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

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

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

For the quarterly period ended June 30, 2018

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

Commission File No.: 000-51821

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

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

(Address(Zip code)
of
principal
executive
offices)

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

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

Yes [X]No [ ]

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

Yes [X]No [ ]

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

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

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

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

Yes [ ] No [X]

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

There were 6,055,519 shares of the registrant's common stock, $0.01 par value per share, outstanding at August 8, 2018.

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PART I Financial Information

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

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

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

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

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

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

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

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

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

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

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

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

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

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

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

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

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

The interim consolidated financial statements included herein as of June 30, 2018 and for the three and six months ended June 30, 2018 and 2017 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and therefore, do not include all information or footnotes necessary for a complete presentation of the consolidated statements of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The consolidated statement of financial condition at December 31, 2017 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information and to make the financial statements not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The consolidated statements of income for the three and six months ended June 30, 2018 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2018.

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

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition as of June 30, 2018 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Note 2 – New Accounting Standards

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

Note 3 – Investment Securities

Debt Securities

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

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

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

Debt Securities

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

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

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

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars in thousands)					
June 30, 2018						
U.S. Government Agencies	$ 1,918	$ (94)	$ -	$ -	$ 1,918	$ (94)
Municipal bonds	4,597	(112)	561	(4)	5,158	(116)
Mortgage-backed securities	14,508	(275)	15,881	(758)	30,389	(1,033)
	$ 21,023	$ (481)	$ 16,442	$ (762)	$ 37,465	$ (1,243)

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

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

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

At June 30, 2018, the Company had several debt securities in the "unrealized losses twelve months or more" category. These securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value and management has the intent and ability to hold these securities until unrealized losses have recovered. Management believes the temporary impairments were due to declines in fair value resulting from changes in interest rates and/or increased credit liquidity spreads since the securities were purchased.

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

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

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

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

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

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

Equity Securities

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

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

	Amortized Cost	Fair Value

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

Note 4 - Allowance for Loan Losses

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

Real Estate Loans:

· One- to Four-Family – are loans secured by first lien collateral on residential real estate primarily held in the Western New York region. These loans can be affected by economic conditions and the value of underlying properties. Western New York’s housing market has consistently demonstrated

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

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

Other Loans:

- Commercial – includes business installment loans, lines of credit, and other commercial loans. Most of our commercial loans have fixed interest rates, and are for terms generally not in excess of 5 years. Whenever possible, we collateralize these loans with a lien on business assets and equipment and require the personal guarantees from principals of the borrower. Commercial loans generally involve a higher degree of credit risk because the collateral underlying the loans may be in the form of intangible assets and/or inventory subject to market obsolescence. Commercial loans can also involve relatively large loan balances to a single borrower or groups of related borrowers, with the repayment of such loans typically dependent on the successful operation of the commercial business and the income stream of the borrower. Such risks can be significantly affected by economic conditions. Although commercial loans may be collateralized by equipment or other business assets, the liquidation of collateral in the event of a borrower default may be an insufficient source of repayment because the equipment or other business assets may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial loan depends primarily on the credit worthiness of the borrowers (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.
- Consumer – consist of loans secured by collateral such as an automobile or a deposit account, unsecured loans and lines of credit. Consumer loans tend to have a higher credit risk due to the loans being either unsecured or secured by rapidly depreciable assets. Furthermore, consumer loan payments are dependent on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

The allowance for loan losses is a valuation account that reflects the Company's evaluation of the losses inherent in its loan portfolio. In order to determine the adequacy of the allowance for loan losses, the Company estimates losses by

loan type using historical loss factors, as well as other environmental factors, such as trends in loan volume and loan type, loan concentrations, changes in the experience, ability and depth

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

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

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

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

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

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

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

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

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

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

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

Although the allocations noted above are by loan type, the allowance for loan losses is general in nature and is available to offset losses from any loan in the Company’s portfolio. The unallocated component of the

allowance for loan losses reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for existing specific and general losses in the portfolio.

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

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	At June 30, 2018			For the Six Months Ended June 30, 2018	
	(Dollars in thousands)				
With no related allowance recorded:					
Residential, one- to four-family	$ 181	$ 181	$ -	$ 182	$ 7
Home equity	19	19	-	20	-
Commercial real estate	411	411	-	414	4
Commercial loans	61	61	-	80	1
Total impaired loans with no related allowance	672	672	-	696	12
With an allowance recorded:					
Commercial real estate	1,700	1,700	90	1,618	9
Total impaired loans with an allowance	1,700	1,700	90	1,618	9
Total of impaired loans:					
Residential, one- to four-family	181	181	-	182	7
Home equity	19	19	-	20	-
Commercial real estate	2,111	2,111	90	2,032	13
Commercial loans	61	61	-	80	1
Total impaired loans	$ 2,372	$ 2,372	$ 90	$ 2,314	$ 21

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	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	At December 31, 2017 (Dollars in thousands)			For the Year Ended December 31, 2017	
With no related allowance recorded:					
Residential, one- to four-family	$ 184	$ 184	$ -	$ 197	$ 15
Home equity	21	21	-	21	-
Commercial real estate	1,498	1,498	-	1,674	222
Commercial loans	54	54	-	54	-
Total impaired loans with no related allowance	1,757	1,757	-	1,946	237
With an allowance recorded:					
Commercial real estate(1)	-	-	-	230	-
Commercial loans(2)	-	-	-	50	6
Total impaired loans with an allowance	-	-	-	280	6
Total of impaired loans:					
Residential, one- to four-family	184	184	-	197	15
Home equity	21	21	-	21	-
Commercial real estate	1,498	1,498	-	1,904	222
Commercial loans	54	54	-	104	6
Total impaired loans	$ 1,757	$ 1,757	$ -	$ 2,226	$ 243

(1)This loan was foreclosed upon during the year ended December 31, 2017 and was recorded in other assets at December 31, 2017.

(2)This loan was paid off during the year ended December 31, 2017.

The following tables provide 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)						
June 30, 2018:							
Real Estate Loans:							
Residential, one- to four-family	$ 1,019	$ 92	$ 1,035	$ 2,146	$ 143,028	$ 145,174	$ 2,161
Home equity	144	10	272	426	39,531	39,957	273
Commercial	172	-	1,860	2,032	134,870	136,902	2,111
Construction - Commercial	-	-	-	-	29,248	29,248	-
Construction - Residential, one- to four-family	-	-	-	-	241	241	-
Other Loans:							
Commercial	55	-	76	131	29,582	29,713	76
Consumer	8	10	21	39	1,326	1,365	22
Total	$ 1,398	$ 112	$ 3,264	$ 4,774	$ 377,826	$ 382,600	$ 4,643

	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, 2017:							
Real Estate Loans:							
Residential, one- to four-family	$ 692	$ 942	$ 1,233	$ 2,867	$ 141,698	$ 144,565	$ 2,196
Home equity	27	59	212	298	37,780	38,078	235
Commercial	411	-	1,265	1,676	121,071	122,747	1,323
Construction - Commercial	-	-	-	-	30,802	30,802	-
Construction - Residential, one- to four-family	-	-	-	-	49	49	-
Other Loans:							
Commercial	61	8	54	123	27,489	27,612	54
Consumer	22	2	22	46	1,309	1,355	25
Total	$ 1,213	$ 1,011	$ 2,786	$ 5,010	$ 360,198	$ 365,208	$ 3,833

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 six month periods ended June 30, 2018 and 2017 was $143,000 and $147,000, respectively.

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 tables summarize the internal loan grades applied to the Company's loan portfolio as of June 30, 2018 and December 31, 2017:

	Pass/Performing	Special Mention	Substandard	Doubtful	Loss	Total
	(Dollars in thousands)					
June 30, 2018						
Real Estate Loans:						
Residential, one- to four-family	$ 142,374	$ -	$ 2,800	$ -	$ -	$ 145,174
Home equity	39,476	-	481	-	-	39,957
Commercial	132,718	739	3,445	-	-	136,902
Construction - Commercial	29,248	-	-	-	-	29,248
Construction - Residential, one- to four-family	241	-	-	-	-	241
Other Loans:						
Commercial	28,305	63	1,345	-	-	29,713
Consumer	1,357	-	7	-	1	1,365
Total	$ 373,719	$ 802	$ 8,078	$ -	$ 1	$ 382,600

	Pass/Performing	Special Mention	Substandard	Doubtful	Loss	Total
	(Dollars in thousands)					
December 31, 2017						
Real Estate Loans:						
Residential, one- to four-family	$ 141,751	$ -	$ 2,814	$ -	$ -	$ 144,565
Home equity	37,611	-	467	-	-	38,078
Commercial	118,977	866	2,904	-	-	122,747
Construction - Commercial	30,802	-	-	-	-	30,802
Construction - Residential, one- to four-family	49	-	-	-	-	49
Other Loans:						
Commercial	26,165	1,093	354	-	-	27,612
Consumer	1,342	-	11	-	2	1,355
Total	$ 356,697	$ 1,959	$ 6,550	$ -	$ 2	$ 365,208

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 June 30, 2018								
Real Estate Loans:								
Residential, one- to four-family	5	$ 181	-	$ -	5	$ 181	-	$ -
Home equity	1	19	1	19	-	-	-	-
Total	6	$ 200	1	$ 19	5	$ 181	-	$ -
At December 31, 2017								
Real Estate Loans:								
Residential, one- to four-family	5	$ 184	-	$ -	5	$ 184	-	$ -
Home equity	2	21	1	19	1	2	-	-
Total	7	$ 205	1	$ 19	6	$ 186	-	$ -

No additional loan commitments were outstanding to these borrowers at June 30, 2018 and December 31, 2017.

There were no loans restructured and classified as TDRs during the three and six month periods ended June 30, 2018 and June 30, 2017, respectively.

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 $479,000 and $435,000 at June 30, 2018 and December 31, 2017, respectively, and was included as a component of other assets on the consolidated statements of financial condition. The recorded investment of consumer loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction was $1.2 million and $965,000 at June 30, 2018 and December 31, 2017, respectively.

Note 5 – Earnings per Share

Earnings per share was calculated for the three and six months ended June 30, 2018 and 2017, 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 June 30,	
	2018	2017
Numerator – net income	$ 1,006,000	$ 1,142,000
Denominator:		
Basic weighted average shares outstanding	6,084,737	6,122,800
Increase in weighted average shares outstanding due to:		
Stock options	14,838	9,081
Diluted weighted average shares outstanding (1)	6,099,575	6,131,881
Earnings per share:		
Basic	$ 0.17	$ 0.19
Diluted	$ 0.16	$ 0.19

	Six Months Ended June 30,	
	2018	2017
Numerator – net income	$ 1,942,000	$ 1,858,000
Denominator:		
Basic weighted average shares outstanding	6,092,041	6,106,585
Increase in weighted average shares outstanding due to:		
Stock options	13,078	9,088
Diluted weighted average shares outstanding (1)	6,105,119	6,115,673
Earnings per share:		
Basic	$ 0.32	$ 0.30
Diluted	$ 0.32	$ 0.30

(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 for each plan were outstanding during the three and six month periods ended June 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 June 30, 2018 and December 31, 2017. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

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The following commitments to extend credit were outstanding as of the dates specified:

	Contract Amount	
	June 30, 2018	December 31, 2017
	(Dollars in thousands)	
Commitments to grant loans	$ 34,340	$ 16,426
Unfunded commitments under lines of credit	$ 43,963	$ 41,395

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer. At June 30, 2018 and December 31, 2017, the Company's loan commitments with fixed interest rates for the next five years totaled $7.0 million and $7.9 million, respectively. The range of interest rates on these fixed rate commitments was 3.375% to 6.25% at June 30, 2018.

Note 7 – Stock-based Compensation

As of June 30, 2018, 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 $152,000 and $149,000 for the three months ended June 30, 2018 and 2017, respectively. The compensation cost that has been recorded for the six months ended June 30, 2018 and 2017 was $290,000 and $272,000, 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 six months ended June 30, 2018 and 2017 is presented below:

:

June 30, 2018	June 30, 2017

	Options	Weighted Average Exercise Price	Remaining Contractual Life	Options	Weighted Average Exercise Price	Remaining Contractual Life
Outstanding at beginning of year	82,321	$ 12.98		82,826	$ 12.95	
Granted	-	-		-	-	
Exercised	-	-		-	-	
Forfeited	-	-		-	-	
Outstanding at end of period	82,321	$ 12.98	6.9 years	82,826	$ 12.95	7.8 years
Options exercisable at end of period	30,681	$ 10.61	6.9 years	18,279	$ 7.88	7.8 years
Fair value of options granted		$ -			$ -	

At June 30, 2018, stock options outstanding had an intrinsic value of $344,000 and there were no remaining options available for grant under the Stock Option Plan. There were no stock options exercised during the three and six months ended June 30, 2018 and 2017. Compensation expense related to the Stock Option Plan for the three month period ended June 30, 2018 and 2017 was $8,000, respectively. Compensation expense related to the Stock Option Plan for the six month period ended June 30, 2018 and 2017 was $17,000, respectively. At June 30, 2018, $113,000 of unrecognized compensation cost related to the Stock Option Plan is expected to be recognized over a period of 40 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 June 30, 2018, there were 101,906 shares vested or distributed to eligible participants under the RRP. Compensation expense amounted to $22,000 for the three months ended June 30, 2018 and 2017, respectively. Compensation expense amounted to $44,000 for the six months ended June 30, 2018 and 2017, respectively. At June 30, 2018, $152,000 of unrecognized compensation cost related to the RRP is expected to be recognized over a period of 40 months.

A summary of the status of unvested shares under the RRP for the six months ended June 30, 2018 and 2017 is as follows:

	2018	Weighted Average Grant Price (per Share)	2017	Weighted Average Grant Price (per Share)
Unvested shares outstanding at beginning of year	17,119	$ 13.06	24,110	$ 12.96
Granted	-	-	-	-
Vested	-	-	-	-
Forfeited	-	-	-	-
Unvested shares outstanding at end of period	17,119	$ 13.06	24,110	$ 12.96

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.

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The Board of Directors granted restricted stock awards under the EIP during the six months ended June 30, 2018 as follows:

Grant Date	Number of Restricted Stock Awards	Vesting	Fair Value per Share of Award on Grant Date	Awardees
February 7, 2018	5,285	100% on December 14, 2018	$ 17.00	Non-employee directors
April 24, 2018	44	100% on December 14, 2018	16.88	Non-employee director

A summary of the status of unvested restricted stock awards under the EIP for the six months ended June 30, 2018 and 2017 is as follows:

	2018	Weighted Average Grant Price (per Share)	2017	Weighted Average Grant Price (per Share)
Unvested shares outstanding at beginning of year	42,915	$ 14.40	26,072	$ 12.77
Granted	5,329	17.00	27,348	15.90
Vested	-	-	-	-
Forfeited	-	-	(100)	13.35
Unvested shares outstanding at end of period	48,244	$ 14.69	53,320	$ 14.38

As of June 30, 2018, there were 31,797 shares vested or distributed to eligible participants under the EIP. Compensation expense related to restricted stock awards under the EIP amounted to $85,000 and $84,000 for the three months ended June 30, 2018 and 2017, respectively. Compensation expense related to EIP restricted stock awards during the six months ended June 30, 2018 and 2017 was $157,000 and $143,000, respectively. At June 30, 2018, $308,000 of unrecognized compensation cost related to unvested restricted stock awards is expected to be recognized over a period of 18 months.

A summary of the status of stock options under the EIP for the six months ended June 30, 2018 and 2017 is presented below:

	June 30, 2018			June 30, 2017		
	Options	Exercise Price	Remaining Contractual Life	Options	Exercise Price	Remaining Contractual Life
Outstanding at beginning of year	20,000	$ 14.38		20,000	$ 14.38	
Granted	-	-		-	-	
Exercised	-	-		-	-	

Forfeited	-	-		-	-	
Outstanding at end of period	20,000	$ 14.38	8.3 years	20,000	$ 14.38	9.3 years
Options exercisable at end of period	3,998	$ 14.38	8.3 years	-	$ -	
Fair value of options granted		-			-	

At June 30, 2018, stock options outstanding had an intrinsic value of $55,000 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 June 30, 2018 and 2017, respectively, and amounted to $5,000 for the six months ended June 30, 2018 and 2017, respectively. At June 30, 2018, $35,000 of unrecognized compensation cost related to unvested stock options is expected to be recognized over a period of 40 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 June 30, 2018, 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 June 30, 2018, there were 70,031 allocated shares and 142,830 unallocated shares compared to 64,200 allocated shares and 150,765 unallocated shares at June 30, 2017. The ESOP compensation expense was $34,000 for the three months ended June 30, 2018 and $32,000 for the three months ended June 30, 2017 based on 1,984 shares earned in each of those quarters. The ESOP compensation expense was $67,000 for the six months ended June 30, 2018 and $63,000 for the six months ended June 30, 2017 based on 3,968 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 June 30, 2018 and December 31, 2017 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 June 30, 2018 and December 31, 2017 were as follows:

	Fair Value Measurements at June 30, 2018			
	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:				
Debt Securities				
U.S. Government Agencies	$ 1,918	$ 1,918	$ -	$ -
Municipal bonds	46,047	-	46,047	-
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	28	-	28	-
Collateralized mortgage obligations-government sponsored entities	32,344	-	32,344	-
Government National Mortgage Association	212	-	212	-
Federal National Mortgage Association	2,614	-	2,614	-
Federal Home Loan Mortgage Corporation	1,379	-	1,379	-
Asset-backed securities:				
Private label	296	-	296	-
Government sponsored entities	52	-	52	-
Total Debt Securities	$ 84,890	$ 1,918	$ 82,972	$ -
Equity Securities	36	-	36	-
Total Securities Available for Sale	$ 84,926	$ 1,918	$ 83,008	$ -

	Fair Value Measurements at December 31, 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:				
Debt Securities				
U.S. Government Agencies	$ 1,987	$ 1,987	$ -	$ -
Municipal bonds	45,562	-	45,562	-
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	30	-	30	-
Collateralized mortgage obligations-government sponsored entities	27,654	-	27,654	-
Government National Mortgage Association	245	-	245	-
Federal National Mortgage Association	2,929	-	2,929	-
Federal Home Loan Mortgage Corporation	1,553	-	1,553	-
Asset-backed securities:				
Private label	344	-	-	344
Government sponsored entities	60	-	60	-
Total Debt Securities	$ 80,364	$ 1,987	$ 78,033	$ 344
Equity Securities	57	-	57	-
Total Securities Available for Sale	$ 80,421	$ 1,987	$ 78,090	$ 344

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 six months ended June 30, 2018 and for the year ended December 31, 2017. During the six months ended June 30, 2018, asset-backed securities – private label were transferred from the Level 3 category to the Level 2 category. These securities were transferred to Level 2 because the Company changed its method of valuing these securities and that method now uses Level 2 inputs.

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 fair value of securities available for sale are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1) or matrix pricing (Level 2), which is a mathematical technique used widely

in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted prices. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. treasury yield curve, live trading levels, trade execution date, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things. Level 2 securities which are fixed income instruments that are not quoted on an exchange, but are traded in active markets, are valued using prices obtained from our custodian, who use third party data service providers. Securities available for

sale measured within the Level 3 category as of December 31, 2017 consisted of private label asset-backed securities.

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 six months ended June 30, 2018 and 2017:

	2018	2017
	(Dollars in thousands)	
Beginning Balance	$ 344	$ 832
Total gains - realized/unrealized:		
Included in earnings	-	-
Included in other comprehensive loss	-	9
Total losses - realized/unrealized:	-	
Included in earnings	-	-
Included in other comprehensive loss	-	(44)
Sales	-	-
Principal paydowns	-	(287)
Transfers to (out of) Level 3	(344)	-
Ending Balance	$ -	$ 510

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 December 31, 2017 (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
December 31, 2017						
Asset-backed securities - private label	$ 344	Sub-prime First and Prime Second Lien - Residential Real Estate	B- thru D	5-12	3.0-5.0%	75.0% - 100.0%

At December 31, 2017, Level 3 inputs were 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 June 30, 2018 and December 31, 2017 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 June 30, 2018				
Impaired loans	$ 1,643	$ -	$ -	$ 1,643
Foreclosed real estate	397	-	-	397
At December 31, 2017				
Impaired loans	$ 35	$ -	$ -	$ 35
Foreclosed real estate	438	-	-	438

The following table presents additional quantitative information about assets measured at fair value on a non-recurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

	Quantitative Information about Level 3 Fair Value Measurements			
(Dollars in thousands)	Fair Value Estimate	Valuation Technique	Unobservable Input	Range
At June 30, 2018				
Impaired loans	$ 1,643	Market valuation of underlying collateral (1)	Direct Disposal Costs (2)	7.00-15.80%

Foreclosed real estate	397	Market valuation of property (1)	Direct Disposal Costs (2)	3.90-7.00%
At December 31, 2017				
Impaired loans	$ 35	Market valuation of underlying collateral (1)	Direct Disposal Costs (2)	7.00%
Foreclosed real estate	438	Market valuation of property (1)	Direct Disposal Costs (2)	7.00-16.80%

(1) Fair value is generally determined through independent third-party appraisals of the underlying collateral, which generally includes various Level 3 inputs which are not observable.

(2) The fair value basis of impaired loans and foreclosed real estate may be adjusted to reflect management estimates of disposal costs including, but not necessarily limited to, real estate brokerage commissions, legal fees, and delinquent property taxes.

At June 30, 2018, impaired loans valued using Level 3 inputs had a carrying amount of $1.7 million and valuation allowances of $90,000. By comparison at December 31, 2017, impaired loans valued using Level 3 inputs had a carrying amount of $35,000 and no valuation allowances.

Once a loan is determined to be impaired, the fair value of the loan continues to be evaluated based upon the market value of the underlying collateral securing the loan or by using a discounted future cash flow method if the loan is not collateral dependent. At June 30, 2018, impaired loans with a carrying amount that had been written down utilizing Level 3 inputs during the six months ended June 30, 2018 comprised of three loans with a fair value of $1.7 million and resulted in an additional provision for loan loss of $90,000.

At June 30, 2018, foreclosed real estate valued using Level 3 inputs had a carrying amount of $509,000 and valuation allowances of $112,000. By comparison at December 31, 2017, foreclosed real estate valued using Level 3 inputs had a carrying amount of $557,000 and valuation allowances of $119,000.

Once a loan is foreclosed, the fair value of the real estate owned continues to be evaluated based upon the market value of the repossessed real estate originally securing the loan. At June 30, 2018, foreclosed real estate with a carrying value that had been written down utilizing Level 3 inputs during the six months ended June 30, 2018 comprised of one property with a fair value of $350,000 and resulted in a subsequent write-down recorded in non-interest expense of $21,000. At December 31, 2017, foreclosed real estate with a carrying value that had been written down utilizing Level 3 inputs during the year ended December 31, 2017 comprised of two properties with a fair value of $399,000 and resulted in an additional provision for loan losses of $75,000 and subsequent write-downs recorded in non-interest expense of $15,000.

The carrying amount and estimated fair value of the Company’s financial instruments, whether carried at cost or fair value, are as follows:

	Fair Value Measurements at June 30, 2018				
	Carrying Amount	Estimated 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)				
Financial assets:					
Cash and cash equivalents	$ 43,123	$ 43,123	$ 43,123	$ -	$ -
Securities available for sale	84,926	84,926	1,918	83,008	-
Federal Home Loan Bank stock	1,545	1,545	-	1,545	-
Loans receivable, net	382,319	366,743	-	-	366,743
Accrued interest receivable	1,828	1,828	-	1,828	-
Financial liabilities:					
Deposits	432,311	435,116	-	435,116	-

Long-term debt	24,650	24,114	-	24,114	-
Accrued interest payable	74	74	-	74	-
Off-balance-sheet financial instruments	-	-	-	-	-

	Fair Value Measurements at December 31, 2017				
	Carrying Amount	Estimated 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)				
Financial assets:					
Cash and cash equivalents	$ 40,913	$ 40,913	$ 40,913	$ -	$ -
Securities available for sale	80,421	80,421	1,987	78,090	344
Federal Home Loan Bank stock	1,631	1,631	-	1,631	-
Loans receivable, net	365,063	356,275	-	-	356,275
Accrued interest receivable	1,801	1,801	-	1,801	-
Financial liabilities:					
Deposits	405,153	408,348	-	408,348	-
Long-term debt	26,950	26,634	-	26,634	-
Accrued interest payable	57	57	-	57	-
Off-balance-sheet financial instruments	-	-	-	-	-

Note 9 – Treasury Stock

During the three months ended June 30, 2018, the Company repurchased 14,300 shares of common stock at an average cost of $16.94 per share. During the six months ended June 30, 2018, the Company repurchased 34,300 shares of common stock at an average cost of $16.66 per share. These shares were repurchased pursuant to the Company's publicly announced common stock repurchase program. As of June 30, 2018, there were 120,190 shares remaining to be repurchased under the existing stock repurchase program. During the six months ended June 30, 2018, the Company transferred 5,329 shares of common stock out of treasury stock reserved for the 2012 Equity Incentive Plan, at an average cost of $9.39 per share to fund awards that had been granted under the plan. During the six months ended June 30, 2018, there were 9,368 shares transferred back into treasury stock reserved for the 2012 Equity Incentive Plan at an average cost of $9.39 per share due to stock forfeitures.

During the three and six months ended June 30, 2017, the Company repurchased 13,500 shares of common stock at an average cost of $15.72 per share. These shares were repurchased pursuant to the Company's publicly announced common stock repurchase program. As of June 30, 2017, there were 71,001 shares remaining to be repurchased under the existing stock repurchase program. During the six months ended June 30, 2017, the Company transferred 27,348 shares of common stock out of the treasury stock reserved for the 2012 Equity Incentive Plan, at an average cost of $9.88 per share to fund awards that had been granted under the plan. During the six months ended June 30, 2017, there were 200 shares transferred back into treasury stock reserved for the 2012 Equity Incentive Plan at an average cost of $9.55 per share due to stock forfeitures.

Note 10 – Other Comprehensive Loss

In addition to presenting the Consolidated Statements of Comprehensive Income herein, the following table shows the tax effects allocated to the Company’s single component of other comprehensive loss for the periods presented:

	For the Three Months Ended June 30, 2018			For The Three Months Ended June 30, 2017		
	Pre-Tax Amount	Tax Benefit	Net of Tax Amount	Pre-Tax Amount	Tax Benefit	Net of Tax Amount
	(Unaudited) (Dollars in thousands)					
Net unrealized (losses) gains on securities available for sale:						
Net unrealized (losses) gains arising during the period	$ (376)	$ 79	$ (297)	$ 100	$ (34)	$ 66
Less: reclassification adjustment related to:						
Recovery on previously impaired investment securities included in net income	(68)	14	(54)	(32)	11	(21)
Gain on sale of securities included in net income	-	-	-	(197)	67	(130)
Total Other Comprehensive Loss	$ (444)	$ 93	$ (351)	$ (129)	$ 44	$ (85)

	For the Six Months Ended June 30, 2018			For The Six Months Ended June 30, 2017		
	Pre-Tax Amount	Tax Benefit	Net of Tax Amount	Pre-Tax Amount	Tax Benefit	Net of Tax Amount
	(Dollars in thousands)					
Net unrealized (losses) gains on securities available for sale:						
Net unrealized (losses) gains arising during the period	$ (1,236)	$ 259	$ (977)	$ 40	$ (14)	$ 26
Less: reclassification adjustment related to:						
Recovery on previously impaired investment securities included in net income	(90)	19	(71)	(71)	24	(47)
Gain on sale of securities included in net income	-	-	-	(222)	76	(146)
Total Other Comprehensive Loss	$ (1,326)	$ 278	$ (1,048)	$ (253)	$ 86	$ (167)

The following table presents the amounts reclassified out of the single component of the Company's accumulated other comprehensive loss for the indicated periods:

Details about Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss for the three months ended June 30,		Affected Line Item on the Consolidated Statements of Income
	2018	2017	
	(Dollars in thousands)		
Net unrealized gains and losses on securities available for sale:			
Recovery on previously impaired investment securities	$ (68)	$ (32)	Recovery on previously impaired investment securities
Sale of securities	-	(197)	Gain on sale of securities available for sale
	(68)	(229)	
Provision for income tax benefit	14	78	Income Tax Expense
Total reclassification for the period	$ (54)	$ (151)	Net Income

Details about Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss for the six months ended June 30,				Affected Line Item on the Consolidated Statements of Income
	2018		2017		
	(Dollars in thousands)				
Net unrealized gains and losses on securities available for sale:					
Recovery on previously impaired investment securities	$	(90)	$	(71)	Recovery on previously impaired investment securities
Sale of securities		-		(222)	Gain on sale of securities available for sale
		(90)		(293)	
Provision for income tax benefit		19		100	Income Tax Expense
Total reclassification for the period	$	(71)	$	(193)	Net Income

Note 11 – Revenue Recognition

As of January 1, 2018, the Company adopted FASB ASU 2014-09 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”) for non-interest revenue streams. The Company has elected to apply ASU 2014-09 using the modified retrospective method. The implementation of the new standard did not have a material impact on the

measurement or recognition of revenue; and as such, a cumulative effect adjustment to retained earnings was not deemed necessary under the modified retrospective implementation method. The adoption of ASU 2014-09 did, however, require additional disclosures.

The Company's non-interest revenue streams primarily result from services it provides to its deposit customers. When a customer makes a deposit, the Company records a liability under ASC 405 because the Company has an obligation to deliver cash to its customer on demand. A contract between the Company and a deposit account customer is typically documented in writing and is often terminable at will by the customer alone or by both the customer and the Company without penalty. The term of a deposit contract between a customer and the Company will likely be day-to-day or minute-to-minute, and the termination clause is likely similar to a renewal right where each day or minute represents the renewal of the contract. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The Company's primary non-interest revenue streams within the scope of ASU 2014-09 are described in further detail below. The Company has no material unsatisfied performance obligations as of June 30, 2018.

Service Charges on Deposit Accounts

Service charges and fees on deposit accounts consist of transaction-based fees, account maintenance fees, and overdraft service fees for various retail and business deposit customers. Transaction-based fees, such as stop payment charges, are recognized at the time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn directly from the customer's account balance.

Fees, Interchange Income, and Other Service Charges

Fees, interchange income, and other service charges are primarily comprised of debit card income, ATM fees, merchant services income and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit cards are used to purchase goods or services from a merchant via a card payment network, such as MasterCard. Interchange fees from cardholder transactions

represent a percentage of the underlying transaction value. ATM fees are comprised of fees earned whenever a Company's ATM or debit card is used at a non-Company ATM or a non-Company cardholder uses a Company ATM. ATM fees represent a fixed fee for the convenience to cardholders for accessibility of funds. Merchant services income mainly represents fees charged to merchants serviced by a third party vendor under contract with the Company for debit or credit card processing, and represents a percentage of the underlying transaction value. Other service charges include revenue from services provided to our retail or business customers, which may include fees for wire transfer processing, bill pay services, cashier's checks and other services. The Company's performance obligation for fees, interchange income and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically immediately or in the following month.

Other

Other non-interest income consists of safe deposit rental fees and other miscellaneous revenue streams. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation.

Gain/Losses on Sale of OREO

The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present. There were no sales of OREO in which the Company financed the sale during the three and six months ended June 30, 2018.

Contract Balances

The Company's non-interest revenue streams are largely based on transactional activity. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

The following presents non-interest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and six months ended June 30, 2018 and 2017:

	For the Three Months Ended	For the Six Months Ended

	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(Dollars in thousands)			
Non-Interest Income				
In-Scope of Topic 606:				
Service charges on deposit accounts	$ 219	$ 232	$ 437	$ 469
Fees, interchange income and other service charges	206	192	392	365
Other	38	41	85	78
Non-interest Income (in-scope of Topic 606)	463	465	914	912
Non-interest Income (out of scope of Topic 606)	194	342	333	525
Total Non-Interest Income	$ 657	$ 807	$ 1,247	$ 1,437

Note 12 – Subsequent Events

On July 25, 2018, the Board of Directors declared a quarterly cash dividend of $0.10 per share on the Company's common stock, payable on August 21, 2018 to shareholders of record as of August 7, 2018. Lake Shore, MHC (the "MHC"), which holds 3,636,875 shares, or approximately 60.1% of the Company's total outstanding stock, elected to waive its right to receive this cash dividend of approximately $364,000. On March 9, 2018, the MHC received the non-objection of the Federal Reserve Bank of Philadelphia to waive its right to receive dividends paid by the Company during the twelve months ending February 7, 2019, aggregating up to $0.40 per share. The MHC waived $364,000 of dividends during the three months ended June 30, 2018 and $728,000 during the six months ended June 30, 2018. Cumulatively, Lake Shore, MHC has waived approximately $10.1 million of cash dividends as of June 30, 2018. The dividends waived by Lake Shore, MHC are considered a restriction on the retained earnings of the Company.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-Looking Statements

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

The following factors, including the factors set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q (if applicable) and in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2017, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements:

- general and local economic conditions;

- changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values and competition;

- the ability of our customers to make loan payments;

- our ability to continue to control costs and expenses;

- changes in accounting principles, policies or guidelines;

- our success in managing the risks involved in our business;

- inflation, and market and monetary fluctuations;

- the impact of more stringent capital requirements being imposed by banking regulators;

- changes in legislation or regulation, including the implementation of the Dodd-Frank Act; and

- other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may differ from actual outcomes. They can be affected by inaccurate assumptions we might make or known or unknown risks and uncertainties. Consequently, no forward-looking statements can

be guaranteed. We undertake no obligation to publicly update any forward looking statement, whether as a result of new information, future events or otherwise.

Overview

The following discussion and analysis is presented to assist in the understanding and evaluation of our consolidated financial condition and results of operations. It is intended to complement the unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q and should be read in conjunction therewith. The detailed discussion focuses on our consolidated financial condition as of June 30, 2018 compared to the consolidated financial condition as of December 31, 2017 and the consolidated results of operations for the three and six months ended June 30, 2018 and 2017.

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

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

Financial institutions like us, in general, are significantly affected by economic conditions, competition, and the monetary and fiscal policies of the federal government. Lending activities are influenced by the demand for and supply of housing and commercial real estate, competition among lenders, interest rate conditions, and funds availability. Our operations and lending are principally concentrated in the Western New York area, and our operations and earnings are influenced by local economic conditions. Deposit balances and cost of funds are influenced by prevailing market rates on competing investments, customer preferences, and levels of personal income and savings in our primary market area. Operations are also significantly impacted by government policies and actions of regulatory authorities. Future changes in applicable law, regulations or government policies may materially impact the Company.

To operate successfully, we must manage various types of risk, including but not limited to, interest rate risk, credit risk, liquidity risk, operational and information technology risks, strategic risk, reputation risk and compliance risk. A significant form of market risk for the Company is interest rate risk, as the Company's assets and liabilities are sensitive to changes in interest rates. Interest rate risk is the exposure of our net interest income to adverse movements in interest rates. Net interest income is our primary source of revenue and interest rate risk is a significant non-credit related risk to which our Company is exposed. Net interest income is affected by changes in interest rates as well as fluctuations in the level and duration of our assets and liabilities. In addition to directly impacting net interest income, changes in interest rates can also affect the amount of new loan originations, the ability of borrowers and debt issuers to repay loans and debt securities, the volume of loan repayments and refinancing, the flow and mix of deposits and the fair value of available for sale securities. In recent years, the Company has adjusted its strategies to manage interest rate risk by originating a greater volume of shorter-term, adjustable rate commercial real estate and commercial business loans and increasing its concentration of core deposits, which are less interest rate sensitive.

Credit risk is the risk to our earnings and stockholders' equity that results from customers, to whom loans have been made, and from issuers of debt securities in which the Company has invested, failing to repay their obligations. The

magnitude of this risk depends on the capacity and willingness of borrowers and debt issuers to repay and the sufficiency of the value of collateral obtained to secure the loans made or investments purchased. This risk is managed by policies approved by the Company's Board of Directors, review of compliance with the policies and periodic reporting and evaluation of loans or securities that are non-performing or demonstrate other characteristics of potential loss.

Management Strategy

There have been no material changes in the Company's management strategy from what was disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Critical Accounting Policies

Disclosure of the Company's significant accounting policies is included in the notes to the consolidated financial statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Some of these policies require significant judgment, estimates and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses, as well as management's evaluation of securities valuation, impairment of securities and income taxes. There have been no material changes in critical accounting policies since December 31, 2017.

Analysis of Net Interest Income

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

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

	For the Three Months Ended June 30, 2018			For the Three Months Ended June 30, 2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
	(Dollars in thousands)					
Interest-earning assets:						
Interest-earning deposits & federal funds sold	$ 39,577	$ 169	1.71%	$ 28,326	$ 48	0.68%
Securities(1)	83,831	653	3.12%	82,126	621	3.02%
Loans	374,571	4,445	4.75%	348,486	4,105	4.71%
Total interest-earning assets	497,979	5,267	4.23%	458,938	4,774	4.16%
Other assets	38,219			37,252		
Total assets	$ 536,198			$ 496,190		
Interest-bearing liabilities						
Demand & NOW accounts	$ 50,581	$ 14	0.11%	$ 50,820	$ 16	0.13%
Money market accounts	115,484	198	0.69%	83,763	59	0.28%
Savings accounts	53,769	7	0.05%	54,435	7	0.05%
Time deposits	149,216	482	1.29%	148,250	417	1.13%
Borrowed funds	26,446	140	2.12%	19,390	97	2.00%
Other interest-bearing liabilities	827	19	9.19%	886	21	9.48%
Total interest-bearing liabilities	396,323	860	0.87%	357,544	617	0.69%
Other non-interest bearing liabilities	61,258			61,201		
Stockholders' equity	78,617			77,445		
Total liabilities & stockholders' equity	$ 536,198			$ 496,190		
Net interest income		$ 4,407			$ 4,157	
Interest rate spread			3.36%			3.47%
Net interest margin			3.54%			3.62%

(1) The tax equivalent adjustment for bank qualified municipal securities results in rates of 3.62% and 4.09% for the three months ended June 30, 2018 and 2017, respectively.

	For the Six Months Ended June 30, 2018			For the Six Months Ended June 30, 2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
	(Dollars in thousands)					
Interest-earning assets:						
Interest-earning deposits & federal funds sold	$ 36,034	$ 282	1.57%	$ 28,950	$ 86	0.59%
Securities(1)	82,304	1,276	3.10%	84,309	1,279	3.03%
Loans	372,014	8,817	4.74%	341,863	8,167	4.78%
Total interest-earning assets	490,352	10,375	4.23%	455,122	9,532	4.19%
Other assets	38,075			37,021		
Total assets	$ 528,427			$ 492,143		
Interest-bearing liabilities						
Demand & NOW accounts	$ 50,081	$ 27	0.11%	$ 51,114	$ 32	0.13%
Money market accounts	109,789	334	0.61%	81,964	111	0.27%
Savings accounts	53,195	15	0.06%	53,791	15	0.06%
Time deposits	149,323	942	1.26%	148,008	818	1.11%
Borrowed funds	26,696	279	2.09%	19,171	189	1.97%
Other interest-bearing liabilities	832	39	9.38%	901	42	9.32%
Total interest-bearing liabilities	389,916	1,636	0.84%	354,949	1,207	0.68%
Other non-interest bearing liabilities	59,889			60,073		
Stockholders' equity	78,622			77,121		
Total liabilities & stockholders' equity	$ 528,427			$ 492,143		
Net interest income		$ 8,739			$ 8,325	
Interest rate spread			3.39%			3.51%
Net interest margin			3.56%			3.66%

(1) The tax equivalent adjustment for bank qualified municipal securities results in rates of 3.61% and 4.10% for the six months ended June 30, 2018 and 2017, respectively.

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

	Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest-earning assets:			
Interest-earning deposits & federal funds sold	$ 96	$ 25	$ 121
Securities	19	13	32
Loans, including fees	31	309	340
Total interest-earning assets	146	347	493
Interest-bearing liabilities:			
Demand & NOW accounts	(2)	-	(2)
Money market accounts	110	29	139
Savings accounts	-	-	-
Time deposits	62	3	65
Total deposits	170	32	202
Other interest-bearing liabilities:			
Borrowed funds & other interest-bearing liabilities	5	36	41
Total interest-bearing liabilities	175	68	243
Total change in net interest income	$ (29)	$ 279	$ 250

	Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest-earning assets:			
Interest-earning deposits & federal funds sold	$ 170	$ 26	$ 196
Securities	28	(31)	(3)
Loans, including fees	(65)	715	650
Total interest-earning assets	133	710	843
Interest-bearing liabilities:			
Demand & NOW accounts	(4)	(1)	(5)
Money market accounts	175	48	223
Savings accounts	-	-	-
Time deposits	117	7	124
Total deposits	288	54	342
Other interest-bearing liabilities:			
Borrowed funds & other interest-bearing liabilities	12	75	87
Total interest-bearing liabilities	300	129	429
Total change in net interest income	$ (167)	$ 581	$ 414

The average balance of the loan portfolio increased by $26.1 million, or 7.5%, during the three months ended June 30, 2018 as compared to the second quarter of 2017. This increase was primarily due to an increase in the average balance of higher yielding commercial real estate, home equity and commercial business loans, which had a positive impact on the overall average yield of interest-earning assets during the second quarter of 2018, which increased by seven basis points. The 18 basis points increase in the average interest rate paid

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on interest bearing liabilities during the three month period ended June 30, 2018 as compared to second quarter 2017 was primarily due to an increase in the average interest rates being paid as a result of an increase in market rates and competition for deposit accounts. The net interest margin and interest rate spread decreased by eight basis points and eleven basis points, respectively, for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, primarily due to the increase in average interest rates being paid on interest bearing liabilities during the second quarter of 2018.

The average balance of the loan portfolio increased by $30.2 million, or 8.8%, during the six months ended June 30, 2018 as compared to the same six month period in 2017. The increase in the average balance of the loan portfolio was primarily due to an increase in the average balance of higher yielding commercial real estate, home equity and commercial business loans. The decrease in the average yield of the loan portfolio during the six months ended June 30, 2018, when compared to the same period in the prior year, was partially due to the prior year receipt of $202,000 of interest income on one non-performing commercial real estate loan which paid off during the six months ended June 30, 2017. The increase in the average interest rate paid on interest bearing liabilities during the six months ended June 30, 2018 as compared to the same period in 2017 was primarily due to an increase in the average interest rates being paid on money market accounts, time deposit accounts and borrowings as a result of an increase in market rates and competition for deposit accounts. The increase in average interest rates being paid on interest bearing liabilities and the prior year receipt of $202,000 of loan interest income on one non-performing commercial real estate loan which paid off during the first six months of 2017 resulted in a decrease in the net interest margin and interest rate spread. The net interest margin and interest rate spread decreased by ten basis points and twelve basis points, respectively, for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, primarily due to the increase in average interest rates being paid on interest bearing liabilities during the six months ended June 30, 2018.

Comparison of Financial Condition at June 30, 2018 and December 30, 2017

Total assets at June 30, 2018 were $543.3 million, an increase of $24.3 million, or 4.7%, from $519.0 million at December 31, 2017. The increase in total assets was primarily due to a $17.3 million increase in loans receivable, a $4.5 million increase in securities available for sale and a $2.2 million increase in cash and cash equivalents.

Cash and cash equivalents increased by $2.2 million, or 5.4%, from $40.9 million at December 31, 2017 to $43.1 million at June 30, 2018. The increase was primarily due to a $27.2 million increase in deposits, partially offset by a net cash outflow of $17.8 million relating to net loan originations and principal collections and a net outflow of $5.8 million for purchases, sales and maturities on the investment portfolio during the six months ended June 30, 2018.

Securities available for sale increased by $4.5 million, or 5.6%, to $84.9 million at June 30, 2018 compared to $80.4 million at December 31, 2017. The increase was primarily due to $10.0 million of new securities purchased, partially offset by the receipt of $4.3 million for maturities, prepayments and calls of securities and a $1.3 million decrease in unrealized gains on the securities portfolio during the six months ended June 30, 2018. The decrease in unrealized gains on the securities portfolio was primarily due to an increase in market interest rates during the first six months of 2018.

Net loans receivable increased during the six months ended June 30, 2018 as shown in the table below:

	At June 30, 2018	At December 31, 2017	Change $	%
	(Dollars in thousands)			
Real Estate Loans:				
Residential, one- to four-family	$ 145,174	$ 144,565	$ 609	0.4 %
Home equity	39,957	38,078	1,879	4.9 %
Commercial	136,902	122,747	14,155	11.5 %
Construction - Commercial	29,248	30,802	(1,554)	(5.0) %
Construction - Residential, one- to four-family	241	49	192	391.8 %
Total real estate loans	351,522	336,241	15,281	4.5 %
Other Loans:				
Commercial	29,713	27,612	2,101	7.6 %
Consumer	1,365	1,355	10	0.7 %
Total gross loans	382,600	365,208	17,392	4.8 %
Allowance for loan losses	(3,474)	(3,283)	(191)	5.8 %
Net deferred loan costs	3,193	3,138	55	1.8 %
Loans receivable, net	$ 382,319	$ 365,063	$ 17,256	4.7 %

As fixed rate one- to four-family residential real estate loans present additional interest rate risk to our loan portfolio as a result of the longer duration of these types of assets, we remain strategically focused in 2018 on originating shorter duration commercial real estate and commercial business loans to diversify our asset mix, to reduce interest rate risk, to take advantage of the opportunities available to serve small businesses in our market area, and to increase our net interest margin.

Loans Past Due and Non-Performing Assets. The following table presents information regarding our non-accrual loans, accruing loans delinquent 90 days or more, non-performing loans, foreclosed real estate, and non-performing and performing loans classified as troubled debt restructurings, as of the dates indicated.

	At June 30, 2018	At December 31, 2017
	(Dollars in thousands)	
Loans past due 90 days or more but still accruing:		
Real estate loans:		
Residential, one- to four-family	$ 120	$ -
Home equity	4	-
Commercial	-	-
Construction – Commercial and Residential, one- to four-family	-	-
Other loans:		
Commercial	-	-
Consumer	-	-
Total	$ 124	$ -
Loans accounted for on a non-accrual basis:		
Real estate loans:		
Residential, one- to four-family	$ 2,161	$ 2,196
Home equity	273	235
Commercial	2,111	1,323
Construction – Commercial and Residential, one- to four-family	-	-
Other loans:		
Commercial	76	54
Consumer	22	25

Total non-accrual loans		4,643			3,833	
Total non-performing loans		4,767			3,833	
Foreclosed real estate		479			435	
Total non-performing assets	$	5,246		$	4,268	
Ratios:						
Non-performing loans as a percent of total loans:		1.25	%		1.05	%
Non-performing assets as a percent of total assets:		0.97	%		0.82	%
Troubled debt restructuring:						
Loans accounted for on a non-accrual basis						
Real estate loans:						
Home equity	$	19		$	19	
Performing loans						
Real estate loans:						
Residential, one- to four-family	$	181		$	184	
Home equity		-			2	

Total non-performing loans increased by $934,000, or 24.4%, to $4.8 million at June 30, 2018 from $3.8 million at December 31, 2017, primarily due to an increase in non-performing commercial real estate loans. Management is actively pursuing all actions necessary to collect the outstanding balance on all non-performing loans, which may include foreclosure on the related properties.

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

	At or for the Six Months Ended June 30,	
	2018	2017
	(Dollars in thousands)	
Balance at beginning of period	$ 3,283	$ 2,882
Provision for loan losses	190	375
Charge-offs:		
Real estate loans:		
Residential, one- to four-family	-	-
Home equity	-	(3)
Commercial	-	-
Construction – Commercial and Residential, one- to four-family	-	-
Other loans:		
Commercial	-	(18)
Consumer	(23)	(28)
Total charge-offs	(23)	(49)
Recoveries:		
Real estate loans:		
Residential, one- to four-family	18	1
Home equity	1	3
Commercial	-	-
Construction – Commercial and Residential, one- to four-family	-	-
Other loans:		
Commercial	1	1
Consumer	4	10
Total recoveries	24	15
Net recoveries (charge-offs)	1	(34)
Balance at end of period	$ 3,474	$ 3,223
Average loans outstanding	$ 372,014	$ 341,863
Allowance for loan losses as a percent of total net loans	0.91%	0.89%
Allowance for loan losses as a percent of non-performing loans	72.88%	78.10%
Ratio of net charge-offs to average loans outstanding(1)	0.00%	(0.02)%

(1) Annualized

The table below shows changes in deposit balances by type of deposit account between June 30, 2018 and December 31, 2017:

	At June 30, 2018	At December 31, 2017	Change $	%
	(Dollars in thousands)			
Core Deposits				
Demand deposits and NOW accounts:				
Non-interest bearing	$ 56,974	$ 54,618	$ 2,356	4.3 %
Interest bearing	52,600	49,869	2,731	5.5 %
Money market	121,038	99,305	21,733	21.9 %
Savings	53,334	52,922	412	0.8 %
Total core deposits	283,946	256,714	27,232	10.6 %
Non-core Deposits				
Time deposits	148,365	148,439	(74)	- %
Total deposits	$ 432,311	$ 405,153	$ 27,158	6.7 %

The increase in total deposits was primarily due to growth in core deposits. The growth in core deposits was the result of the Company's continued strategic focus on growing lower-cost core deposits among its retail and commercial customers in an effort to manage interest expense and strengthen customer relationships.

Our borrowings, consisting of advances from the Federal Home Loan Bank of New York ("FHLBNY"), decreased by $2.3 million, or 8.5%, from $27.0 million at December 31, 2017 to $24.7 million at June 30, 2018. Excess liquidity was used to pay off long-term debt which matured during the first six months of 2018.

Total stockholders' equity increased $154,000, or 0.2%, from $78.4 million at December 31, 2017 to $78.5 million at June 30, 2018. The increase in stockholders' equity was primarily attributed to net income of $1.9 million and a $100,000 increase in additional paid in capital attributed to stock based compensation, partially offset by $892,000 in other comprehensive losses, $572,000 of stock repurchases and $458,000 in cash dividends paid during the first six months of 2018.

Comparison of Results of Operations for the Three Months Ended June 30, 2018 and 2017

General. Net income was $1.0 million for the three months ended June 30, 2018, or $0.16 per diluted share, a decrease of $136,000, or 11.9%, compared to net income of $1.1 million, or $0.19 per diluted share, for the three months ended June 30, 2017. Net income for the three months ended June 30, 2018 reflected a $280,000 increase in non-interest expenses, a $150,000 decrease in non-interest income and a $90,000 increase in provision for loan losses which was partially offset by a $250,000 increase in net interest income and a $134,000 decrease in income tax expense.

Interest Income. Interest income increased by $493,000, or 10.3%, for the three months ended June 30, 2018 compared to the three months ended June 30, 2017 primarily due to an increase in loan interest income. Loan interest

income increased by $340,000, or 8.3%, to $4.4 million for the three months ended June 30, 2018 compared to the three months ended June 30, 2017, primarily due to an increase in the average balance of the loan portfolio by $26.1 million, or 7.5%, from $348.5 million for the three months ended June 30, 2017 to $374.6 million for the three months ended June 30, 2018. The average yield on the loan portfolio increased from 4.71% for the three months ended June 30, 2017 to 4.75% for the three months ended June 30, 2018. The increase in the average balance and average yield of loans was primarily due to an increase in the average balance of higher yielding commercial real estate, home equity and commercial business loans.

Investment interest income increased $32,000, or 5.2%, for the three months ended June 30, 2018 compared to the three months ended June 30, 2017. The average yield on the investment portfolio increased from

3.02% for the three months ended June 30, 2017 to 3.12% for the three months ended June 30, 2018. The increase in the average yield was primarily due to the purchase of higher yielding securities and the paydowns and sales of lower yielding securities. The average balance of the investment portfolio increased from $82.1 million for the three months ended June 30, 2017 to $83.8 million for the three months ended June 30, 2018. The increase was primarily due to the purchase of securities, which was partially offset by sales proceeds and paydowns received on the securities portfolio since June 30, 2017.

Other interest income was $169,000 for the three months ended June 30, 2018, a $121,000, or 252.1%, increase as compared to the three months ended June 30, 2017. This increase was primarily due to a 103 basis points increase in the average yield on the interest-earning deposits and federal funds sold portfolio. The average yield increased from 0.68% for the three months ended June 30, 2017 to 1.71% for the three months ended June 30, 2018. The average yield increased as a result of a 75 basis points increase in the fed funds rate since June 30, 2017. The average balance of the interest-earning deposits and federal funds sold portfolio increased by $11.3 million, or 39.7%, from $28.3 million for the three months ended June 30, 2017 to $39.6 million for the three months ended June 30, 2018. The increase in the average balance was primarily due to an increase in deposits that have not yet been utilized to fund loan originations or securities purchases.

Interest Expense. Interest expense increased $243,000, or 39.4%, to $860,000 for the three months ended June 30, 2018 compared to $617,000 for the three months ended June 30, 2017. Interest paid on deposits increased by $202,000, or 40.5%, to $701,000 for the three months ended June 30, 2018 when compared to the three months ended June 30, 2017. Interest expense was primarily impacted by a 41 and 16 basis points increase, respectively, in the average interest rates paid on money market and time deposit accounts as a result of the increase in short term market interest rates since June 30, 2017. The increase was also due to a $30.8 million increase in average core deposits for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017 as a result of the Company's continued strategic focus on growing lower cost core deposits. The average balance of deposits for the three months ended June 30, 2018 was $369.1 million with an average rate of 0.76% compared to the average balance of deposits of $337.3 million and an average rate of 0.59% for the three months ended June 30, 2017.

The interest expense related to advances from the FHLBNY increased $43,000, or 44.3%, to $140,000 for the three months ended June 30, 2018 when compared to the three months ended June 30, 2017, as a result of an increase in the average balance and average rate of FHLBNY advances. The average balance of advances from the FHLBNY for the three months ended June 30, 2018 was $26.4 million with an average rate of 2.12% compared to an average balance of $19.4 million and an average rate of 2.00% for the three months ended June 30, 2017. The increase in the average balance was due to additional borrowings that allowed the Bank to take advantage of low fixed-rates to fund loan growth and the increase in the average rate paid was primarily due to the increase in market interest rates since the three months ended June 30, 2017.

Provision for Loan Losses. An $115,000 provision to the allowance for loan losses was recorded during the three months ended June 30, 2018, which was a $90,000, or 360.0%, increase in comparison to the provision recorded during the three months ended June 30, 2017. The increase in the provision expense was primarily due to the downgrade in loan classification for one commercial business loan and an increase in reserves associated with impaired commercial real estate loans during the three months ended June 30, 2018.

The $115,000 provision recorded during the three months ended June 30, 2018 was a result of a comprehensive quarterly evaluation. The evaluation reflects analyses of individual borrowers and historical loss experience, supplemented as necessary by credit judgment that considers observable trends, conditions, and other relevant environmental and economic factors. The quarterly evaluation consisted of the following:

- $182,000 provision for commercial real estate loans, which included a:

- o $122,000 general allowance on performing commercial real estate loans, primarily due to a $10.6 million increase in the loan portfolio during the second quarter of 2018 to reflect inherent losses within the portfolio;
- o $60,000 provision for an increase in reserves associated with impaired commercial real estate loans during the three months ended June 30, 2018;
- · $27,000 net provision for commercial business loans which included a:

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o $72,000 provision to reflect the downgrade of one commercial business loan; which was partially offset by a
o $45,000 credit provision for changes in the related environmental factors used to qualitatively assess inherent loan losses on commercial business loans;
· $90,000 net credit for one-to four-family, home equity, consumer and construction – commercial loans, which included a:
o $69,000 credit provision for changes in the related environmental factors used to qualitatively assess inherent loan losses on one-to four-family and home equity loans; and
o $21,000 decrease in general allowance on performing commercial - construction loans, primarily due to a $1.8 million decrease in the loan portfolio during the second quarter of 2018; and
· $4,000 unallocated credit to the provision for loan losses, to reflect the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general losses in the portfolio.

During the three months ended June 30, 2017, the Company recorded a $25,000 provision to the allowance for loan losses. The provision primarily consisted of the following:

· $80,000 net credit provision for commercial real estate loans which included a:
o $140,000 credit provision attributed to a net decrease in reserves being set aside for impaired loans. This was primarily due to an increase in the estimated value of the collateral for one impaired commercial real estate loan, as a result of an increase in the occupancy rate; which was partially offset by
o $60,000 provision to record probable inherent losses on commercial real estate loans originated during the quarter. The commercial real estate loan portfolio increased by $5.3 million, or 4.5%, during the three months ended June 30, 2017;
· $110,000 provision on performing construction loans primarily due to a $9.9 million, or 55.2%, increase in the construction loan portfolio during the three months ended June 30, 2017, to reflect inherent losses within the portfolio;
· $50,000 credit provision for commercial business loans primarily related to changes in the environmental factors used to qualitatively assess inherent loan losses;
· $28,000 provision on one-to four-family, home equity and consumer loans primarily to reflect an increase in classified loans during the three months ended June 30, 2017; and
· $17,000 provision to reflect the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general losses in the portfolio.

Refer to Note 4 of the Notes to the Consolidated Financial Statements for additional details on the provision for loan losses.

Non-interest Income. Non-interest income decreased by $150,000, or 18.6%, to $657,000 for the three months ended June 30, 2018 as compared to $807,000 for the three months ended June 30, 2017. The decrease was primarily attributed to a $197,000 pre-tax realized gain on the sale of securities during the second quarter of 2017 as compared to there being no sales of securities during the second quarter of 2018. The decrease was partially offset by a $36,000 increase in recoveries on previously impaired investment securities during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

Non-interest Expenses. Non-interest expenses increased $280,000, or 8.0%, from $3.5 million for the three months ended June 30, 2017 to $3.8 million for the three months ended June 30, 2018. Salaries and employee benefits increased $212,000, or 11.6%, primarily due to annual salary increases and higher expenses related to health insurance, retirement benefits and stock compensation awards. Other expenses increased $41,000, or 13.8%, primarily due to an increase in charitable donations. Data processing expenses increased $25,000, or 8.1%, due to

implementation of new technology and growth in deposit and loan accounts. Advertising expenses increased $24,000, or 16.6%, primarily due to the development of new marketing campaigns during the second quarter of 2018. These increases were partially offset by a decrease in expenses for postage and supplies of $27,000, or 33.3%.

Income Taxes Expense. Income tax expense decreased by $134,000, or 45.4%, from $295,000 for the three months ended June 30, 2017 to $161,000 for the three months ended June 30, 2018. The income tax expense decreased primarily due to a decrease in the effective tax rate and a decrease in income before taxes. The effective tax rate for the three months ended June 30, 2018 was 13.8%, while the effective tax rate for the three months ended June 30, 2017 was 20.5%. The decrease in the effective tax rate was primarily due to the Tax Cuts and Jobs Act ("Tax Act") which lowered the federal corporate tax rate from 34% to 21% as of January 1, 2018. The impact of the lower corporate tax rate was partially offset by a decrease in the projected mix of tax-exempt income derived from our municipal bond portfolio and bank-owned life insurance in relation to our projection of pre-tax income for the current year.

Comparison of Results of Operations for the Six Months Ended June 30, 2018 and 2017

General. Net income was $1.94 million for the six months ended June 30, 2018, or $0.32 per diluted share, an increase of $84,000, or 4.5%, compared to net income of $1.86 million, or $0.30 per diluted share, for the six months ended June 30, 2017. Net income for the six months ended June 30, 2018 reflected a $414,000 increase in net interest income, an $185,000 decrease in provision for loan losses and a $136,000 decrease in income tax expense which was partially offset by a $461,000 increase in non-interest expenses and a $190,000 decrease in non-interest income.

Interest Income. Interest income increased by $843,000, or 8.4%, for the six months ended June 30, 2018 compared to the six months ended June 30, 2017 primarily due to an increase in loan interest income. Loan interest income increased by $650,000, or 8.0%, to $10.4 million for the six months ended June 30, 2018 compared to the six months ended June 30, 2017, primarily due to an increase in the average balance of the loan portfolio by $30.2 million, or 8.8%, from $341.9 million for the six months ended June 30, 2017 to $372.0 million for the six months ended June 30, 2018. The increase in the average balance was primarily due to an increase in the average balance of higher yielding commercial real estate, home equity and commercial business loans. The average yield on the loan portfolio decreased from 4.78% for the six months ended June 30, 2017 to 4.74% for the six months ended June 30, 2018. The decrease in the average yield on the loan portfolio was primarily due to the prior year receipt of $202,000 of interest income on one non-performing commercial real estate loan which paid off during the first six months of 2017. The average yield on the loan portfolio would have been 4.66% for the six months ended June 30, 2017 if the $202,000 of interest income received on the non-performing loan payoff was excluded.

Investment interest income decreased $3,000, or 0.2%, for the six months ended June 30, 2018 compared to the six months ended June 30, 2017. The average yield on the investment portfolio increased from 3.03% for the six months ended June 30, 2017 to 3.10% for the six months ended June 30, 2018. The increase in the average yield was primarily due to the purchase of higher yielding securities and the paydowns and sales of lower yielding securities. The average balance of the investment portfolio decreased from $84.3 million for the six months ended June 30, 2017 to $82.3 million for the six months ended June 30, 2018. The decrease was primarily due to sales proceeds and paydowns received on the securities portfolio, partially offset by securities purchases since June 30, 2017.

Other interest income was $282,000 for the six months ended June 30, 2018, which was a $196,000, or 227.9%, increase when compared to the six months ended June 30, 2017. This increase was primarily due to a 98 basis points increase in the average yield on the interest-earning deposits and federal funds sold portfolio. The average yield increased from 0.59% for the six months ended June 30, 2017 to 1.57% for the six months ended June 30, 2018. The average yield increased as a result of a 75 basis points increase in the fed funds rate since June 30, 2017. The average balance of the interest-earning deposits and federal funds sold portfolio increased by $7.1 million, or 24.5%, from $29.0 million for the six months ended June 30, 2017 to $36.0 million for the six months ended June 30, 2018. The increase in the average balance was primarily due to an increase in deposits that have not yet been used to fund loan originations or securities purchases.

Interest Expense. Interest expense increased $429,000, or 35.5%, to $1.6 million for the six months ended June 30, 2018 compared to $1.2 million for the six months ended June 30, 2017. Interest paid on deposits increased by

$342,000, or 35.0%, to $1.3 million for the six months ended June 30, 2018 when compared to the six months ended June 30, 2017. Interest expense was primarily impacted by a 34 and 15 basis points

increase, respectively, in the average interest rates paid on money market and time deposit accounts as a result of the increase in short term market interest rates since June 30, 2017. The increase was also due to a $26.2 million increase in average core deposits for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017 as a result of the Company's continued strategic focus on growing lower cost core deposits. The average balance of deposits for the six months ended June 30, 2018 was $362.4 million with an average rate of 0.73% compared to the average balance of deposits of $334.9 million and an average rate of 0.58% for the six months ended June 30, 2017.

The interest expense related to advances from the FHLBNY increased $90,000, or 47.6%, to $279,000 for the six months ended June 30, 2018 when compared to the six months ended June 30, 2017, as a result of an increase in the average balance and average rate of FHLBNY advances. The average balance of advances from the FHLBNY for the six months ended June 30, 2018 was $26.7 million with an average rate of 2.09% compared to an average balance of $19.2 million and an average rate of 1.97% for the six months ended June 30, 2017. The increase in the average balance was due to additional borrowings that allowed the Bank to take advantage of low fixed-rates to fund loan growth and the increase in the average rate paid was primarily due to the increase in market interest rates since the six months ended June 30, 2017.

Provision for Loan Losses. A $190,000 provision to the allowance for loan losses was recorded during the six months ended June 30, 2018, which was an $185,000, or 49.3%, decrease in comparison to the provision recorded during the six months ended June 30, 2017. The decrease in provision expense was primarily due to a higher provision being recorded for the downgrade in loan classification for two commercial loan relationships during the six months ended June 30, 2017. As of June 30, 2018, these specific commercial loans were performing, and well collateralized by commercial real estate, as well as by fixtures and equipment.

The $190,000 provision recorded during the six months ended June 30, 2018 was a result of a comprehensive quarterly evaluation. The evaluation reflects analyses of individual borrowers and historical loss experience, supplemented as necessary by credit judgment that considers observable trends, conditions, and other relevant environmental and economic factors. The quarterly evaluations consisted of the following:

· $224,000 net provision for commercial real estate loans, which included a:
o $155,000 general allowance on performing commercial real estate loans, primarily due to a $14.2 million, or 11.5%, increase in the loan portfolio since December 31, 2017, to reflect inherent losses within the portfolio;
o $90,000 provision for a commercial real estate loan which became impaired during the six months ended June 30, 2018; which was partially offset by a
o $21,000 credit to reflect a $199,000 decrease in criticized and classified commercial real estate loans during the six months ended June 30, 2018;
· $113,000 net provision for commercial business loans which included a:
o $68,000 net provision for increased reserves on criticized and classified commercial business loans;
o $39,000 provision for changes in the related environmental factors used to qualitatively assess inherent loan losses on commercial business loans;
o $37,000 provision to reflect inherent risk associated with growth in commercial business loan originations. The commercial business loan portfolio increased by $2.1 million, or 7.6%, since December 31, 2017; which was partially offset by a
o $31,000 credit to reflect a decrease in the historical average net charge-offs for this loan type over the last five years;
· $130,000 credit for one-to four-family, home equity, construction - commercial, and consumer loans which included a:
o $72,000 credit provision for changes in the related environmental factors used to qualitatively assess inherent loan losses on one-to four-family, home equity loans and consumer loans;
o

$40,000 credit for one-to four-family, home equity, construction and consumer loans primarily to reflect a decrease in the historical average net charge-offs for these loan

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types over the last five years and for net recoveries recorded during the six months ended June 30, 2018;

- o $18,000 decrease in general allowance on performing commercial - construction loans, primarily due to a $1.8 million decrease in the loan portfolio during the six months ended June 30, 2018; and
- · $17,000 unallocated credit to the provision for loan losses, to reflect the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general losses in the portfolio.

During the six months ended June 30, 2017, the Company recorded a $375,000 provision to the allowance for loan losses. The provision consisted of the following:

- · $153,000 provision on performing construction loans primarily due to a $9.9 million, or 55.2%, increase in the construction loan portfolio during the six months ended June 30, 2017, to reflect inherent losses within the portfolio;
- · $85,000 net provision for commercial real estate loans consisting of:
- o $215,000 provision was recorded to appropriately reflect risk associated with growth in commercial real estate loan originations. The commercial real estate loan portfolio increased by $15.7 million, or 14.7%, since December 31, 2016;
- o $186,000 provision was recorded due to the downgrade of two performing commercial loan relationships from a special mention to substandard classification. These two loan relationships totaled $1.2 million as of June 30, 2017 with a loan to value ratio of 49.3% and 63.3%, respectively; which was partially offset by a
- o $176,000 credit provision related to changes in the related environmental factors used to qualitatively assess inherent loan losses on commercial real estate loans; and
- o $140,000 credit provision related to reserves set aside for impaired loans. The decrease in impaired reserves was primarily due to an increase in the estimated value of the collateral for one impaired commercial real estate loan, as a result of an increase in the occupancy rate;
- o $80,000 provision for one-to four family, home equity, commercial business and consumer loans to reflect an increase in the historical average net charge-offs for these loans types over the last five years and due to net charge-offs during the six months ended June 30, 2017;
- o $57,000 provision to reflect the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general losses in the portfolio.

Refer to Note 4 of the Notes to the Consolidated Financial Statements for additional details on the provision for loan losses.

Non-interest Income. Non-interest income decreased by $190,000, or 13.2%, to $1.2 million for the six months ended June 30, 2018 as compared to $1.4 million for the six months ended June 30, 2017. The decrease was primarily attributed to a $222,000 pre-tax realized gain on the sale of securities during the six months ended June 30, 2017 as compared to there being no sales of securities during the six months ended June 30, 2018. The decrease was partially offset by a $19,000 increase in recoveries on previously impaired investment securities and a $14,000 increase on unrealized gains on equity securities during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

Non-interest Expenses. Non-interest expenses increased $461,000, or 6.5%, from $7.1 million for the six months ended June 30, 2017 to $7.5 million for the six months ended June 30, 2018. Salaries and employee benefits increased $387,000, or 10.4%, primarily due to annual salary increases and higher expenses related to health insurance, retirement benefits and stock compensation awards. Other expenses increased $63,000, or 11.0%, primarily due to an increase in charitable donations and loan related origination costs. Data processing expenses increased $46,000, or 7.5%, due to implementation of new technology and growth in deposit and loan accounts. These increases were partially offset by a decrease in expense for occupancy and equipment of $27,000, or 2.3%, and a decrease in expenses for postage and supplies of $26,000, or 18.1%.

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Income Taxes Expense. Income tax expense decreased by $136,000, or 30.2%, from $450,000 for the six months ended June 30, 2017 to $314,000 for the six months ended June 30, 2018. The income tax expense decreased primarily due to a decrease in the effective tax rate. The effective tax rate for the six months ended June 30, 2018 was 13.9%, while the effective tax rate for the six months ended June 30, 2017 was 19.5%. The decrease in the effective tax rate was primarily due to the Tax Act which lowered the federal corporate tax rate from 34% to 21% as of January 1, 2018. The impact of the lower corporate tax rate was partially offset by a decrease in the projected mix of tax-exempt income derived from our municipal bond portfolio and bank-owned life insurance in relation to our projection of pre-tax income for the current year.

Liquidity and Capital Resources

Liquidity describes our ability to meet the financial obligations that arise during the ordinary course of business. Liquidity is primarily needed to fund loan commitments, to pay the deposit withdrawal requirements of our customers as well as to fund current and planned expenditures. Our primary sources of funds consist of deposits, fed funds balances, scheduled amortization and prepayments of loans and securities, maturities and sales of investments and loans, interest earning deposits at other financial institutions and funds provided from operations. We have written agreements with the FHLBNY, which allows us to borrow the maximum lending values designated by the type of collateral pledged. As of June 30, 2018, the maximum amount that we can borrow from the FHLBNY was $104.0 million and was collateralized by a pledge of certain fixed-rate residential, one- to four-family loans. At June 30, 2018, we had outstanding advances under this agreement of $24.7 million. We have a written agreement with the Federal Reserve Bank discount window for overnight borrowings which is collateralized by a pledge of our securities, and allows us to borrow up to the value of the securities pledged, which was equal to a book value of $11.0 million and a fair value of $11.2 million as of June 30, 2018. There were no balances outstanding with the Federal Reserve Bank at June 30, 2018. We have also established lines of credits with correspondent banks for $22.0 million, of which $20.0 million is unsecured and the remaining $2.0 million will be secured by a pledge of our securities when a draw is made. There were no borrowings on these lines as of June 30, 2018.

Historically, loan repayments and maturing investment securities were a relatively predictable source of funds. However, deposit flows, calls of investment securities, and prepayments of loans and mortgage-backed securities are strongly influenced by interest rates, general and local economic conditions, and competition in the marketplace. These factors reduce the predictability of the timing of these sources of funds. To the extent possible, the Bank manages the cash flows of its loan and deposit portfolios by the rates it offers customers.

Our primary investing activities include the origination of loans and the purchase of investment securities. For the six months ended June 30, 2018, we originated loans of approximately $54.9 million as compared to approximately $73.8 million of loans originated during the six months ended June 30, 2017. Loan originations exceeded principal repayments and other deductions during the first six months of 2018 by $17.8 million. The loan originations were funded through principal payments received on loans and securities, proceeds from the sale of securities, customer deposits, borrowings and cash reserves. Purchases of investment securities totaled $10.1 million and $1.7 million during the six months ended June 30, 2018 and 2017, respectively.

At June 30, 2018, we had loan commitments to borrowers of approximately $34.3 million and overdraft lines of protection, unused home equity lines of credit and unused commercial lines of credit of approximately $44.0 million. Total deposits were $432.3 million at June 30, 2018, as compared to $405.2 million at December 31, 2017. The increase in total deposits was primarily due to growth in core deposits during the first six months of 2018. The Company’s strategic focus is on growing lower-cost core deposits among its retail and commercial customers in an effort to manage interest expenses. Time deposit accounts scheduled to mature within one year were $58.7 million at June 30, 2018. Based on our deposit retention experience, current pricing strategy, and competitive pricing policies, we anticipate that a significant portion of these time deposits will remain with us following their maturity.

We are committed to maintaining a strong liquidity position; therefore, we monitor our liquidity position on a daily basis. We anticipate that we will have sufficient funds to meet our current funding commitments. The marginal cost of new funding, however, whether from deposits or borrowings from the FHLBNY, will be

carefully considered as we monitor our liquidity needs. Therefore, in order to minimize our cost of funds, we may consider additional borrowings from the FHLBNY in the future.

We do not anticipate any material capital expenditures in 2018. We do not have any balloon or other payments due on any long-term obligations or any off-balance sheet items other than loan commitments as described in Note 6 in the Notes to our Consolidated Financial Statements and the borrowing agreements noted above.

Capital

As of January 1, 2015, new regulations that substantially amended the bank capital requirements became applicable to us. These regulations implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act, as discussed in the “Supervision and Regulation – Federal Banking Regulation – Capital Requirements” section included in our Annual Report on Form 10-K for the year ended December 31, 2017.

As a result of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act, the federal banking agencies are required to develop a “Community Bank Leverage Ratio” (the ratio of a bank’s tangible equity capital to average total consolidated assets) for financial institutions with assets of less than $10 billion. A “qualifying community bank” that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered “well capitalized” under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution’s risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. A financial institution can elect to be subject to this new definition.

As of June 30, 2018, as shown in the table below, the Bank’s Tier 1 and risk-based capital levels exceeded levels necessary to be considered “Well Capitalized” under Prompt Corrective Action provisions, as determined by the Office of the Comptroller of the Currency (the “OCC”), our primary regulator.

The Bank’s actual capital amounts and ratios and those required by the regulatory standards in effect as of the dates presented are as follows:

At June 30, 2018	Actual Ratio	Minimum For Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Provisions
Common Equity Tier 1 ("CET1") capital (to risk-weighted assets)	19.55 %	>= 4.50 %	>= 6.50 %
Tier 1 capital (to risk-weighted assets)	19.55 %	>= 6.00 %	>= 8.00 %
Total capital (to risk-weighted assets)	20.47 %	>= 8.00 %	>= 10.00 %
Tier 1 Leverage (to adjusted total assets)	13.81 %	>= 4.00 %	>= 5.00 %
At December 31, 2017	Actual Ratio	Minimum For Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action

			Provisions
CET 1 capital (to risk-weighted assets)	20.82 %	>= 4.50 %	>= 6.50 %
Tier 1 capital (to risk-weighted assets)	20.82 %	>= 6.00 %	>= 8.00 %
Total capital (to risk-weighted assets)	21.75 %	>= 8.00 %	>= 10.00 %
Tier 1 Leverage (to adjusted total assets)	14.40 %	>= 4.00 %	>= 5.00 %

In order to avoid limitations on distributions, including dividend payments, and certain discretionary bonus payments to executive officers, an institution must hold a capital conservation buffer above its minimum risk-based capital requirements. As of June 30, 2018, the Bank's capital conservation buffer was 12.47% exceeding the minimum of 1.875% for 2018.

Off-Balance Sheet Arrangements

Other than loan commitments, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors. Refer to Note 6 in the Notes to our Consolidated Financial Statements for a summary of loan commitments outstanding as of June 30, 2018.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable as the Company is a smaller reporting company.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

The Company’s management, with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company’s disclosure controls and procedures (as defined in Rules 13(a)-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon such evaluation, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company’s disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have not been any changes in the Company’s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II

Item 1A. Risk Factors.

There have been no material changes in the Company’s risk factors from those disclosed in its Annual Report on Form 10-K.

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

The following table reports information regarding repurchases by Lake Shore Bancorp of its common stock in each month of the quarter ended June 30, 2018:

COMPANY PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (1)
April 1 through April 30, 2018	10,000	$ 16.93	10,000	37,401
May 1 through May 31, 2018	3,300	16.90	3,300	34,101
June 1 through June 30, 2018	1,000	17.20	1,000	120,190
Total	14,300	$ 16.94	14,300	120,190

(1) On May 16, 2018, our Board of Directors approved a new stock repurchase plan pursuant to which we can repurchase up to 121,190 shares of our outstanding common stock. This amount represented approximately 5% of our outstanding common stock not owned by the MHC as of May 16, 2018. The repurchase plan does not have an expiration date and superseded all of the prior stock repurchase programs. This plan superseded the prior Board of Directors approved stock repurchase plan from December 11, 2015 which had 34,101 shares available to purchase at May 15, 2018.

Item 6. Exhibits

31.1	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.INS	XBRL Instance Document*
101.SCH	

	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Label Linkbase Document*
101.PRE	XBRL Taxonomy Presentation Linkbase Document*

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*Filed herewith.

SIGNATURES

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

		LAKE SHORE BANCORP, INC. (Registrant)
August 10, 2018	By:	/s/ Daniel P. Reininga Daniel P. Reininga President and Chief Executive Officer (Principal Executive Officer)
August 10, 2018	By:	/s/ Rachel A. Foley Rachel A. Foley Chief Financial Officer (Principal Financial and Accounting Officer)

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