LAKE SHORE BANCORP, INC.
Form 10-Q
May 11, 2018

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

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

For the quarterly period ended March 31, 2018

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

Commission File No.: 000-51821

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

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

(Address(Zip code)
of
principal
executive
offices)

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

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

Yes [X]No [ ]

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

Yes [X]No [ ]

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

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

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

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

Yes [ ] No [X]

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

There were 6,060,714 shares of the registrant's common stock, $0.01 par value per share, outstanding at May 8, 2018.

TABLE OF CONTENTS

PART I Financial Information

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	March 31, 2018 (Unaudited)	December 31, 2017
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 7,236	$ 7,709
Interest earning deposits	3,377	6,570
Federal funds sold	36,925	26,634
Cash and Cash Equivalents	47,538	40,913
Securities available for sale	78,429	80,421
Federal Home Loan Bank stock, at cost	1,631	1,631
Loans receivable, net of allowance for loan losses 2018 $3,367; 2017 $3,283	371,166	365,063
Premises and equipment, net	9,327	9,373
Accrued interest receivable	1,947	1,801
Bank owned life insurance	18,161	18,077
Other assets	1,885	1,698
Total Assets	$ 530,084	$ 518,977
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 362,619	$ 350,535
Non-interest bearing	55,133	54,618
Total Deposits	417,752	405,153
Long-term debt	26,950	26,950
Advances from borrowers for taxes and insurance	2,199	3,000
Other liabilities	4,990	5,499
Total Liabilities	$ 451,891	$ 440,602
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,827,741 shares issued and 6,073,970 shares outstanding at March 31, 2018 and 6,827,741 shares issued and 6,098,323 shares outstanding at December 31, 2017	$ 68	$ 68

Additional paid-in capital	30,766	30,719
Treasury stock, at cost (753,771 shares at March 31, 2018 and 729,418 shares at December 31, 2017)	(7,679)	(7,309)
Unearned shares held by ESOP	(1,514)	(1,535)
Unearned shares held by compensation plans	(429)	(540)
Retained earnings	56,731	56,181
Accumulated other comprehensive income	250	791
Total Stockholders' Equity	78,193	78,375
Total Liabilities and Stockholders' Equity	$ 530,084	$ 518,977

See notes to consolidated financial statements.

1

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended March 31,	
	2018	2017
	(Unaudited) (Dollars in thousands, except per share data)	
Interest Income		
Loans, including fees	$ 4,372	$ 4,062
Investment securities, taxable	230	210
Investment securities, tax-exempt	393	448
Other	113	38
Total Interest Income	5,108	4,758
Interest Expense		
Deposits	617	477
Long-term debt	139	92
Other	20	21
Total Interest Expense	776	590
Net Interest Income	4,332	4,168
Provision for Loan Losses	75	350
Net Interest Income after Provision for Loan Losses	4,257	3,818
Non-Interest Income		
Service charges and fees	451	447
Earnings on bank owned life insurance	84	87
Unrealized gain on equity securities	8	-
Recovery on previously impaired investment securities	22	39
Gain on sale of securities available for sale	-	25
Net gain on sale of loans	2	7
Other	23	25
Total Non-Interest Income	590	630
Non-Interest Expenses		
Salaries and employee benefits	2,065	1,890
Occupancy and equipment	587	610
Data processing	328	307
Professional services	224	227
Advertising	153	167
Postage and supplies	64	63
FDIC Insurance	38	36
Other	299	277
Total Non-Interest Expenses	3,758	3,577
Income before Income Taxes	1,089	871
Income Tax Expense	153	155
Net Income	$ 936	$ 716
Basic and diluted earnings per common share	$ 0.15	$ 0.12
Dividends declared per share	$ 0.10	$ 0.08

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended March 31,	
	2018	2017
	(Unaudited)	
	(Dollars in thousands)	
Net Income	$ 936	$ 716
Other Comprehensive Loss, net of tax benefit:		
Unrealized holding losses on securities available for sale, net of tax benefit	(680)	(40)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(17)	(26)
Net gain on sale of securities included in net income, net of tax expense	-	(16)
Total Other Comprehensive Loss	(697)	(82)
Total Comprehensive Income	$ 239	$ 634

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Stockholders’ Equity

Three Months Ended March 31, 2018 and 2017 (Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by Compensation Plans	Retained Earnings	Accumulated Other Comprehensive Income	Total
	(Dollars in thousands, except share and per share data)							
Balance - January 1, 2017	$ 68	$ 30,532	$ (7,300)	$ (1,620)	$ (578)	$ 53,546	$ 1,382	$ 76,030
Net income	-	-	-	-	-	716	-	716
Other comprehensive loss, net of tax benefit of $42	-	-	-	-	-	-	(82)	(82)
ESOP shares earned (1,984 shares)	-	10	-	21	-	-	-	31
Stock based compensation	-	11	-	-	-	-	-	11
Compensation plan shares granted (27,348 shares)	-	-	270	-	(270)	-	-	-
Compensation plan shares forfeited (200 shares)	-	-	(2)	-	2	-	-	-
Compensation plan shares earned (5,862 shares)	-	18	-	-	63	-	-	81
Cash dividends declared ($0.08 per share)	-	-	-	-	-	(186)	-	(186)
Balance - March 31, 2017	$ 68	$ 30,571	$ (7,032)	$ (1,599)	$ (783)	$ 54,076	$ 1,300	$ 76,601
Balance - January 1, 2018	$ 68	$ 30,719	$ (7,309)	$ (1,535)	$ (540)	$ 56,181	$ 791	$ 78,375
Net income	-	-	-	-	-	936	-	936
Other comprehensive loss, net of tax benefit of $185	-	-	-	-	-	-	(697)	(697)
Reclassification of the Income Tax Effects of the Tax Cuts and Jobs Act from AOCI	-	-	-	-	-	(156)	156	-

ESOP shares earned (1,984 shares)	-	12	-	21	-	-	-	33
Stock based compensation	-	11	-	-	-	-	-	11
Compensation plan shares granted (5,285 shares)	-	-	50	-	(50)	-	-	-
Compensation plan shares forfeited (9,638 shares)	-	-	(91)	-	91	-	-	-
Compensation plan shares earned (6,613 shares)	-	24	-	-	70	-	-	94
Purchase of treasury stock, at cost (20,000 shares)	-	-	(329)	-	-	-	-	(329)
Cash dividends declared ($0.10 per share)	-	-	-	-	-	(230)	-	(230)
Balance - March 31, 2018	$ 68	$ 30,766	$ (7,679)	$ (1,514)	$ (429)	$ 56,731	$ 250	$ 78,193

See notes to consolidated financial statements.

4

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Three Months Ended March 31,	
	2018	2017
	(Unaudited)	
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 936	$ 716
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	21	34
Net amortization of deferred loan costs	118	125
Provision for loan losses	75	350
Recovery on previously impaired investment securities	(22)	(39)
Unrealized gain on equity securities	(8)	-
Gain on sale of investment securities	-	(25)
Originations of loans held for sale	(198)	(451)
Proceeds from sales of loans held for sale	200	458
Gain on sale of loans	(2)	(7)
Depreciation and amortization	196	225
Increase in bank owned life insurance, net	(84)	(87)
ESOP shares committed to be released	33	31
Stock based compensation expense	105	92
Increase in accrued interest receivable	(146)	(200)
Increase in other assets	(2)	(116)
(Decrease) increase in other liabilities	(744)	139
Net Cash Provided by Operating Activities	478	1,245
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	-	736
Maturities, prepayments and calls	1,629	2,274
Purchases	(275)	(399)
Loan origination and principal collections, net	(6,296)	(19,142)
Additions to premises and equipment	(150)	(105)
Net Cash Used in Investing Activities	(5,092)	(16,636)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	12,599	4,917
Net decrease in advances from borrowers for taxes and insurance	(801)	(934)
Proceeds from issuance of long-term debt	1,500	700
Repayment of long-term debt	(1,500)	(700)
Purchase of treasury stock	(329)	-
Cash dividends paid	(230)	(186)
Net Cash Provided by Financing Activities	11,239	3,797
Net Increase (Decrease) in Cash and Cash Equivalents	6,625	(11,594)
CASH AND CASH EQUIVALENTS - BEGINNING	40,913	45,479
CASH AND CASH EQUIVALENTS - ENDING	$ 47,538	$ 33,885
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 765	$ 588

Income taxes paid	$ -	$ -
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Securities purchased and not settled	$ 235	$ -

See notes to consolidated financial statements.

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 March 31, 2018 and for the three months ended March 31, 2018 and 2017 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and therefore, do not include all information or footnotes necessary for a complete presentation of the consolidated statements of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The consolidated statement of financial condition at December 31, 2017 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information and to make the financial statements not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The consolidated statements of income for the three months ended March 31, 2018 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2018.

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

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition as of March 31, 2018 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Note 2 – New Accounting Standards

The Company adopted Financial Accounting Standards Board ("FASB") Accounting Standard Update ("ASU") 2014-09 "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09") on January 1, 2018. The objective of ASU 2014-09 is to align the recognition of revenue with the transfer of promised goods or services provided to customers in an amount that reflects consideration which the entity expects to be entitled in exchange for those goods or services. 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. Based on management's evaluation of ASU 2014-09, substantially all of the Company's interest income and non-interest income were not impacted by the adoption of ASU 2014-09 because the revenue from those contracts with customers is covered by other guidance in U.S. GAAP or the revenue recognition outcomes are similar to the Company's current revenue recognition practices. The Company evaluated certain noninterest revenue streams, including, deposit related fees, service and interchange fees, merchant income and gains (losses) on the sale of owned real estate ("OREO") to determine the potential impact of the guidance on the Company's Consolidated Financial Statements. The Company concluded that a prior period adjustment was not needed upon adoption of ASU 2014-09 using the modified retrospective method. Since the guidance does not apply to revenue associated with financial instruments, the adoption of ASU 2014-09 does not have a material effect on the Company's consolidated financial statements. The additional disclosures required by ASU 2014-09 have been included in Note 11.

The Company adopted FASB ASU 2016-01 "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01") effective January 1, 2018. 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: a) use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; b) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; and c) 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. The requirement to use the exit price method for the fair value measurement of financial instruments did not have an impact on the Company's consolidated financial statements upon adoption of ASU 2016-01, as the Company had elected to use this method in prior reporting periods. The requirement to record changes in the fair value of equity securities in net income did not have a material impact on the Company's consolidated financial statements upon adoption of ASU 2016-01. The adoption of ASU 2016-01 did not have any impact on the valuation allowance of deferred tax assets related to available for sale securities.

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

Note 3 – Investment Securities

Debt Securities

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

	March 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
Debt Securities				
U.S. Government Agencies	$ 2,013	$ -	$ (64)	$ 1,949
Municipal bonds	44,760	876	(119)	45,517
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	28	-	-	28
Collateralized mortgage obligations-government sponsored entities	26,802	15	(857)	25,960
Government National Mortgage Association	218	10	-	228
Federal National Mortgage Association	2,720	57	(25)	2,752
Federal Home Loan Mortgage Corporation	1,456	17	(12)	1,461
Asset-backed securities-private label	32	415	-	447
Asset-backed securities-government sponsored entities	54	3	-	57
Total Debt Securities	$ 78,083	$ 1,393	$ (1,077)	$ 78,399
Equity Securities	22	8	-	30
Total Securities Available for Sale	$ 78,105	$ 1,401	$ (1,077)	$ 78,429

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

Debt Securities

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

At March 31, 2018 and December 31, 2017, thirty-three municipal bonds with a cost of $11.3 million and fair value of $11.6 million and $11.7 million, respectively, were pledged under a collateral agreement with the Federal Reserve Bank (“FRB”) of New York for liquidity borrowing. In addition at March 31, 2018 and December 31, 2017, twenty municipal bonds with a cost of $5.1 million and fair value of $5.2 million and $5.3 million, respectively, were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation (“FDIC”) insurance limits.

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

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars In thousands)					
March 31, 2018						
U.S. Government Agencies	$ 1,949	$ (64)	$ -	$ -	$ 1,949	$ (64)
Municipal bonds	4,089	(114)	561	(5)	4,650	(119)
Mortgage-backed securities	10,604	(213)	16,476	(681)	27,080	(894)
	$ 16,642	$ (391)	$ 17,037	$ (686)	$ 33,679	$ (1,077)

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

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

At March 31, 2018, the Company's investment portfolio included several debt securities in the "unrealized losses less than twelve months" category. The debt securities were not evaluated further for OTTI as the unrealized losses on the individual debt securities were less than 20% of book value, which management deemed to be immaterial, the securities were issued by government sponsored enterprises and management has the intent and ability to hold these securities.

At March 31, 2018, the Company had several debt securities in the "unrealized losses twelve months or more" category. These securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value and management has the intent and ability to hold these securities until unrealized losses have recovered. Management believes the temporary impairments were due to declines in fair value resulting from changes in interest rates and/or increased credit liquidity spreads since the securities were purchased.

Management completed an OTTI analysis for three private label asset-backed securities, which did not have unrealized losses as of March 31, 2018. Management concluded that there was a limited risk of principal losses for these securities and that additional OTTI charges were not required as of March 31, 2018 on these securities.

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

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

	For The Three Months Ended March 31,	
	2018	2017
	(Dollars in thousands)	
Beginning balance	$ 435	$ 554
Additions:		
Credit loss not previously recognized	-	-
Reductions:		
Losses realized during the period on OTTI previously recognized	-	-
Receipt of cash flows on previously recorded OTTI	(22)	(39)
Ending balance	$ 413	$ 515

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

During the three months ended March 31, 2018, the Company did not sell any available for sale debt securities. During the three months ended March 31, 2017, the Company sold three municipal bonds for total proceeds of $736,000 resulting in realized gains of $25,000.

Equity Securities

At March 31, 2018 and December 31, 2017, available for sale equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock. During the three months ended March 31, 2018, the Company recognized an unrealized gain of $8,000 on the equity securities held at March 31, 2018, which was recorded in noninterest income in the consolidated statements of income. There were no sales of equity securities during the three months ended March 31, 2018.

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

	Amortized Cost	Fair Value

	(Dollars in thousands)	
March 31, 2018:		
After one year through five years	$ 3,716	$ 3,818
After five years through ten years	23,560	24,074
After ten years	19,497	19,574
Mortgage-backed securities	31,224	30,429
Asset-backed securities	86	504
Equity securities	22	30
	$ 78,105	$ 78,429

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

12

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 months ended March 31, 2018 and 2017 and the distribution of the allowance for loan losses and loan receivable by loan portfolio class and impairment method as of March 31, 2018 and December 31, 2017:

	Real Estate Loans				Other Loans			
	One- to Four-Family (2)	Home Equity	Commercial	Construction - Commercial	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
March 31, 2018								
Allowance for Loan Losses:								
Balance – January 1, 2018	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Charge-offs	-	-	-	-	-	(12)	-	(12)
Recoveries	18	-	-	-	-	3	-	21
Provision (Credit)	(53)	6	42	3	86	4	(13)	75
Balance – March 31, 2018	$ 476	$ 128	$ 1,705	$ 350	$ 630	$ 30	$ 48	$ 3,367
Ending balance: individually evaluated for impairment	$ -	$ -	$ 30	$ -	$ -	$ -	$ -	$ 30
Ending balance: collectively evaluated for impairment	$ 476	$ 128	$ 1,675	$ 350	$ 630	$ 30	$ 48	$ 3,337
Gross Loans Receivable (1):								
Ending balance	$ 143,385	$ 39,321	$ 126,335	$ 31,095	$ 29,934	$ 1,335	$ -	$ 371,405
	$ 182	$ 21	$ 2,122	$ -	$ 80	$ -	$ -	$ 2,405

Ending balance: individually evaluated for impairment								
Ending balance: collectively evaluated for impairment	$ 143,203	$ 39,300	$ 124,213	$ 31,095	$ 29,854	$ 1,335	$ -	$ 369,000

(1) Gross Loans Receivable does not include allowance for loan losses of $(3,367) or deferred loan costs of $3,128.
(2) Includes one- to four- family construction loans.

	Real Estate Loans				Other Loans			
	One- to Four-Family(1)	Home Equity	Commercial	Construction - Commercial	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
March 31, 2017								
Allowance for Loan Losses:								
Balance – January 1, 2017	$ 432	$ 114	$ 1,803	$ 149	$ 338	$ 28	$ 18	$ 2,882
Charge-offs	-	-	-	-	(18)	(22)	-	(40)
Recoveries	1	-	-	-	1	4	-	6
Provision (Credit)	29	3	165	42	60	11	40	350
Balance – March 31, 2017	$ 462	$ 117	$ 1,968	$ 191	$ 381	$ 21	$ 58	$ 3,198

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

The following table summarizes the distribution of the allowance for loan losses and loans receivable by loan portfolio class as of December 31, 2017:

	Real Estate Loans				Other Loans			
	One- to Four-Family(2)	Home Equity	Commercial	Construction - Commercial	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
December 31, 2017								
Allowance for Loan Losses:								
Balance – December 31, 2017	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Gross Loans Receivable (1):								
Ending Balance	$ 144,614	$ 38,078	$ 122,747	$ 30,802	$ 27,612	$ 1,355	$ -	$ 365,208
Ending balance: individually	$ 184	$ 21	$ 1,498	$ -	$ 54	$ -	$ -	$ 1,757

evaluated for impairment								
Ending balance: collectively evaluated for impairment	$ 144,430	$ 38,057	$ 121,249	$ 30,802	$ 27,558	$ 1,355	$ -	$ 363,451

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

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

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

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

Unpaid	Average