ 8.04	3.2 years
Fair value of options granted		$ -			$ -	

At September 30, 2017, stock options outstanding had an intrinsic value of $253,000 and there were no remaining options available for grant under the Stock Option Plan. There were no stock options exercised during the nine month period ended September 30, 2017. The intrinsic value of stock options exercised during the nine month period ended September 30, 2016 was $216,000. Compensation expense related to the Stock Option Plan for the three month period ended September 30, 2017 was $8,000. Compensation expense related to the Stock Option Plan for the nine month period ended September 30, 2017 was $25,000. There was no compensation expense related to the Stock Option Plan for the three and nine month periods ended September 30, 2016. At September 30, 2017, $138,000 of unrecognized compensation cost related to the Stock Option Plan is expected to be recognized over a period of 49 months.

2006 Recognition and Retention Plan

The Company's 2006 Recognition and Retention Plan ("RRP"), which was approved by the Company's stockholders, permitted the grant of restricted stock awards ("Awards") to employees and non-employee directors for up to 119,025 shares of common stock. The RRP expired on October 24, 2016, and as of October 24, 2016 all shares permitted under the plan have been granted.

As of September 30, 2017, there were 99,889 shares vested or distributed to eligible participants under the RRP. Compensation expense amounted to $23,000 and $17,000 for the three months ended September 30, 2017 and 2016, respectively. Compensation expense amounted to $66,000 and $49,000 for the nine months ended September 30, 2017 and 2016, respectively. At September 30, 2017, $218,000 of unrecognized compensation cost related to the RRP is expected to be recognized over a period of 49 months.

A summary of the status of unvested shares under the RRP for the nine months ended September 30, 2017 and 2016 is as follows:

	2017	Weighted Average Grant Price (per Share)	2016	Weighted Average Grant Price (per Share)
Unvested shares outstanding at beginning of year	24,110	$ 12.96	21,397	$ 12.25
Granted	-	-	-	-
Vested	(4,974)	12.14	(4,974)	12.14
Forfeited	-	-	-	-
Unvested shares outstanding at end of period	19,136	$ 13.18	16,423	$ 12.28

2012 Equity Incentive Plan

The Company's 2012 Equity Incentive Plan (the "EIP"), which was approved by the Company's stockholders on May 23, 2012, authorizes the issuance of up to 180,000 shares of common stock pursuant to grants of restricted stock awards and up to 20,000 shares of common stock pursuant to grants of incentive stock options and non-qualified stock options, subject to permitted adjustments for certain corporate transactions. Employees and directors of Lake Shore Bancorp or its subsidiaries are eligible to receive awards under the EIP, except that non-employees may not be granted incentive stock options.

The Board of Directors granted restricted stock awards under the EIP during 2017 as follows:

Grant Date	Number of Restricted Stock Awards	Vesting		Fair Value per Share of Award on Grant Date	Awardees
February 8, 2017	21,675	100% on December 15, 2019, if three year performance metric is achieved	$	15.90	Employees
February 8, 2017	5,673	100% on December 15, 2017		15.90	Non-employee directors

A summary of the status of unvested restricted stock awards under the EIP for the nine months ended September 30, 2017 and 2016 is as follows:

	2017		Weighted Average Grant Price (per Share)	2016		Weighted Average Grant Price (per Share)
Unvested shares outstanding at beginning of year	26,072	$	12.77	27,769	$	12.64
Granted	27,348		15.90	20,354		13.38
Vested	(4,207)		12.16	(4,213)		12.16
Forfeited	(625)		13.76	-		-
Unvested shares outstanding at end of period	48,588	$	14.57	43,910	$	13.02

As of September 30, 2017, there were 26,124 of restricted stock shares vested or distributed to eligible participants under the EIP. Compensation expense related to restricted stock awards under the EIP amounted to $81,000 for the three months ended September 30, 2017 and $68,000 for the three months ended September 30, 2016. Compensation expense related to restricted stock awards under the EIP amounted to $224,000 for the nine months ended September 30, 2017 and $181,000 for the nine months ended September 30, 2016. At September 30, 2017, $457,000 of unrecognized compensation cost related to unvested restricted stock awards is expected to be recognized over a period of 3 to 27 months.

A summary of the status of stock options awarded in the fourth quarter of 2016 under the EIP for the nine months ended September 30, 2017 is presented below:

	September 30, 2017			
	Options		Exercise Price	Remaining Contractual Life
Outstanding at beginning of year	20,000	$	14.38	
Granted	-		-	

Exercised	-	-	
Forfeited	-	-	
Outstanding at end of period	20,000	$ 14.38	9.1 years
Options exercisable at end of period	-	$ -	
Fair value of options granted		-	

At September 30, 2017, stock options outstanding had an intrinsic value of $32,000 and there were no remaining options available for grant under the EIP. Compensation expense related to stock options outstanding under the EIP amounted to $3,000 for the three months ended September 30, 2017 and $8,000 for the nine months ended September 30, 2017. There was no compensation expense for the three and nine months

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ended September 30, 2016 related to stock options outstanding under the EIP. At September 30, 2017, $43,000 of unrecognized compensation cost related to unvested stock options is expected to be recognized over a period of 49 months.

Employee Stock Ownership Plan (“ESOP”)

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 once the employee is eligible to participate in the ESOP. The Company utilized $2.6 million of the proceeds of its 2006 stock offering to extend a loan to the ESOP and 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. As of September 30, 2017, the balance of the loan to the ESOP was $1.6 million and the fair value of unallocated shares was $2.4 million. As of September 30, 2017, there were 62,956 allocated shares and 150,765 unallocated shares compared to 63,574 allocated shares and 158,699 unallocated shares at September 30, 2016. The ESOP compensation expense was $31,000 for the three months ended September 30, 2017 and $25,000 for the three months ended September 30, 2016 based on 1,984 shares earned in each of those quarters. The ESOP compensation expense was $94,000 for the nine months ended September 30, 2017 and $79,000 for the nine months ended September 30, 2016 based on 5,951 shares earned in each of those periods.

Note 8 - Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company’s financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of September 30, 2017 and December 31, 2016 and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. The estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported here.

The measurement of fair value under FASB ASC Topic 820, “Fair Value Measurements and Disclosures” (“ASC Topic 820”) establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities measurements (Level 1) and the lowest priority to unobservable input measurements (Level 3). The three levels of the fair value hierarchy under ASC Topic 820 are as follows:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly.

Level 3: Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

An asset's 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.

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2017 and December 31, 2016 were as follows:

	Fair Value Measurements at September 30, 2017			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Measured at fair value on a recurring basis:				
Securities available for sale:				
Municipal bonds	$ 43,801	$ -	$ 43,801	$ -
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	34	-	34	-
Collateralized mortgage obligations-government sponsored entities	23,707	-	23,707	-
Government National Mortgage Association	265	-	265	-
Federal National Mortgage Association	3,092	-	3,092	-
Federal Home Loan Mortgage Corporation	1,641	-	1,641	-
Asset-backed securities:				
Private label	442	-	-	442
Government sponsored entities	62	-	62	-
Equity securities	64	-	64	-
Total	$ 73,108	$ -	$ 72,666	$ 442

	Fair Value Measurements at December 31, 2016			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Measured at fair value on a recurring basis:				
Securities available for sale:				
Municipal bonds	$ 50,698	$ -	$ 50,698	$ -
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	37	-	37	-
Collateralized mortgage obligations-government sponsored entities	28,830	-	28,830	-
Government National Mortgage Association	329	-	329	-
Federal National Mortgage Association	3,582	-	3,582	-
Federal Home Loan Mortgage Corporation	1,867	-	1,867	-
Asset-backed securities:				
Private label	832	-	-	832
Government sponsored entities	76	-	76	-
Equity securities	84	-	84	-
Total	$ 86,335	$ -	$ 85,503	$ 832

Any transfers between levels would be recognized as of the actual date of event or change in circumstances that caused the transfer. There were no reclassifications between the Level 1 and Level 2 categories for the nine months ended September 30, 2017 and for the year ended December 31, 2016.

Level 2 inputs for assets or liabilities measured at fair value on a recurring basis might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

The following table presents a reconciliation of the securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3), specifically, asset-backed securities - private label, for the nine months ended September 30, 2017 and 2016:

	2017	2016
	(Dollars in thousands)	
Beginning Balance	$ 832	$ 1,501
Total gains - realized/unrealized:		
Included in earnings	-	-
Included in other comprehensive loss	11	42
Total losses - realized/unrealized:		
Included in earnings	-	-
Included in other comprehensive loss	(64)	(72)
Sales	-	-
Principal paydowns	(337)	(480)
Transfers to (out of) Level 3	-	-
Ending Balance	$ 442	$ 991

Both observable and unobservable inputs may be used to determine the fair value of assets and liabilities measured on a recurring basis that the Company has classified within the Level 3 category. As a result, any unrealized gains and losses for assets within the Level 3 category may include changes in fair value attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

The following table presents additional quantitative information about the Level 3 inputs for the asset-backed securities - private label category. The fair values for this category were developed using the discounted cash flow technique with the following unobservable input ranges as of September 30, 2017 and December 31, 2016 (dollars in thousands):

				Unobservable Inputs		
Security Category	Fair Value	Loan Type/Collateral	Credit Ratings	Constant Prepayment Speed (CPR)	Probability of Default (Annual Default Rate)	Loss Severity
September 30, 2017						
Asset-backed securities - private label	$ 442	Sub-prime First and Prime Second Lien - Residential Real Estate	B- thru D	5-12	3.0-5.0%	75.0% - 100.0%
December 31, 2016						
Asset-backed securities - private	$ 832	Sub-prime First and Prime Second Lien - Residential	B- thru D	5 - 10	5.0%	70.0% - 100.0%

label	Real Estate

Level 3 inputs are determined by the Company's management using inputs from its third party financial advisor on a quarterly basis. The significant unobservable inputs used in the fair value measurement of the reporting entity's asset-backed, private label securities are prepayment rates, probability of default and loss severity in the event of default. Significant increases or decreases in any of those inputs in isolation would result in a significantly lower or higher fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

In addition to disclosure of the fair value of assets on a recurring basis, ASC Topic 820 requires disclosures for assets and liabilities measured at fair value on a non-recurring basis, such as impaired assets and foreclosed real estate. Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of these loans. Non-recurring adjustments also include certain impairment amounts for collateral-dependent loans calculated as required by ASC Topic 310, “Receivables – Loan Impairment,” when establishing the allowance for loan losses. An impaired loan is carried at fair value based on either a recent appraisal less estimated selling costs of underlying collateral or discounted cash flows based on current market conditions.

For assets measured at fair value on a non-recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2017 and December 31, 2016 were as follows:

	Fair Value Measurements			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Measured at fair value on a non-recurring basis:				
At September 30, 2017				
Impaired loans	$ 35	$ -	$ -	$ 35
Foreclosed real estate	513	-	-	513
At December 31, 2016				