LAKE SHORE BANCORP, INC.
Form 10-Q
November 13, 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 September 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 every Interactive Data File required to be submitted 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 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	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 6,019,919 shares of the registrant's common stock, $0.01 par value per share, outstanding at November 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

	September 30, 2018 (Unaudited)	December 31, 2017
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 7,792	$ 7,709
Interest earning deposits	2,459	6,570
Federal funds sold	27,818	26,634
Cash and Cash Equivalents	38,069	40,913
Securities available for sale	83,147	80,421
Federal Home Loan Bank stock, at cost	1,545	1,631
Loans receivable, net of allowance for loan losses 2018 $3,388; 2017 $3,283	388,437	365,063
Premises and equipment, net	9,383	9,373
Accrued interest receivable	2,044	1,801
Bank owned life insurance	20,100	18,077
Other assets	3,428	1,698
Total Assets	$ 546,153	$ 518,977
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 376,892	$ 350,535
Non-interest bearing	59,009	54,618
Total Deposits	435,901	405,153
Long-term debt	24,650	26,950
Advances from borrowers for taxes and insurance	1,625	3,000
Other liabilities	5,176	5,499
Total Liabilities	$ 467,352	$ 440,602
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,827,741 shares issued and 6,046,819 shares outstanding at September 30, 2018 and 6,827,741 shares issued and 6,098,323 shares outstanding at December 31, 2017	$ 68	$ 68

Additional paid-in capital	30,870	30,719
Treasury stock, at cost (780,922 shares at September 30, 2018 and 729,418 shares at December 31, 2017)	(8,137)	(7,309)
Unearned shares held by ESOP	(1,471)	(1,535)
Unearned shares held by compensation plans	(273)	(540)
Retained earnings	58,339	56,181
Accumulated other comprehensive (loss) income	(595)	791
Total Stockholders' Equity	78,801	78,375
Total Liabilities and Stockholders' Equity	$ 546,153	$ 518,977

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Unaudited)			
	(Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$ 4,663	$ 4,289	$ 13,480	$ 12,456
Investment securities, taxable	267	189	753	597
Investment securities, tax-exempt	403	388	1,193	1,259
Other	157	81	439	167
Total Interest Income	5,490	4,947	15,865	14,479
Interest Expense				
Deposits	783	523	2,101	1,499
Long-term debt	134	139	413	328
Other	38	20	77	62
Total Interest Expense	955	682	2,591	1,889
Net Interest Income	4,535	4,265	13,274	12,590
Provision for Loan Losses	125	75	315	450
Net Interest Income after Provision for Loan Losses	4,410	4,190	12,959	12,140
Non-Interest Income				
Service charges and fees	457	441	1,371	1,353
Earnings on bank owned life insurance	103	91	273	268
Unrealized (loss) gain on equity securities	(5)	-	9	-
Recovery on previously impaired investment securities	34	25	124	96
Gain on sale of securities available for sale	-	22	-	244
Net gain on sale of loans	4	1	10	10
Other	36	37	89	83
Total Non-Interest Income	629	617	1,876	2,054
Non-Interest Expenses				
Salaries and employee benefits	2,083	1,898	6,182	5,610
Occupancy and equipment	587	565	1,735	1,740
Data processing	337	320	1,000	937
Professional services	237	231	716	703
Advertising	151	127	473	439
Postage and supplies	71	53	189	197
FDIC Insurance	40	38	114	111
Other	331	381	968	955
Total Non-Interest Expenses	3,837	3,613	11,377	10,692
Income before Income Taxes	1,202	1,194	3,458	3,502
Income Tax Expense	144	254	458	704
Net Income	$ 1,058	$ 940	$ 3,000	$ 2,798
Basic and diluted earnings per common share	$ 0.17	$ 0.15	$ 0.49	$ 0.46
Dividends declared per share	$ 0.10	$ 0.08	$ 0.30	$ 0.24

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended September 30,	
	2018	2017
	(Unaudited) (Dollars in thousands)	
Net Income	$ 1,058	940
Other Comprehensive Loss, net of tax benefit:		
Unrealized holding losses on securities available for sale, net of tax benefit	(467)	(60)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(27)	(16)
Net gain on sale of securities included in net income, net of tax expense	-	(15)
Total Other Comprehensive Loss	(494)	(91)
Total Comprehensive Income	$ 564	$ 849

	Nine Months Ended September 30,	
	2018	2017
	(Unaudited) (Dollars in thousands)	
Net Income	$ 3,000	$ 2,798
Other Comprehensive Loss, net of tax benefit:		
Unrealized holding losses on securities available for sale, net of tax benefit	(1,444)	(34)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(98)	(63)
Net gain on sale of securities included in net income, net of tax expense	-	(161)
Total Other Comprehensive Loss	(1,542)	(258)
Total Comprehensive Income	$ 1,458	$ 2,540

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

Nine Months Ended September 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	-	-	-	-	-	2,798	-	2,798
Other comprehensive loss, net of tax benefit of $133	-	-	-	-	-	-	(258)	(258)
ESOP shares earned (5,951 shares)	-	30	-	64	-	-	-	94
Stock based compensation	-	33	-	-	-	-	-	33
Compensation plan shares granted (27,348 shares)	-	-	270	-	(270)	-	-	-
Compensation plan shares forfeited (1,104 shares)	-	-	(10)	-	10	-	-	-
Compensation plan shares earned (20,569 shares)	-	72	-	-	220	-	-	292
Purchase of treasury stock, at cost (17,100 shares)	-	-	(269)	-	-	-	-	(269)
Cash dividends declared ($0.24 per share)	-	-	-	-	-	(559)	-	(559)
Balance - September 30, 2017	$ 68	$ 30,667	$ (7,309)	$ (1,556)	$ (618)	$ 55,785	$ 1,124	$ 78,161
Balance - January 1, 2018	$ 68	$ 30,719	$ (7,309)	$ (1,535)	$ (540)	$ 56,181	$ 791	$ 78,375
Net income	-	-	-	-	-	3,000	-	3,000
Other comprehensive loss, net of tax benefit of $410	-	-	-	-	-	-	(1,542)	(1,542)

Reclassification of the Income Tax Effects of the Tax Cuts and Jobs Act from AOCI	-	-	-	-	-	(156)	156	-
ESOP shares earned (5,951 shares)	-	36	-	64	-	-	-	100
Stock based compensation	-	33	-	-	-	-	-	33
Compensation plan shares granted (5,329 shares)	-	-	51	-	(51)	-	-	-
Compensation plan shares forfeited (10,433 shares)	-	-	(99)	-	93	-	-	(6)
Compensation plan shares earned (21,366 shares)	-	82	-	-	225	-	-	307
Purchase of treasury stock, at cost (46,400 shares)	-	-	(780)	-	-	-	-	(780)
Cash dividends declared ($0.30 per share)	-	-	-	-	-	(686)	-	(686)
Balance - September 30, 2018	$ 68	$ 30,870	$ (8,137)	$ (1,471)	$ (273)	$ 58,339	$ (595)	$ 78,801

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2018	2017
	(Unaudited)	
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,000	$ 2,798
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	66	88
Net amortization of deferred loan costs	423	425
Provision for loan losses	315	450
Recovery on previously impaired investment securities	(124)	(96)
Unrealized gain on equity securities	(9)	-
Gain on sale of investment securities	-	(244)
Originations of loans held for sale	(777)	(796)
Proceeds from sales of loans held for sale	787	806
Gain on sale of loans	(10)	(10)
Depreciation and amortization	579	648
Increase in bank owned life insurance, net	(273)	(268)
ESOP shares committed to be released	100	94
Stock based compensation expense	334	325
Increase in accrued interest receivable	(243)	(234)
(Increase) decrease in other assets	(6)	161
Decrease in other liabilities	(323)	(99)
Net Cash Provided by Operating Activities	3,839	4,048
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	-	6,510
Maturities, prepayments and calls	6,215	8,980
Purchases	(10,826)	(2,402)
Purchases of Federal Home Loan Bank Stock	(20)	(375)
Redemptions of Federal Home Loan Bank Stock	106	84
Loan origination and principal collections, net	(25,426)	(37,384)
Additions to premises and equipment	(589)	(1,294)
Purchase of bank owned life insurance	(1,750)	-
Net Cash Used in Investing Activities	(32,290)	(25,881)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	30,748	15,030
Net decrease in advances from borrowers for taxes and insurance	(1,375)	(1,475)
Proceeds from issuance of long-term debt	1,500	9,700
Repayment of long-term debt	(3,800)	(1,700)
Purchase of treasury stock	(780)	(269)
Cash dividends paid	(686)	(559)
Net Cash Provided by Financing Activities	25,607	20,727
Net Decrease in Cash and Cash Equivalents	(2,844)	(1,106)
CASH AND CASH EQUIVALENTS - BEGINNING	40,913	45,479

CASH AND CASH EQUIVALENTS - ENDING	$ 38,069	$ 44,373
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 2,564	$ 1,869
Income taxes paid	$ 477	$ 750
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	$ 1,495	$ 554

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

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

The interim consolidated financial statements included herein as of September 30, 2018 and for the three and nine months ended September 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 nine months ended September 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 September 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 Financial Accounting Standards Board ("FASB") Accounting Standards Update ("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.

In July 2018, the FASB issued ASU 2018-11 "Leases (Topic 842): Targeted Improvements" ("ASU 2018-11"). ASU 2018-11 makes targeted improvements in order to provide relief to an entity's costs to implement certain aspects of ASU 2016-02 "Leases" (Topic 842)" ("ASU 2016-02"). ASU 2018-11 allows lessors to combine lease and associated non-lease components by class of underlying asset in contracts that meet certain criteria. For a lessor to qualify for this practical expedient, the lease and related non-lease components must have the same timing and pattern of transfer, and the lease component, if accounted for on a stand-alone basis, would be classified as an operating lease. ASU 2018-11 also provides entities with an optional transition method that allows entities to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the ASU 2016-02 adoption period. This method eliminates the requirement for entities to restate the comparative periods presented to comply with ASU 2016-02. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2018, and is to be applied on a modified retrospective basis. The amount of assets and liabilities to be added to the balance sheet under ASU 2016-02 and ASU 2018-11 are not expected to have a material impact on the Company’s consolidated financial statements per preliminary estimates.

In August 2018, the FASB issued ASU 2018-13 “Fair Value Measurement” (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement” (“ASU 2018-13”). ASU 2018-13 clarifies the fair value measurement disclosure requirements of Accounting Standards Codification (“ASC”) 820 by adding, eliminating and modifying certain disclosure requirements. The amendments in ASU 2018-13 are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. This update is not expected to have a material effect on the Company’s consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (ASU 2016-13). ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (“CECL”) model). Under the CECL model entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. Further, ASU 2016-13 made certain targeted amendments to the existing impairment for available for sale (“AFS”) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. ASU 2016-13 is effective for public business entities that are U.S. Securities and Exchange Commission (“SEC”) filers for fiscal periods beginning after December 15, 2019, including interim reporting periods within those periods. An entity will apply the amendments in ASU 2016-13 through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. We are currently assessing the potential impact on our consolidated financial statements; however, due to the significant differences in the revised guidance from existing GAAP, the implementation of this guidance may result in material changes in our accounting for credit losses on financial instruments. We are also reviewing the impact of additional disclosures required under ASU 2016-13 on our ongoing financial reporting. Alternative methodologies are being considered, data requirements and integrity are being reviewed and enhancements to the current process are being considered. The Company is continuing to evaluate and implement this guidance.

Note 3 – Investment Securities

Debt Securities

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

	September 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	$ -	$ (123)	$ 1,889
Municipal bonds	46,174	522	(265)	46,431
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	27	-	-	27
Collateralized mortgage obligations-government sponsored entities	31,626	4	(1,165)	30,465
Government National Mortgage Association	196	6	-	202
Federal National Mortgage Association	2,477	28	(37)	2,468
Federal Home Loan Mortgage Corporation	1,314	13	(29)	1,298
Asset-backed securities-private label	-	291	-	291
Asset-backed securities-government sponsored entities	44	1	-	45
Total Debt Securities	$ 83,870	$ 865	$ (1,619)	$ 83,116
Equity Securities	22	9	-	31
Total Securities Available for Sale	$ 83,892	$ 874	$ (1,619)	$ 83,147

	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 September 30, 2018, thirty-two municipal bonds with a cost of $11.0 million and fair value of $11.1 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 September 30, 2018, twenty-one 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)					
September 30, 2018						
U.S. Government Agencies	$ 1,889	$ (123)	$ -	$ -	$ 1,889	$ (123)
Municipal bonds	8,057	(255)	554	(10)	8,611	(265)
Mortgage-backed securities	15,304	(326)	17,068	(905)	32,372	(1,231)
	$ 25,250	$ (704)	$ 17,622	$ (915)	$ 42,872	$ (1,619)

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 September 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 September 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 until maturity. 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 two private label asset-backed securities, which did not have unrealized losses as of September 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 September 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 Nine Months Ended September 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	(67)	(96)
Ending balance	$ 368	$ 458

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 nine months ended September 30, 2018, the Company did not sell any available for sale debt securities. During the nine months ended September 30, 2017, the Company sold eighteen municipal bonds for total proceeds of $6.5 million resulting in realized gains of $244,000.

Equity Securities

At September 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 nine months ended September 30, 2018, the Company recognized an unrealized gain of $9,000 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 nine months ended September 30, 2018.

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

	Amortized Cost	Fair Value

	(Dollars in thousands)	
September 30, 2018:		
After one year through five years	$ 5,472	$ 5,570
After five years through ten years	24,450	24,772
After ten years	18,264	17,978
Mortgage-backed securities	35,640	34,460
Asset-backed securities	44	336
Equity securities	22	31
	$ 83,892	$ 83,147

Note 4 - Allowance for Loan Losses

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

Real Estate Loans:

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

Other Loans:

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

bankruptcy.

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

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

Although the allocations noted below 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.

The following tables summarize the activity in the allowance for loan losses for the three and nine months ended September 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 September 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)							
September 30, 2018								
Allowance for Loan Losses:								
Balance – July 1, 2018	$ 440	$ 86	$ 1,887	$ 329	$ 658	$ 30	$ 44	$ 3,474
Charge-offs	(23)	-	(181)	-	-	(9)	-	(213)
Recoveries	-	-	-	-	-	2	-	2
Provision (Credit)	18	2	249	(80)	(48)	2	(18)	125
Balance – September 30, 2018	$ 435	$ 88	$ 1,955	$ 249	$ 610	$ 25	$ 26	$ 3,388
Balance – January 1, 2018	$ 511	$ 122	$ 1,663	$ 347	$ 544	$ 35	$ 61	$ 3,283
Charge-offs	(23)	-	(181)	-	-	(32)	-	(236)
Recoveries	18	1	-	-	1	6	-	26
Provision (Credit)	(71)	(35)	473	(98)	65	16	(35)	315
Balance – September 30, 2018	$ 435	$ 88	$ 1,955	$ 249	$ 610	$ 25	$ 26	$ 3,388
Ending balance: individually evaluated for impairment	$ -	$ -	$ 30	$ -	$ -	$ -	$ -	$ 30
Ending balance: collectively evaluated for impairment	$ 435	$ 88	$ 1,925	$ 249	$ 610	$ 25	$ 26	$ 3,358
Gross Loans Receivable (1):								
Ending balance	$ 148,792	$ 41,132	$ 148,725	$ 22,150	$ 26,410	$ 1,332	$ -	$ 388,541
Ending balance: individually evaluated for impairment	$ 179	$ 19	$ 665	$ -	$ 61	$ -	$ -	$ 924
Ending balance: collectively evaluated for	$ 148,613	$ 41,113	$ 148,060	$ 22,150	$ 26,349	$ 1,332	$ -	$ 387,617

impairment

(1) Gross Loans Receivable does not include allowance for loan losses of $(3,388) or deferred loan costs of $3,284.
(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)							
September 30, 2017								
Allowance for Loan Losses:								
Balance – July 1, 2017	$ 471	$ 124	$ 1,888	$ 302	$ 331	$ 32	$ 75	$ 3,223
Charge-offs	-	-	(75)	-	(2)	(8)	-	(85)
Recoveries	1	1	-	-	-	2	-	4
Provision (Credit)	54	10	(145)	15	167	5	(31)	75
Balance – September 30, 2017	$ 526	$ 135	$ 1,668	$ 317	$ 496	$ 31	$ 44	$ 3,217
Balance – January 1, 2017	$ 432	$ 114	$ 1,803	$ 149	$ 338	$ 28	$ 18	$ 2,882
Charge-offs	-	(3)	(75)	-	(20)	(36)	-	(134)
Recoveries	2	4	-	-	1	12	-	19
Provision (Credit)	92	20	(60)	168	177	27	26	450
Balance – September 30, 2017	$ 526	$ 135	$ 1,668	$ 317	$ 496	$ 31	$ 44	$ 3,217

(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.

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

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
				For the Nine Months Ended	
	At September 30, 2018			September 30, 2018	
	(Dollars in thousands)				
With no related allowance recorded:					
Residential, one- to four-family	$ 179	$ 179	$ -	$ 181	$ 10
Home equity	19	19	-	19	-
Commercial real estate	409	409	-	413	-
Commercial loans	61	61	-	73	1
Total impaired loans with no related allowance	668	668	-	686	11
With an allowance recorded:					
Commercial real estate(1)	256	256	30	1,584	3
Total impaired loans with an allowance	256	256	30	1,584	3
Total of impaired loans:					
Residential, one- to four-family	179	179	-	181	10
Home equity	19	19	-	19	-
Commercial real estate	665	665	30	1,997	3
Commercial loans	61	61	-	73	1
Total impaired loans	$ 924	$ 924	$ 30	$ 2,270	$ 14

(1) Two commercial real estate loans with a combined recorded investment of $1.4 million and a related allowance of $60,000 were foreclosed upon during the nine months ended September 30, 2018 and included in Other Assets on the Consolidated Statement of Financial Condition at September 30, 2018.

	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)						
September 30, 2018:							
Real Estate Loans:							
Residential, one- to four-family	$ 674	$ 407	$ 1,205	$ 2,286	$ 146,160	$ 148,446	$ 2,187
Home equity	153	52	341	546	40,586	41,132	336
Commercial	-	-	589	589	148,136	148,725	665
Construction - Commercial	-	-	-	-	22,150	22,150	-
Construction - Residential, one- to four-family	-	-	-	-	346	346	-
Other Loans:							
Commercial	-	52	76	128	26,282	26,410	76
Consumer	9	4	-	13	1,319	1,332	-
Total	$ 836	$ 515	$ 2,211	$ 3,562	$ 384,979	$ 388,541	$ 3,264

	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 nine month periods ended September 30, 2018 and 2017 was $205,000 and $209,000, 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 September 30, 2018 and December 31, 2017:

	Pass/Performing	Special Mention	Substandard	Doubtful	Loss	Total
	(Dollars in thousands)					
September 30, 2018						
Real Estate Loans:						
Residential, one- to four-family	$ 145,747	$ -	$ 2,699	$ -	$ -	$ 148,446
Home equity	40,640	-	492	-	-	41,132
Commercial	146,011	728	1,986	-	-	148,725
Construction - Commercial	22,150	-	-	-	-	22,150
Construction - Residential, one- to four-family	346	-	-	-	-	346
Other Loans:						
Commercial	25,024	62	1,324	-	-	26,410
Consumer	1,328	-	4	-	-	1,332
Total	$ 381,246	$ 790	$ 6,505	$ -	$ -	$ 388,541

	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				