LAKE SHORE BANCORP, INC.
Form 10-Q
November 08, 2016

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, 2016

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 6,097,756 shares of the registrant’s common stock, $0.01 par value per share, outstanding at November 4, 2016.

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PART I

Item 1. Financial Statements

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Financial Condition

	September 30, 2016 (Unaudited)	December 31, 2015
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	$ 8,622	$ 7,296
Interest earning deposits	10,783	12,714
Federal funds sold	19,074	14,217
Cash and Cash Equivalents	38,479	34,227
Securities available for sale	91,047	113,213
Federal Home Loan Bank stock, at cost	1,340	1,454
Loans receivable, net of allowance for loan losses 2016 $2,120; 2015 $1,985	320,421	297,101
Premises and equipment, net	8,738	9,144
Accrued interest receivable	1,732	1,648
Bank owned life insurance	15,145	14,938
Other assets	1,529	1,660
Total Assets	$ 478,431	$ 473,385
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	$ 320,660	$ 323,931
Non-interest bearing	53,806	45,224
Total Deposits	374,466	369,155
Long-term debt	18,950	21,150
Advances from borrowers for taxes and insurance	1,847	3,285
Other liabilities	5,842	5,919
Total Liabilities	$ 401,105	$ 399,509
Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,826,414 shares issued and 6,097,756 shares outstanding at September 30, 2016 and 6,727,428 shares issued	$ 68	$ 67

and 6,003,416 shares outstanding at December 31, 2015		
Additional paid-in capital	30,524	29,359
Treasury stock, at cost (728,658 shares at September 30, 2016 and 724,012 shares at December 31, 2015)	(7,167)	(7,026)
Unearned shares held by ESOP	(1,642)	(1,706)
Unearned shares held by compensation plans	(591)	(580)
Retained earnings	53,567	50,919
Accumulated other comprehensive income	2,567	2,843
Total Stockholders' Equity	77,326	73,876
Total Liabilities and Stockholders' Equity	$ 478,431	$ 473,385

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,	
	2016	2015	2016	2015
	(Unaudited) (Dollars in thousands, except per share data)			
Interest Income				
Loans, including fees	$ 3,681	$ 3,474	$ 10,797	$ 10,268
Investment securities, taxable	237	435	879	1,377
Investment securities, tax-exempt	449	513	1,351	1,573
Other	30	5	81	16
Total Interest Income	4,397	4,427	13,108	13,234
Interest Expense				
Deposits	449	538	1,373	1,794
Long-term debt	93	99	280	296
Other	23	25	69	74
Total Interest Expense	565	662	1,722	2,164
Net Interest Income	3,832	3,765	11,386	11,070
Provision for Loan Losses	125	30	310	240
Net Interest Income after Provision for Loan Losses	3,707	3,735	11,076	10,830
Non-Interest Income				
Service charges and fees	461	406	1,326	1,184
Earnings on bank owned life insurance	70	68	207	204
Recovery on previously impaired investment securities	39	48	107	123
Gain on sale of securities available for sale	-	440	1,636	440
Net gain on sale of loans	56	28	117	73
Other	32	38	78	85
Total Non-Interest Income	658	1,028	3,471	2,109
Non-Interest Expenses				
Salaries and employee benefits	1,803	1,663	5,388	5,150
Occupancy and equipment	549	561	1,707	1,697
Data processing	289	264	815	766
Professional services	257	235	784	738
Advertising	81	92	383	301
FDIC Insurance	68	75	192	219
Postage and supplies	69	74	179	201
Other	304	300	865	761
Total Non-Interest Expenses	3,420	3,264	10,313	9,833
Income before Income Taxes	945	1,499	4,234	3,106
Income Tax Expense	188	263	859	602
Net Income	$ 757	$ 1,236	$ 3,375	$ 2,504
Basic and diluted earnings per common share	$ 0.13	$ 0.21	$ 0.56	$ 0.42
Dividends declared per share	$ 0.07	$ 0.07	$ 0.21	$ 0.21

See notes to consolidated financial statements.

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Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Three Months Ended September 30,	
	2016	2015
	(Unaudited) (Dollars in thousands)	
Net Income	$ 757	$ 1,236
Other Comprehensive Income (Loss), net of tax (expense) benefit:		
Unrealized holding (losses) gains on securities available for sale, net of tax benefit (expense)	(451)	626
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(26)	(32)
Net gain on sale of securities included in net income, net of tax expense	-	(290)
Total Other Comprehensive (Loss) Income	(477)	304
Total Comprehensive Income	$ 280	$ 1,540

	Nine Months Ended September 30,	
	2016	2015
	(Unaudited) (Dollars in thousands)	
Net Income	$ 3,375	$ 2,504
Other Comprehensive Income (Loss), net of tax (expense) benefit:		
Unrealized holding gains on securities available for sale, net of tax expense	875	174
Reclassification adjustments related to:		
Recovery on previously impaired investment securities included in net income, net of tax expense	(71)	(81)
Net gain on sale of securities included in net income, net of tax expense	(1,080)	(290)
Total Other Comprehensive Loss	(276)	(197)

Total Comprehensive Income	$ 3,099	$ 2,307

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

Nine Months Ended September 30, 2016 and 2015 (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
	(Dollars in thousands, except share and per share data)							
Balance - January 1, 2015	$ 67	$ 28,684	$ (6,420)	$ (1,791)	$ (622)	$ 48,192	$ 3,520	$ 71,630
Net income	-	-	-	-	-	2,504	-	2,504
Other comprehensive loss, net of tax benefit of $510	-	-	-	-	-	-	(197)	(197)
Stock options exercised (11,775 shares)	-	136	-	-	-	-	-	136
ESOP shares earned (5,951 shares)	-	17	-	64	-	-	-	81
Stock based compensation	-	1	-	-	-	-	-	1
Compensation plan shares granted (15,455 shares)	-	-	145	-	(145)	-	-	-
Compensation plan shares earned (12,909 shares)	-	53	-	-	137	-	-	190
Purchase of treasury stock, at cost (39,900 shares)	-	-	(541)	-	-	-	-	(541)
Cash dividends declared ($0.21 per share)	-	-	-	-	-	(459)	-	(459)
Balance - September 30, 2015	$ 67	$ 28,891	$ (6,816)	$ (1,727)	$ (630)	$ 50,237	$ 3,323	$ 73,345
Balance - January 1, 2016	$ 67	$ 29,359	$ (7,026)	$ (1,706)	$ (580)	$ 50,919	$ 2,843	$ 73,876
Net income	-	-	-	-	-	3,375	-	3,375
Other comprehensive loss, net of tax benefit of $142	-	-	-	-	-	-	(276)	(276)
Stock options exercised (98,986 shares)	1	1,108	-	-	-	-	-	1,109

ESOP shares earned (5,951 shares)	-	15	-	64	-	-	-	79
Compensation plan shares granted (20,354 shares)	-	-	197	-	(197)	-	-	-
Compensation plan shares earned (17,833 shares)	-	42	-	-	186	-	-	228
Purchase of treasury stock, at cost (25,000 shares)	-	-	(338)	-	-	-	-	(338)
Cash dividends declared ($0.21 per share)	-	-	-	-	-	(727)	-	(727)
Balance - September 30, 2016	$ 68	$ 30,524	$ (7,167)	$ (1,642)	$ (591)	$ 53,567	$ 2,567	$ 77,326

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2016	2015
	(Unaudited)	
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,375	$ 2,504
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	138	228
Net amortization of deferred loan costs	412	416
Provision for loan losses	310	240
Recovery on previously impaired investment securities	(107)	(123)
Gain on sale of investment securities	(1,636)	(440)
Originations of loans held for sale	(4,628)	(6,811)
Proceeds from sales of loans held for sale	4,745	6,884
Gain on sale of loans	(117)	(73)
Depreciation and amortization	646	625
Increase in bank owned life insurance, net	(207)	(204)
ESOP shares committed to be released	79	81
Stock based compensation expense	228	191
Increase in accrued interest receivable	(84)	(86)
Decrease in other assets	326	452
Increase in other liabilities	65	211
Net Cash Provided by Operating Activities	3,545	4,095
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Sales	14,406	9,846
Maturities, prepayments and calls	8,947	11,178
Purchases of Federal Home Loan Bank Stock	(3)	(254)
Redemptions of Federal Home Loan Bank Stock	117	274
Loan origination and principal collections, net	(24,237)	(10,646)
Additions to premises and equipment	(240)	(262)
Net Cash (Used in) Provided by Investing Activities	(1,010)	10,136
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	5,311	(15,069)
Net decrease in advances from borrowers for taxes and insurance	(1,438)	(1,521)
Proceeds from issuance of long-term debt	-	8,250
Repayment of long-term debt	(2,200)	(8,250)
Proceeds from stock options exercised	1,109	136
Purchase of treasury stock	(338)	(541)
Cash dividends paid	(727)	(459)
Net Cash Provided by (Used in) Financing Activities	1,717	(17,454)
Net Increase (Decrease) in Cash and Cash Equivalents	4,252	(3,223)
CASH AND CASH EQUIVALENTS - BEGINNING	34,227	35,811
CASH AND CASH EQUIVALENTS - ENDING	$ 38,479	$ 32,588
SUPPLEMENTARY CASH FLOWS INFORMATION		

Interest paid	$ 1,728	$ 2,169
Income taxes paid	$ 760	$ 370
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	$ 199	$ 265

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Basis of Presentation

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

The interim consolidated financial statements included herein as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 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, 2015 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, 2015. The consolidated statements of income for the three and nine months ended September 30, 2016 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2016.

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, 2016 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

There were no new accounting standards affecting the Company during the period that were not previously disclosed.

Note 3 – Investment Securities

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

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
Municipal bonds	$ 48,878	$ 3,011	$ -	$ 51,889
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	43	-	-	43
Collateralized mortgage obligations-government sponsored entities	31,573	210	(91)	31,692
Government National Mortgage Association	327	32	-	359
Federal National Mortgage Association	3,694	227	-	3,921
Federal Home Loan Mortgage Corporation	1,929	107	-	2,036
Asset-backed securities-private label	618	393	(20)	991
Asset-backed securities-government sponsored entities	74	7	-	81
Equity securities	22	13	-	35
	$ 87,158	$ 4,000	$ (111)	$ 91,047

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
SECURITIES AVAILABLE FOR SALE:				
U.S. Treasury bonds	$ 12,778	$ 1,333	$ -	$ 14,111
Municipal bonds	49,064	2,746	(2)	51,808
Mortgage-backed securities:				
Collateralized mortgage obligations-private label	48	-	-	48
Collateralized mortgage obligations-government sponsored entities	38,838	124	(620)	38,342
Government National Mortgage Association	396	31	-	427
Federal National Mortgage Association	4,355	187	-	4,542
Federal Home Loan Mortgage Corporation	2,217	84	-	2,301
Asset-backed securities-private label	1,099	464	(62)	1,501
Asset-backed securities-government sponsored entities	89	8	-	97
Equity securities	22	14	-	36
	$ 108,906	$ 4,991	$ (684)	$ 113,213

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

At September 30, 2016 and at December 31, 2015, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation ("FHLMC") common stock.

At September 30, 2016 and December 31, 2015, thirty-four municipal bonds with a cost of $11.1 million and fair value of $11.8 million and $11.7 million, respectively, were pledged under a collateral agreement with the Federal Reserve Bank ("FRB") of New York for liquidity borrowing. In addition, at September 30, 2016, fourteen municipal bonds with a cost and fair value of $3.6 million and $3.8 million, respectively, were pledged as collateral for customer deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") insurance limits. At December 31, 2015, nine municipal bonds with a cost and fair value of $2.0 million and $2.1 million, respectively, 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, 2016						
Mortgage-backed securities	$ 2,968	$ (6)	$ 9,501	$ (85)	$ 12,469	$ (91)
Asset-backed securities -private label	598	(20)	-	-	598	(20)
	$ 3,566	$ (26)	$ 9,501	$ (85)	$ 13,067	$ (111)
December 31, 2015						
Municipal bonds	$ -	$ -	$ 567	$ (2)	$ 567	$ (2)
Mortgage-backed securities	8,627	(103)	21,249	(517)	29,876	(620)
Asset-backed securities -private label	379	(11)	658	(51)	1,037	(62)
	$ 9,006	$ (114)	$ 22,474	$ (570)	$ 31,480	$ (684)

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 discount 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 (loss), net of taxes.

At September 30, 2016, the Company’s investment portfolio included five mortgage-backed securities and two private label asset-backed securities in the “unrealized losses less than twelve months” category.

At September 30, 2016, the Company had fourteen mortgage-backed securities in the "unrealized losses twelve months or more" category. The fourteen 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 private label asset-backed securities noted above 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 tables provide additional information relating to the private label asset-backed securities as of September 30, 2016 and December 31, 2015 (dollars in thousands):

At September 30, 2016

Security	Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Over 90 days	Foreclosure%	OREO%
1	$ 420	$ 403	$ (17)	Caa1	15.80%	15.00%	6.10%	1.20%
2	198	195	(3)	CCC	13.00%	11.90%	4.50%	1.00%
Total	$ 618	$ 598	$ (20)					

At December 31, 2015

Security	Book Value	Fair Value	Unrealized Loss	Lowest Rating	Delinquent % Over 60 days	Over 90 days	Foreclosure%	OREO%
1	$ 709	$ 658	$ (51)	CCC	18.20%	17.40%	7.50%	2.60%
2	390	379	(11)	CCC	16.30%	15.10%	7.00%	1.50%
Total	$ 1,099	$ 1,037	$ (62)					

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 private label asset-backed securities occurred due to challenges in the economic environment resulting from the financial crisis 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 as of September 30, 2016. 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 prior to their maturity.

Management also completed an OTTI analysis for two private label asset-backed securities, which did not have unrealized losses as of September 30, 2016. 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, 2016 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 prior to their maturity.

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 Stockholders' Equity.

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

	For The Nine Months Ended September 30,	
	2016	2015
	(Dollars in thousands)	
Beginning balance	$ 696	$ 858
Additions:		
Credit loss not previously recognized	-	-
Reductions:		
Losses realized during the period on OTTI previously recognized	-	(2)
Receipt of cash flows on previously recorded OTTI	(107)	(123)
Ending balance	$ 589	$ 733

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, 2016:		
After one year through five years	$ 2,449	$ 2,594
After five years through ten years	28,364	30,156
After ten years	18,065	19,139
Mortgage-backed securities	37,566	38,051
Asset-backed securities	692	1,072
Equity securities	22	35
	$ 87,158	$ 91,047

During the nine months ended September 30, 2016, the Company sold nine U.S. Treasury Bonds for total proceeds of $14.4 million, resulting in realized gains of $1.6 million. During the nine months ended September 30, 2015, the Company sold twenty-seven municipal bonds and two mortgage-backed securities for total proceeds of $9.8 million, resulting in realized gains of $440,000.

Note 4 - Allowance for Loan Losses

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

Real Estate Loans:

- One- to Four-Family – are loans secured by first lien collateral on residential real estate primarily held in the Western New York region. These loans can be affected by economic conditions and the value of underlying properties. Western New York's housing market has consistently demonstrated stability in home prices despite economic conditions. Furthermore, the Company has conservative underwriting standards and its residential lending policies and procedures ensure that its one- to four-family residential mortgage loans generally conform to secondary market guidelines.
- Home Equity - are loans or lines of credit secured by first or second liens on owner-occupied residential real estate primarily held in the Western New York region. These loans can also be affected by economic conditions and the values of underlying properties. Home equity loans may have

increased risk of loss if the Company does not hold the first mortgage resulting in the Company being in a secondary position in the event of collateral liquidation. The Company does not originate interest only home equity loans.

- Commercial Real Estate – are loans used to finance the purchase of real property, which generally consists of developed real estate that is held as first lien collateral for the loan. These loans are secured by real estate properties that are primarily held in the Western New York region. Commercial real estate lending involves additional risks compared with one- to four-family residential lending, because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, and/or the collateral value of the commercial real estate securing the loan, and repayment of such loans may be subject to adverse conditions in the real estate market or economic conditions to a greater extent than one- to four-family residential mortgage loans. Also, commercial real estate loans typically involve relatively large loan balances to single borrowers or groups of related borrowers. Accordingly, the nature of these types of loans make them more difficult for the Company to monitor and evaluate.
- Construction – are loans to finance the construction of either one- to four-family owner occupied homes or commercial real estate. At the end of the construction period, the loan automatically converts to either a one- to four-family or commercial mortgage, as applicable. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion compared to the actual cost of construction. The Company limits its risk during construction as disbursements are not made until the required work for each advance has been completed and an updated lien search is performed. The completion of the construction progress is verified by inspections performed by a Company loan officer or an independent appraisal firm. Construction delays may also impair the borrower’s ability to repay the loan.

Other Loans:

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

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

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

The following tables summarize the activity in the allowance for loan losses for the three and nine months ended September 30, 2016 and 2015 and the distribution of the allowance for loan losses and loan receivable by loan portfolio class and impairment method as of September 30, 2016:

	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2016								
Allowance for Loan Losses:								
Balance – July 1, 2016	$ 424	$ 129	$ 1,064	$ 129	$ 275	$ 22	$ 17	$ 2,060
Charge-offs	(16)	-	-	-	(46)	(8)	-	(70)
Recoveries	1	-	-	-	-	4	-	5
Provision (Credit)	12	(13)	50	-	72	12	(8)	125
Balance – September 30, 2016	$ 421	$ 116	$ 1,114	$ 129	$ 301	$ 30	$ 9	$ 2,120
Balance – January 1, 2016	$ 351	$ 120	$ 1,204	$ 59	$ 197	$ 22	$ 32	$ 1,985
Charge-offs	(65)	(18)	(1)	-	(76)	(40)	-	(200)
Recoveries	11	1	-	-	1	12	-	25
Provision (Credit)	124	13	(89)	70	179	36	(23)	310
Balance – September 30, 2016	$ 421	$ 116	$ 1,114	$ 129	$ 301	$ 30	$ 9	$ 2,120
Ending balance: individually evaluated for impairment	$ -	$ -	$ 5	$ -	$ 10	$ -	$ -	$ 15
Ending balance: collectively evaluated for impairment	$ 421	$ 116	$ 1,109	$ 129	$ 291	$ 30	$ 9	$ 2,105
Gross Loans Receivable (1):								
Ending balance	$ 151,069	$ 34,062	$ 97,062	$ 11,707	$ 24,167	$ 1,472	$ -	$ 319,539
Ending balance: individually evaluated for	$ 191	$ 4	$ 3,260	$ -	$ 177	$ -	$ -	$ 3,632

impairment								
Ending balance: collectively evaluated for impairment	$ 150,878	$ 34,058	$ 93,802	$ 11,707	$ 23,990	$ 1,472	$ -	$ 315,907

(1) Gross Loans Receivable does not include allowance for loan losses of $(2,120) or deferred loan costs of $3,002.

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	Real Estate Loans				Other Loans			
	One- to Four-Family	Home Equity	Commercial	Construction	Commercial	Consumer	Unallocated	Total
	(Dollars in thousands)							
September 30, 2015								
Allowance for Loan Losses:								
Balance – July 1, 2015	$ 393	$ 103	$ 1,394	$ -	$ 187	$ 27	$ 21	$ 2,125
Charge-offs	(40)	-						