Lake Shore Bancorp, Inc.
Form 10-Q
August 16, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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

Commission file number: 000-51821

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

United States (State or other jurisdiction of incorporation or organization)	20-4729288 (I.R.S. Employer Identification Number)
125 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 ¨ 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 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:

Common stock ($0.01 par value) 6,063,851 shares outstanding as of July 30, 2010.

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PART I

Item 1. Financial Statements

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	June 30, 2010	December 31, 2009
	(Unaudited)	
	(Dollars in thousands)	
Assets		
Cash and due from banks	$7,490	$7,057
Interest bearing deposits	12,268	7,754
Federal funds sold	13,549	7,253
Cash and Cash Equivalents	33,307	22,064
Securities available for sale	142,464	118,381
Federal Home Loan Bank stock, at cost	2,686	2,535
Loans receivable, net of allowance for loan losses 2010 $1,776; 2009 $1,564	258,153	259,174
Premises and equipment, net	8,548	7,950
Accrued interest receivable	1,703	1,721
Bank owned life insurance	10,971	10,842
Other assets	2,609	2,989
Total Assets	$460,441	$425,656
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$324,234	$297,242
Non-interest bearing	23,311	21,172
Total Deposits	347,545	318,414
Short-term borrowings	2,750	6,850
Long-term debt	42,750	36,150
Advances from borrowers for taxes and insurance	2,882	3,070
Other liabilities	6,886	5,726
Total Liabilities	402,813	370,210
Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized;	66	66

6,612,500 shares issued and 6,074,722 shares outstanding at June 30, 2010 and 6,612,500 shares issued and 6,157,162 shares outstanding at December 31, 2009		
Additional paid-in capital	27,877	27,838
Treasury stock, at cost (537,778 shares at June 30, 2010 and 455,338 shares at December 31, 2009)	(5,125)	(4,467)
Unearned shares held by ESOP	(2,174)	(2,217)
Unearned shares held by RRP	(874)	(987)
Retained earnings	35,288	34,224
Accumulated other comprehensive income	2,570	989
Total Stockholders' Equity	57,628	55,446
Total Liabilities and Stockholders' Equity	$460,441	$425,656

See notes to consolidated financial statements.

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(Unaudited) (Dollars in Thousands, except per share data)			
Interest Income				
Loans, including fees	$3,513	$3,499	$7,055	$6,965
Investment securities, taxable	1,176	1,198	2,291	2,399
Investment securities, tax-exempt	302	185	578	356
Other	13	26	22	56
Total Interest Income	5,004	4,908	9,946	9,776
Interest Expense				
Deposits	1,180	1,586	2,339	3,165
Short-term borrowings	4	11	11	35
Long-term debt	377	446	729	895
Other	28	28	57	57
Total Interest Expense	1,589	2,071	3,136	4,152
Net Interest Income	3,415	2,837	6,810	5,624
Provision for Loan Losses	200	40	250	160
Net Interest Income after Provision for Loan Losses	3,215	2,797	6,560	5,464
Non-Interest Income				
Service charges and fees	492	483	946	935
Earnings on bank owned life insurance	68	67	129	134
Gain on sale of loans	-	27	-	27
Other	21	23	52	49
Total Non-Interest Income	581	600	1,127	1,145
Non-Interest Expenses				
Salaries and employee benefits	1,516	1,342	3,090	2,727
Occupancy and equipment	422	342	810	715
Professional services	280	307	531	588
Data processing	135	120	275	253
Advertising	112	124	267	178
FDIC Insurance	130	440	243	488
Postage and supplies	70	67	148	141
Other	277	224	499	553
Total Non-Interest Expenses	2,942	2,966	5,863	5,643
Income before Income Taxes	854	431	1,824	966

Income Taxes	205	77	454	207
Net Income	$649	$354	$1,370	$759
Basic and diluted earnings per common share	$0.11	$0.06	$0.24	$0.13
Dividends declared per share	$0.06	$0.05	$0.12	$0.10

See notes to consolidated financial statements.

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2010 and 2009 (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	Total
	(Dollars in thousands, except per share data)							
Balance – January 1, 2009	$66	$ 27,754	$(3,748)	$(2,302)	$(1,190)	$32,520	$ 1,128	$54,228
Cumulative effect of adoption of revised ASC Topic 320 (net of $4 tax effect)	-	-	-	-	-	8	(8)	-
Comprehensive income:								
Net income	-	-	-	-	-	759	-	759
Other comprehensive loss	-	-	-	-	-	-	(459)	(459)
Total Comprehensive Income								300
ESOP shares earned (3,968 shares)	-	(17)	-	43	-	-	-	26
Stock based compensation	-	74	-	-	-	-	-	74
RRP shares earned (7,504 shares)	-	(17)	-	-	100	-	-	83
Purchase of treasury stock, at cost (62,984 shares)	-	-	(438)	-	-	-	-	(438)
Cash dividends declared ($0.10 per share)	-	-	-	-	-	(223)	-	(223)
Balance – June 30, 2009	$66	$ 27,794	$(4,186)	$(2,259)	$(1,090)	$33,064	$ 661	$54,050
Balance – January 1, 2010	$66	$ 27,838	$(4,467)	$(2,217)	$(987)	$34,224	$ 989	$55,446
Comprehensive income:								
Net income	-	-	-	-	-	1,370	-	1,370
Other comprehensive income	-	-	-	-	-	-	1,581	1,581
Total Comprehensive Income								2,951

ESOP shares earned (3,968 shares)	-	(11)	-	43	-	-	-	32
Stock based compensation	-	73	-	-	-	-	-	73
RRP shares earned (8,458 shares)	-	(23)	-	-	113	-	-	90
Purchase of treasury stock, at cost (82,440 shares)	-	-	(658)	-	-	-	-	(658)
Cash dividends declared ($0.12 per share)	-	-	-	-	-	(306)	-	(306)
Balance – JUNE 30, 2010	$66	$ 27,877	$(5,125)	$(2,174)	$(874)	$35,288	$ 2,570	$57,628

See notes to consolidated financial statements.

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
	(Unaudited) (Dollars in thousands)	
Cash Flows from Operating Activities		
Net income	$ 1,370	$ 759
Adjustments to reconcile net income to net cash provided by operating activities:		
Net accretion of investment securities	(41)	(139)
Amortization of deferred loan costs	220	223
Provision for loan losses	250	160
Loss on sale of interest rate floor derivative product	-	135
Originations of loans held for sale	(181)	(6,201)
Proceeds from sale of loans	181	6,228
Gain on sale of loans	-	(27)
Depreciation and amortization	288	271
Earnings on bank owned life insurance	(129)	(134)
ESOP shares committed to be released	32	26
Stock based compensation expense	163	157
Decrease in accrued interest receivable	18	99
Increase in other assets	(17)	(158)
Increase (decrease) in other liabilities	(97)	546
Net Cash Provided by Operating Activities	2,057	1,945
Cash Flows from Investing Activities		
Activity in available for sale securities:		
Maturities, prepayments and calls	13,277	18,162
Purchases	(34,052)	(24,672)
Purchases of Federal Home Loan Bank Stock	(354)	(49)
Redemptions of Federal Home Loan Bank Stock	203	202
Proceeds from sale of interest rate floor derivative product	-	890
Loan origination and principal collections, net	519	(12,122)
Additions to premises and equipment	(886)	(88)
Net Cash Used in Investing Activities	(21,293)	(17,677)
Cash Flows from Financing Activities		
Net increase in deposits	29,131	15,029
Net decrease in advances from borrowers for taxes and insurance	(188)	(112)
Net decrease in short-term borrowings	(4,100)	(2,050)
Proceeds from issuance of long-term debt	9,300	1,000
Repayment of long-term debt	(2,700)	(3,440)
Purchase of Treasury Stock	(658)	(438)
Cash dividends paid	(306)	(223)

Net Cash Provided by Financing Activities	30,479	9,766
Net Increase (Decrease) in Cash and Cash Equivalents	11,243	(5,966)
Cash and Cash Equivalents – Beginning	22,064	29,038
Cash and Cash Equivalents – Ending	$33,307	$23,072
Supplementary Cash Flows Information		
Interest paid	$3,125	$4,178
Income taxes paid	$959	$431
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	$32	$233
Securities purchased and not settled	$690	$-

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") 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, 2010 and for the three and six months ended June 30, 2010 and 2009 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 balance sheet at December 31, 2009 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. 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 Form 10-K for the year ended December 31, 2009. The consolidated results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2010.

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 balance sheet as of June 30, 2010 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 January 2010, the FASB issued Accounting Standards Update 2010-06 "Fair Value Measurements and Disclosures" ("ASU 2010-06"). ASU 2010-06 requires a greater level of disaggregated information and more robust disclosure about valuation techniques and inputs to fair value measurements. Expanded disclosures will be required for information about changes in the reporting entity's Level 3 fair value measurements due to purchases, sales, issuance, and settlements. ASU 2010-06 will also require additional disclosure on significant transfers between the Level 1, Level 2 and Level 3 fair value measurements. This statement is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in the Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning

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NOTE 2 – NEW ACCOUNTING STANDARDS (continued)

after December 15, 2010, and for interim periods within those fiscal years. Portions of this update are already adopted. The adopted portions of this update did not have a material impact on the Company's consolidated financial condition or results of operations and management is evaluating the impact of the portions of the update that are not yet effective.

In July 2010, the FASB issued Accounting Standards Update 2010-20, "Receivables ("Subtopic 310"): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" ("ASU 2010-20"). The main objective of ASU 2010-20 is to provide financial statement users greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. Existing disclosure guidance was amended to require an entity to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. In addition, the amendments in ASU 2010-20 require an entity to disclose credit quality indicators, past due information, and modifications of its financing receivables. These improvements will help financial statement users assess an entity's credit risk exposures and its allowance for credit losses. ASU 2010-20 is effective for interim or annual period ending on or after December 15, 2010. Since ASU 2010-20 only requires enhanced disclosures, management does not expect the adoption of this statement to have a material impact on the Company's consolidated financial condition or results of operations.

NOTE 3 – OTHER COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and other-than-temporary impairment ("OTTI") related to non-credit factors, are reported as a separate component of the stockholders' equity section of the consolidated statements of financial condition, such items, along with net income, are components of other comprehensive income.

The components of other comprehensive income and related tax effects for the three and six months ended June 30, 2010 and 2009 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(In Thousands)			
Changes in net unrealized holding gains (losses) on securities available for sale	$2,397	$(976)	$2,577	$(749)
Changes in Net Unrealized Gains (Losses)	2,397	(976)	2,577	(749)
Income tax (expense) benefit	(927)	378	(996)	290
Other Comprehensive Income (Losses)	$1,470	$(598)	$1,581	$(459)

NOTE 4 – INVESTMENT SECURITIES

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

	June 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Securities Available for Sale:				
U.S. Treasury bonds	$5,125	$812	$-	$5,937
Municipal bonds	34,371	1,115	(49)	35,437
Mortgage-backed securities:				
Collateralized mortgage obligations - private label	1,552	-	(279)	1,273
Collateralized mortgage obligations - government sponsored entities	73,355	2,569	(2)	75,922
Government National Mortgage Association	5	1	-	6
Federal National Mortgage Association	8,257	637	-	8,894
Federal Home Loan Mortgage Corporation	6,980	506	(1)	7,485
Asset-backed securities -private label	8,333	328	(1,432)	7,229
Asset-backed securities - government sponsored entities	273	-	(1)	272
Equity securities	22	-	(13)	9
	$138,273	$5,968	$(1,777)	$142,464

NOTE 4 – INVESTMENT SECURITIES (continued)

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Securities Available for Sale:				
U.S. Treasury bonds	$5,129	$340	$-	$5,469
Municipal bonds	27,303	757	(93)	27,967
Mortgage-backed securities:				
Collateralized mortgage obligations - private label	1,888	1	(124)	1,765
Collateralized mortgage obligations - government sponsored entities	53,661	1,570	(74)	55,157
Government National Mortgage Association	7	-	-	7
Federal National Mortgage Association	9,564	425	-	9,989
Federal Home Loan Mortgage Corporation	9,615	413	-	10,028
Asset-backed securities -private label	9,256	-	(1,619)	7,637
Asset-backed securities - government sponsored entities	322	7	-	329
Equity securities	22	11	-	33
	$116,767	$3,524	$(1,910)	$118,381

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

At June 30, 2010 and December 31, 2009, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation common stock.

At June 30, 2010, thirty municipal bonds and one U.S. Treasury bond with a cost of $10.6 million and fair value of $11.5 million were pledged under a collateral agreement with the Federal Reserve Bank of New York for liquidity borrowing. In addition, at June 30, 2010, eight municipal bonds with a cost of $3.3 million and fair value of $3.3 million were pledged as collateral for customer deposits in excess of the FDIC insurance limits. At December 31, 2009, thirty municipal bonds and one U.S. Treasury bond with a cost of $10.6 million and fair value of $11.2 million were pledged under a collateral agreement with the Federal Reserve Bank of New York for liquidity borrowing. In addition, at December 31, 2009 seven municipal bonds with a cost of $3.0 million and fair value of $3.1 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:

NOTE 4 – INVESTMENT SECURITIES (continued)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(In Thousands)			
June 30, 2010:						
Municipal bonds	$4,580	$(49)	$-	$-	$4,580	$(49)
Mortgage-backed securities	1,589	(3)	1,148	(279)	2,737	(282)
Asset-backed securities - private label	-	-	5,732	(1,432)	5,732	(1,432)
Asset-backed securities - government sponsored entities	272	(1)	-	-	272	(1)
Equity securities	9	(13)	-	-	9	(13)
	$6,450	$(66)	$6,880	$(1,711)	$13,330	$(1,777)
December 31, 2009:						
Municipal bonds	$5,303	$(93)	$-	$-	$5,303	$(93)
Mortgage-backed securities	6,940	(74)	1,724	(124)	8,664	(198)
Asset-backed securities – private label	-	-	7,637	(1,619)	7,637	(1,619)
	$12,243	$(167)	$9,361	$(1,743)	$21,604	$(1,910)

The Company reviews investment securities on an ongoing basis for the presence of OTTI with formal reviews performed quarterly.

The Company determines whether the unrealized losses are other-than-temporary in accordance with FASB ASC Topic 320. 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, 2010 the Company's investment portfolio included thirteen municipal bonds, four mortgage-backed securities, one government sponsored entity asset-backed security, and one equity security with gross unrealized losses in the less than twelve months category. These securities were not evaluated further for OTTI as the unrealized losses on the individual securities were less than 20% of their book value, which management deemed to be immaterial, and the credit ratings remained strong. 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.

NOTE 4 – INVESTMENT SECURITIES (continued)

As of June 30, 2010, the Company had three mortgage-backed securities and six private-label asset-backed securities in the unrealized loss of twelve months or more category. One of the mortgage-backed securities and four of the six private-label asset-backed securities in this category were subject to a formal OTTI review as the unrealized losses were greater than 20% of book value for the individual security, or the related credit ratings were below investment grade, or the Company's analysis indicated a possible loss of principal. The OTTI analysis for these securities is discussed below. The remaining two mortgage-backed securities and two private-label asset-backed securities in this category were not evaluated further for OTTI as the unrealized loss was less than 20% of book value and the credit ratings remained high. The temporary impairments in these remaining securities are due to declines in fair values resulting from changes in interest rates or increased credit/liquidity spreads since the time 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 following table provides information relating to the one mortgage-backed security and four private-label asset-backed securities that had unrealized losses of 12 months or more as of June 30, 2010 (dollars in thousands):

					Delinquent %			
Security	Book Value	Fair Value	Unrealized Gain/(Loss)	Lowest Rating	Over 60 days	Over 90 days	Foreclosure/OREO / Bankruptcy%	OREO%
1	$2,000	$1,354	$ (646)	CC	37.60 %	34.00 %	6.30 %	1.40 %
2	1,683	1,309	(374)	B	30.80 %	27.70 %	4.80 %	0.80 %
3	1,000	782	(218)	CCC	15.60 %	14.50 %	9.10 %	0.50 %
4	543	416	(127)	C	47.30 %	44.20 %	18.00 %	7.20 %
5	1,015	748	(267)	Ba3	24.70 %	24.20 %	7.70 %	5.20 %
	$6,241	$4,609	$ (1,632)					

The four private-label asset-backed securities listed above (# 1 thru # 4) were evaluated for OTTI under the guidance of FASB ASC Topic 320. For one of the four securities, an OTTI impairment charge had already been recorded during 2008. The Company believes the unrealized losses on these four private-label asset-backed securities occurred due to the current challenging economic environment, high unemployment rates, a continued decline in 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 did not reflect the need to record initial or additional OTTI charges against earnings during the quarter ended June 30, 2010. In the case where an OTTI impairment charge was recorded in 2008, it was determined that the amount already taken was sufficient. For the remaining securities, management determined that an initial OTTI impairment charge was not required as of June 30, 2010, as the calculations of the estimated discounted cash flows did not show additional principal losses for these securities under various prepayment and default rate scenarios. Management also concluded that it does not intend to sell the securities and that it is not likely it will be required to sell the securities.

The one mortgage-backed security listed above (#5) was also evaluated for OTTI under the guidance of FASB ASC Topic 320. The Company believes the unrealized loss on this security is due to the current challenging economic environment, a continued decline in housing values in many areas of the country, and increased delinquency trends. It is possible that principal losses may be incurred on the tranche that we hold in this security. Management did not complete an estimate of the discounted cash flow in comparison to the amortized book value at this time, as it has only had an unrealized loss of more than 20% for six months. Management will continue to closely monitor this security and evaluate it for OTTI in the future.

NOTE 4 – INVESTMENT SECURITIES (continued)

Management does not intend to sell this security and it is not likely that we will be required to sell the security.

Management also completed an OTTI analysis for three non-agency asset backed securities, which did not have unrealized losses as of June 30, 2010. However, an impairment charge had been taken on these securities during 2008. Management reviewed key credit metrics for these securities, including delinquency rates, cumulative default rates, prepayment speeds, foreclosure rates, loan-to-values 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, 2010 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 above 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, 2010
Beginning balance, January 1, 2010	$1,922,000
Additions: Credit related OTTI recorded in current period	-
Ending balance, June 30, 2010	$1,922,000

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
	(In Thousands)	
June 30, 2010		
Within one year	$999	$1,008
After one year through five years	2,265	2,439
After five years through ten years	6,345	6,780
After ten years	29,887	31,147
Mortgage-backed securities	90,149	93,580
Asset-backed securities	8,606	7,501
Equity securities	22	9
	$138,273	$142,464

During the six months ended June 30, 2010 and the year ended December 31, 2009, the Company did not sell any securities available for sale.

NOTE 5 – EARNINGS PER SHARE

Earnings per share was calculated for the three and six months ended June 30, 2010 and 2009, 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 and unvested restricted stock 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.