

Lake Shore Bancorp, Inc.
Form 10-K
March 31, 2009
Table of Contents

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, 2008

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)

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United States
(State or Other Jurisdiction of

20-4729288
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

125 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: Nasdaq Global Market.

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 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. (Check one):

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 Act). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2008 was \$23,403,153 based on the per share closing price as of June 30, 2008 on the Nasdaq Global Market for the registrant's common stock, which was \$8.57.

There were 6,210,748 shares of the registrant's common stock, \$.01 par value per share, outstanding at March 25 2009.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the registrant's Proxy Statement for the 2009 Annual Meeting of Stockholders

**Part of 10-K
where incorporated
III**

Table of Contents

LAKE SHORE BANCORP, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2008
TABLE OF CONTENTS

ITEM		PAGE
<u>PART I</u>		
1	<u>BUSINESS</u>	1
1A	<u>RISK FACTORS</u>	41
2	<u>PROPERTIES</u>	47
3	<u>LEGAL PROCEEDINGS</u>	48
4	<u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	48
<u>PART II</u>		
5	<u>MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	48
6	<u>SELECTED FINANCIAL DATA</u>	50
7	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	52
7A	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	67
8	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	69
9	<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	69
9A(T)	<u>CONTROLS AND PROCEDURES</u>	69
9B	<u>OTHER INFORMATION</u>	70
<u>PART III</u>		
10	<u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	70
11	<u>EXECUTIVE COMPENSATION</u>	70
12	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	70
13	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	70
14	<u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	70
<u>PART IV</u>		
15	<u>EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	70
	<u>SIGNATURES</u>	73

Table of Contents

PART I

Item 1. Business.

General

Lake Shore Bancorp, Inc. (Lake Shore Bancorp, us, or we) is a federally-chartered corporation organized in 2006 and is registered as a savings and loan holding company with the Office of Thrift Supervision (OTS). Lake Shore Bancorp serves as the holding company for Lake Shore Savings Bank (Lake Shore Savings). As of March 25, 2009, Lake Shore, MHC, a federal mutual holding company registered as a savings and loan holding company with the OTS, owned 58.6% of the outstanding shares of Lake Shore Bancorp s common stock. Our common stock is quoted 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 does not engage in any business activity other than its investment in a majority of the common stock of Lake Shore Bancorp. Federal law and regulations require that as long as Lake Shore, MHC is in existence, it must own at least a majority of Lake Shore Bancorp s common stock.

At December 31, 2008, Lake Shore Bancorp had total assets of \$407.8 million, of which \$241.9 million was comprised of loans receivable and \$112.9 million was comprised of available for sale securities. At December 31, 2008, total deposits were \$293.2 million and total equity was \$54.2 million.

For over 117 years we have served the local community of Dunkirk, New York. Lake Shore Savings was chartered as a New York savings and loan association in 1891. In 1987, we opened our second office in Fredonia, New York. Since 1993, we have more than tripled our asset-size and expanded to nine branch offices. In addition, we have added three administrative office buildings which comprise our corporate headquarters in Dunkirk, New York. Our principal business consists of (1) attracting retail deposits from the general public in the areas surrounding our corporate headquarters in Dunkirk, New York and nine branch offices in Chautauqua and Erie Counties, New York and (2) investing those deposits, together with funds generated from operations, primarily in one- to four-family residential mortgage loans, home equity loans and lines of credit and commercial real estate loans and, to a lesser extent, commercial business loans, consumer loans, and investment securities. Our revenues are principally derived from interest generated from our loans and interest earned and dividends received on our investment securities. Our primary sources of funds for lending and investments are deposits, payments of loan principal, payments on mortgage-backed and asset-backed securities, maturities and calls of investment securities and income resulting from operations in prior periods.

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.

Table of Contents

Market Area

Our operations are conducted out of our corporate headquarters in Dunkirk, New York and nine branch offices. Our branches in Chautauqua County, New York are located in Dunkirk, Fredonia, Jamestown, Lakewood and Westfield. In Erie County, New York our branch offices are located in Orchard Park, East Amherst, Hamburg and Kenmore. Our first branch in Erie County opened during April 2003 and the most recent branch opened in December 2008. We also have six stand-alone ATMs. The opening of the Orchard Park, East Amherst, Hamburg and Kenmore offices demonstrates the implementation of our growth strategy which is focused on expansion within Erie County while preserving our market share in Chautauqua County. We continue to be among the top residential mortgage lenders in Chautauqua County.

Our geographic market area for loans and deposits is principally Chautauqua and Erie Counties, New York. Northern Chautauqua County is located on Lake Erie in the western portion of New York and is approximately 45 miles from Buffalo, New York. There are multiple prime industrial and building sites in this county and a skilled and productive labor force. Northern Chautauqua County is served by three accredited hospitals and offers higher education opportunities. We have lending and deposit relationships with such institutions. Southern Chautauqua County is more of a tourist area, featuring Chautauqua Lake, but it also hosts a broad diversity of industry, commercial establishments and financial institutions as well as a skilled and productive workforce. Jamestown, New York, where we opened the first of two branch offices in 1996, is the most populous city in Chautauqua County.

Erie County is a metropolitan center located on the western border of New York covering 1,058 square miles. Located within Erie County is the city of Buffalo, the second largest city in the State of New York. As the city of Buffalo has redeveloped, so too have its suburbs throughout Erie County, which also host the Buffalo Niagara International Airport in Cheektowaga, New York and professional sports franchises. One of the main commercial thorough-fares in Erie County is Transit Road, which has experienced robust development in recent years and is the location of one of our branch offices. Our newest branch office, which opened in December 2008, is in Kenmore, New York, also located in Erie County.

The demographic characteristics of our market area are less attractive than national and state measures. Both Chautauqua and Erie Counties exhibit slower rates of population growth when compared to the United States and New York State averages. In addition, both Chautauqua and Erie Counties have lower per capita income and slower growth in per capita income when compared to the United States and the New York State averages. Since Chautauqua County has historically exhibited less attractive demographic characteristics, we may have limited growth opportunities in Chautauqua County. However, Erie County displays a stronger housing market and Erie County's population base is five times larger than Chautauqua County, which offers us a new source of customers in the form of deposit and lending opportunities. Notwithstanding these demographic characteristics, 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 the largest manufacturing industry in the Buffalo area, as well as production of component parts. The principal employment sectors are service-related (excluding financial), wholesale and retail trade, and durable-goods manufacturing. Similar to national trends, most of the job growth currently realized in Chautauqua and Erie Counties has been in service-related industries, and service jobs now account for the largest portion of the workforce.

The current crisis affecting the national and global financial markets is not having a significant effect on the housing prices in our market area. However, unemployment rates in 2009 have increased which may affect our ability to originate residential mortgage loans.

Table of Contents

Our future growth will be influenced by opportunities and stability in 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 in our local market area.

Competition

We face intense competition both in making loans and attracting deposits. New York State has a high concentration of financial institutions, many of which are branches of large money centers and 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 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.

Our competition for loans comes principally from commercial banks, savings institutions, mortgage banking firms, credit unions, mortgage brokers, finance companies, insurance companies, and brokerage and investment banking firms. The most direct competition for deposits has historically come from credit unions, commercial banks, savings banks and savings and loan associations. Specifically, we compete with regional financial institutions such as Jamestown Savings Bank and Evans National Bank; state-wide financial institutions such as M&T Bank, Key Bank, and First Niagara Bank; and nation-wide financial institutions such as HSBC Bank USA and Bank of America. We are significantly smaller than many of these state-wide and nation-wide financial institution competitors. We face additional competition for deposits from short-term money market funds, corporate and government securities funds, and from brokerage firms, mutual funds and insurance companies.

To remain competitive, we provide superior customer service and are active participants in our local community. The following are examples of our commitment to customer service:

We built additional branch offices to both grow our customer base and to provide greater convenience to our existing customers.

We began offering a Direct Access Secure Hotline (DASH) with 24 hour, 7 days a week access to all customer accounts via telephone access.

In addition to online bill pay (added in 2005) and providing e-statements to our customers (added in 2006), we added a secure account management on-line banking website which allows customers instant access via the internet. We continue to upgrade our on-line banking as technology evolves and now offer check imaging through our website.

Customers with a Smart Account, which is a checking account, Free & Easy Checking or Money Market Checking, are offered a Navigator Card, our no-annual fee ATM/Debit card which may be used at ATM machines within our ATM network for deposits and withdrawals and as a debit card anywhere MasterCard is accepted.

We entered into alliances with Key Bank, NA and Evans National Bank to provide customers free access to their accounts with us through the ATMs of these institutions as well as our own.

We continue to upgrade our corporate headquarters, branch offices, ATMs and drive-through facilities to ensure that we are providing a high level of customer satisfaction.

Table of Contents

We offer a variety of mortgage loan products, including: 5/1, 7/1 and 7/23 adjustable rate mortgages, an 80/15/5 loan, which is a combined mortgage and home equity product, a construction end loan, a no closing cost mortgage and home equity product, and a Rural Development Guaranteed Loan Program (GLP) mortgage loan, which provides 100% financing.

In our last three Community Reinvestment Act evaluations by the Office of Thrift Supervision, most recently concluding on November 28, 2007, we consistently received an Outstanding rating.

Since 2007, we have offered a Home Equity Line of Credit product which provides an option to convert either a portion, or the entire line of credit balance, to a term loan at a fixed rate of interest. As the customer pays down the balance on the term loan, the funds available on the line of credit increase by a like amount.

We implemented Remote Deposit services to our commercial customers, which allows the customer to deposit checks electronically from their place of business and provide access to detailed reports of their deposit activity. Customers gain efficiencies from time saved having to go to a branch office to make a deposit. In addition, we started issuing Business Debit Cards to allow our business customers the convenience of accessing their funds through the use of a debit card instead of writing checks. The Business Debit Card carries the MasterCard logo and enables the business to use their card anywhere MasterCard is accepted.

Lending Activities

General. We have a long-standing commitment to the origination of residential mortgage loans, including home equity loans, and we also originate commercial real estate, commercial and consumer loans. We currently retain substantially all of the loans that we originate; however, we have sold and may in the future sell residential mortgage loans into the secondary market, retaining servicing rights. At December 31, 2008, we had total loans of \$240.5 million, of which \$175.8 million, or 73.4%, were one-to-four family residential mortgages. Of residential mortgage loans outstanding at that date, 5.2% were adjustable-rate mortgage loans and 94.8% were fixed rate loans. At December 31, 2008, 11.7% of the loan portfolio was comprised of home equity loans, of which 65.5% were adjustable rate loans and 34.5% were fixed rate loans. The remainder of our loans at December 31, 2008, amounting to \$35.7 million, or 14.9% of total loans, consisted of 8.1% commercial real estate loans, 2.7% construction loans, 3.1% commercial loans and 1.0% consumer loans, which includes personal loans, home improvement loans, overdraft lines of credit, automobile loans and guaranteed student loans.

The interest rates we offer for loans are affected principally by the demand for loans, the supply of money available for lending purposes and the interest rates offered by our competitors. These factors, in turn, are affected by general and local economic conditions and monetary policies of the federal government, including the Federal Reserve Board.

Table of Contents

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.

	2008		2007		At December 31, 2006		2005		2004	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
(Dollars in thousands)										
Mortgage loans:										
One-to-four family	\$ 175,808	73.35%	\$ 157,834	72.36%	\$ 149,408	72.72%	\$ 148,172	71.85%	\$ 142,222	71.14%
Commercial real estate	19,513	8.14	20,394	9.35	17,150	8.34	16,827	8.16	15,310	7.66
Construction loans	6,479	2.70	2,775	1.27	1,570	0.76	1,635	0.79	2,463	1.23
Home equity loans and lines of credit	28,143	11.74	26,569	12.18	25,896	12.60	28,624	13.88	28,442	14.23
	229,943	95.93	207,572	95.16	194,024	94.43	195,258	94.68	188,437	94.26
Other loans:										
Commercial loans	7,403	3.09	8,246	3.78	8,746	4.26	8,264	4.00	8,615	4.30
Consumer loans	2,350	0.98	2,306	1.06	2,689	1.31	2,712	1.32	2,870	1.44
	9,753	4.07	10,552	4.84	11,435	5.57	10,976	5.32	11,485	5.74
Total loans	239,696	100.00%	218,124	100.00%	205,459	100.00%	206,234	100.00%	199,922	100.00%
Deferred loan costs	2,243		1,813		1,475		1,166		891	
Allowance for loan losses	(1,476)		(1,226)		(1,257)		(1,240)		(1,288)	
Loans, net	\$ 240,463		\$ 218,711		\$ 205,677		\$ 206,160		\$ 199,525	

Table of Contents

Loan Maturity. The following table presents the contractual maturity of our loans at December 31, 2008. The table does not include the effect of prepayments or scheduled principal amortization. Loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

	Real Estate One-to-Four Family	Real Estate Commercial	Home Equity	Construction	Commercial	Consumer	Total
	(Dollars in thousands)						
Amounts due in:							
One year or less	\$ 71	\$ 37	\$ 39	\$	\$ 389	\$ 1,160	\$ 1,696
After one year through five years	2,836	617	4,736		1,296	642	10,127
Beyond five years	172,901	18,859	23,368	6,479	5,718	548	227,873
Total	\$ 175,808	\$ 19,513	\$ 28,143	\$ 6,479	\$ 7,403	\$ 2,350	\$ 239,696
Interest rate terms on amounts due after one year:							
Fixed rate	\$ 166,616	\$ 13,958	\$ 9,685	\$ 6,297	\$ 2,654	\$ 1,139	\$ 200,349
Adjustable rate	9,121	5,518	18,419	182	4,360	51	37,651
Total	\$ 175,737	\$ 19,476	\$ 28,104	\$ 6,479	\$ 7,014	\$ 1,190	\$ 238,000

Table of Contents

The following table presents our loan originations, purchases, sales, and principal payments for the periods indicated.

	2008	For the Year Ended December 31,			2004
		2007	2006	2005	
		(Dollars in thousands)			
Total loans:					
Balance outstanding at beginning of period	\$ 218,124	\$ 205,459	\$ 206,234	\$ 199,922	\$ 187,595
Originations:					
Mortgage loans	61,229				