LAKE SHORE BANCORP, INC.
Form 10-Q
November 12, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

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

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 5,938,951 shares of the registrant's common stock, $0.01 par value per share, outstanding at November 1, 2014.

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PART I

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	September 30, 2014	December 31, 2013
	(Unaudited)	
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 8,162	$ 7,748
Interest earning deposits	27,381	2,321
Federal funds sold	6,349	7,133
Cash and Cash Equivalents	41,892	17,202
Securities available for sale	140,951	157,964
Federal Home Loan Bank stock, at cost	1,375	1,560
Loans receivable, net of allowance for loan losses 2014 $1,803; 2013 $1,813	275,156	277,345
Premises and equipment, net	9,529	9,642
Accrued interest receivable	1,864	1,787
Bank owned life insurance	14,597	14,407
Other assets	1,223	2,260
Total Assets	$ 486,587	$ 482,167
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 349,800	$ 353,915
Non-interest bearing	39,705	34,320
Total Deposits	389,505	388,235
Short-term borrowings	-	11,650
Long-term debt	18,950	7,850
Advances from borrowers for taxes and insurance	2,039	3,454
Other liabilities	6,366	5,707
Total Liabilities	$ 416,860	$ 416,896

Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,622,849 shares issued and 5,938,951 shares outstanding at September 30, 2014 and 6,619,203 shares issued and 5,915,835 shares outstanding at December 31, 2013	$ 66	$ 66
Additional paid-in capital	28,104	28,039
Treasury stock, at cost (683,898 shares at September 30, 2014 and 703,368 shares at December 31, 2013)	(6,420)	(6,588)
Unearned shares held by ESOP	(1,812)	(1,876)
Unearned shares held by compensation plans	(669)	(499)
Retained earnings	47,544	45,624
Accumulated other comprehensive income	2,914	505
Total Stockholders' Equity	69,727	65,271
Total Liabilities and Stockholders' Equity	$ 486,587	$ 482,167

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(Unaudited)			
	(Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$ 3,307	$ 3,426	$ 9,977	$ 10,361
Investment securities, taxable	552	696	1,884	2,071
Investment securities, tax-exempt	530	499	1,589	1,463
Other	6	5	10	13
Total Interest Income	4,395	4,626	13,460	13,908
Interest Expense				
Deposits	724	797	2,229	2,413
Short-term borrowings	-	12	20	38
Long-term debt	102	50	182	165
Other	25	27	76	79
Total Interest Expense	851	886	2,507	2,695
Net Interest Income	3,544	3,740	10,953	11,213
Provision for Loan Losses	70	60	70	105
Net Interest Income after Provision for Loan Losses	3,474	3,680	10,883	11,108
Non-Interest Income				
Service charges and fees	396	421	1,202	1,234
Earnings on bank owned life insurance	65	66	190	215
Recovery on previously impaired investment securities	35	-	136	-
Gain on sale of securities available for sale	-	206	59	206
Gain on sale of loans	5	-	5	-
Total other-than-temporary impairment (“OTTI”) losses	-	(613)	-	(613)
Portion of OTTI losses recognized in other comprehensive income (before taxes)	-	433	-	433
Net OTTI losses recognized in earnings	-	(180)	-	(180)
Other	30	28	89	96
Total Non-Interest Income	531	541	1,681	1,571
Non-Interest Expenses				
Salaries and employee benefits	1,682	1,524	4,936	4,664
Occupancy and equipment	531	520	1,648	1,509
Professional services	298	333	956	1,079
Data processing	202	163	579	480
Advertising	85	93	353	357
FDIC Insurance	70	64	211	194
Postage and supplies	61	55	194	192
Other	279	261	838	900
Total Non-Interest Expenses	3,208	3,013	9,715	9,375

Income before Income Taxes	797	1,208	2,849	3,304
Income Tax Expense	109	222	487	612
Net Income	$ 688	$ 986	$ 2,362	$ 2,692
Basic and Diluted earnings per common share	$ 0.12	$ 0.17	$ 0.41	$ 0.47
Dividends declared per share	$ 0.07	$ 0.07	$ 0.21	$ 0.21

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income/(Loss)

	Three Months Ended September 30,	
	2014	2013
	(Unaudited) (Dollars in thousands)	
Net Income	$ 688	$ 986
Other Comprehensive Income (Loss), net of tax (expense) benefit		
Unrealized holding gains (losses) on securities available for sale, net of tax (expense) benefit 2014 $(40); 2013 $141	62	(223)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities, net of tax expense(1) 2014 $14	(21)	-
Net gain on sale of securities included in net income, net of tax expense(2) 2013 $80	-	(126)
Impairment charge for losses included in net income, net of tax benefit(3) 2013 $70	-	110
Total Other Comprehensive Income (Loss)	41	(239)
Total Comprehensive Income	$ 729	$ 747

(1) Gross amount included in recovery on previously impaired investment securities on consolidated statements of income 2014 $35
(2) Gross amount included in gain on sale of securities available for sale on consolidated statements of income 2013 $206
(3) Included in net OTTI losses recognized in earnings on consolidated statements of income 2013 $(180)

	Nine Months Ended September 30,	
	2014	2013
	(Unaudited) (Dollars in thousands)	
Net Income	$ 2,362	$ 2,692
Other Comprehensive Income (Loss), net of tax (expense) benefit		
	2,528	(3,900)

Unrealized holding gains (losses) on securities available for sale, net of tax (expense) benefit 2014 $(1,597); 2013 $2,461		
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense(1) 2014 $53	(83)	-
Net gain on sale of securities included in net income, net of tax expense(2) 2014 $23; 2013 $80	(36)	(126)
Impairment charge for losses included in net income, net of tax benefit(3) 2013 $70	-	110
Total Other Comprehensive Income (Loss)	2,409	(3,916)
Total Comprehensive Income (Loss)	$ 4,771	$ (1,224)

(1) Gross amount included in recovery on previously impaired investment securities on consolidated statements of income 2014 $136
(2) Gross amount included in gain on sale of securities available for sale on consolidated statements of income 2014 $59; 2013 $206
(3) Included in net OTTI losses recognized in earnings on consolidated statements of income 2013 $(180)

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Stockholders’ Equity

Nine Months Ended September 30, 2014 and 2013 (Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by Compensation Plans	Retained Earnings	Accumulated Other Comprehensive Income	Total
	(In thousands, except share and per share data)							
Balance - January 1, 2013	$ 66	$ 27,973	$ (6,469)	$ (1,961)	$ (553)	$ 42,468	$ 5,461	$ 66,985
Net income	-	-	-	-	-	2,692	-	2,692
Other comprehensive loss, net of tax benefit of $2,471	-	-	-	-	-	-	(3,916)	(3,916)
Stock options exercised (506 shares)	-	4	-		-	-	-	4
ESOP shares earned (5,951 shares)	-	3	-	64	-	-	-	67
Stock based compensation	-	7	-	-	-	-	-	7
Compensation plan shares earned (3,017 shares)	-	(11)	-	-	41	-	-	30
Purchase of treasury stock, at cost (5,000 shares)	-	-	(58)	-	-	-	-	(58)
Cash dividends declared ($0.21 per share)	-	-	-	-	-	(441)	-	(441)
Balance - September 30, 2013	$ 66	$ 27,976	$ (6,527)	$ (1,897)	$ (512)	$ 44,719	$ 1,545	$ 65,370
Balance - January 1, 2014	$ 66	$ 28,039	$ (6,588)	$ (1,876)	$ (499)	$ 45,624	$ 505	$ 65,271
Net income	-	-	-	-	-	2,362	-	2,362
Other comprehensive income, net of tax expense of $1,521	-	-	-	-	-	-	2,409	2,409
Stock options exercised (3,646 shares)	-	54	-	-	-	-	-	54
ESOP shares earned (5,951 shares)	-	9	-	64	-	-	-	73
	-	(3)	-	-	-	-	-	(3)

Stock based compensation								
Compensation plan shares granted (24,570 shares)	-	-	230	-	(230)	-	-	-
Compensation plan shares earned (5,322 shares)	-	5	-	-	60	-	-	65
Purchase of treasury stock, at cost (5,100 shares)	-	-	(62)	-	-	-	-	(62)
Cash dividends declared ($0.21 per share)	-	-	-	-	-	(442)	-	(442)
Balance - September 30, 2014	$ 66	$ 28,104	$ (6,420)	$ (1,812)	$ (669)	$ 47,544	$ 2,914	$ 69,727

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Nine Months Ended September 30, 2014	2013
	(Unaudited)	
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,362	$ 2,692
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	223	405
Amortization of deferred loan costs	341	386
Provision for loan losses	70	105
Impairment of investment securities	-	180
Recovery on previously impaired investment securities	(136)	-
Net gain on sale of investment securities	(59)	(206)
Originations of loans held for sale	(386)	(891)
Proceeds from sales of loans held for sale	391	891
Gain on sale of loans	(5)	-
Depreciation and amortization	559	516
Increase in bank owned life insurance, net	(190)	(215)
ESOP shares committed to be released	73	67
Stock based compensation expense	62	37
Increase in accrued interest receivable	(77)	(150)
Decrease in other assets	268	319
Increase in other liabilities	52	245
Net Cash Provided by Operating Activities	3,548	4,381
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	10,337	3,863
Maturities, prepayments and calls	10,577	22,060
Purchases	-	(34,651)
Purchases of Federal Home Loan Bank Stock	(351)	-
Redemptions of Federal Home Loan Bank Stock	536	231
Loan origination and principal collections, net	1,634	(1,625)
Additions to premises and equipment	(446)	(636)
Net Cash Provided by (Used in) Investing Activities	22,287	(10,758)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	1,270	12,609
Net decrease in advances from borrowers for taxes and insurance	(1,415)	(1,281)
Net (decrease) increase in short term borrowings	(11,650)	500
Proceeds from issuance of long-term debt	15,200	1,750
Repayment of long-term debt	(4,100)	(7,000)
Proceeds from stock options exercised	54	4
Purchase of treasury stock	(62)	(58)
Cash dividends paid	(442)	(441)
Net Cash (Used in) Provided by Financing Activities	(1,145)	6,083
Net Increase (Decrease) in Cash and Cash Equivalents	24,690	(294)
CASH AND CASH EQUIVALENTS - BEGINNING	17,202	19,765

CASH AND CASH EQUIVALENTS - ENDING	$ 41,892	$ 19,471
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	$ 2,492	$ 2,715
Income taxes paid	$ 648	$ 868
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	$ 171	$ 299
Securities sold and not settled	$ -	$ 520

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 September 30, 2014 and for the three and nine months ended September 30, 2014 and 2013 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, 2013 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, 2013. The consolidated results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2014.

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

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition as of September 30, 2014 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 May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09") which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue model to contracts within its scope, an entity will identify the contract(s) with a customer (step 1), identify the performance obligations in the contract (step 2), determine the transaction price (step 3), allocate the transaction price to the performance obligations in the contract (step 4), and recognize revenue when (or as) the entity satisfies a performance obligation (step 5). ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB ASC. ASU 2014-09 requires entities to disclose both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for annual reporting periods, including interim reporting periods within those periods, beginning after December 15, 2016. Early application is not permitted. The Company has not yet determined the impact the adoption of ASU 2014-09 will have on its financial condition and results of operations.

In June 2014 the FASB issued ASU 2014-12, "Compensation – Stock Compensation ("Topic 718"): "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period" ("ASU 2014-12"). ASU 2014-12 applies to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The update requires that a performance target be treated as a performance condition. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 is effective for the reporting periods beginning after December 15, 2015. Management does not expect the adoption of this update to have a material impact on the Company's consolidated financial statements or results of operations.

In August 2014, the FASB issued ASU 2014-14, "Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure" ("ASU 2014-14"). ASU 2014-14 applies to all creditors that hold government-guaranteed mortgage loans. The update requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if three conditions are met. The first condition would be that the loan has a government guarantee that is not separable from the loan before foreclosure. The second condition is that at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim. The third and final condition is that at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. ASU 2014-14 is effective for the reporting periods beginning after December 15, 2014. Management does not expect the adoption of this update to have a material impact on the Company's consolidated financial statements or results of operations.

Note 3 – Investment Securities

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

	September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,827	$ 1,301	$ -	$ 14,128
Municipal bonds	57,168	3,360	(54)	60,474
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	65	-	-	65
Collateralized mortgage obligations-government sponsored entities	53,593	282	(1,049)	52,826
Government National Mortgage Association	551	40	-	591
Federal National Mortgage Association	7,475	328	(12)	7,791
Federal Home Loan Mortgage Corporation	2,746	101	-	2,847
Asset-backed securities-private label	1,635	530	(122)	2,043
Asset-backed securities-government sponsored entities	116	11	-	127
Equity securities	22	37	-	59
	$ 136,198	$ 5,990	$ (1,237)	$ 140,951

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,857	$ 991	$ -	$ 13,848
Municipal bonds	57,199	1,385	(540)	58,044
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	77	4	-	81
Collateralized mortgage obligations-government sponsored entities	63,840	362	(1,577)	62,625
Government National Mortgage Association	2,153	66	-	2,219
Federal National Mortgage Association	11,452	318	(136)	11,634
Federal Home Loan Mortgage Corporation	5,774	117	(75)	5,816
Asset-backed securities-private label	3,637	618	(757)	3,498
Asset-backed securities-government sponsored entities	130	4	-	134
Equity securities	22	43	-	65
	$ 157,141	$ 3,908	$ (3,085)	$ 157,964

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

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At September 30, 2014 and at December 31, 2013, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock.

At September 30, 2014 and December 31, 2013, thirty-one municipal bonds with a cost of $10.7 million and fair value of $11.4 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 September 30, 2014, six municipal bonds with a cost and fair value of $1.5 million and $1.6 million, respectively, were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") insurance limits. At December 31, 2013, five municipal bonds with a cost and fair value of $1.1 million were pledged as collateral for customer deposits in excess of the FDIC insurance limits.

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

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars In thousands)					
September 30, 2014						
Municipal bonds	$ -	$ -	$ 1,721	$ (54)	$ 1,721	$ (54)
Mortgage-backed securities	10,598	(122)	25,732	(939)	36,330	(1,061)
Asset-backed securities -private label	-	-	1,513	(122)	1,513	(122)
	$ 10,598	$ (122)	$ 28,966	$ (1,115)	$ 39,564	$ (1,237)

	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, 2013						
Municipal bonds	$ 14,052	$ (540)	$ -	$ -	$ 14,052	$ (540)
Mortgage backed securities	41,094	(1,267)	12,768	(521)	53,862	(1,788)
Asset-backed securities -private label	-	-	2,794	(757)	2,794	(757)
	$ 55,146	$ (1,807)	$ 15,562	$ (1,278)	$ 70,708	$ (3,085)

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 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 September 30, 2014, the Company's investment portfolio included ten mortgage-backed securities in the "unrealized losses less than twelve months" category. The 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 enterprises. 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 September 30, 2014, the Company had five municipal bonds, twenty one mortgage-backed securities and two private label asset-backed securities in the "unrealized losses twelve months or more" category.

The five municipal bonds and twenty one mortgage-backed securities were not evaluated further for OTTI, as the unrealized losses were less than 20% of book value. The temporary impairments were due to declines in fair value resulting from changes in interest rates and/or increased credit liquidity spreads since the securities were purchased. 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 two private label asset-backed securities in this category were evaluated further for OTTI, as the probability of default is high and 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 September 30, 2014 (dollars in thousands):

Security	Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Over 90 days	Foreclosure/ OREO/ Bankruptcy %	OREO%
1	$ 949	$ 859	$ (90)	CCC	24.10%	22.50%	12.30%	1.20%
2	686	654	(32)	CCC	17.40%	15.90%	6.00%	1.50%
Total	$ 1,635	$ 1,513	$ (122)					

The two 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 two private label asset-backed securities occurred due to the ongoing challenges in the economic environment and increased levels of delinquency trends in the underlying loan pools. 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 during the nine months ended September 30, 2014. The estimated discounted cash flows for these securities did not show an additional principal loss under various prepayment and default rate 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 September 30, 2014. 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 September 30, 2014 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 (loss), 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 Nine Months Ended September 30, 2014	For The Nine Months Ended September 30, 2013
	(Dollars in thousands)	
Beginning balance	$ 1,318	$ 1,155
Additions:		
Credit loss not previously recognized	-	180
Reductions:		
Realized loss on sale of security on OTTI previously recognized	(282)	-
Losses realized during the period on OTTI previously recognized	(3)	(13)
Receipt of cash flows on previously recorded OTTI	(136)	-
Ending balance	$ 897	$ 1,322

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)	
September 30, 2014:		
After one year through five years	$ 597	$ 649
After five years through ten years	30,825	33,119
After ten years	38,573	40,834
Mortgage-backed securities	64,430	64,120
Asset-backed securities	1,751	2,170
Equity securities	22	59
	$ 136,198	$ 140,951

The Company sold one private-label asset-backed security and six mortgage-backed securities during the nine months ended September 30, 2014, for total proceeds of $10.3 million, resulting in gross realized gains of $274,000 and gross realized losses of $215,000. During the nine months ended September 30, 2013, the Company sold available for sale securities for total proceeds of $3.0 million, resulting in gross realized gains of $206,000. During the nine months ended September 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. The Company does not originate interest only home equity loans.
- Commercial Real Estate – are loans used to finance the purchase of real property, which generally consists of developed real estate that is held as first lien collateral for the loan. These loans are secured by real estate properties that are primarily held in the Western New York region. Commercial real estate lending involves additional risks compared with one- to four-family residential lending, because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, and/or the collateral value of the commercial real estate securing the loan, and repayment of such loans may be subject to adverse conditions in the real estate market or economic conditions to a greater extent than one- to four-family residential mortgage loans. Also, commercial real estate loans typically involve 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 fixed interest rates, 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 business 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 loans and the amount of loss allowances are subject to review by regulatory agencies, which can require the establishment of additional loss allowances.

The Company also reviews all loans on which the collectability of principal may not be reasonably assured, by reviewing payment status, financial conditions and estimated value of loan collateral. These loans are assigned an internal loan grade, and the Company assigns 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 nine months ended September 30, 2014 and 2013 and the distribution of the allowance for loan losses and loan receivable by loan portfolio class and impairment method as of September 30, 2014.

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2013								
Allowance for Loan Losses:								
Balance – July 1, 2013	$ 454	$ 41	$ 1,082	$ -	$ 226	$ 5	$ 15	$ 1,823
Charge-offs	(52)	-	(21)	-	(17)	(2)	-	(92)
Recoveries	27	-	-	-	1	-	-	28
Provision (Credit)	(81)	38	119	2	(12)	8	(14)	60
Balance – September 30, 2013	$ 348	$ 79	$ 1,180	$ 2	$ 198	$ 11	$ 1	$ 1,819
Balance – January 1, 2013	$ 393	$ 79	$ 1,118	$ -	$ 202	$ 14	$ -	$ 1,806
Charge-offs	(52)	-	(21)	-	(47)	(19)	-	(139)
Recoveries	35	4	5	-	3	-	-	47
Provision (Credit)	(28)	(4)	78	2	40	16	1	105
Balance – September 30, 2013	$ 348	$ 79	$ 1,180	$ 2	$ 198	$ 11	$ 1	$ 1,819

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2014								
Allowance for Loan Losses:								
Balance – July 1, 2014	$ 345	$ 97	$ 1,049	$ -	$ 196	$ 22	$ 64	$ 1,773
Charge-offs	-	(12)	-	-	(21)	(11)	-	(44)
Recoveries	1	1	-	-	-	2	-	4
Provision (Credit)	82	15	(5)	-	25	11	(58)	70
Balance – September 30, 2014	$ 428	$ 101	$ 1,044	$ -	$ 200	$ 24	$ 6	$ 1,803
Balance – January 1, 2014	$ 355	$ 80	$ 1,104	$ -	$ 218	$ 9	$ 47	$ 1,813
Charge-offs	(17)	(25)	-	-	(25)	(29)	-	(96)
Recoveries	3	1	-	-	-	12	-	16
Provision (Credit)	87	45	(60)	-	7	32	(41)	70
Balance – September 30, 2014	$ 428	$ 101	$ 1,044	$ -	$ 200	$ 24	$ 6	$ 1,803
Ending balance: individually evaluated for impairment	$ -	-	125	-	6	-	-	$ 131
Ending balance: collectively evaluated for impairment	$ 428	$ 101	$ 919	$ -	$ 194	$ 24	$ 6	$ 1,672
Gross Loans Receivable (1):								
Ending balance	$ 167,301	$ 32,100	$ 58,585	$ 2,657	$ 11,809	$ 1,584	$ -	$ 274,036
Ending balance: individually evaluated for impairment	$ 213	$ 10	$ 3,023	$ -	$ 11	$ -	$ -	$ 3,257
Ending balance: collectively evaluated for impairment	$ 167,088	$ 32,090	$ 55,562	$ 2,657	$ 11,798	$ 1,584	$ -	$ 270,779

(1) Gross Loans Receivable does not include allowance for loan losses of $(1,803) or deferred loan costs of $2,923.

The following table summarizes the distribution of the allowance for loan losses and loans receivable by loan portfolio class as of December 31, 2013:

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
December 31, 2013								
Allowance for Loan Losses:								
Balance – December 31, 2013	$ 355	$ 80	$ 1,104	$ -	$ 218	$ 9	$ 47	$ 1,813
Ending balance: individually evaluated for impairment	$ -	-	125	-	-	-	-	$ 125
Ending balance: collectively evaluated for impairment	$ 355	$ 80	$ 979	$ -	$ 218	$ 9	$ 47	$ 1,688