

LAKE SHORE BANCORP, INC.
Form 10-K
March 27, 2019

United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

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

Commission File No.: 000-51821

Lake Shore Bancorp, Inc.

(Exact Name of Registrant as Specified in Its Charter)

United States
(State or Other Jurisdiction of Incorporation or Organization) 20-4729288
(I.R.S. Employer Identification No.)

31 East Fourth Street, Dunkirk, NY 14048

(Address of Principal Executive Offices, including zip code)

(716) 366-4070

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: Common Stock, \$0.01 par value per share

Name of each exchange on which registered: The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [] No [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2018 was \$33,585,514 based on the per share closing price as of June 30, 2018 on the Nasdaq Global Market for the registrant's common stock, which was \$17.15.

There were 6,002,550 shares of the registrant's common stock, \$.01 par value per share, outstanding at March 26, 2019.

DOCUMENTS INCORPORATED BY REFERENCE:

	Part of 10-K
Portions of the registrant's Proxy Statement for the 2019 Annual Meeting of Stockholders	where incorporated III

LAKE SHORE BANCORP, INC.
 ANNUAL REPORT ON FORM 10-K
 FOR THE FISCAL YEAR ENDED
 DECEMBER 31, 2018

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PART I

Item 1. Business.

General

Lake Shore Bancorp, Inc. (“Lake Shore Bancorp,” the “Company,” “us,” or “we”) operates as a mid-tier, federally chartered savings and loan holding company for Lake Shore Savings Bank (“Lake Shore Savings” or the “Bank”). A majority of Lake Shore Bancorp’s issued and outstanding common stock (60.6% as of December 31, 2018) is held by Lake Shore, MHC (the “MHC”), a federally chartered mutual holding company, which serves as the parent company to Lake Shore Bancorp. The remaining shares of common stock are owned by public shareholders and Lake Shore Saving Bank’s Employee Stock Ownership Plan (“ESOP”). Our common stock is traded on the Nasdaq Global Market under the symbol “LSBK”. Unless the context otherwise requires, all references herein to Lake Shore Bancorp or Lake Shore Savings include Lake Shore Bancorp and Lake Shore Savings on a consolidated basis.

Lake Shore, MHC

Lake Shore, MHC was organized in 2006 as a federally chartered mutual holding company. The MHC does not engage in any substantial business activity other than its investment in a majority of the common stock of Lake Shore Bancorp. The Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) is the regulator for the MHC. Federal law and regulations require that as long as the MHC is in existence, it must own at least a majority of Lake Shore Bancorp’s common stock.

Lake Shore Bancorp, Inc.

Lake Shore Bancorp, Inc. was organized in 2006 for the purpose of acting as the savings and loan holding company for Lake Shore Savings Bank in connection with the Company’s initial public stock offering. The Company, a federal corporation, is regulated by the Federal Reserve Board.

Lake Shore Savings Bank

Lake Shore Savings Bank was chartered as a New York savings and loan association in 1891. In 2006, the Bank converted from a New York-chartered mutual savings and loan association to a federal savings bank charter. The Bank is subject to the supervision and regulation of the Office of the Comptroller of the Currency (“OCC”).

Lake Shore Savings Bank’s principal business consists of attracting retail deposits from the general public in the areas surrounding its branch offices and investing those deposits, together with funds generated from operations, primarily in one- to four-family residential mortgage loans, commercial real estate loans, home equity lines of credit and, to a lesser extent, commercial business loans, consumer loans, and investment securities. Our revenues are principally derived from interest earned on our loans and investment securities. Our primary sources of funds for lending and investments are deposits, borrowings, receipts of principal and interest payments on loans and securities, proceeds from sales of loans or securities, maturities and calls of investment securities and income resulting from operations in prior periods.

Recent Events

On November 26, 2018, Lake Shore Savings Bank filed an application with the OCC seeking approval to convert the bank's charter from a federal savings bank to a national bank under the name "Lake Shore Bank, National Association." Lake Shore Savings Bank's conversion to a national bank charter will enable it to engage in business activities authorized for national banks, including establishing deposit and account relationships with New York municipalities and other public entities. Currently, under New York law, municipalities and public entities within New York State may not deposit funds with either state- or federally-chartered savings banks. In connection with Lake Shore Savings Bank's charter conversion, the Company and the MHC, the majority

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stockholder of the Company, have filed applications seeking approval from the Federal Reserve Board to become bank holding companies. In order to become bank holding companies, the Company and the MHC will be required to eliminate their federal charters, and will reincorporate as a Maryland corporation and a Delaware non-stock corporation, respectively. After Lake Shore Savings Bank's charter conversion and the Company's reincorporation in Maryland, the Company will remain in the public mutual holding company structure with the same stock ownership percentages that existed prior to the charter conversions. On February 25, 2019, the OCC approved the charter conversion of Lake Shore Savings Bank. The Federal Reserve Board continues to review the applications filed by the Company and the MHC.

Available Information

Lake Shore Bancorp's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are made available free of charge on our website, www.lakeshoresavings.com, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. Such reports are also available on the Securities and Exchange Commission's website at www.sec.gov. Information on our website shall not be considered a part of this Form 10-K.

Market Area

Lake Shore Savings Bank is a community bank that offers a variety of banking products to serve the market areas surrounding our eleven branch offices located within the Western New York region of New York State.

Our geographic market area for loans and deposits is principally located within Erie and Chautauqua Counties, within Western New York. As of 2018, Erie and Chautauqua Counties had a combined population of approximately 1.1 million. Our market area is bounded by Lake Erie to the west and Canada to the north, and includes the city of Buffalo, the second largest city in the State of New York by population. The market area includes 13 hospitals, a medical school and a major cancer research and treatment facility, along with a centralized medical campus to cultivate clinical care, research, education and entrepreneurship. The area has ten colleges and universities, three community colleges and various vocational and technical schools. Western New York is home to professional sports franchises and an international airport. The area hosts a broad diversity of industry, commercial establishments and financial institutions as well as a skilled and productive workforce.

New York State currently has several incentive programs for businesses to invest in the Western New York region. One example is the "Start-Up NY" program, which offers tax incentives to start, expand or relocate a qualified business to a tax-free area within the state, primarily near a university or community college campus, in order to access top talent and research facilities. Qualified businesses for this program include advance materials & manufacturing, biotech & life sciences, tech & electronics, and optics & imaging. This program has generated significant interest in Western New York for new business development, due to its proximity to Canada, history of being a strong industrial and manufacturing center, and the number of quality colleges and universities in the area.

The Erie County region and the City of Buffalo have recently experienced economic expansion led by major growth in the health care and education sectors, and resurgence in the central business district, which has led to an influx of private investment in development of hotels and housing in the downtown sector. Major construction projects have been recently completed or are currently underway. The Buffalo Niagara Medical Campus has grown significantly

with the construction of a new children's hospital, expansion of an existing cancer/research hospital and construction of a new medical school by the State University of New York at Buffalo. Development on the waterfront has centered on redevelopment of property for mixed use, including public access and private development that includes office space, ice rinks, hotels and restaurants. The economic development within the region also impacts the small business and middle-market customers that we focus on and we believe we will be able to capitalize on opportunities created by economic growth in this section of our market area.

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Our primary market area has historically been stable, with a diversified base of employers and employment sectors. The local economies that we serve are not dependent on one key employer. Transportation equipment is a large manufacturing industry in the Buffalo area, as well as production of automobile component parts. The principal employment sectors are service-related, wholesale and retail trade, and durable-goods manufacturing.

Our future growth will be influenced by the strength of our regional economy, other demographic trends and the competitive environment. We believe that we have developed lending products and marketing strategies to address the credit-related needs of the residents and small businesses in our local market area.

Competition

We face intense competition both in making loans and attracting deposits. Western New York has a significant number of financial institutions, many of which are branches of large money centers and regional and super regional banks which have resulted from the consolidation of the banking industry in New York and surrounding states. Some of these competitors have greater resources than we do and may offer services that we do not or cannot provide. For example, we do not offer trust or investment services. Customers who seek “one stop shopping” may be drawn to our competitors who offer such services. We also face significant competition from online service providers who offer financial services, including loan and deposit products.

Our competition for loans comes principally from commercial banks, savings banks, mortgage banking companies, credit unions, online retail mortgage lenders and other financial service companies. The most direct competition for deposits comes from commercial banks, savings banks, credit unions, and online banks. We face additional competition for deposits from non-depository competitors such as mutual funds, securities and brokerage firms and insurance companies. We are significantly smaller than many of the financial institution competitors in our market area. Some of our competitors are not subject to the same degree of regulation as that imposed on federal savings banks or federally insured institutions, and these other institutions may be able to price loans and deposits more aggressively. We remain very competitive in Chautauqua County, New York and, as of June 30, 2018 (the latest date such information is available), we had 14.7% of total deposits and ranked fifth out of the nine banks in this market area, according to the Federal Deposit Insurance Corporation (“FDIC”) annual deposit market share report. Our deposit market share in Erie County, New York has increased since we entered this market area in 2003 and we had the largest percentage increase in market share (13.6% increase) from June 30, 2017 to June 30, 2018 when compared to the other top ten banks in Erie County. We believe the primary factors in competing for deposits and loans is through personalized service, knowledge of the local market area and its economy factors, local decision making, technological convenience via mobile and online banking and active participation and support of the communities we serve.

Lending Activities

General. Historically, as a thrift institution, we primarily originated residential mortgage loans, including home equity loans. In recent years, we have become more focused on originating commercial real estate and commercial business loans, also known as C&I Lending, to add adjustable rate loans to our portfolio, meet the needs of small business

customers and manage interest rate risk. We retain the majority of loans that we originate. However, we have sold residential mortgage loans into the secondary market, with retention of servicing rights, from time to time in order to manage interest rate risk, and we may do so again in the future, when deemed appropriate. In prior years we have purchased a limited number of equipment loans from a third party broker, which are secured by first liens on the new equipment purchases by small businesses located throughout the Northeastern United States. We have not purchased these types of loans since the first quarter of 2015.

Loan Portfolio. The following table sets forth the composition of our loan portfolio, by type of loan, in dollar amounts and in percentages at the dates indicated. We did not have any loans held for sale as of these dates.

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At December 31,	2017		2016		2015		2014	
2018	Percent of		Percent of		Percent of		Percent of	
Amount	Total		Total		Total		Total	
\$	%		%		%		%	

(Dollars in thousands)

Real Estate
loans: