LAKE SHORE BANCORP, INC.
Form 10-Q
August 13, 2013

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

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

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

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

Yes [X] No [ ]

Indicate by check mark whether the registrant 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, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

Yes [ ] No [X]

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

There were 5,919,638 shares of the registrant’s common stock, $.01 par value per share, outstanding at August 1, 2013.

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PART I

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	June 30, 2013 (Unaudited)	December 31, 2012
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 7,047	$ 7,374
Interest earning deposits	5,424	4,392
Federal funds sold	23,637	7,999
Cash and Cash Equivalents	36,108	19,765
Securities available for sale	153,927	159,368
Federal Home Loan Bank stock, at cost	1,704	1,852
Loans receivable, net of allowance for loan losses 2013 $1,823; 2012 $1,806	269,872	272,933
Premises and equipment, net	9,923	9,685
Accrued interest receivable	1,784	1,802
Bank owned life insurance	14,273	14,124
Other assets	1,371	2,858
Total Assets	$ 488,962	$ 482,387
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 359,032	$ 346,065
Non-interest bearing	34,060	32,478
Total Deposits	393,092	378,543
Short-term borrowings	13,150	11,200
Long-term debt	9,550	14,400

Advances from borrowers for taxes and insurance	3,106	3,209
Other liabilities	5,269	8,050
Total Liabilities	$ 424,167	$ 415,402
Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,613,006 shares issued and 5,919,638 shares outstanding at June 30, 2013 and 6,612,500 shares issued and 5,919,132 shares outstanding at December 31, 2012	$ 66	$ 66
Additional paid-in capital	27,978	27,973
Treasury stock, at cost (693,368 shares at June 30, 2013 and December 31, 2012)	(6,469)	(6,469)
Unearned shares held by ESOP	(1,918)	(1,961)
Unearned shares held by RRP	(526)	(553)
Retained earnings	43,880	42,468
Accumulated other comprehensive income	1,784	5,461
Total Stockholders' Equity	64,795	66,985
Total Liabilities and Stockholders' Equity	$ 488,962	$ 482,387

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
	(Unaudited) (Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$ 3,456	$ 3,553	$ 6,935	$ 7,150
Investment securities, taxable	676	972	1,375	1,982
Investment securities, tax-exempt	484	479	964	948
Other	5	9	8	13
Total Interest Income	4,621	5,013	9,282	10,093
Interest Expense				
Deposits	806	1,036	1,616	2,117
Short-term borrowings	13	13	26	23
Long-term debt	52	117	115	264
Other	26	27	52	54
Total Interest Expense	897	1,193	1,809	2,458
Net Interest Income	3,724	3,820	7,473	7,635
Provision for Loan Losses	-	85	45	50
Net Interest Income after Provision for Loan Losses	3,724	3,735	7,428	7,585
Non-Interest Income				
Service charges and fees	420	429	813	848
Earnings on bank owned life insurance	71	61	149	120
Total other-than-temporary impairment (“OTTI”) losses	-	(566)	-	(566)
Portion of OTTI losses recognized in other comprehensive income (before taxes)	-	509	-	509
Net OTTI losses recognized in earnings	-	(57)	-	(57)
Other	24	24	68	67
Total Non-Interest Income	515	457	1,030	978
Non-Interest Expenses				
Salaries and employee benefits	1,578	1,539	3,140	3,076
Occupancy and equipment	497	448	989	890
Professional services	396	352	746	668

Data processing	160	153	317	305
Advertising	173	81	264	253
Postage and supplies	62	56	137	122
FDIC Insurance	66	56	130	117
Other	327	359	639	680
Total Non-Interest Expenses	3,259	3,044	6,362	6,111
Income before Income Taxes	980	1,148	2,096	2,452
Income Tax Expense	180	253	390	550
Net Income	$ 800	$ 895	$ 1,706	$ 1,902
Basic and diluted earnings per common share	$ 0.14	$ 0.16	$ 0.30	$ 0.33
Dividends declared per share	$ 0.07	$ 0.07	$ 0.14	$ 0.14

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended June 30,	
	2013	2012
	(Unaudited) (Dollars in thousands)	
Net Income	$ 800	$ 895
Other Comprehensive (Loss) Income, net of tax benefit (expense)		
Unrealized holding (losses) gains on securities available for sale, net of tax benefit (expense) 2013 $1,830; 2012 $(354)	(2,901)	562
Reclassification adjustments related to:		
Impairment charge for losses included in net income, net of tax benefit 2012 $22	-	35
Total Other Comprehensive (Loss) Income	(2,901)	597
Total Comprehensive (Loss) Income	$ (2,101)	$ 1,492

	Six Months Ended June 30,	
	2013	2012
	(Unaudited) (Dollars in thousands)	
Net Income	$ 1,706	$ 1,902
Other Comprehensive (Loss) Income, net of tax benefit (expense)		
Unrealized holding (losses) gains on securities available for sale, net of tax benefit (expense) 2013 $2,320; 2012 $(40)	(3,677)	64
Reclassification adjustments related to:		
Impairment charge for losses included in net income, net of tax benefit 2012 $22	-	35
Total Other Comprehensive (Loss) Income	(3,677)	99
Total Comprehensive (Loss) Income	$ (1,971)	$ 2,001

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

Six Months Ended June 30, 2013 and 2012 (unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by RRP	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(In thousands, except share and per share data)							
Balance - January 1, 2012	$ 66	$ 27,987	$ (6,260)	$ (2,046)	$ (606)	$ 39,770	$ 5,036	$ 63,947
Net income	-	-	-	-	-	1,902	-	1,902
Other comprehensive income, net of tax expense of $62	-	-	-	-	-	-	99	99
ESOP shares earned (3,968 shares)	-	(3)	-	42	-	-	-	39
Stock based compensation	-	5	-	-	-	-	-	5
RRP shares earned (1,966 shares)	-	(11)	-	-	26	-	-	15
Cash dividends declared ($0.14 per share)	-	-	-	-	-	(296)	-	(296)
Balance - June 30, 2012	$ 66	$ 27,978	$ (6,260)	$ (2,004)	$ (580)	$ 41,376	$ 5,135	$ 65,711
Balance - January 1, 2013	$ 66	$ 27,973	$ (6,469)	$ (1,961)	$ (553)	$ 42,468	$ 5,461	66,985
Net income	-	-	-	-	-	1,706	-	1,706
Other comprehensive loss, net of tax benefit of $2,320	-	-	-	-	-	-	(3,677)	(3,677)
Stock options exercised (506 shares)	-	4	-	-	-	-	-	4
ESOP shares earned (3,968 shares)	-	1	-	43	-	-	-	44
Stock based compensation	-	4	-	-	-	-	-	4
RRP shares earned (2,000 shares)	-	(4)	-	-	27	-	-	23
Cash dividends declared ($0.14 per share)	-	-	-	-	-	(294)	-	(294)
Balance - June 30, 2013	$ 66	$ 27,978	$ (6,469)	$ (1,918)	$ (526)	$ 43,880	$ 1,784	$ 64,795

See notes to consolidated
financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Six Months Ended June 30, 2013	2012
	(Unaudited) (Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,706	$ 1,902
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	293	160
Amortization of deferred loan costs	255	276
Provision for loan losses	45	50
Impairment of investment securities	-	57
Originations of loans held for sale	(588)	(156)
Proceeds from sales of loans held for sale	588	156
Depreciation and amortization	338	326
Increase in bank owned life insurance, net	(149)	(120)
ESOP shares committed to be released	44	39
Stock based compensation expense	27	20
Increase in accrued interest receivable	18	118
Decrease in other assets	406	448
Decrease in other liabilities	(564)	(434)
Net Cash Provided by Operating Activities	2,419	2,842
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	1,410	-
Maturities, prepayments and calls	16,248	15,884
Purchases	(17,097)	(22,454)
Purchases of Federal Home Loan Bank Stock	-	(17)
Redemptions of Federal Home Loan Bank Stock	148	120
Loan origination and principal collections, net	2,536	7,784
Additions to premises and equipment	(577)	(297)
Net Cash Provided by Investing Activities	2,668	1,020
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	14,549	4,981
Net decrease in advances from borrowers for taxes and insurance	(103)	(181)
Net increase in short term borrowings	1,950	7,410
Proceeds from issuance of long-term debt	1,750	-
Repayment of long-term debt	(6,600)	(10,080)
Proceeds from issuance of stock options	4	-
Cash dividends paid	(294)	(296)
Net Cash Provided by Financing Activities	11,256	1,834
Net Increase in Cash and Cash Equivalents	16,343	5,696

CASH AND CASH EQUIVALENTS - BEGINNING	19,765	23,704
CASH AND CASH EQUIVALENTS - ENDING	$ 36,108	$ 29,400
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 1,830	$ 2,498
Income taxes paid	$ 711	$ 706
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	$ 228	$ 887

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Nature of Operations and Basis of Presentation

Lake Shore Bancorp, Inc. (the "Company", "us," "our", or "we") was formed on April 3, 2006 to serve as the stock holding company for Lake Shore Savings Bank ("the Bank") as part of the Bank's conversion and reorganization from a New York-chartered mutual savings and loan association to the federal mutual holding company form of organization.

The interim consolidated financial statements include the accounts of the Company and the Bank, its wholly owned subsidiary. All intercompany accounts and transactions of the consolidated subsidiary have been eliminated in consolidation.

The interim financial statements included herein as of June 30, 2013 and for the three and six months ended June 30, 2013 and 2012 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, 2012 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, 2012. The consolidated results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2013.

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, 2013 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

In July 2013, the FASB issued ASU 2013-11, "Income Taxes ("Topic 740"): "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." ("ASU 2013-11"). ASU 2013-11 amends existing guidance on the financial statement presentation of an unrecognized tax benefit, when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASUI 2013-11 requires an entity to present unrecognized tax benefits, or a portion of an unrecognized tax benefit in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward with certain exceptions, The amendments in ASU 2013-11 do not require new recurring disclosures. ASU 2013-11 is effective for all interim and annual reporting periods beginning after December 15, 2013 and is to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. Management does not expect the adoption of this update to have a material impact on the Company's consolidated financial condition or results of operations.

Note 3 – Investment Securities

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

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars In thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,876	$ 1,449	$ -	$ 14,325
Municipal bonds	53,504	1,972	(430)	55,046
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	82	4	-	86
Collateralized mortgage obligations-government sponsored entities	60,476	368	(893)	59,951
Government National Mortgage Association	2,329	115	-	2,444
Federal National Mortgage Association	12,658	442	(66)	13,034
Federal Home Loan Mortgage Corporation	4,811	239	(29)	5,021
Asset-backed securities-private label	4,118	592	(870)	3,840
Asset-backed securities-government sponsored entities	141	9	-	150
Equity securities	22	8	-	30
	$ 151,017	$ 5,198	$ (2,288)	$ 153,927

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars In thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,896	$ 2,299	$ -	$ 15,195
Municipal bonds	51,666	4,598	-	56,264
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	92	2	-	94
Collateralized mortgage obligations-government sponsored entities	57,574	684	(91)	58,167
Government National Mortgage Association	2,607	289	-	2,896
Federal National Mortgage Association	15,232	1,040	-	16,272
Federal Home Loan Mortgage Corporation	5,708	486	-	6,194
Asset-backed securities-private label	4,514	530	(927)	4,117
Asset-backed securities-government sponsored entities	150	13	-	163
Equity securities	22	-	(16)	6
	$ 150,461	$ 9,941	$ (1,034)	$ 159,368

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All of our mortgage-backed securities and collateralized mortgage obligations are backed by residential mortgages.

At June 30, 2013 and at December 31, 2012, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock.

At June 30, 2013 and December 31, 2012, thirty-two municipal bonds with a cost of $10.0 million and fair value of $10.6 million and $11.1 million, respectively, were pledged under a collateral agreement with the Federal Reserve Bank of New York for liquidity borrowing. In addition, at June 30, 2013 and December 31, 2012, five municipal bonds with a cost of $1.1 million and a fair value of $1.1 million and $1.2 million, respectively, were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") insurance limits.

The following table sets forth the Company's investment in 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, 2013						
Municipal bonds	$ 7,465	$ (430)	$ -	$ -	$ 7,465	$ (430)
Mortgage-backed securities	40,964	(963)	1,699	(25)	42,663	(988)
Asset-backed securities -private label	-	-	3,102	(870)	3,102	(870)
	$ 48,429	$ (1,393)	$ 4,801	$ (895)	$ 53,230	$ (2,288)

	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)					
December 31, 2012						
Mortgage-backed securities	$ 11,800	$ (60)	$ 2,623	$ (31)	$ 14,423	$ (91)
Asset-backed securities -private label	-	-	3,367	(927)	3,367	(927)
Equity securities	-	-	6	(16)	6	(16)
	$ 11,800	$ (60)	$ 5,996	$ (974)	$ 17,796	$ (1,034)

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

The Company determines whether the unrealized losses are other-than-temporary in accordance with FASB Accounting Standards Codification ("ASC") Topic 320 "Investments - Debt and Equity Securities." The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral and the continuing performance of the securities.

Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which fair value has been less than cost, and near-term prospects of the issuer. The Company uses the cash flow expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the provisions in the applicable bond indenture and other factors, then applies a discounting rate equal to the effective yield of the security. If the present value of the expected cash flows is less than the amortized book value it is considered a credit loss. The fair value of the security is determined using the same expected cash flows; the discount rate is a rate the Company determines from open market and other sources as appropriate for the security. The difference between the fair value and the credit loss is recognized in other comprehensive income, net of taxes.

At June 30, 2013, the Company's investment portfolio included twenty-six municipal bonds and twenty-six mortgage-backed securities in the unrealized losses less than twelve months category. The municipal bonds and mortgage-backed securities were not evaluated further for OTTI as the unrealized losses on the individual securities were less than 20% of book value, which management deemed to be immaterial, and the mortgage-backed securities were issued by government sponsored entities. The Company expects these securities to be repaid in full, with no losses realized. Management does not intend to sell these securities and it is more likely than not that it will not be required to sell these securities.

At June 30, 2013, the Company had seven mortgage-backed securities and three private label asset-backed securities in the "unrealized losses twelve months or more" category.

The mortgage-backed securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value. The temporary impairment was due to declines in fair value resulting from changes in interest rates and/or increased credit liquidity spreads since the securities were purchased. The Company expects these securities to be repaid in full, with no losses realized. Management does not intend to sell these securities and it is more likely than not that it will not be required to sell these securities.

The private label asset-backed securities in this category were evaluated further for OTTI, as the unrealized loss was greater than 20% of book value for the individual security, the probability of default is high, or the Company's analysis indicated a possible loss of principal. The following table provides additional information relating to these private label asset-backed securities as of June 30, 2013 (dollars in thousands):

Security	Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Over 90 days	Foreclosure/ OREO/ Bankruptcy %	OREO%
1	$ 1,898	$ 1,436	$ (462)	C	33.90%	32.70%	14.60%	1.10%
2	1,105	820	(285)	CCC	28.00%	26.90%	10.60%	0.90%
3	969	846	(123)	CCC	20.40%	19.20%	11.10%	0.90%
Total	$ 3,972	$ 3,102	$ (870)					

The three private label asset-backed securities listed above were evaluated for OTTI under the guidance of FASB ASC Topic 320. The Company believes the unrealized losses on these three private label asset-backed securities occurred due to the current challenging economic environment, high unemployment rates, stressed housing values in many areas of the country, and increased delinquency trends. It is possible that principal losses may be incurred on the tranches we hold in these specific securities. Management's evaluation of the estimated discounted cash flows in comparison to the amortized book value for the securities listed above did not reflect the need to record an OTTI charge against earnings for the six months ended June 30, 2013. The estimated discounted cash flows for these remaining securities did not show an additional principal loss under various prepayment and default scenarios. Management concluded that it does not intend to sell these securities and that it is not likely it will be required to sell these securities.

Management also completed an OTTI analysis for two private label asset-backed securities, which did not have unrealized losses as of June 30, 2013. Management reviewed key credit metrics for these securities, including delinquency rates, cumulative default rates, prepayment speeds, foreclosure rates, loan-to-value ratios and credit support levels. Management's calculation of the estimated discounted cash flows did not show additional principal losses for these securities under various prepayment and default rate scenarios. As a result of the stress tests that were performed, management concluded that additional OTTI charges were not required as of June 30, 2013 on these securities. Management also concluded that it does not intend to sell the securities and that it is not likely it will be required to sell these securities.

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

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

	For the Six Months Ended June 30, 2013	For the Six Months Ended June 30, 2012
	(Dollars in thousands)	
Beginning balance	$ 1,155	$ 1,084
Additions:		
Credit loss not previously recognized	-	57
Reductions:		
Losses realized during the period on OTTI previously recognized	(9)	(20)
Ending balance	$ 1,146	$ 1,121

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

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

	Amortized Cost	Fair Value
	(Dollars in thousands)	
June 30, 2013:		
After one year through five years	$ 734	$ 784
After five years through ten years	23,768	25,673
After ten years	41,878	42,914
Mortgage-backed securities	80,356	80,536
Asset-backed securities	4,259	3,990
Equity securities	22	30
	$ 151,017	$ 153,927

During the six months ended June 30, 2013 and 2012, the Company did not sell any available for sale securities. During the six months ended June 30, 2013, the Company received a $1.4 million settlement related to the sale of available for sale securities in the fourth quarter of 2012.

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 has not been impacted as severely as other parts of the country by fluctuating real estate prices. Furthermore, the Company has conservative underwriting standards and does not have any sub-prime loans in its loan portfolio.
- Home Equity - are loans or lines of credit secured by second lien collateral on owner-occupied residential real estate primarily held in the Western New York area. 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.
- 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 large loan balances to 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 conventional 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.

Other Loans:

- Commercial – includes business installment loans, lines of credit, and other commercial loans. Most of our commercial loans have variable interest rates tied to the prime rate, and are for terms generally not in excess of 10 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 businesses and the income stream of the borrower. Such risks can be significantly affected by economic conditions.
- Consumer – consist of loans secured by collateral such as an automobile or a deposit account, unsecured loans and lines of credit. Consumer loans tend to have a higher credit risk due to the loans being either unsecured or secured

by rapidly depreciable assets. Furthermore, consumer loan payments are dependent on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

The allowance for loan losses is a valuation account that reflects the Company's evaluation of the losses inherent in its loan portfolio. In order to determine the adequacy of the allowance for loan losses, the Company estimates losses by loan type using historical loss factors, as well as other environmental factors, such as trends in loan volume and loan type, loan concentrations, changes in the experience, ability and depth of the Company's lending management, and national and local economic conditions. The Company's determination as to the classification of our loans and the amount of our loss allowances are subject to review by our regulatory agencies, which can require that we establish 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 the amount of loss components 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, 2013 and 2012 and the distribution of the allowance for loan losses and loan receivable by loan portfolio class and impairment method as of June 30, 2013.

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
June 30, 2012								
Allowance for Loan Losses:								
Balance – April 1, 2012	$ 381	$ 66	$ 719	$ -	$ 146	$ 10	$ 3	$ 1,325
Charge-offs	(94)	-	-	-	-	(1)	-	(95)
Recoveries	-	-	8	-	-	1	-	9
Provision (Credit)	69	22	(40)	2	35	(2)	(1)	85
Balance – June 30, 2012	$ 356	$ 88	$ 687	$ 2	$ 181	$ 8	$ 2	$ 1,324
Balance – January 1, 2012	$ 441	$ 125	$ 522	$ -	$ 265	$ 13	$ -	$ 1,366
Charge-offs	(100)	-	-	-	(1)	(1)	-	(102)
Recoveries	1	-	8	-	-	1	-	10
Provision (Credit)	14	(37)	157	2	(83)	(5)	2	50
Balance – June 30, 2012	$ 356	$ 88	$ 687	$ 2	$ 181	$ 8	$ 2	$ 1,324

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
June 30, 2013								
Allowance for Loan Losses:								
Balance – April 1, 2013	$ 527	$ 73	$ 989	$ -	$ 221	$ 21	$ 3	$ 1,834
Charge-offs	-	-	-	-	(10)	(13)	-	(23)
Recoveries	8	4	-	-	-	-	-	12
Provision (Credit)	(81)	(36)	93	-	15	(3)	12	-
Balance – June 30, 2013	$ 454	$ 41	$ 1,082	$ -	$ 226	$ 5	$ 15	$ 1,823
Balance – January 1, 2013	$ 393	$ 79	$ 1,118	$ -	$ 202	$ 14	$ -	$ 1,806
Charge-offs	-	-	-	-	(30)	(17)	-	(47)
Recoveries	8	4	5	-	2	-	-	19
Provision (Credit)	53	(42)	(41)	-	52	8	15	45
Balance – June 30, 2013	$ 454	$ 41	$ 1,082	$ -	$ 226	$ 5	$ 15	$ 1,823
Ending balance: individually evaluated for impairment	$ -	$ -	$ 30	$ -	$ 20	$ -	$ -	$ 50
Ending balance: collectively evaluated for impairment	$ 454	$ 41	$ 1,052	$ -	$ 206	$ 5	$ 15	$ 1,773
Gross Loans Receivable [(1)]:								
Ending balance	$ 164,500	$ 30,769	$ 58,275	$ 445	$ 13,311	$ 1,732	$ -	$ 269,032
Ending balance: individually evaluated for impairment	$ 175	$ 5	$ 151	$ -	$ 106	$ -	$ -	$ 437
Ending balance: collectively evaluated for impairment	$ 164,325	$ 30,764	$ 58,124	$ 445	$ 13,205	$ 1,732	$ -	$ 268,595

(1) Gross Loans Receivable does not include allowance for loan losses of $(1,823) or deferred loan costs of $2,663.

The following table summarizes the distribution of the allowance for loan losses and loans receivable by loan portfolio class as of December 31, 2012:

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
December 31, 2012								
Allowance for Loan Losses:								
Balance – December 31, 2012	$ 393	$ 79	$ 1,118	$ -	$ 202	$ 14	$ -	$ 1,806
Ending balance: individually evaluated for impairment	$ -	$ -	$ 30	$ -	$ 20	$ -	$ -	$ 50
Ending balance: collectively evaluated for impairment	$ 393	$ 79	$ 1,088	$ -	$ 182	$ 14	$ -	$ 1,756
Gross Loans Receivable [1]:								
Ending Balance	$ 167,794	$ 30,724	$ 57,653	$ 416	$ 13,680	$ 1,791	$ -	$ 272,058
Ending balance: individually evaluated for impairment	$ -	$ -	$ 255	$ -	$ 71	$ -	$ -	$ 326
Ending balance: collectively evaluated for impairment	$ 167,794	$ 30,724	$ 57,398	$ 416	$ 13,609	$ 1,791	$ -	$ 271,732

(1) Gross Loans Receivable does not include allowance for loan losses of $(1,806) or deferred loan costs of $2,681.

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.

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:

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	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
	At June 30, 2013			For the Six Months Ended June 30, 2013	
With no related allowance recorded:					
Residential, one- to four-family	$ 175	$ 175	$ -	$ 177	$ 5
Home Equity	5	5	-	5	-
Commercial real estate	21	21	-	94	1
Commercial loans	35	35	-	39	1
With an allowance recorded:					
Commercial real estate	130	130	30	130	-
Commercial loans	71	71	20	71	-
Total	$ 437	$ 437	$ 50	$ 516	$ 7

	At December 31, 2012			For the Year Ended December 31, 2012	
With no related allowance recorded:					
Commercial real estate	$ 125	$ 125	$ -	$ 155	$ 3
Commercial loans	-	-	-	50	4
With an allowance recorded:					
Commercial real estate	130	130	30	131	7
Commercial loans	71	71	20	73	3
Total	$ 326	$ 326	$ 50	$ 409	$ 17

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current Due	Total Loans Receivable	Loans on Non-Accrual
	(Dollars in thousands)						
June 30, 2013:							
Real Estate Loans:							
Residential, one- to four-family	$ 1,291	$ 428	$ 1,478	$ 3,197	$ 161,303	$ 164,500	$ 1,921
Home equity	165	82	107	354	30,415	30,769	203

Commercial	20	78	330	428	57,847	58,275	151
Construction	-	-	-	-	445	445	-
Other Loans:							
Commercial	82	53	109	244	13,067	13,311	208
Consumer	7	1	31	39	1,693	1,732	4
Total	$ 1,565	$ 642	$ 2,055	$ 4,262	$ 264,770	$ 269,032	$ 2,487
December 31, 2012:							
Real Estate Loans:							
Residential, one- to four-family	$ 1,279	$ 379	$ 1,300	$ 2,958	$ 164,836	$ 167,794	$ 1,628
Home equity	111	28	215	354	30,370	30,724	299
Commercial	30	-	255	285	57,368	57,653	255
Construction	-	-	-	-	416	416	-
Other Loans:							
Commercial	-	20	71	91	13,589	13,680	201
Consumer	19	5	26	50	1,741	1,791	9
Total	$ 1,439	$ 432	$ 1,867	$ 3,738	$ 268,320	$ 272,058	$ 2,392

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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 90 days delinquent in order to be classified as nonaccrual. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. 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, 2013 and June 30, 2012 was $62,000 and $69,000 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. Unless the loan is well secured and in the process of collection, all consumer loans that are more than 90 days past due are classified.

The following table summarizes the internal loan grades applied to the Company's loan portfolio as of June 30, 2013 and December 31, 2012:

	Pass/Performing	Special Mention	Substandard	Doubtful	Loss	Total
	(Dollars in thousands)					
June 30, 2013						
Real Estate Loans:						
Residential, one- to four-family	$ 161,421	$ -	$ 3,049	$ -	$ 30	$ 164,500
Home equity	30,496	-	238	35	-	30,769
Commercial	52,483	2,841	2,821	130	-	58,275
Construction	445	-	-	-	-	445
Other Loans:						
Commercial	12,566	441	232	72	-	13,311
Consumer	1,725	-	7	-	-	1,732
Total	$ 259,136	$ 3,282	$ 6,347	$ 237	$ 30	$ 269,032

December 31, 2012						
Real Estate Loans:						
Residential, one- to four-family	$ 165,023	$ -	$ 2,771	$ -	$ -	$ 167,794
Home equity	30,370	-	331	23	-	30,724
Commercial	51,620	3,422	2,481	130	-	57,653
Construction	416	-	-	-	-	416
Other Loans:						
Commercial	12,988	441	176	75	-	13,680
Consumer	1,775	-	14	2	-	1,791
Total	$ 262,192	$ 3,863	$ 5,773	$ 230	$ -	$ 272,058

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, 2013								
Real Estate Loans:								
Residential, one- to four-family	4	$ 208	1	$ 62	3	$ 146	1	$ 62
Home equity	1	5	-	-	1	5	-	-
Total	5	$ 213	1	$ 62	4	$ 151	1	$ 62
At December 31, 2012								
Real Estate Loans:								
Home equity	1	$ 31	1	$ 31	-	$ -	1	$ 31

The following table details the activity in loans which were first deemed to be TDRs during the three months and six months ended June 30, 2013. No loans were first deemed TDRs during the three and six months ended June 30, 2012.

	For the three months ended June 30, 2013		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)		
Real Estate Loans:			
Residential, one- to four-family	4	$ 208	$ 208
Home equity	1	5	5
Total	5	$ 213	$ 213

	For the six months ended June 30, 2013		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)		
Real Estate Loans:			
Residential, one- to four-family	4	$ 208	$ 208
Home equity	1	5	5
Total	5	$ 213	$ 213

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. The impact on the allowance was immaterial.

Note 5 – Earnings per Share

Earnings per share was calculated for the three and six months ended June 30, 2013 and 2012, 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”) and unearned shares held by the Recognition and Retention Plan (“RRP”). 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, 2013	June 30, 2012
Numerator – net income	$ 800,000	$ 895,000
Denominator:		
Basic weighted average shares outstanding	5,701,724	5,713,328
Increase in weighted average shares outstanding due to[(1)]:		
Stock options	19,548	4,688
Diluted weighted average shares outstanding [(1)]	5,721,272	5,718,016
Earnings per share:		
Basic	$ 0.14	$ 0.16
Diluted	$ 0.14	$ 0.16

	Six Months Ended	
	June 30, 2013	June 30, 2012
Numerator – net income	$ 1,706,000	$ 1,902,000
Denominator:		
Basic weighted average shares outstanding	5,700,657	5,712,336
Increase in weighted average shares outstanding due to [(1)]:		
Stock options	7,550	4,234
Diluted weighted average shares outstanding [(1)]	5,708,207	5,716,570
Earnings per share:		
Basic	$ 0.30	$ 0.33
Diluted	$ 0.30	$ 0.33

[(1)] Stock options to purchase 206,643 shares under the Stock Option Plan at $11.50 per share were outstanding during the three and six month periods ended June 30, 2012, 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. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

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

	Contract Amount	
	June 30, 2013	December 31, 2012
	(Dollars In thousands)	
Commitments to grant loans	$ 9,969	$ 11,369
Unfunded commitments under lines of credit	$ 25,372	$ 26,419

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, 2013 and December 31, 2012, the Company's fixed rate loan commitments totaled $9.2 million and $8.9 million, respectively. The range of interest rates on these fixed rate commitments was 3.60% to 7.25% at June 30, 2013.

Note 7 – Stock-based Compensation

As of June 30, 2013, the Company had three stock-based compensation plans currently allocated, 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 $33,000, and $30,000 for the three months ended June 30, 2013 and 2012, respectively. The compensation cost that has been recorded for the six months ended June 30, 2013 and 2012, respectively, was $65,000 and $59,000.

Stock Option Plan

The Company's 2006 Stock Option Plan (the "Stock Option Plan"), which was approved by the Company's shareholders, permits the grant of options to its employees and non-employee directors for up to 297,562 shares of common stock.

Both incentive stock options and non-qualified stock options may be granted under the Stock Option Plan. The exercise price of each stock option equals the market price of the Company's 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 as of June 30, 2013 and 2012 is presented below:

	June 30, 2013			June 30, 2012		
	Options	Exercise Price	Remaining Contractual Life	Options	Exercise Price	Remaining Contractual Life
Outstanding at beginning of year	236,809	$ 11.05		236,809	$ 11.05	
Granted	-	-		-	-	
Exercised	(506)	8.01		-	-	
Forfeited	-	-		-	-	
Outstanding at end of quarter	236,303	$ 11.05	3 years	236,809	$ 11.05	4 years
Options exercisable at end of quarter	227,043	$ 11.18	3 years	221,845	$ 11.26	4 years
Fair value of options granted		-			-	

:

At June 30, 2013, stock options outstanding had an intrinsic value of $153,000 and 60,753 options remained available for grant under the Stock Option Plan. Compensation expense amounted to $2,000 and $3,000 for the three months ended June 30, 2013 and 2012, respectively. Compensation expense amounted to $4,000 for the six months ended June 30, 2013 and $5,000 for the six months ended June 30, 2012. At June 30, 2013, $9,000 of unrecognized compensation cost related to stock options is expected to be recognized over a period of 6 to 18 months.

Recognition and Retention Plan

The Company's 2006 Recognition and Retention Plan ("RRP"), which was approved by the Company's shareholders, permits the grant of restricted stock awards ("Awards") to employees and non-employee directors for up to 119,025 shares of common stock.

Awards vest at a rate of 20% per year. As of June 30, 2013 there were 77,711 shares vested or distributed to eligible participants under the RRP. Compensation expense related to the RRP amounted to $8,000 for the three months ended June 30, 2013 and 2012. Compensation expense related to the RRP amounted to $17,000 for the six months ended June 30, 2013 and $15,000 for the six months ended June 30, 2012. At June 30, 2013, $39,000 of unrecognized compensation cost related to the RRP is expected to be recognized over a period of 6 to 48 months.

A summary of the status of unvested shares under the RRP for the six months ended June 30, 2013 and 2012 is as follows:

	2013	Weighted Average Grant Price	2012	Weighted Average Grant Price
Unvested shares outstanding at beginning of year	10,630	$ 7.98	14,304	$ 7.92
Granted	-	-	-	-
Vested	(3,975)	7.93	(3,974)	7.93
Forfeited	-	-	-	-
Unvested shares outstanding at end of quarter	6,655	$ 8.01	10,330	$ 7.92

2012 Equity Incentive Compensation

The Company's 2012 Equity Incentive Compensation Plan (the "Equity Incentive Plan"), which was approved by the Company's shareholders on May 23, 2012, permits the grant of restricted stock awards, incentive stock options or non-qualified stock options to employees and non-employee directors for up to 200,000 shares of common stock upon completion of performance goals. As required by federal regulations, awards may not be made under the Equity Incentive Plan until the Federal Reserve Board gives its approval. A request for Federal Reserve Board approval was made in February 2012; however, the Federal Reserve Board has not yet approved or rejected the request. Consequently, awards may not be made under the Equity Incentive Plan until the Federal Reserve Board makes a final determination.

Employee Stock Ownership Plan ("ESOP")

The Company established the ESOP for the benefit of eligible employees of the Company and the 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, 2013, the balance of the loan to the ESOP was $2.0 million and the fair value of unallocated shares was $2.1 million. As of June 30, 2013, there were 46,785 allocated shares and 182,504 unallocated shares compared to 45,191 allocated shares and 190,439 unallocated shares at June 30, 2012. The ESOP compensation expense was $23,000 for the quarter ended June 30, 2013, and $20,000 for the quarter ended June 30, 2012 based on 1,984 shares earned in each of those quarters. The ESOP compensation expense was $44,000 for the six months ended June 30, 2013 and $39,000 for the six months ended June 30, 2012 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, 2013 and December 31, 2012 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” 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 FASB 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 and nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2013 and December 31, 2012 were as follows:

	Fair Value Measurements at June 30, 2013			
	June 30, 2013	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:				
U.S. Treasury bonds	$ 14,325	$ 14,325	$ -	$ -
Municipal bonds	55,046	-	55,046	-
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	86	-	86	-
Collateralized mortgage obligations-government sponsored entities	59,951	-	59,951	-
Government National Mortgage Association	2,444	-	2,444	-
Federal National Mortgage Association	13,034	-	13,034	-
Federal Home Loan Mortgage Corporation	5,021	-	5,021	-
Asset-backed securities:				
Private label	3,840	-	-	3,840
Government sponsored entities	150	-	150	-
Equity securities	30	-	30	-
Total	$ 153,927	$ 14,325	$ 135,762	$ 3,840
Measured at fair value on a non-recurring basis:				
Impaired loans	$ 125	$ -	$ -	$ 125
Foreclosed real estate	332	-	-	332

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, 2013.

	Fair Value Measurements at December 31, 2012			
	December 31, 2012	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:				
U.S. Treasury bonds	$ 15,195	$ 15,195	$ -	$ -
Municipal bonds	56,264	-	56,264	-
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	94	-	94	-
Collateralized mortgage obligations-government sponsored entities	58,167	-	58,167	-
Government National Mortgage Association	2,896	-	2,896	-
Federal National Mortgage Association	16,272	-	16,272	-
Federal Home Loan Mortgage Corporation	6,194	-	6,194	-
Asset-backed securities:				
Private label	4,117	-	244	3,873
Government sponsored entities	163	-	163	-
Equity securities	6	-	6	-
Total	$ 159,368	$ 15,195	$ 140,300	$ 3,873
Measured at fair value on a non-recurring basis:				
Impaired loans	$ 125	$ -	$ -	$ 125
Foreclosed real estate	378	-	-	378

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

The following table presents a reconciliation of the securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3), specifically, asset-backed securities - private label, for the six months ended June 30, 2013 and 2012:

	2013	2012
	(Dollars in thousands)	
Beginning Balance	$ 3,873	$ 3,936
Total gains - realized/unrealized:		
Included in earnings	-	-
Included in other comprehensive income	118	330
Total losses - realized/unrealized:		
Included in earnings	-	(57)
Included in other comprehensive income	-	-
Purchases, issuances and settlements	-	-
Sales	-	-
Principal paydowns	(151)	(223)
Transfers to (out of) Level 3	-	-
Ending Balance	$ 3,840	$ 3,986

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 June 30, 2013 (dollars in thousands):

				Unobservable Inputs		
Security Category	Fair Value Estimate	Loan Type/Collateral	Credit Ratings	Constant Prepayment Speed (CPR)	Probability of Default (Annual Default Rate)	Loss Severity
Asset-backed securities - private label	$ 3,840	Prime First and Second Lien - Residential Real Estate	CCC thru D	2 - 8	5.0% - 8.0%	70.0% - 100.0%

Level 3 inputs are determined by internal management with 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.

An impaired loan is carried at fair value based on either recent appraisals less estimated selling costs of related collateral or discounted cash flows based on current market conditions. As of June 30, 2013 and December 31, 2012, impaired loans with a specific allowance had a carrying amount of $201,000 with a valuation allowance of $50,000. The allocated allowance is based on a fair value of $125,000 less estimated liquidation expenses of 10% of the collateral value and the anticipated receipt of Small Business Administration ("SBA") guaranteed funds on one of the loans, resulting in no additional provision for loan losses during the three month period ended June 30, 2013. The use of independent appraisals, discounted cash flow models and management's best judgment are significant inputs in arriving at the fair value of the underlying collateral of impaired loans and are therefore classified within Level 3 of the fair value hierarchy.

Foreclosed real estate consists of property acquired in settlement of loans which is carried at its fair value based on recent appraisals less estimated selling costs and which has been subsequently written down during the period. Fair value is based upon independent market prices or appraised value of the property. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement. The use of independent appraisals and management's best judgment are significant inputs in arriving at the fair value of the underlying collateral on foreclosed real estate and is therefore classified within Level 3 of the fair value hierarchy. As of June 30, 2013, foreclosed real estate had a carrying amount of $413,000 and was written down to $304,000 based on a fair value of $332,000 less estimated liquidation expenses of 7% to 15% of the collateral value, resulting in no additional write downs during the three month period ended June 30, 2013. As of December 31, 2012 foreclosed real estate had a carrying amount of $457,000 and was written down to $351,000 based on a fair value of $378,000 less estimated liquidation expenses of 7% to 15% of the collateral value.

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, 2013				
	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	$ 36,108	$ 36,108	$ 36,108	$ -	$ -
Securities available for sale	153,927	153,927	14,325	135,762	3,840
Federal Home Loan Bank stock	1,704	1,704	-	1,704	-
Loans receivable, net	269,872	259,637	-	-	259,637
Accrued interest receivable	1,784	1,784	-	1,784	-
Financial liabilities:					
Deposits	393,092	398,720	-	398,720	-
Short-term borrowings	13,150	13,150	-	13,150	-
Long-term debt	9,550	9,756	-	9,756	-
Accrued interest payable	22	22	-	22	-
Off-balance-sheet financial instruments	-	-	-	-	-

	Fair Value Measurements at December 31, 2012				
	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	$ 19,765	$ 19,765	$ 19,765	$ -	$ -
Securities available for sale	159,368	159,368	15,195	140,300	3,873
Federal Home Loan Bank stock	1,852	1,852	-	1,852	-
Loans receivable, net	272,933	273,202	-	-	273,202
Accrued interest receivable	1,802	1,802	-	1,802	-
Financial liabilities:					
Deposits	378,543	383,578	-	383,578	-
Short-term borrowings	11,200	11,200	-	11,200	-
Long-term debt	14,400	14,748	-	14,748	-
Accrued interest payable	43	43	-	43	-
Off-balance-sheet financial instruments	-	-	-	-	-

The following valuation techniques were used to measure the fair value of financial instruments in the above table:

Cash and cash equivalents (carried at cost)

The carrying amount of cash and cash equivalents approximates fair value.

Securities available for sale (carried at fair value)

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 consist of private label asset-backed securities. The fair value measurement for these Level 3 securities is explained more fully earlier in this footnote.

Federal Home Loan Bank stock (carried at cost)

The carrying amount of Federal Home Loan Bank stock approximates fair value.

Loans Receivable (carried at cost)

The fair value of fixed-rate and variable rate performing loans is estimated using a discounted cash flow method. The discount rates take into account interest rates currently being offered to customers for loans with similar terms, the credit risk associated with the loan, estimated maturity and market factors including liquidity. The estimate of maturity is based on the Company's contractual cash flows adjusted for prepayment estimates based on current economic and lending conditions. Fair value for significant nonperforming loans is based on carrying value which does not exceed recent external appraisals of any underlying collateral. Due to the significant judgment involved in evaluating credit quality, loans are classified within Level 3 of the fair value hierarchy.

Accrued Interest Receivable and Payable (carried at cost)

The carrying amount of accrued interest receivable and payable approximates fair value.

Deposits (carried at cost)

The fair value of deposits with no stated maturity, such as savings, money market and checking is the amount payable on demand at the reporting date and are classified within Level 2 of the fair value hierarchy. The fair value of time deposits is based on the discounted value of contractual cash flows at current rates of interest for similar deposits using market rates currently offered for deposits of similar remaining maturities. Due to the minimal amount of unobservable inputs involved in evaluating assumptions used for discounted cash flows of time deposits, these deposits are classified within Level 2 of the fair value hierarchy.

Borrowings (carried at cost)

The fair value of long-term debt was calculated by discounting scheduled cash flows at current market rates of interest for similar borrowings through maturity of each instrument. Due to the minimal amount of unobservable inputs involved in evaluating assumptions used for discounted cash flows of long-term debt, they are classified within Level 2 of the fair value hierarchy. The carrying amount of short term borrowings approximates fair value of such liability.

Off-Balance Sheet Financial Instruments (disclosed at cost)

Fair values of the Company's off-balance sheet financial instruments (lending commitments) are based on fees currently charged to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing. Other than loan commitments, the Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition.

Note 9 – Treasury Stock

During the quarter and six months ended June 30, 2013, the Company did not repurchase any shares of common stock. As of June 30, 2013, there were 71,510 shares remaining to be repurchased under the existing stock repurchase program.

During the quarter and six months ended June 30, 2012, the Company did not repurchase any shares of common stock. As of June 30, 2012, there were 91,510 shares remaining to be repurchased under the existing stock repurchase program.

Note 10 – Subsequent Events

On July 24, 2013, the Board of Directors declared a quarterly dividend of $0.07 per share on the Company’s common stock, payable on August 20, 2013 to shareholders of record as of August 6, 2013. Lake Shore, MHC, which holds 3,636,875 shares, or approximately 61.4% of the Company’s total outstanding stock, elected to waive its right to receive this cash dividend of approximately $255,000. On March 25, 2013, 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 26, 2014, aggregating up to $0.28 per share. The MHC waived $255,000 of dividends during the three months ended June 30, 2013 and $510,000 for the six month period ended June 30, 2013. Cumulatively, Lake Shore, MHC has waived approximately $4.9 million of cash dividends as of June 30, 2013. 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 and previous Quarterly Reports on Form 10-Q and in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2012, 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 transfer of supervisory and enforcement authority over savings banks to the Office of the Comptroller of the Currency and savings and loan holding companies to the Federal Reserve Board;

the effect of new capital standards to be 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, 2013 compared to the financial condition as of December 31, 2012 and the consolidated results of operations for the three and six months ended June 30, 2013 and 2012.

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 and other interest-bearing liabilities. Net interest income is affected by the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates we earn or pay on these balances.

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

While the recession is officially over, continued weakness in the economy and high unemployment remain. These weaknesses can have a negative effect on a bank’s earnings and liquidity. The Federal Reserve is still actively working on keeping interest rates at very low levels. The Fed Funds rate has remained at 0.00%-0.25% for more than four years. The Federal Reserve has indicated that the Fed Funds rate will remain low and may not increase until mid-2015, which is longer than previously anticipated and is regardless of what happens with the quantitative easing (“QE”) programs. Furthermore, the Federal Reserve has recently indicated that it may reduce or “taper” its QE program to purchase up to $85 billion in mortgage-backed securities and treasuries on a monthly basis, which quickly resulted in significant decreases in bond prices and increases in yields. The rates offered on mortgage products have increased with the impact on volume yet to be determined. We will continue to closely monitor the impact of the national and regional economy on our net interest margin, results of operations and critical risk areas, including interest rate risk and credit risk.

As discussed in the Company’s Annual Report on Form 10-K Part I, Item 1 “Business – Supervision and Regulation” for the year ended December 31, 2012, since October 2008, numerous legislative actions, including the Dodd-Frank Act, have been taken in response to the financial crisis affecting the banking system and financial markets. While we do not know all the possible outcomes from these initiatives, we can anticipate that the Company will need to dedicate more resources to ensure compliance with the new legislation and regulations, which may impact profitability. There can be no assurance as to the actual impact any governmental program will have on the financial markets or our financial condition and results of operations. We remain active in monitoring these developments and supporting the interests of our shareholders.

Management Strategy

Our Reputation. Our primary management strategy has been to retain our perceived image as one of the most respected and recognized community banks in Western New York with over 121 years of service to our community. Our management strives to accomplish this goal by continuing to emphasize our high quality customer service and financial strength.

Branching. We opened our sixth branch office in Erie County, New York during the second quarter of 2013. This branch is located in Snyder, New York and is our eleventh branch overall. This office has generated nearly $5.0 million of deposits as of June 30, 2013. Our offices are located in Dunkirk, Fredonia, Jamestown, Lakewood and Westfield in Chautauqua County, New York and in Depew, East Amherst, Hamburg, Kenmore, Orchard Park and Snyder in Erie County, New York. Saturation of the market in Chautauqua County led to our expansion plan in Erie County, which is a critical component of our future profitability and growth.

An important strategic objective is to continue to evaluate the technology supporting our customer service. We are committed to making investments in technology and we believe that it represents an efficient way to deploy a portion of our capital. To this end, the Company has developed a five year plan for the implementation of cost effective and efficient digital services to meet our customer's technology needs, to focus on attracting new customers, and to improve our operational efficiencies. Although we remain committed to expanding our retail branch footprint whenever it makes strategic sense, we will be concentrating our near term efforts on developing "clicks" instead of "bricks."

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

Residential Mortgage and Other Lending. Historically, our lending portfolio has consisted predominately of residential one- to four-family mortgage loans. At June 30, 2013 and December 31, 2012, we held $164.5 million and $167.8 million of residential one- to four-family mortgage loans, respectively, which constituted 61.1% and 61.7% respectively, of our total loan portfolio. We originate commercial real estate loans to finance the purchase of real property, which generally consists of developed real estate. At June 30, 2013 and December 31, 2012, our commercial real estate loan portfolio consisted of loans totaling $58.3 million and $57.7 million respectively, or 21.7% and 21.2%, respectively, of total loans. In addition to commercial real estate loans, we also engage in small business commercial lending, including business installment loans, lines of credit, and other commercial loans. At June 30, 2013 and December 31, 2012, our commercial loan portfolio consisted of loans totaling $13.3 million and $13.7 million, respectively, or 4.9% and 5.0%, respectively, of total loans. Other loan products offered to our customers include home equity loans and lines of credit, construction loans and consumer loans, including automobile loans, overdraft lines of credit and share loans. We may sell one-to four-family residential loans in the future as part of our interest rate risk strategy and asset/liability management, if it is deemed appropriate. We typically retain servicing rights when we sell one- to four-family residential mortgage loans. One- to four-family residential mortgage loans will continue to be the dominant type of loan in our lending portfolio.

Investment Strategy. Our investment policy is designed primarily to manage the interest rate sensitivity of our assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity within established guidelines. We employ a third party financial advisor to assist us in managing our investment portfolio and developing balance sheet strategies.

At June 30, 2013 and December 31, 2012, we had $153.9 million and $159.4 million, respectively, invested in securities available for sale, the majority of which are agency mortgage-backed securities, agency collateralized mortgage obligation securities ("CMOs") and municipal securities.

Asset-Liability Strategy. As stated above, our business consists primarily of originating one- to four-family residential mortgage loans and commercial real estate loans secured by property in our market area and investing in residential mortgage-backed securities, CMOs and municipal securities. Typically, one- to four-family residential mortgage loans involve a lower degree of risk and carry a lower yield than commercial real estate and commercial business loans. Our loans are primarily funded by time deposits and core deposits (i.e. checking, savings and money market accounts). This has resulted in our being vulnerable to increases in interest rates, as our interest-bearing liabilities will mature or re-price more quickly than our interest-earning assets in a rising rate environment. Although we plan to continue to originate one- to four-family residential mortgage loans going forward, we have been and intend to continue to increase our focus on the origination of commercial real estate loans and commercial business loans, which generally provide higher returns and have shorter durations than one- to four-family residential mortgage loans. Furthermore, our interest rate risk strategy involves improving our funding mix by increasing our core deposits in order to help reduce and control our cost of funds. We value core deposits because they represent longer-term customer relationships as well as lower cost of funds. As part of our strategy to expand our commercial loan portfolio, we expect to attract lower cost core deposits as part of these borrower relationships. We offer competitive rates on a variety of deposit products to meet the needs of our customers and we promote long term deposits, where possible, to meet asset-liability goals.

We are actively involved in managing our balance sheet through the direction of our Asset-Liability committee and the assistance of a third party advisor. Recent economic conditions have underscored the importance of a strong balance sheet. We strive to achieve this through managing our interest rate risk and maintaining strong capital levels, putting aside adequate loan loss reserves and keeping liquid assets on hand. Diversifying our asset mix not only improves net interest margin but also reduces the exposure of our net interest income and earnings to interest rate risk. We will continue to manage our interest rate risk by diversifying the type and maturity of our assets in our loan and investment portfolios and monitoring the maturities in our deposit portfolio and borrowing facilities.

Critical Accounting Policies

It is management's opinion that accounting estimates covering certain aspects of our business have more significance than others due to the relative importance of those areas to overall performance, or the level of subjectivity required in making such estimates. Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance for loan losses required for probable credit losses and the material effect that such judgments can have on the results of operations. Management's monthly evaluation of the adequacy of the allowance considers our historical loan loss experience, review of specific loans, current economic conditions, and such other factors considered appropriate to estimate loan losses. Management uses presently available information to estimate probable losses on loans; however, future additions to the allowance may be necessary based on changes in estimates, assumptions, or economic conditions. Significant factors that could give rise to changes in these estimates include, but are not limited to, changes in economic conditions in our local area, concentrations of risk and decline in local property values. The Company's determination as to the amount of its allowance for loan losses is subject to review by its regulatory agencies, which can require that we establish additional loss allowances. Refer to Note 4 of the Notes to Consolidated Financial Statements for more information on the allowance for loan losses.

In management's opinion, the accounting policy relating to the valuation of investments is a critical accounting policy. The fair values of our investments are determined using public quotations, third party dealer quotes, pricing models, or discounted cash flows. Thus, the determination may require significant judgment or estimation, particularly when liquid markets do not exist for the item being valued. The use of different assumptions for these valuations could produce significantly different results which may have material positive or negative effects on the results of our operations. Refer to Note 8 of the Notes to Consolidated Financial Statements for more information on fair value.

Management also considers the accounting policy relating to the impairment of investments to be a critical accounting policy due to the subjectivity and judgment involved and the material effect an impairment loss could have on the consolidated results of income. The credit portion of a decline in the fair market value of investments below cost deemed to be other-than-temporary may be charged to earnings resulting in the establishment of a new cost basis for an asset. Management continually reviews the current value of its investments for evidence of OTTI. Refer to Note 3 of the Notes to Consolidated Financial Statements for more information on OTTI.

These critical policies and their application are reviewed periodically by our Audit Committee and our Board of Directors. All accounting policies are important, and as such, we encourage the reader to review each of the policies included in the notes to our audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2012 to better understand how our financial performance is reported.

Analysis of Net Interest Income

Net interest income represents the difference between the interest we earn on our interest-earning assets, such as mortgage loans and investment securities, and the expense we pay on interest-bearing liabilities, such as 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 sheets and reflects 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 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 municipals.

	For the Three Months Ended June 30, 2013			For the Three Months Ended June 30, 2012		
	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	$ 25,136	$ 5	0.08%	$ 24,114	$ 9	0.15%
Securities	159,656	1,160	2.91%	170,655	1,451	3.40%
Loans	270,058	3,456	5.12%	267,245	3,553	5.32%
Total interest-earning assets	454,850	4,621	4.06%	462,014	5,013	4.34%
Other assets	34,114			30,415		
Total assets	$ 488,964			$ 492,429		
Interest-bearing liabilities						
Demand & NOW accounts	$ 42,453	$ 12	0.11%	$ 41,665	$ 13	0.12%
Money market accounts	73,779	69	0.37%	62,343	83	0.53%
Savings accounts	39,274	10	0.10%	35,812	14	0.16%
Time deposits	200,541	715	1.43%	214,708	926	1.73%
Borrowed funds	23,457	65	1.11%	32,062	130	1.62%
Other interest-bearing liabilities	1,183	26	8.79%	1,227	27	8.80%
Total interest-bearing liabilities	380,687	897	0.94%	387,817	1,193	1.23%
Other non-interest bearing liabilities	40,883			39,128		
Stockholders' equity	67,394			65,484		
Total liabilities & stockholders' equity	$ 488,964			$ 492,429		
Net interest income		$ 3,724			$ 3,820	
Interest rate spread			3.12%			3.11%
Net interest margin			3.27%			3.31%

	For the Six Months Ended June 30, 2013			For the Six Months Ended June 30, 2012		
	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	$ 20,115	$ 8	0.08%	$ 22,505	$ 13	0.12%
Securities	159,207	2,339	2.94%	168,921	2,930	3.47%
Loans	271,063	6,935	5.12%	269,475	7,150	5.31%
Total interest-earning assets	450,385	9,282	4.12%	460,901	10,093	4.38%
Other assets	33,978			30,443		
Total assets	$ 484,363			$ 491,344		
Interest-bearing liabilities						
Demand & NOW accounts	$ 41,879	$ 24	0.11%	$ 41,056	$ 26	0.13%
Money market accounts	71,973	134	0.37%	61,439	165	0.54%
Savings accounts	38,259	20	0.10%	34,885	27	0.15%
Time deposits	199,559	1,438	1.44%	216,504	1,899	1.75%
Borrowed funds	24,169	141	1.17%	32,654	287	1.76%
Other interest-bearing liabilities	1,188	52	8.75%	1,233	54	8.76%
Total interest-bearing liabilities	377,027	1,809	0.96%	387,771	2,458	1.27%
Other non-interest bearing liabilities	39,970			38,262		
Stockholders' equity	67,366			65,311		
Total liabilities & stockholders' equity	$ 484,363			$ 491,344		
Net interest income		$ 7,473			$ 7,635	
Interest rate spread			3.16%			3.11%
Net interest margin			3.32%			3.31%

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, 2013 Compared to Three Months Ended June 30, 2012		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest earning assets:			
Interest-earning deposits & federal funds sold	$ (4)	$ -	$ (4)
Securities	(202)	(89)	(291)
Loans, including fees	(134)	37	(97)
Total interest-earning assets	(340)	(52)	(392)
Interest-bearing liabilities:			
Demand & NOW accounts	(2)	1	(1)
Money market accounts	(27)	13	(14)
Savings accounts	(5)	1	(4)
Time deposits	(153)	(58)	(211)
Total deposits	(187)	(43)	(230)
Other interest-bearing liabilities:			
Borrowed funds & other	(35)	(31)	(66)
Total interest-bearing liabilities	(222)	(74)	(296)
Total change in net interest income	$ (118)	$ 22	$ (96)

	Six Months Ended June 30, 2013 Compared to Six Months Ended June 30, 2012		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest earning assets:			
Interest-earning deposits & federal funds sold	$ (4)	$ (1)	$ (5)
Securities	(430)	(161)	(591)
Loans, including fees	(257)	42	(215)
Total interest-earning assets	(691)	(120)	(811)
Interest-bearing liabilities:			
Demand & NOW accounts	(3)	1	(2)
Money market accounts	(56)	25	(31)
Savings accounts	(9)	2	(7)
Time deposits	(320)	(141)	(461)
Total deposits	(388)	(113)	(501)
Other interest-bearing liabilities:			
Borrowed funds & other	(82)	(66)	(148)
Total interest-bearing liabilities	(470)	(179)	(649)
Total change in net interest income	$ (221)	$ 59	$ (162)

Our earnings may be adversely impacted by an increase in interest rates because the majority of our interest-earning assets are long-term, fixed rate mortgage-related assets that will not reprice as long-term interest rates increase. As rates rise, we expect loan applications to decrease, prepayment speeds to slowdown and the interest rate on our loan portfolio to remain static. Conversely, a majority of our interest-bearing liabilities have much shorter contractual maturities and are expected to reprice, resulting in increased interest expense. A significant portion of our deposits have no contractual maturities and are likely to reprice quickly as short-term interest rates increase. Therefore, in an increasing rate environment, our cost of funds is expected to increase more rapidly than the yields earned on our loan portfolio and securities portfolio. An increasing rate environment is expected to cause a decrease in our net interest rate spread and a decrease in our earnings. In order to mitigate this effect, the Bank's Asset-Liability Committee is continuing to review its options in relation to core deposit growth, implementation of new products, promotion of adjustable rate commercial loan products and use of derivative products.

In a decreasing interest rate environment, our earnings may increase or decrease. If long-term interest-earning assets do not reprice and interest rates on short-term deposits begin to decrease, earnings may rise. However, low interest rates on loan products may result in an increase in prepayments, as borrowers refinance their loans. If we cannot re-invest the funds received from prepayments at a comparable spread, net interest income could be reduced. Also, in a falling interest rate environment, certain categories of deposits may reach a point where market forces prevent further reduction in interest paid on those products. The net effect of these circumstances is reduced net interest income and possibly net interest rate spread.

In the current environment, rates on the lending and investment portfolios have declined significantly, but rates on deposit products and borrowed funds have also dropped, which has assisted in keeping our interest rate spread at a moderate level.

For the three months ended June 30, 2013, the average yields on our loan portfolio and investment portfolio were 5.12% and 2.91%, respectively, in comparison to 5.32% and 3.40%, respectively, for the three months ended June 30, 2012. Overall, the average yield on our interest earning assets decreased by 28 basis points to 4.06% for the three months ended June 30, 2013 in comparison to the three months ended June 30, 2012. For the three months ended June 30, 2013, the average rate that we were paying on interest-bearing liabilities decreased by 29 basis points to 0.94% in comparison to the same period in the prior year. This was partially due to a 51 basis point decrease in the average interest rate paid on our borrowings from 1.62% for the three months ended June 30, 2012 to 1.11% for the three month period ended June 30, 2013 and a 30 basis point decrease in the average rate paid on time deposits from 1.73% for the three month period ended June 30, 2012 to 1.43% for the three month period ended June 30, 2013. Our interest rate spread for the three months ended June 30, 2013 and 2012 was 3.12% and 3.11%, respectively. Our net interest margin was 3.27% and 3.31% for the three months ended June 30, 2013 and 2012, respectively.

For the six month period ended June 30, 2013, the average yields on our loan portfolio and investment portfolio were 5.12% and 2.94%, respectively, in comparison to 5.31% and 3.47%, respectively, for the six months ended June 30, 2012. Overall, the average yield on our interest earning assets decreased by 26 basis points to 4.12% for the six months ended June 30, 2013 from 4.38% for the six months ended June 30, 2012. For the six months ended June 30, 2013, the average rate we were paying on interest-bearing liabilities decreased by 31 basis points to 0.96% in comparison to the same period in the prior year. This was partially due to a 59 basis point decrease in the average interest rate paid on our borrowings from 1.76% for the six months ended June 30, 2012 to 1.17% for the six month period ended June 30, 2013 and a 31 basis point decrease in the average rate paid on time deposits from 1.75% for the six month period ended June 30, 2012 to 1.44% for the six month period ended June 30, 2013. Our interest rate spread for the six months ended June 30, 2013 was 3.16%, which was a 5 basis point increase in comparison to the six months ended June 30, 2012. Our net interest margin was 3.32% and 3.31% for the six months ended June 30, 2013 and 2012, respectively.

Comparison of Financial Condition at June 30, 2013 and December 31, 2012

Total assets at June 30, 2013 were $489.0 million, an increase of $6.6 million, or 1.4%, from $482.4 million at December 31, 2012. The increase in total assets was primarily due to a $16.3 million increase in cash and cash equivalents, partially offset by a $5.4 million decrease in securities available for sale and a $3.1 million decrease in net loans receivable.

Cash and cash equivalents increased by $16.3 million, or 82.7%, from $19.8 million at December 31, 2012 to $36.1 million at June 30, 2013. The increase was primarily attributed to a $15.6 million increase in federal funds sold as a result of a $14.5 million increase in deposits which have not yet fully been used to fund loan originations or to purchase securities available for sale.

Securities available for sale decreased $5.4 million, or 3.4%, to $153.9 million at June 30, 2013 compared to $159.4 million at December 31, 2012. The decrease was primarily due to the $6.0 million decrease in the mark to market value of the securities available for sale portfolio between December 31, 2012 and June 30, 2013. During the six month period ended June 30, 2013, the Company purchased $17.1 million of available for sale securities, including collateralized mortgage obligations and municipal bonds. The purchases were primarily funded by the receipt of $16.2 million in pay-downs on the investment portfolio with the remainder being funded by deposit growth.

Net loans receivable decreased during the six month period ended June 30, 2013, as shown in the table below:

	At June 30, 2013	At December 31, 2012	Change $	%
	(Dollars in thousands)			
Real Estate Loans:				
Residential, one- to four-family	$ 164,500	$ 167,794	$ (3,294)	(2.0)%
Home equity	30,769	30,724	45	0.1 %
Commercial	58,275	57,653	622	1.1 %
Construction	445	416	29	7.0 %
Total real estate loans	253,989	256,587	(2,598)	(1.0)%
Other Loans:				
Commercial	13,311	13,680	(369)	(2.7)%
Consumer	1,732	1,791	(59)	(3.3)%
Total gross loans	269,032	272,058	(3,026)	(1.1)%
Allowance for loan losses	(1,823)	(1,806)	(17)	0.9 %
Net deferred loan costs	2,663	2,681	(18)	(0.7)%
Loans receivable, net	$ 269,872	$ 272,933	$ (3,061)	(1.1)%

The decrease in net loans receivable was primarily due to a decrease in all loan categories except for commercial real estate, home equity loans, and construction. During 2013, we remain strategically focused on our commercial real estate and commercial loan portfolios to diversify our asset mix, to take advantage of the opportunities available to serve small businesses in our market area, and to maintain an effective net interest margin. During the first six months of 2013, the Company continued its strategic decision to not match lower rates offered by our competitors on residential one- to four- family mortgage loans in an effort to avoid increased interest rate risk. Management continues to look for high quality loans to add to its portfolio and will continue to emphasize loan originations to the extent that it is profitable and prudent.

Other assets decreased by $1.5 million, or 52.0%, to $1.4 million as of June 30, 2013 in comparison to $2.9 million at December 31, 2012. The decrease was primarily due to the sale of $1.4 million of available for sale securities in the fourth quarter of 2012, which settled during the first quarter of 2013.

The table below shows changes in deposit balances by type of deposit between June 30, 2013 and December 31, 2012:

	At June 30, 2013	At December 31, 2012	Change $	Change %
	(Dollars in thousands)			
Demand deposits and NOW accounts:				
Non-interest bearing	$ 34,060	$ 32,478	$ 1,582	4.9 %
Interest bearing	42,577	42,350	227	0.5 %
Money market	74,880	68,228	6,652	9.7 %
Savings	39,975	36,990	2,985	8.1 %
Time deposits	201,600	198,497	3,103	1.6 %
Total deposits	$ 393,092	378,543	14,549	3.8 %

The increase in total deposits was primarily due to an increase in all deposit categories. The growth in money market, savings and checking accounts was the result of the Company's continued strategic focus on growing core deposits among its retail and commercial customers. The growth in time deposits was primarily due to the opening of our newest branch office in Snyder, New York, during the second quarter of 2013.

Our borrowings, consisting of advances from the Federal Home Loan Bank of New York ("FHLBNY"), decreased by $2.9 million, or 11.3%, from $25.6 million at December 31, 2012 to $22.7 million at June 30, 2013. Long-term debt decreased $4.9 million, or 33.7%, from $14.4 million at December 31, 2012 to $9.6 million at June 30, 2013. Short-term borrowings increased $1.9 million, or 17.4%, from $11.2 million at December 31, 2012 to $13.2 million at June 30, 2013. As long-term debt matured, the Company paid off $2.9 million of such debt in order to reduce interest expense, and the remaining proceeds were transferred into short-term borrowings to take advantage of lower interest rates.

Total stockholders' equity decreased by $2.2 million, or 3.3%, to $64.8 million as of June 30, 2013 in comparison to $67.0 million as of December 31, 2012. The decrease was primarily due to a $3.7 million decrease in unrealized gains on available for sale securities (after taxes) due to the increase in interest rates during June 2013 and $294,000 in cash dividends paid during the six month period ended June 30, 2013, partially offset by net income of $1.7 million for the same time period.

Comparison of Results of Operations for the Three Months Ended June 30, 2013 and 2012

General. Net income was $800,000 for the three month period ended June 30, 2013, or $0.14 per diluted share, a decrease of $95,000, or 10.6%, compared to net income of $895,000 or $0.16 per diluted share, for the three month period ended June 30, 2012. The decrease in net income was primarily due to a $96,000 decrease in net interest income and a $215,000 increase in non-interest expenses, partially offset by a $85,000 decrease in the provision for loan losses, $58,000 increase in non-interest income and a $73,000 decrease in income tax expense.

Interest Income. Interest income decreased by $392,000, or 7.8%, to $4.6 million for the three month period ended June 30, 2013 compared to the three month period ended June 30, 2012. Loan interest income decreased by $97,000, or 2.7%, to $3.5 million for the three month period ended June 30, 2013 compared to the three month period ended June 30, 2012, due to a decrease in the average yield on loans from 5.32% for the three month period ended June 30, 2012 to 5.12% for the three month period ended June 30, 2013. The average yield on the loan portfolio decreased as new loans were originated or existing loans were refinanced at lower yields than the rates earned on loans which had paid off, as a result of the current low interest rate environment. The average balance of the loan portfolio increased $2.8 million, or 1.1%, from $267.2 million for the three month period ended June 30, 2012 to $270.1 million for the three month period ended June 30, 2013. The increase in the average balance of loans receivable was primarily due to an increase in the average balance of commercial real estate and home equity loans, partially offset by a decrease in the average balance of one- to four-family real estate loans. As previously indicated, the decrease in the average balance of one- to four- family real estate loans was a strategic decision by the Company to not match competitor rates in an effort to avoid increased interest rate risk. Investment interest income decreased by $291,000, or 20.1%, to $1.2 million for the three month period ended June 30, 2013 compared to $1.5 million for the three month period ended June 30, 2012 due to a decrease in the average yield on securities from 3.40% for the three month period ended June 30, 2012 to 2.91% for the three month period ended June 30, 2013. The average yield on the investment portfolio decreased as new securities were purchased at lower yields than the rates earned on securities which had paid off, as a result of the current low interest rate environment. The average balance of the investment portfolio decreased from $170.7 million for the three months ended June 30, 2012 to $159.7 million for the three months ended June 30, 2013 primarily due to the receipt of paydowns which have not yet been re-invested.

Interest Expense. Interest expense decreased by $296,000, or 24.8%, to $897,000 for the three month period ended June 30, 2013 compared to $1.2 million for the three month period ended June 30, 2012. Interest expense on deposits decreased by $230,000, or 22.2%, to $806,000 for the three month period ended June 30, 2013 when compared to the three month period ended June 30, 2012 primarily due to the decrease in the average rate paid on deposits. The average balance of deposits for the three month period ended June 30, 2013 was $356.0 million with an average rate of 0.91% compared to the average balance of deposits of $354.5 million and an average rate of 1.17% for the three month period ended June 30, 2012. The decrease in the average rate paid on deposits was due to the continued low interest rate environment in 2013. The increase in the average balance of deposits was primarily due to deposit growth in core deposit accounts, partially offset by a decrease in the average balance of time deposits. Interest expense related to advances from the FHLBNY decreased $65,000, or 50.0%, to $65,000 for the three month period ended June 30, 2013 when compared to the three month period ended June 30, 2012. This decrease was due to an $8.6 million decrease in average FHLBNY advance balances and a 51 basis point decline in the average rate paid on FHLBNY advances when comparing the three month period ended June 30, 2013 with the three month period ended June 30, 2012. The decrease in the average FHLBNY advance balances was a result of the Company's decision to utilize excess cash obtained from loan prepayments to pay down borrowings. The low interest rate environment caused the average rate paid on borrowings to decrease.

Provision for Loan Losses. A provision to the allowance for loan losses was not recorded during the three month period ended June 30, 2013, resulting in a decrease of $85,000, compared to a provision of $85,000 during the three month period ended June 30, 2012. Net charge-offs were $11,000 for the three month period ended June 30, 2013 compared to $86,000 for the three month period ended June 30, 2012. Our credit quality remains strong, with non-performing loans increasing slightly to $2.9 million, or 1.09% of total loans, at June 30, 2013 as compared to $2.1 million, or 0.89% of total loans, at June 30, 2012.

During the three month period ended June 30, 2013, the Company recorded a $93,000 provision for loan losses in commercial real estate loans due to changes in the related environmental factors, including an increase in average commercial real estate loan balances. The Company recorded a $120,000 credit for loan losses on one- to four-family loans, home equity and consumer loans during the three month period ended June 30, 2013, due to a decrease in classified loans. The Company recorded a $15,000 provision for loan losses on commercial business loans primarily due to loan charge-offs.

During the three month period ended June 30, 2012, the Company recorded a $91,000 provision for loan losses as part of its review of certain environmental factors for residential real estate and home equity loans. Management concluded that an adjustment was considered necessary due to the lengthening of the foreclosure process in New York State based on changes in state law. The increased delay between when a bank begins the foreclosure process and obtains ownership of the collateral increases the Bank's risk of loss due to additional expenses for past due taxes, property deterioration due to lack of property maintenance, and legal fees. Management did not take this change in foreclosure law into account when calculating the provision during prior periods. As such, historical loss factors used in prior periods were understated. This adjustment will increase the provision to more accurately reflect the losses inherent in the residential mortgage and home equity loan portfolios. During the quarter ended June 30, 2012, a $40,000 decrease in the provision was recorded for commercial real estate loans, due to an upgrade in the classification of certain loans as well as the payoff of one loan. This was offset by a $35,000 increase in the provision for commercial loans primarily related to the Company's equipment loan portfolio due to the standard risks present by the inherent nature of these types of loans.

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

Non-interest Income. Non-interest income increased $58,000, or 12.7%, from $457,000 for the three months ended June 30, 2012 to $515,000 for the three months ended June 30, 2013. The increase was primarily due to a non-cash, pre-tax impairment charge of $57,000 to write-down a single asset-backed security during the quarter ended June 30, 2012. The impairment charge was attributable to a significant decline in the market value of a bond that was not expected to be recovered over its term.

Non-interest Expense. Non-interest expense increased by $215,000, or 7.1%, to $3.3 million for the three month period ended June 30, 2013 compared to the three month period ended June 30, 2012. Salaries and employee benefits expense increased $39,000, or 2.5%, for the three month period ended June 30, 2013 compared to the three month period ended June 30, 2012. The increase was primarily due to staffing for our newest branch office in Snyder, NY which opened in April 2013, annual salary increases and lower deferred salary expenses due to a decrease in loan originations during the three months ended June 30, 2013 when compared to the same period in 2012. Occupancy and equipment expense increased $49,000, or 10.9%, for the three month period ended June 30, 2013 compared to the three month period ended June 30, 2012 primarily due to increases in software maintenance costs, property taxes, maintenance and repairs of buildings and equipment and the opening of the Snyder branch office. Professional services expense increased $44,000, or 12.5%, for the three month period ended June 30, 2013 compared to the three month period ended June 30, 2012, primarily due to higher accounting and consulting expenses to ensure compliance with regulatory and SEC guidance. Advertising expense increased $92,000, or 113.6%, for the three month period ended June 30, 2013 when compared to the same time period in 2012 primarily due to increased advertising for the opening of our newest branch office. FDIC insurance expense increased $10,000, or 17.9%, for the three month period ended June 30, 2013 compared to the three month period June 30, 2012, primarily due to an increase in assessed fees resulting from an increase in deposits since June 30, 2012. Data processing expenses increased $7,000, or 4.5%, during the three month period ended June 30, 2013. Furthermore, postage and supplies increased $6,000, or 10.7%, during the three month period ended June 30, 2013 compared to the same period in the prior year. Both of these increases were primarily due to the costs associated with the opening of our newest branch office. These increases were partially offset by a $32,000 decrease in other non-interest expenses from $359,000 for the three month period ended June 30, 2012 to $327,000 for the three month period ended June 30, 2013, primarily due to a decrease in foreclosure and other real estate owned expenses.

Income Tax Expense. Income tax expense decreased by $73,000, or 28.9%, from $253,000 for the three month period ended June 30, 2012 to $180,000 for the three month period ended June 30, 2013. The decrease was primarily due to a decrease in income before income taxes during the three month period ended June 30, 2013 as well as a decrease in the effective tax rate from 22.0% for the three month period ended June 30, 2012 to 18.4% for the three month period ended June 30, 2013. The decrease in the effective tax rate was primarily due to a decrease in income as well as a disproportionate increase in tax exempt income.

Comparison of Results of Operations for the Six Months Ended June 30, 2013 and 2012

General. Net income was $1.7 million for the six month period ended June 30, 2013, or $0.30 per diluted share, a decrease of $196,000, or 10.3%, compared to net income of $1.9 million or $0.33 per diluted share, for the six month period ended June 30, 2012. The decrease in net income was primarily due to a $162,000 decrease in net interest income and a $251,000 increase in non-interest expenses, partially offset by a $5,000 decrease in provision for loan losses, a $52,000 increase in non-interest income and a $160,000 decrease in income tax expense.

Interest Income. Interest income decreased by $811,000, or 8.0%, to $9.3 million for the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012. Loan interest income decreased by $215,000, or 3.0%, to $6.9 million for the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012, due to a decrease in the average yield of the loan portfolio from 5.31% for the six month period ended June 30, 2012 to 5.12% for the six month period ended June 30, 2013. The average yield on the loan portfolio decreased as new loans were originated or existing loans were refinanced at lower yields than the rates earned on loans which had paid off, as a result of the current low interest rate environment. The average balance of the loan portfolio increased $1.6 million, or 0.6%, from $269.5 million for the six month period ended June 30, 2012 to $271.1 million for the six month period ended June 30, 2013. The increase in the average balance of loans receivable was primarily due to an increase in the average balance of commercial real estate and home equity loans, partially offset by a decrease in the average balance of one- to four-family real estate loans. As previously indicated, the decrease in the average balance of one- to four- family real estate loans was a strategic decision by the Company to not match competitor rates in an effort to avoid increased interest rate risk. Investment interest income decreased by $591,000, or 20.2%, from $2.9 million for the six month period ended June 30, 2012 to $2.3 million for the six month period ended June 30, 2013 due to a decrease in the average yield from 3.47% for the six month period ended June 30, 2012 to 2.94% for the six month period ended June 30, 2013. The average yield on the investment portfolio decreased as new securities were purchased at lower yields than the rates earned on securities which had paid off, as a result of the current low interest rate environment. The average balance of the investment portfolio decreased from $168.9 million for the six months ended June 30, 2012 to $159.2 million for the six months ended June 30, 2013 primarily due to paydowns which have not yet been re-invested.

Interest Expense. Interest expense decreased by $649,000, or 26.4%, to $1.8 million for the six month period ended June 30, 2013 compared to $2.5 million for the six month period ended June 30, 2012. Interest expense on deposits decreased by $501,000, or 23.7%, to $1.6 million for the six month period ended June 30, 2013 when compared to the six month period ended June 30, 2012 primarily due to the decrease in the average rate paid and the average balance of deposits. The average balance of deposits for the six month period ended June 30, 2013 was $351.7 million with an average rate of 0.92% compared to the average balance of deposits of $353.9 million and an average rate of 1.20% for the six month period ended June 30, 2012. The decrease in the average rate paid on deposits was due to the continued low interest rate environment in 2013. The decrease in the average balance of deposits was primarily due to a decrease in the average balance of time deposits partially offset by deposit growth in core deposit accounts. The interest expense related to advances from the FHLBNY decreased $146,000, or 50.9%, to $141,000 for the six month period ended June 30, 2013 when compared to the six month period ended June 30, 2012. This decrease was due to an $8.5 million decrease in average FHLBNY advance balances and a 59 basis point decline in the average rate paid on FHLBNY advances when comparing the six month period ended June 30, 2013 with the six month period ended June 30, 2012. The decrease in the average FHLBNY advance balances was a result of the Company's decision to utilize excess cash obtained from loan prepayments to pay down borrowings. The low interest rate environment caused the average rate paid on borrowings to decrease.

Provision for Loan Losses. A provision of $45,000 was recorded to the allowance for loan losses during the six month period ended June 30, 2013, compared to a provision of $50,000 during the six month period ended June 30, 2012. Net charge-offs were $28,000 for the six month period ended June 30, 2013 compared to $92,000 for the six month period ended June 30, 2012. Our credit quality remains strong, with non-performing loans increasing slightly to $2.9 million, or 1.09% of total loans, at June 30, 2013 as compared to $2.1 million, or 0.89% of total loans, at June 30, 2012.

During the six month period ended June 30, 2013, the Company recorded a $61,000 provision for loan losses on one- to four-family loans and consumer loans that had become classified loans or had been downgraded due to certain factors, such as delinquency or bankruptcy of the borrower. The Company recorded a $52,000 provision for loan losses on commercial business loans primarily due to changes in the environmental factors that reflected an increase in average net charge-offs during the three year period ended December 31, 2012, as well as an increase in loan charge-offs during the six month period ended June 30, 2013. Upon review of the environmental factors relating to home equity loans during the six month period ended June 30, 2013, the Company determined that a $42,000 credit for loan losses was necessary due to a decrease in classified loan balances. During the six month period ended June 30, 2013, the Company recorded a $41,000 credit for loan losses for commercial real estate loans upon review of the environmental factors due to a decrease in classified loan balances.

During the six month period ended June 30, 2012, the Company recorded a $157,000 provision for loan losses on commercial real estate loans due to an increase in the loan balances and number of classified loans in this category. This provision was offset by an $83,000 reduction in the provision for loan losses on commercial business loans due to a reduction in the loan portfolio balances for this loan type. The provision for loan losses was further reduced by a net $28,000 decrease on the residential real estate loans (including one- to four-family loans and home equity loans) and consumer loans due to declining loan balances in these categories. The decrease in provision for loan losses on residential real estate loans was partially offset by the lengthening of the foreclosure process in New York State based on changes in state law, as discussed earlier in this document.

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

Non-interest Income. Non-interest income increased $52,000, or 5.3%, from $978,000 for the six months ended June 30, 2012 to $1.0 million for the six months ended June 30, 2013. The increase was primarily due to a non-cash, pre-tax impairment charge of $57,000 to write-down a single asset-backed security during the second quarter ended June 30, 2012. The impairment charge was attributable to a significant decline in the market value of a bond that was not expected to be recovered over its term.

Non-interest Expense. Non-interest expense increased by $251,000, or 4.1%, to $6.4 million for the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012. Salaries and employee benefits expense increased $64,000, or 2.1%, for the six month period ended June 30, 2013 compared to the six month period June 30, 2012. The increase was primarily due to staffing for our newest branch office in Snyder, NY, which opened in April 2013, annual salary increases and lower deferred salary expenses due to a decrease in loan originations during the six months ended June 30, 2013 when compared to the same period in 2012. Occupancy and equipment expense increased $99,000, or 11.1%, for the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012, primarily due to increases in software maintenance costs, property taxes, maintenance and repairs of buildings and equipment and the opening of the Snyder branch office. Professional services expense increased $78,000, or 11.7%, for the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012, primarily due to higher accounting and consulting expenses to ensure compliance with regulatory and SEC guidance. Advertising expense increased $11,000, or 4.4%, for the six month period ended June 30, 2013 when compared to the same time period in 2012 primarily due to increased advertising for the opening of our newest branch office. FDIC insurance expense increased $13,000, or 11.1%, for the six month period ended June 30, 2013 compared to the six month period ended June 30, 2012, resulting from an increase in assessed fees because of an increase in deposits since June 30, 2012. Data processing expenses increased $12,000, or 3.9%, during the six month period ended June 30, 2013. Furthermore, postage and supplies increased $15,000, or 12.3%, during the six month period ended June 30, 2013 compared to the same period in the prior year. Both of these increases were primarily due to the costs associated with the opening of our newest branch office. These increases were partially offset by a $41,000 decrease in other non-interest expenses from $680,000 for the six month period ended June 30, 2012 to $639,000 for the six month period ended June 30, 2013, primarily due to a decrease in foreclosure and other real estate owned expenses.

Income Tax Expense. Income tax expense decreased by $160,000, or 29.1%, from $550,000 for the six month period ended June 30, 2012 to $390,000 for the six month period ended June 30, 2013. The decrease was primarily due to a decrease in income before income taxes during the six months ended June 30, 2013 as well as a decrease in the effective tax rate from 22.4% for the six month period ended June 30, 2012 to 18.6% for the six month period ended June 30, 2013. The decrease in the effective tax rate was primarily due to a decrease in income as well as a disproportionate increase in tax exempt income.

Loans Past Due and Non-performing Assets. We define non-performing loans as loans that are either non-accruing, accruing whose payments are 90 days or more past due or are classified as troubled debt restructurings. Non-performing assets, including non-performing loans and foreclosed real estate, totaled $3.6 million, or 0.74% of total assets, at June 30, 2013 and $3.0 million, or 0.62% of total assets, at December 31, 2012.

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

	At June 30, 2013	At December 31, 2012
	(Dollars in thousands)	
Loans past due 90 days or more but still accruing:		
Real estate loans:		
Residential, one- to four-family	$ 377	$ 10
Home equity	19	-
Commercial	-	-
Construction	-	-
Other loans:		
Commercial loans	38	-
Consumer loans	28	18
Total	$ 462	$ 28
Loans accounted for on a nonaccrual basis:		
Real estate loans:		
Residential, one- to four-family (1)	$ 1,921	$ 1,628
Home equity (2)	203	299
Commercial	151	255
Construction	-	-
Other loans:		
Commercial loans	208	201
Consumer loans	4	9
Total non-accrual loans	2,487	2,392
Total nonperforming loans	2,949	2,420
Foreclosed real estate	539	580
Performing restructured loans	151	-

Total nonperforming assets	$ 3,639	$ 3,000
Ratios:		
Nonperforming loans as a percent of net loans:	1.09 %	0.89
Nonperforming assets as a percent of total assets:	0.74 %	0.62

(1) As of June 30, 2013, one residential, one- to four-family loan for $62,000 and accounted for on a non-accrual basis was restructured and classified as a troubled debt restructuring, due to the borrower's financial difficulties.

(2) As of December 31, 2012, one home equity loan for $31,000 and accounted for on a non-accrual basis was restructured and classified as a troubled debt restructuring, due to the borrower's financial difficulties.

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,	
	2013	2012
	(Dollars in thousands)	
Balance at beginning of period:	$ 1,806	$ 1,366
Provision for loan losses	45	50
Charge-offs:		
Real estate loans:		
Residential, one- to four-family	-	(100)
Construction	-	-
Commercial real estate	-	-
Home equity	-	-
Other loans:		
Commercial	(30)	(1)
Consumer	(17)	(1)
Total charge-offs	(47)	(102)
Recoveries:		
Real estate loans:		
Residential, one- to four-family	8	1
Construction	-	-
Commercial real estate	5	8
Home equity	4	-
Other loans:		
Commercial	2	-
Consumer	-	1
Total recoveries	19	10
Net charge-offs	(28)	(92)
Balance at end of period	$ 1,823	$ 1,324
Average loans outstanding	$ 271,063	$ 269,475
Allowance for loan losses as a percent of total net loans	0.68%	0.50%
Allowance for loan losses as a percent of non-performing loans	61.82%	64.30%
Ratio of net charge-offs to average loans outstanding(1)	0.02%	0.07%

(1) Annualized

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Liquidity and Capital Resources

Liquidity describes our ability to meet the financial obligations that arise during the ordinary course of business. Liquidity is primarily needed to meet the lending and deposit withdrawal requirements of our customers and to fund current and planned expenditures. Our primary sources of funds consist of deposits, scheduled amortization and prepayments of loans and mortgage-backed and asset-backed securities, maturities and sales of other investments, interest earning deposits at other financial institutions and funds provided from operations. We have a written agreement with the Federal Home Loan Bank of New York, which allows us to borrow up to $120.2 million as of June 30, 2013, and is collateralized by a pledge of our mortgage loans. At June 30, 2013, we had outstanding advances under this agreement of $22.7 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 $10.0 million and a fair value of $10.6 million as of June 30, 2013. There were no balances outstanding with the Federal Reserve Bank discount window at June 30, 2013. We have also established a line of credit with M&T Bank for $7.0 million, of which $5.0 million is unsecured and the remaining $2.0 million is required to be secured by a pledge of our securities when a draw is made. There were no borrowings on this line as of June 30, 2013.

Historically, loan repayments and maturing investment securities were a relatively predictable source of funds. However, in light of the current economic environment, there are now more risks related to loan repayments and the valuation and maturity of investment securities. In addition, 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 and the current economic environment reduce the predictability of the timing of these sources of funds.

Our primary investing activities include the origination of loans and the purchase of investment securities. For the six months ended June 30, 2013, we originated loans of approximately $23.2 million in comparison to approximately $19.8 million of loans originated during the six months ended June 30, 2012. Purchases of investment securities totaled $17.1 million in the six months ended June 30, 2013 and $22.5 million in the six months ended June 30, 2012.

At June 30, 2013, we had loan commitments to borrowers of approximately $10.0 million and overdraft lines of protection and unused home equity lines of credit of approximately $25.4 million. Total deposits were $393.1 million at June 30, 2013, as compared to $384.8 million at June 30, 2012. Time deposit accounts scheduled to mature within one year were $74.9 million at June 30, 2013. 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.

In recent years, macro-economic conditions negatively impacted liquidity and credit quality across the financial markets as the U.S. economy experienced an economic downturn. Although recent reports have indicated improvements in the macro-economic conditions, the economic downturn has had far-reaching effects. However, our financial condition, credit quality and liquidity position remain strong.

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

We do not anticipate any material capital expenditures during the remainder of 2013. 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.

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 commitments outstanding as of June 30, 2013.

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, 2013 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, 2013:

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, 2013	-	$ -	-	71,510
May 1 through May 31, 2013	-	-	-	71,510
June 1 through June 30, 2013	-	-	-	71,510
Total	-	$ -	-	71,510

[1] On November 17, 2010, our Board of Directors approved a new stock repurchase plan pursuant to which we can repurchase up to 116,510 shares of our outstanding common stock. This amount represented 5% of our outstanding stock not owned by the MHC as of November 23, 2010. The repurchase plan does not have an expiration date and superseded all of the prior stock repurchase programs.

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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[1]
101.SCH	

	XBRL Taxonomy Extension Schema Document[1]
101.CAL	XBRL Taxonomy Calculation Linkbase Document[1]
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document[1]
101.LAB	XBRL Taxonomy Label Linkbase Document[1]
101.PRE	XBRL Taxonomy Presentation Linkbase Document[1]

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* Filed herewith.

1 As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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 13, 2013	By:	/s/ Daniel P. Reininga Daniel P. Reininga President and Chief Executive Officer (Principal Executive Officer)
August 13, 2013	By:	/s/ Rachel A. Foley Rachel A. Foley Chief Financial Officer (Principal Financial and Accounting Officer)