Lake Shore Bancorp, Inc.
Form 10-Q
November 14, 2007
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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 September 30, 2007

¨ 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-accelerated Filer 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) 6,463,719 outstanding shares as of October 31, 2007.

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PART I

Item 1. Financial Statements

LAKE SHORE BANCORP, INC. and SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2007 (Unaudited)	December 31, 2006
	(Dollars in thousands, except per share amounts)	
ASSETS		
Cash and due from banks	**$ 6,800**	$ 9,070
Interest bearing deposits	**1,215**	1,211
Federal funds sold	**15**	8,401
Cash and Cash Equivalents	**8,030**	18,682
Securities available for sale	**108,898**	108,016
Federal Home Loan Bank stock, at cost	**3,100**	2,481
Loans receivable, net of allowance for loan losses $1,280 and $1,257	**216,739**	205,677
Premises and equipment, net	**7,030**	7,234
Accrued interest receivable	**1,509**	1,404
Bank owned life insurance	**10,060**	9,749
Other assets	**1,005**	994
Total Assets	**$ 356,371**	$ 354,237
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Deposits:		
Interest bearing	**$ 222,250**	$ 232,179
Non-interest bearing	**17,931**	17,458
Total Deposits	**240,181**	249,637
Short-term borrowings	**27,502**	10,605
Long-term debt	**29,360**	32,750
Advances from borrowers for taxes and insurance	**1,413**	2,545
Other liabilities	**4,628**	4,953
Total Liabilities	**$ 303,084**	$ 300,490
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Common stock, $0.01 par value per share, 25,000,000 shares authorized; 6,612,500 shares issued and 6,463,719 outstanding	**$ 66**	$ 66
Additional paid-in capital	**27,626**	27,537
Treasury stock, at cost (148,781 shares at September 30, 2007)	**(1,852)**	
Unearned shares held by ESOP	**(2,409)**	(2,473)

Unearned shares held by RRP	**(1,417)**	(1,565)
Retained earnings	**30,964**	30,063
Accumulated other comprehensive income	**309**	119
Total Stockholders Equity	**53,287**	53,747
Total Liabilities and Stockholders Equity	**$ 356,371**	$ 354,237

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Unaudited)			
	(In Thousands, except per share amounts)			
Interest Income				
Loans, including fees	**$ 3,523**	$ 3,239	**$ 9,849**	$ 9,451
Investment securities, taxable	**1,151**	1,148	**3,474**	3,321
Investment securities, tax-exempt	**100**		**263**	
Other	**3**	158	**114**	551
Total Interest Income	**4,777**	4,545	**13,700**	13,323
Interest Expense				
Deposits	**1,749**	1,504	**5,225**	4,236
Short-term borrowings	**208**	117	**502**	462
Long-term debt	**309**	363	**948**	1,083
Other	**30**	30	**90**	113
Total Interest Expense	**2,296**	2,014	**6,765**	5,894
Net Interest Income	**2,481**	2,531	**6,935**	7,429
Provision for Loan Losses		45	**45**	56
Net Interest Income after Provision for Loan Losses	**2,481**	2,486	**6,890**	7,373
Non-Interest Income				
Service charges and fees	**381**	393	**1,083**	1,080
Earnings on bank owned life insurance	**106**	50	**310**	144
Other	**43**	44	**98**	92
Total Non-Interest Income	**530**	487	**1,491**	1,316
Non-Interest Expenses				
Salaries and employee benefits	**1,199**	1,104	**3,701**	3,475
Occupancy and equipment	**318**	322	**985**	1,045
Data processing	**132**	108	**371**	326
Advertising	**65**	50	**174**	188
Postage and supplies	**63**	54	**189**	198
Professional services	**320**	271	**925**	693
Other	**190**	185	**578**	606
Total Non-Interest Expenses	**2,287**	2,094	**6,923**	6,531
Income before Income Taxes	**724**	879	**1,458**	2,158
Income Taxes	**182**	299	**315**	716

Net Income	**$ 542**	$ 580	**$ 1,143**	$ 1,442
Basic earnings per common share	**$ 0.09**	$ 0.09	**$ 0.18**	$ 0.23
Diluted earnings per common share	**$ 0.09**	$ 0.09	**$ 0.18**	$ 0.23
Dividends declared per share	**$ 0.03**	$	**$ 0.09**	$

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Nine Months Ended September 30, 2007 and 2006 (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 (Loss)	Total
				(In Thousands)				
BALANCE DECEMBER 31, 2005	$	$	$	$	$	$ 28,326	$ (331)	$ 27,995
Net income						1,442		1,442
Comprehensive income:								
Change in unrealized net gains on securities available for sale, net of tax and reclassification adjustment							186	186
TOTAL COMPREHENSIVE INCOME								1,628
Initial capitalization of MHC		(100)						(100)
Issuance of common stock, net of offering costs (6,612,500 shares)	66	27,621						27,687
Common shares acquired by ESOP (238,500 shares)				(2,558)				(2,558)
ESOP shares earned (5,290 shares)		(2)		57				55
BALANCE SEPTEMBER 30, 2006	$ 66	$ 27,519	$	$ (2,501)	$	$ 29,768	$ (145)	$ 54,707
BALANCE DECEMBER 31, 2006	$ 66	$ 27,537	$	$ (2,473)	$ (1,565)	$ 30,063	$ 119	$ 53,747
Net income						1,143		1,143
Comprehensive income:								
Change in unrealized net gains on securities available for sale, net of tax and reclassification adjustment							190	190
TOTAL COMPREHENSIVE INCOME								1,333
ESOP shares earned (5,951 shares)		6		64				70
Stock based compensation		104						104
RRP shares earned (11,042 shares)		(21)			148			127
Purchase of treasury stock, at cost			(1,852)					(1,852)
Cash dividends declared ($0.09 per share)						(242)		(242)
BALANCE SEPTEMBER 30, 2007	**$ 66**	**$ 27,626**	**$ (1,852)**	**$ (2,409)**	**$ (1,417)**	**$ 30,964**	**$ 309**	**$ 53,287**

See notes to consolidated financial statements.

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LAKE SHORE BANCORP, INC. and SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(Unaudited) (In Thousands)	
Cash Flows from Operating Activities		
Net income	**$ 1,143**	$ 1,442
Adjustments to reconcile net income to net cash provided by operating activities:		
Net gains on sales of loans		(2)
Net amortization of investment securities premium	**1**	7
Provision for loan losses	**45**	56
Depreciation and amortization	**408**	498
Earnings on bank owned life insurance	**(310)**	(144)
ESOP shares committed to be released	**70**	55
Stock based compensation expense	**231**	
Increase in accrued interest receivable	**(105)**	(43)
Increase in other assets	**(86)**	635
Increase (decrease) in other liabilities	**(325)**	1,743
Net Cash Provided by Operating Activities	**1,072**	4,247
Cash Flows from Investing Activities		
Activity in available for sale securities:		
Maturities, prepayments and calls	**12,850**	14,747
Purchases	**(13,430)**	(21,993)
Activity in held to maturity securities:		
Maturities, prepayments and calls		62
Purchases of Federal Home Loan Bank Stock	**(1,634)**	(417)
Redemptions of Federal Home Loan Bank Stock	**1,015**	579
Proceeds from sales of loans	**32**	852
Loan origination and principal collections, net	**(11,173)**	(231)
Additions to premises and equipment	**(209)**	(217)
Net Cash Used in Investing Activities	**(12,549)**	(6,618)
Cash Flows from Financing Activities		
Net decrease in deposits	**(9,456)**	(7,070)
Net decrease in advances from borrowers for taxes and insurance	**(1,132)**	(1,061)
Net increase (decrease) in short-term borrowings	**16,897**	(2,100)
Proceeds from issuance of long-term debt	**1,000**	3,500
Repayment of long-term debt	**(4,390)**	(5,100)
Proceeds from issuance of common stock, net of offering costs		27,687
Cash provided to ESOP for purchase of shares		(2,558)
Purchase of Treasury Stock	**(1,852)**	
Cash dividends paid	**(242)**	
Initial capitalization of MHC		(100)
Net Cash Provided by (Used in) Financing Activities	**825**	13,198

Net Increase (Decrease) in Cash and Cash Equivalents	**(10,652)**	10,827
Cash and Cash Equivalents Beginning	**18,682**	12,053
Cash and Cash Equivalents Ending	**$ 8,030**	$ 22,880
Supplementary Cash Flows Information		
Interest paid	**$ 6,743**	$ 5,873
Income taxes paid	**$ 802**	$ 445
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	**$ 34**	$ 157

See notes to consolidated financial statements.

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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. For a further discussion of the Company s formation and operations, see the Company s registration statement on Form S-1, as amended, which was declared effective by the Securities and Exchange Commission on February 13, 2006 (File Number 333-129439).

The interim financial statements included herein as of September 30, 2007 and for the three and nine months ended September 30, 2007 and 2006 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 financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. These interim financial statements should be read in conjunction with the financial statements and notes thereto included in the audited financial statements included in the Company s Form 10-K for the period ended December 31, 2006. The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2007.

To prepare these financial statements in conformity with generally accepted accounting principles, 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.

NOTE 2 STOCK OFFERING

The Company completed its initial public stock offering on April 3, 2006. Prior to that time, the Bank was a mutual savings and loan association. The Company sold 2,975,625 shares, or 45% of its outstanding common stock, to subscribers in the offering and issued 3,636,875 shares, or 55% of its then-outstanding common stock to Lake Shore, MHC, a federally-chartered mutual holding company. Due to stock repurchases, the 3,636,875 shares of common stock owned by Lake Shore, MHC represents 56% of the Company s outstanding common stock.

Net proceeds from the stock offering amounted to approximately $ 27.7 million. Expenses related to the offering were approximately $2.1 million. One half of the proceeds were retained by the Company. The remaining proceeds were contributed to the Bank. The Company utilized $2.6 million of the proceeds to extend a loan to an employee stock ownership plan (the ESOP). As of September 30, 2007, the ESOP had used $2.6 million in loan proceeds to purchase 238,050 shares of stock on the open market at an average price of $10.70 per share, plus commission expenses. As a result of the purchase of shares by the ESOP, total stockholders equity of the Company was reduced by $2.6 million.

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NOTE 3 DERIVATIVE INSTRUMENTS

In August 2006, the Company entered into a derivative contract as part of its risk management strategy to protect against market fluctuations in interest rates. An interest rate floor was purchased for $221,000 to protect against a decline in the prime rate earned on a $10 million notional amount of adjustable rate loans within our portfolio. The term of the interest rate floor product is 60 months. The Company follows Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, to account for this transaction. SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives must be recognized in earnings when they occur, unless the derivative qualifies as a hedge. If a derivative qualifies as a hedge, a company can elect to use hedge accounting to eliminate or reduce income statement volatility that would arise from reporting changes in a derivative s fair value in income. The Company did not elect to use hedge accounting for this transaction. The interest rate floor is recorded in Other Assets on the Consolidated Statement of Financial Condition and the change in fair value is recorded in Loan Interest Income on the Consolidated Statement of Income. As of September 30, 2007 and December 31, 2006, respectively, the fair market value of the interest rate floor was $295,000 and $220,000, resulting in $75,000 of interest income for the nine months ended September 30, 2007. During the quarter ended September 30, 2007, $176,000 of interest income was recorded for the increase in the fair market value of the interest rate floor.

NOTE 4 RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that companies recognize in their financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company adopted FIN 48 on January 1, 2007 and FIN 48 did not have a material impact on the Company s consolidated financial position and results of operations.

In May 2007, the FASB issued FASB Staff Position (FSP) FIN 48-1 Definition of Settlement in FASB Interpretation No. 48 (FSP FIN 48-1). FSP FIN 48-1 provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1 is effective retroactively to January 1, 2007. The implementation of this standard did not have a material impact on our consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 157 on its consolidated financial position, results of operations and cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for the Company on January 1, 2008. The Company is evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

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In March 2007, the FASB ratified EITF Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. The Company does not expect EITF 06-11 to have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB s Emerging Issues Task Force (EITF) issued EITF Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements (EITF 06-4). EITF 06-4 requires the recognition of a liability related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement. The consensus highlights that the employer (who is also the policyholder) has a liability for the benefit it is providing to its employee. As such, if the policyholder has agreed to maintain the insurance policy in force for the employee s benefit during his or her retirement, then the liability recognized during the employee s active service period should be based on the future cost of insurance to be incurred during the employee s retirement. Alternatively, if the policy holder has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS No. 106 or Accounting Principals Board (APB) Opinion No. 12, as appropriate. For transition, an entity can choose to apply the guidance using either of the following approaches: (a) a change in accounting principle through retrospective application to all periods presented or (b) a change in accounting principle through a cumulative-effect adjustment to the balance in retained earnings at the beginning of the year of adoption. The disclosures are required in fiscal years beginning after December 15, 2007, with early adoption permitted. The Company does not believe that the implementation of this guidance will have a material impact on the Company s consolidated financial statements.

On September 7, 2006, the Task Force reached a conclusion on EITF Issue No. 06-5, Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (EITF 06-5). The scope of EITF 06-5 consists of six separate issues relating to accounting for life insurance policies purchased by entities protecting against the loss of key persons . The six issues are clarifications of previously issued guidance on FASB Technical Bulletin No. 85-4. EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The Company has evaluated the potential impact on the Company s consolidated financial statements and determined that the impact is minimal.

NOTE 5 COMPREHENSIVE INCOME (LOSS)

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, are reported as a separate component of the stockholders equity section of the consolidated statement of financial condition, such items, along with net income, are components of comprehensive income.

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The components of other comprehensive income (loss) and related tax effects for the three and nine months ended September 30, 2007 and 2006 are as follows:

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(Unaudited)			
	(In Thousands)			
Unrealized holding gains on securities available for sale	$ 1,097	$ 1,658	$ 303	$ 294
Reclassification adjustment for (gains) losses realized in income				
Net Unrealized Gains	1,097	1,658	303	294
Income tax effect	(406)	(613)	(113)	(108)
Net of Tax Amount	$ 691	$ 1,045	$ 190	$ 186

NOTE 6 EARNINGS PER SHARE

Earnings per share is calculated for the three and nine month periods ending September 30, 2007. The earnings per share for the three and nine months ended September 30, 2006 is calculated for the period after the offering was closed and stock issued on April 3, 2006. The Company had no dilutive securities as of September 30, 2006. Basic net income per share is based upon the weighted average number of common shares outstanding, while diluted net income 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.

The difference between the common shares issued and the common shares outstanding, for the purposes of calculating basic earnings per share, is a result of the unallocated ESOP, restricted stock shares, and treasury stock.

The calculated basic and diluted earnings per share (EPS) are as follows:

	Three Months ending September 30, 2007	Three Months ending September 30, 2006
Numerator net income	$ 542,000	$ 580,000
Denominator:		
Basic weighted average shares outstanding	6,115,226	6,377,996
Earnings per share:		
Basic	$ 0.09	$ 0.09
Diluted	$ 0.09	$ 0.09

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	Nine Months ending September 30, 2007	Nine Months ending September 30, 2006
Numerator net income	$ 1,143,000	$ 1,442,000
Denominator:		
Basic weighted average shares outstanding	6,126,389	6,376,710
Earnings per share:		
Basic	$ 0.18	$ 0.23
Diluted	$ 0.18	$ 0.23

Options to purchase 214,546 shares at $11.50 and restricted unvested shares of 106,081 were outstanding during 2007, but were not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive.

NOTE 7 COMMITMENTS TO EXTEND CREDIT

The Company has commitments to extend credit with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition.

The Company s exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

The following commitments to extend credit were outstanding:

	Contract Amount	
	September 30, 2007	December 31, 2006
	(In Thousands)	
Commitments to grant loans	**$ 7,957**	$ 5,671
Unfunded commitments under lines of credit	**$ 21,067**	$ 21,298

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management s credit evaluation of the customer. At September 30, 2007 and December 31, 2006, the Company s fixed rate loan commitments totaled $5.8 million and $3.9 million, respectively. The range of interest rates on these fixed rate commitments was 5.45% to 9.75% at September 30, 2007.

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NOTE 8 STOCK-BASED COMPENSATION

As of September 30, 2007, the Company had three stock-based compensation plans, which are described below. The Company accounts for the fair value of its grants under those plans in accordance with SFAS 123R, Share Based Payment . The compensation cost that has been charged against income for these plans was $99,000 for the three months ending September 30, 2007 and $301,000 for the nine months ending September 30, 2007.

Stock Option Plan

The Company s 2006 Stock Option Plan (the Stock Option Plan), which is shareholder-approved, permits the grant of options to its employees and non-employee directors for up to 297,562 shares of common stock. On November 15, 2006, the Board of Directors granted 241,546 of options to members of management and non-employee directors. Both incentive stock options and non-qualified stock options may be granted under the Stock Option Plan. The exercise price of each option equals the market price of the Company s stock on the date of grant and an option s maximum term is ten years. The options generally vest over a five year period.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 1.04%; expected volatility of 9.64%; risk-free interest rate of 4.617%; and expected life of 10 years.

A summary of the status of the Company s stock option plan as of September 30, 2007 is presented below:

	2007	
	Options	**Exercise Price**
Outstanding at beginning of year	241,546	$ 11.50
Granted		
Outstanding as of September 30, 2007	241,546	$ 11.50
Options exerciseable as of September 30, 2007		
Fair value of options granted	$ 3.27	

At September 30, 2007, stock options outstanding did not have an intrinsic value (as the stock price on that date was below the exercise price) and 56,016 options remain unawarded. Compensation expense amounted to $35,000 for the three months ended September 30, 2007 and $105,000 for the nine months ended September 30, 2007 based on 10,793 and 32,017 options earned, respectively, through those dates. At September 30, 2007, $667,000 of unrecognized compensation cost related to stock options is expected to be recognized over a period of 51 months.

Recognition and Retention Plan

The Company s 2006 Recognition and Retention Plan (the RRP), which is shareholder-approved, permits the grant of restricted stock awards (Awards) to employees and non-employee directors for up to 119,025 shares of common stock. On November 15, 2006, the Board of Directors granted 83,305 shares under the RRP to members of management and non-employee directors. Shares vest at a rate of 20% per year with the first vesting period ending December 31, 2007. The fair value of the common stock on the grant date was $11.50. As of September 30, 2007, there were no shares vested or distributed to eligible participants. Compensation expense amounted to $43,000 for the three months ended September 30, 2007 and $127,000 for the nine months ended September 30, 2007 based on 3,721 shares and 11,042 shares earned, respectively, through those dates. At September 30, 2007, $809,000 of unrecognized compensation cost related to the RRP is expected to be recognized over a period of 51 months.

Employee Stock Ownership Plan

In connection with the stock offering, the Company established the Employee Stock Ownership Plan of Lake Shore Bancorp, Inc. (ESOP) for the benefit of eligible employees of the Company and the Bank. All Company and Bank employees meeting certain age and service requirements are eligible to participate in the ESOP. Participants benefits become fully vested after five years of service. As of September 30, 2007, there were 7,905 allocated shares and 230,115 unallocated shares. The ESOP compensation expense was $21,000 for the three months ending September 30, 2007 and $70,000 for the nine months ending September 30, 2007, based on 1,984 and 5,951 shares earned, respectively, for those periods.

NOTE 9 TREASURY STOCK

During the quarter ended June 30, 2007, the Company repurchased 148,781 shares of common stock at an average cost of $12.45 per share, pursuant to the Company s publicly announced common stock repurchase program. As of June 30, 2007, all of the shares authorized by the plan had been repurchased.

NOTE 10 SUBSEQUENT EVENT

On October 17, 2007, the Board of Directors declared a quarterly dividend of $0.04 per share on the Company s common stock, payable on November 16, 2007 to shareholders of record as of November 2, 2007. Lake Shore, MHC, which owns 56% of the Company s outstanding common stock elected to waive its right to receive cash dividends of approximately $109,000 for the three month period ending September 30, 2007 and $327,000 for the nine month period ending September 30, 2007. Lake Shore, MHC has waived approximately $436,000 of cash dividends cumulatively as of September 30, 2007. The dividends waived by Lake Shore, MHC are considered a restriction on the retained earnings of the Company.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements may be identified by words such as believe, will, expect, project, may, could, anticipate, estimate, ir targets and similar expressions. These statements are based upon our current beliefs and expectations and are subject to significant risks and uncertainties. Actual results may differ materially from those set forth in the forward-looking statements as a result of numerous factors.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements:

- general and local economic conditions;
- changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values and competition;
- the ability of our customers to make loan payments;
- our ability to continue to control costs and expenses;
- our ability to effectively deploy the capital raised in our April 2006 initial public offering;
- changes in accounting principles, policies or guidelines;
- our success in managing the risks involved in our business;
- inflation, and market and monetary fluctuations;
- changes in legislation or regulation; and
- other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may differ from actual outcomes. They can be affected by inaccurate assumptions we might make or known or unknown risks and uncertainties. Consequently, no forward-looking statements can be guaranteed. We undertake no obligation to publicly update any forward looking statement, whether as a result of new information, future events or otherwise.

Overview

Lake Shore Savings and Loan Association completed its reorganization from a New York State-chartered mutual savings and loan association into the federal mutual holding company form of organization on April 3, 2006. In connection with the reorganization, Lake Shore Savings and Loan Association changed its name to Lake Shore Savings Bank. When used herein, the name Lake Shore Savings refers to either Lake Shore Savings and Loan Association or Lake Shore Savings Bank, as context requires.

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As part of the reorganization, Lake Shore Bancorp was organized as a federally-chartered corporation, registered as a savings and loan holding company with the Office of Thrift Supervision. Lake Shore Savings became a wholly-owned subsidiary of Lake Shore Bancorp. In connection with the reorganization, Lake Shore Bancorp sold 2,975,625 shares of its common stock to the public, representing 45% of its outstanding shares, at a price of $10.00 per share. The remaining 3,636,875 shares, or 55% of its outstanding shares, were issued to Lake Shore, MHC. Lake Shore, MHC, a federal mutual holding company registered as a savings and loan holding company with the Office of Thrift Supervision (OTS), was formed as part of the reorganization.

The following discussion and analysis is presented to assist in the understanding and evaluation of our consolidated financial condition and results of operations. It is intended to complement the unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q and should be read in conjunction therewith. The detailed discussion focuses on our consolidated financial condition as of September 30, 2007 compared to the financial condition as of December 31, 2006 and the consolidated results of operations for the three and nine months ended September 30, 2007 and 2006.

Our results of operations depend primarily on our net interest income, which is the difference between the interest income we earn on loans and investments and the interest we pay on deposits and other interest-bearing liabilities. Net interest income is affected by the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates we earn or pay on these balances.

Our operations are also affected by non-interest income, such as service fees and gains and losses on the sales of securities and loans, our provision for loan losses and non-interest expenses, which include salaries and employee benefits, occupancy costs, and other general and administrative expenses.

Financial institutions like us are significantly affected by economic conditions, competition, and the monetary and fiscal policies of the federal government. Lending activities are influenced by the demand for and supply of housing, competition among lenders, interest rate conditions, and funds availability. Our operations and lending are principally concentrated in the Western New York area, and our operations and earnings are influenced by local economic conditions. Deposit balances and cost of funds are influenced by prevailing market rates on competing investments, customer preferences, and levels of personal income and savings in our primary market area.

Management Strategy

Our Reputation. With more than 115 years of service to our community, our primary management strategy has been to maintain our reputation as one of the most respected and recognized community banks in Western New York. We strive to accomplish this goal by continuing to emphasize our high quality customer service and financial strength. We are one of the largest lenders in market share of residential mortgages in Chautauqua County.

Branching. In 2003, we opened new branch offices in Orchard Park and East Amherst, New York. These new offices have generated deposits of $24.4 million and $15.1 million as of September 30, 2007, respectively. We also opened a new branch office in Hamburg, New York in December 2005, which has generated deposits of $11.5 million as of September 30, 2007. Our offices are located in Dunkirk, Fredonia, Jamestown, Lakewood and Westfield, in Chautauqua County, New York and in East Amherst, Hamburg and Orchard Park in Erie County, New York. Saturation of the market in Chautauqua County led to our expansion plan in Erie County, which is a critical component of our future profitability and growth.

Our People. A large part of our success is related to customer service and customer satisfaction. Having employees who understand and value our clientele and their business is a key component to our success. We believe that our employees constitute one of our competitive strengths. Thus, the retention of such persons and our ability to continue to attract high quality personnel are high priorities.

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Residential Mortgage and Other Lending. Historically, our lending portfolio has been composed predominantly of residential mortgage loans. At September 30, 2007 and December 31, 2006, we held $156.6 million and $149.4 million of residential mortgage loans, respectively, which constituted 72.4% and 72.7% of our total loan portfolio, at such respective dates. We also originate commercial real estate loans to finance the purchase of real property, which generally consists of developed real estate. At September 30, 2007 and December 31, 2006, our commercial real estate loan portfolio consisted of loans totaling $19.3 million and $17.2 million respectively, or 8.9% and 8.3%, respectively, of total loans. In addition to commercial real estate loans, we also engage in small business commercial lending, including business installment loans, lines of credit, and other commercial loans. At September 30, 2007 and December 31, 2006, our commercial loan portfolio consisted of loans totaling $8.1 million and $8.7 million, respectively, or 3.8% and 4.3%, respectively, of total loans. Other loan products offered to our customers include home equity loans, construction loans and consumer loans, including auto loans, overdraft lines of credit and share loans. We will sell loans when appropriate and will retain servicing rights to those loans. We will invest excess funds in permissible investments such as mortgage-backed securities and asset-backed securities, when such investment opportunities are prudent. Residential mortgage loans will continue to be the dominant type of loan in our lending portfolio.

Investment Strategy. Our investment policy is designed primarily to manage the interest rate sensitivity of our assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity within established guidelines. At September 30, 2007 and December 31, 2006, our investment securities totaled $112.0 million and $110.5 million, respectively.

Treasury Yield Curve. Banks generate revenue on the difference between the interest earned on loans, which are generally for longer terms, and the interest paid on deposits, which are generally for shorter terms. This mismatch between shorter term deposits and longer term loans usually produces a positive contribution to earnings because the yield curve is normally positively sloped. From May 2004 until July 2007, the Federal Reserve had increased the short-term federal funds rate. During this time frame, short and intermediate term interest rates increased, while some long term rates, most notably the yield on 30 year U.S. Treasury bonds decreased. The yield curve became inverted with short term interest rates higher than long term rates. In this environment, the margin between interest earning assets and interest bearing liabilities began to shrink, resulting in reduced net interest income. Furthermore, the rate earned on new investments and loans did not necessarily offset the cost of repricing deposits and borrowings. In addition, borrowers that had adjustable rate loans may have opted to prepay their loans rather than pay more interest because loan rates have adjusted higher. Adjustable rate loans are generally tied to short term indexes that move in conjunction with the changes in interest rates orchestrated by the Federal Reserve. If we experience a high level of prepayments on adjustable rate loans, that could reduce interest income.

The inverted yield curve during the eight month period ending August 31, 2007 made it difficult to execute an organic growth strategy to improve income. Most depositors prefer shorter term deposits. When banks have to pay higher rates to attract new deposits, the marginal cost may exceed the marginal revenue earned on new loans or investments, due in part because short term rates are higher than long term rates. Attracting short term deposits may also increase the repricing mismatch between assets and liabilities.

In September 2007, the Federal Reserve cut the federal funds rate by 50 basis points to 4.75%. That action, combined with the continued weakness in the housing market and credit concerns over sub-prime loan defaults has caused the Treasury yield curve to shift. On July 1, 2007 the yield curve was virtually flat at 5%. During the quarter ended September 30, 2007, yields on short-term maturities were down by 80 to 90 basis points, and yields on intermediate term maturities were down by 30 to 50 basis points.

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For example, the yield on the 2 year Treasury bond declined from 4.86% to 4.00% at the end of the quarter and the yield on the 10 year Treasury bond declined from 5.02% to 4.86%. However, because of credit concerns over mortgage related securities, the yield spread for mortgage securities widened over Treasury bonds. For example, on June 30, 2007 we offered 30 year fixed rate loans at a rate of 6.50%. On September 30, 2007, the rate we offered on these loan types was 6.375%, a decline of only 12.5 basis points. Given the changes in the treasury yield curve and spread relationships, our net interest margin could improve if our funding costs decline and if interest rates on loans remain relatively unchanged.

The change in the yield curve in September 2007 will allow us to reprice some of our short term borrowings to lower interest rates and allow us to reduce the interest rates we offer on our certificates of deposit, which may increase our net interest margin. If we reduce rates on our deposit products, our deposit balances may decrease, which may require us to tap into other funding sources to grow our balance sheet.

We anticipated that the housing crisis would create credit problems for the economy, so we avoided credit risk. We remain free of exposure to credit problems that are affecting many lenders. We do not have any sub-prime loans or other high-risk mortgage products within our loan or investment portfolios. Our strategy to improve interest income was to increase our interest rate risk exposure. To mitigate the risk of falling interest rates on our adjustable rate home equity and commercial loans, we purchased an interest rate floor product during August 2006 for $221,000 on a notional principal amount of $10 million. This product allows us to receive payments if the prime rate drops below 8%. The prime rate as of September 30, 2007 was 7.75%. As a result, we will begin to receive payments on the interest rate floor product, which will offset the expected loss in loan interest income on adjustable rate loans that are tied to the prime rate. The interest rate floor expires on August 1, 2011. Refer to Note 3 of Notes to our Consolidated Financial Statements for more information.

We believe that the cumulative impact of the strategies we elected to pursue will improve our earnings in a lower interest rate environment.

We employ a third party financial advisor to assist us in managing the investment portfolio and developing balance sheet strategies. At September 30, 2007 and December 31, 2006, we had $108.9 million and $108.0 million, respectively, invested in securities available for sale, the majority of which are mortgage-backed or asset backed securities. All of our mortgage-backed and asset-backed securities are rated AAA or are guaranteed by an agency of the federal government. We do not own any collateralized debt obligations (CDOs).

Critical Accounting Policies

It is management s opinion that accounting estimates covering certain aspects of our business have more significance than others due to the relative importance of those areas to overall performance, or the level of subjectivity required in making such estimates. Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance for loan losses required for probable credit losses and the material effect that such judgments can have on the results of operations. Management s quarterly evaluation of the adequacy of the allowance considers our historical loan loss experience, review of specific loans, current economic conditions, and such other factors considered appropriate to estimate loan losses. Management uses presently available information to estimate probable losses on loans; however, future additions to the allowance may be necessary based on changes in estimates, assumptions, or economic conditions. Significant factors that could give rise to changes in these estimates include, but are not limited to, changes in economic conditions in the local area, concentrations of risk and decline in local property values.

Our evaluation of risk in maintaining the allowance for loan losses includes the review of all loans on which the collectibility of principal may not be reasonably assured. We consider the following factors as part of this evaluation: historical loan loss experience, payment status, the estimated value of the underlying collateral, loans originated in areas outside of the historic market area for loan activity, trends in loan volume, and national and local economic conditions. There may be other factors that may warrant consideration in maintaining an allowance at a level sufficient to provide for probable loan losses. Although our management believes that it has established and maintained the allowance for loan losses to reflect losses inherent in our loan portfolio, based on its evaluation of the factors noted above, future additions may be necessary if economic and other conditions differ substantially from the current operating environment.

The allowance consists of allocated, general and unallocated components. The allocated component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value for that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management also considers the accounting policy relating to the impairment of investments to be a critical accounting policy due to the subjectivity and judgment involved and the material effect an impairment loss could have on the results of operations. A decline in the fair value of investments below cost deemed to be other than temporary is charged to earnings resulting in the establishment of a new cost basis for an asset. Management continually reviews the current value of its investments for evidence of other than temporary impairment.

These critical policies and their application are reviewed periodically by our Audit Committee and our Board of Directors. All accounting policies are important, and as such, we encourage the reader to review each of the policies included in the notes to the consolidated financial statements of our audited consolidated financial statements included in Form 10-K for the year ended December 31, 2006 to better understand how our financial performance is reported.

Analysis of Net Interest Income

Net interest income represents the difference between the interest we earn on our interest-earning assets, such as mortgage loans and investment securities, and the expense we pay on interest-bearing liabilities, such as time deposits. Net interest income depends on both the volume of our interest-earning assets and interest-bearing liabilities and the interest rates we earn or pay on them.

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Average Balances, Interest and Average Yields. The following tables set forth certain information relating to our average balance sheets and reflects the average yields on interest-earnings assets and average cost of interest-bearing liabilities, interest earned and interest paid for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods presented. Average balances are derived from daily balances over the periods indicated. The average balances for loans are net of allowance for loan losses, but include non-accrual loans. Interest income on securities does not include a tax equivalent adjustment for bank qualified municipals.

	At September 30, 2007		For the Three Months ended September 30, 2007			For the Three Months ended September 30, 2006		
	Actual Balance	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
			(Dollars in thousands)					
Interest-earning assets:								
Federal funds sold & other interest-bearing deposits	$ 1,230	5.01%	$ 1,348	$ 3	0.89%	$ 13,789	$ 158	4.58%
Securities	111,998	4.45%	111,319	1,251	4.50%	104,292	1,148	4.39%
Loans	216,739	6.06%	212,435	3,523	6.63%	205,410	3,239	6.31%
Total interest-earning assets	329,967	5.38%	325,102	4,777	5.88%	323,491	4,545	5.62%
Other assets	26,404		26,464			21,693		
Total assets	$ 356,371		$ 351,566			$ 345,184		
Interest-bearing liabilities:								
Demand and NOW accounts	$ 36,089	0.68%	$ 36,907	$ 60	0.65%	$ 37,057	$ 62	0.67%
Money market accounts	22,183	1.48%	24,040	79	1.31%	24,594	66	1.07%
Savings accounts	27,088	0.50%	27,427	35	0.51%	27,221	38	0.56%
Time deposits	136,890	4.57%	138,671	1,575	4.54%	135,354	1,338	3.95%
Borrowed funds	56,862	3.40%	45,668	517	4.53%	45,568	480	4.21%
Other interest-bearing liabilities	1,389	8.64%	1,391	30	8.63%	1,411	30	8.50%
Total interest bearing liabilities	280,501	3.22%	274,104	2,296	3.35%	271,205	2,014	2.94%
Other non-interest bearing liabilities	22,583		24,826			20,173		
Stockholders equity	53,287		52,636			53,806		
Total liabilities and stockholders equity	$ 356,371		$ 351,566			$ 345,184		
Net interest income				$ 2,481			$ 2,531	
Interest rate spread					2.53%			2.68%
Net interest margin					3.05%			3.13%

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	At September 30, 2007		For the Nine Months ended September 30, 2007			For the Nine Months ended September 30, 2006		
	Actual Balance	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
			(Dollars in thousands)					
Interest-earning assets:								
Federal funds sold & other interest-bearing deposits	$ 1,230	5.01%	$ 4,264	$ 114	3.56%	$ 16,909	$ 551	4.33%
Securities	111,998	4.45%	110,513	3,737	4.51%	103,455	3,321	4.27%
Loans	216,739	6.06%	208,259	9,849	6.31%	205,281	9,451	6.12%
Total interest-earning assets	329,967	5.38%	323,036	13,700	5.65%	325,645	13,323	5.44%
Other assets	26,404		25,420			23,167		
Total assets	$ 356,371		$ 348,456			$ 348,812		
Interest-bearing liabilities:								
Demand and NOW accounts	$ 36,089	0.68%	$ 37,007	$ 183	0.66%	$ 37,214	$ 154	0.55%
Money market accounts	22,183	1.48%	24,804	247	1.33%	25,910	190	0.98%
Savings accounts	27,088	0.50%	26,883	102	0.51%	25,665	108	0.56%
Time deposits	136,890	4.57%	140,341	4,693	4.46%	138,934	3,784	3.62%
Borrowed funds	56,862	3.40%	43,579	1,450	4.44%	49,932	1,545	4.12%
Advances from borrowers on taxes and insurance***						2,135	22	1.37%
Other interest-bearing liabilities	1,389	8.64%	1,396	90	8.60%	1,416	91	8.55%
Total interest bearing liabilities	280,501	3.22%	274,010	6,765	3.29%	281,206	5,894	2.78%
Other non-interest bearing liabilities	22,583		20,925			25,905		
Stockholders equity	53,287		53,521			41,701		
Total liabilities and stockholders equity	$ 356,371		$ 348,456			$ 348,812		
Net interest income				$ 6,935			$ 7,429	
Interest rate spread					2.36%			2.66%
Net interest margin					2.86%			3.03%

*** Beginning in July 2006, we no longer paid interest on funds held in escrow accounts. In 2007, the balance of funds in escrow accounts is included in the other non-interest bearing liabilities section.

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Rate Volume Analysis. The following tables analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It shows the amount of the change in interest income or expense caused by either changes in outstanding balances (volume) or changes in interest rates. The effect of a change in volume is measured by applying the average rate during the first period to the volume change between the two periods. The effect of changes in rate is measured by applying the change in rate between the two periods to the average volume during the first period. Changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to the absolute value of the change due to volume and the change due to rate.

	Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006		
	Rate	**Volume**	**Net Change**
		(Dollars in thousands)	
Interest-earning assets:			
Federal funds sold and other interest-bearing deposits	$ (73)	$ (82)	$ (155)
Securities	24	79	103
Loans	171	113	284
Total interest-earning assets	122	110	232
Interest-bearing liabilities:			
Demand and NOW accounts	(2)		(2)
Money market accounts	15	(2)	13
Savings accounts	(3)		(3)
Time deposits	204	33	237
Total deposits	214	31	245
Other interest-bearing liabilities:			
Borrowed funds	36	1	37
Total interest-bearing liabilities	250	32	282
Net change in interest income	$ (128)	$ 78	$ (50)

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	Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006		
	Rate	Volume	Net Change
	(Dollars in thousands)		
Interest-earning assets:			
Federal funds sold and other interest-bearing deposits	$ (85)	$ (352)	$ (437)
Securities	183	233	416
Loans	260	138	398
Total interest-earning assets	358	19	377
Interest-bearing liabilities:			
Demand and NOW accounts	30	(1)	29
Money market accounts	65	(8)	57
Savings accounts	(11)	5	(6)
Time deposits	870	39	909
Total deposits	954	35	989
Other interest-bearing liabilities:			
Borrowed funds	111	(206)	(95)
Advances from borrowers on taxes and insurance and other interest-bearing liabilities	(21)	(2)	(23)
Total interest-bearing liabilities	1,044	(173)	871
Net change in interest income	$ (686)	$ 192	$ (494)

Our earnings may be adversely impacted by an increase in interest rates because the majority of our interest-earning assets are long-term, fixed rate mortgage-related assets that will not reprice as long-term interest rates increase. Conversely, a majority of our interest-bearing liabilities have much shorter contractual maturities and are expected to reprice. A significant portion of our deposits have no contractual maturities and are likely to reprice quickly as short-term interest rates increase. Therefore, in an increasing rate environment, our cost of funds is expected to increase more rapidly than the yields earned on our loan portfolio and securities portfolio. An increasing rate environment is expected to cause a further narrowing of our net interest rate spread and a decrease in our earnings.

However, in September 2007, interest rates began to decrease. In a decreasing interest rate environment, our earnings may increase if long-term interest-earning assets do not reprice and interest rates on short-term deposits begin to decrease.

For the three months ended September 30, 2007, the average yield/rate on our loan and investment portfolios were 6.63% and 4.50%, respectively, in comparison to rates of 6.31% and 4.39%, respectively, for the three months ended September 30, 2006. The increase in yield on our loan portfolio during the three months ended September 30, 2007 in comparison to the same period in the prior year is partially due to the $176,000 gain incurred on our interest rate floor product during the quarter ended September 30, 2007. This gain is recorded as an increase to loan interest income. Overall, the average yield/rate on our interest earning assets has increased by 0.26% for the three months ended September 30, 2007 in comparison to the three months ended September 30, 2006. For the three months ended September 30, 2007, the average yield/rate that we were paying on deposit products had increased by 0.40% in comparison to the same period in the prior year. Furthermore, the interest paid on our borrowings had increased from 4.21% to 4.53%. Our interest rate spread for the three months ended September 30, 2007 was 2.53%, which was a 0.15% decrease in comparison to the three months ended September 30, 2006. Our net interest margin was 3.05% and 3.13% as of September 30, 2007 and 2006, respectively.

For the nine months ended September 30, 2007, the average yield/rate on our loan and investment portfolios were 6.31% and 4.51%, respectively, in comparison to rates of 6.12% and 4.27%, respectively, for the nine months ended September 30, 2006. Overall, the average yield/rate on our interest earning assets has increased by 0.21% for the nine months ended September 30, 2007 in comparison

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to the nine months ended September 30, 2006. For the nine months ended September 30, 2007, the average yield/rate that we were paying on deposit products had increased by 0.57% in comparison to the same period in the prior year. Furthermore, the interest paid on our borrowings had increased from 4.12% to 4.44%. Our interest rate spread for the nine months ended September 30, 2007 was 2.36%, which was a 0.30% decrease in comparison to the nine months ended September 30, 2006. Our net interest margin was 2.86% and 3.03% as of September 30, 2007 and 2006, respectively.

Comparison of Financial Condition at September 30, 2007 and December 31, 2006

Total assets at September 30, 2007 were $356.4 million, an increase of $2.2 million from $354.2 million at December 31, 2006. The increase in total assets is primarily due to an $11.1 million increase in loans receivable, net and a $1.5 million increase in the investment portfolio, partially offset by a $10.7 million decrease in cash and cash equivalents.

Cash and cash equivalents decreased by $10.7 million from $18.7 million as of December 31, 2006 to $8.0 million as of September 30, 2007. The decrease is attributable to an $8.4 million decrease in federal funds sold. Federal funds sold decreased due to cash being utilized to repurchase $1.9 million of outstanding common stock under our stock repurchase plan during the second quarter. For the nine months ended September 30, 2007, we had an overall net decrease in total deposits of $9.5 million due to the competitive interest rate environment on deposit accounts in our market area. We have opted to allow deposit outflows, primarily in certificates of deposit, rather than to reprice our deposit base at higher rates.

Investment securities increased by $1.5 million to $112.0 million at September 30, 2007 from $110.5 million at December 31, 2006. The increase is attributable to the purchase of new securities in excess of the receipt of paydowns from securities within our investment portfolio. We do not have any exposure to sub-prime loans in our investment portfolio. All of our mortgage-backed and asset-backed securities are rated AAA or are guaranteed by an agency of the federal government. We do not own any collateralized debt obligations (CDOs).

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Loans receivable, net increased by $11.1 million to $216.7 million at September 30, 2007 from $205.7 million at December 31, 2006. The table below shows the changes in loan volume by loan type between December 31, 2006 and September 30, 2007:

	September 30, 2007	December 31, 2006	Change $	Change %
		(in thousands)		
Real Estate Loans:				
Residential, 1-4 Family	$ 156,560	$ 149,408	$ 7,152	4.8%
Home Equity	26,687	25,896	791	3.1%
Commercial	19,293	17,150	2,143	12.5%
Construction	3,050	1,570	1,480	94.3%
	205,590	194,024	11,566	6.0%
Commercial Loans	8,124	8,746	(622)	(7.1)%
Consumer Loans	2,561	2,689	(128)	(4.8)%
Total Gross Loans	216,275	205,459	10,816	5.3%
Allowance for Loan Losses	(1,280)	(1,257)	(23)	(1.8)%
Net deferred loan costs	1,744	1,475	269	18.2%
Loans receivable, net	$ 216,739	$ 205,677	$ 11,062	5.4%

The increase in commercial real estate loans and construction loans is attributable to our efforts to increase originations in this area. Residential mortgage loans increased due to increased sales of new and existing homes during the nine month period ending September 30, 2007. Mortgage loans and commercial real estate loans represented 72.4% and 8.9%, respectively, of the loan portfolio at September 30, 2007. We do not carry any sub-prime loans in our mortgage portfolio.

The table below shows changes in deposit volumes by type of deposit between December 31, 2006 and September 30, 2007:

	September 30, 2007	December 31, 2006	Change $	Change %
		(in thousands)		
Demand Deposits:				
Non-interest bearing	$ 17,931	$ 17,458	$ 473	2.7%
Interest bearing	36,089	38,992	(2,903)	(7.4)%
Money market	22,183	24,551	(2,368)	(9.6)%
Savings	27,088	25,922	1,166	4.5%
Time deposits	136,890	142,714	(5,824)	(4.1)%
Total Deposits	$ 240,181	$ 249,637	$ (9,456)	(3.8)%

The overall decrease in time deposits may be attributed to the competitive interest rates being offered by other banks, credit unions, mutual funds and financial service groups in our market area and our unwillingness to pay premium rates that will increase our interest expense. We have opted to allow deposit outflows, primarily in time deposits, rather than to reprice our deposit base at higher rates.

Our borrowings, consisting of advances from the Federal Home Loan Bank of New York, increased by $13.5 million from $43.4 million at December 31, 2006, to $56.9 million at September 30, 2007. The increase in borrowings is attributed to the increase of $11.1 million in our loans receivable and the decrease of $9.5 million in our deposit portfolio. Typically, we fund new loans with loan payments received from existing borrowers and from increases in our deposit portfolio. During the nine months ended September 30, 2007, we closed more new loans than funding was available from these two sources. As a result, we had to obtain the necessary funds for these new loans by drawing on borrowing capabilities at the Federal Home Loan Bank.

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Total stockholders equity decreased by $460,000 from $53.7 million at December 31, 2006 to $53.3 million at September 30, 2007. The decrease in total stockholders equity was primarily due to the purchase of $1.9 million in outstanding common stock under our stock repurchase plan during the second quarter. The decrease was offset by net income of $1.1 million for the nine months ending September 30, 2007. Stockholders equity was also affected by an increase in the net of tax unrealized gain on securities available for sale of $190,000. Dividends declared and paid in 2007 reduced stockholders equity by $242,000 and stock-based compensation expenses increased stockholders equity by $301,000.

Comparison of Results of Operations for the Three Months Ended September 30, 2007 and 2006

General. Net income was $542,000 for the three months ended September 30, 2007 a decrease of $38,000, or 6.6%, compared to net income of $580,000 for the three months ended September 30, 2006. The decrease in net income is attributed to an increase in non-interest expenses of $193,000, or 9.2% to $2.3 million for the three months ended September 30, 2007 from $2.1 million for the three months ended September 30, 2006, partially offset by a $117,000 decrease in income tax expense and a $43,000 increase in non-interest income. Earnings per share remained steady at $0.09 per share for the three months ended September 30, 2007 and 2006.

Interest Income. Interest income increased $232,000 or 5.1%, from $4.5 million for the three months ended September 30, 2006 to $4.8 million for the three months ended September 30, 2007. Loan interest income increased by $284,000, or 8.8% from $3.2 million for the three months ended September 30, 2006 to $3.5 million for the three months ended September 30, 2007. The average balance on our loan portfolio increased $7.0 million from an average balance of $205.4 million for the three months ended September 30, 2006 to an average balance of $212.4 million for the three months ended September 30, 2007. The average yield on our loan portfolio increased from 6.31% to 6.63% for the three months ended September 30, 2006 and 2007, respectively. Interest income on our loan portfolio was increased by a $176,000 gain on the fair value of our interest rate floor derivative product during the three months ended September 30, 2007. Investment interest income increased by $103,000, or 9.0% from $1.1 million for the quarter ended September 30, 2006 to $1.3 million for the quarter ended September 30, 2007. The investment portfolio had an average balance of $111.3 million and an average yield of 4.5% for the quarter ended September 30, 2007 compared to an average balance of $104.3 million and an average yield of 4.4% for the quarter ended September 30, 2006. Other interest income decreased by $155,000, or 98.1%, from $158,000 for the quarter ended September 30, 2006 to $3,000 for the quarter ended September 30, 2007. This occurred due to the decrease in the average balance of federal funds sold and other interest bearing deposits from $13.8 million for the quarter ended September 30, 2006 to $1.3 million for the quarter ended September 30, 2007. The proceeds from our stock offering on April 3, 2006 were initially invested in federal funds sold. Since that time, the proceeds have been moved to other investments, resulting in the significant decrease in the average federal funds sold balance.

Interest Expense. Interest expense increased by $282,000 or 14.0%, from $2.0 million for the three months ended September 30, 2006 to $2.3 million for the three months ended September 30, 2007. The interest paid on deposits increased by $245,000 from $1.5 million for the three months ended September 30, 2006 to $1.7 million for the three months ended September 30, 2007. This was due to an increase in the average yield paid on interest-bearing deposits from 2.68% for the three months ended September 30, 2006 to 3.08% for the three months ended September 30, 2007. The interest expense related to advances from the Federal Home Loan Bank of New York increased by $37,000, or 7.7%, from $480,000 for the three months ended September 30, 2006 to $517,000 for the three months ended September 30, 2007. The average yield on these borrowings increased from 4.21% for the three months ending September 30, 2006 to 4.53% for the three months ending September 30, 2007.

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***Provision for Loan Losses*.** For the three months ended September 30, 2007 and 2006, a provision for loan losses of $0 and $45,000 was recorded, respectively. A provision for loan losses was not deemed necessary during the three months ended September 30, 2007 based on management s evaluation of various factors, including trends in loan volume, type and volume of loans, and collection efforts. Management will continue to evaluate its allowance for loan losses on a quarterly basis.

We establish provisions for loan losses, which are charged to operations, in order to maintain the allowance for loan losses at a level management considers necessary to absorb probable incurred credit losses in the loan portfolio. The amount of allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or later events occur. Management assesses the allowance for loan losses on a quarterly basis and makes provisions for loan losses in order to maintain the adequacy of the allowance.

***Non-interest Income*.** For the three months ended September 30, 2007, non-interest income, which is a total of service charges and fees, earnings on bank-owned life insurance, and other income totaled $530,000, which was an increase of $43,000 in comparison to the corresponding period in the prior year. The increase is attributed to $56,000 of increased earnings on bank owned life insurance, resulting from our purchase of an additional $3.8 million of bank owned life insurance in the fourth quarter of 2006 to fund supplemental employee retirement plans. The increase was partially offset by a $12,000 decrease in service charges and fees.

***Non-interest Expense*.** Non-interest expense increased by $193,000 or 9.2 % from $2.1 million for the three months ended September 30, 2006 to $2.3 million for the three months ended September 30, 2007. Non-interest expense includes the expense of salaries and employee benefits, occupancy and equipment, data processing and other items not related to expenses on deposits or borrowings. Salaries and employee benefits increased by $95,000, or 8.6%, due to $99,000 in additional expenses for stock-based plans that were implemented after being approved by shareholders in October 2006. Professional service fees increased by $49,000, or 18.1%, due to increased expenses for legal and other services related to being a public company. In addition, funds were paid to an outside consultant during the three months ending September 30, 2007 for services relating to enhancement of fee income. As a result of these services, we project fee income to increase during the remainder of 2007 and into 2008. Data processing expenses increased by $24,000 this quarter due to increased expenses relating to electronic transaction processing as a result of adding two new off-site ATMs to our network in 2007 and due to increased use of debit cards by our customers. Advertising expense increased by $15,000 during the current quarter, in comparison to the same quarter last year, due to targeted efforts to reach additional customers in our market area via television.

***Income Tax Expense*.** Income taxes decreased by $117,000, or 39.1%, from $299,000 for the three months ended September 30, 2006 to $182,000 for the three months ended September 30, 2007. This was partially attributable to lower income before income taxes during the three month period ended September 30, 2007 as compared to the same period in the prior year. During the quarter ended September 30, 2007, our tax-exempt income on our municipal bond portfolio and bank-owned life insurance increased in total as well as a percentage of pre-tax income in comparison to the quarter ended September 30, 2006. Our municipal bond portfolio has more than doubled since September 30, 2006 and income on bank-owned life insurance has increased due to an additional purchase during the fourth quarter of 2006. As a result, our effective tax rate was reduced from 34.0% for the three months ended September 30, 2006 to 25.1% for the three months ended September 30, 2007. The effective tax rate for the quarter ended September 30, 2007 increased by 6.1% from 19.0% for the quarter ended June 30, 2007. The increase in the effective tax rate during the third quarter of 2007 is primarily attributed to an increase in the mix of taxable income as compared to tax-exempt income that was projected as of June 30, 2007. As taxable income is higher than expected, additional tax expense needed to be posted during the third quarter of 2007.

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Comparison of Results of Operations for the Nine Months Ended September 30, 2007 and 2006

General. Net income was $1.1 million for the nine months ended September 30, 2007, a decrease of $299,000, or 20.7%, compared to net income of $1.4 million for the nine months ended September 30, 2006. The decrease in net income was primarily attributed to a $483,000 decrease in net interest income from $7.4 million for the nine month period ended September 30, 2006 to $6.9 million for the nine months ended September 30, 2007. The decrease in net interest income is primarily attributable to an increase in deposit interest expense of $989,000, partially offset by an increase in interest income of $377,000 and a decrease in interest expense on borrowings of $95,000.

Interest Income. Interest income increased $377,000 or 2.8%, from $13.3 million for the nine months ended September 30, 2006 to $13.7 million for the nine months ended September 30, 2007. A majority of this increase is due to a $416,000 increase in interest on investment securities, the average balance of which increased by $7.1 million over the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The investment portfolio had an average yield of 4.51% for the nine months ended September 30, 2007 compared to an average yield of 4.27% for the nine months ended September 30, 2006. Interest income on loans increased $398,000 from $9.5 million for the nine months ending September 30, 2006 to $9.8 million for the nine months ending September 30, 2007. The average yield on the loan portfolio increased from 6.12% for the nine months ending September 30, 2006 to 6.31% for the nine months ended September 30, 2007 due to an increase in our loan volume and an increase in rates on loan products. Interest income on our loan portfolio was affected by a $75,000 gain on the fair value of our interest rate floor derivative product during the nine months ended September 30, 2007. The increase in interest income on loans and investment securities was partially offset by a $437,000 decrease in other interest income. This decrease was attributable to a decrease in the average balance of Fed Funds sold and other interest bearing deposits from $16.9 million as of September 30, 2006 to $4.3 million as of September 30, 2007. The average yield on Fed Funds sold and other interest bearing deposits was 3.56% for the nine months ending September 30, 2007 compared to 4.33% for the nine months ended September 30, 2006. The proceeds from our stock offering on April 3, 2006 were initially invested in federal funds sold. Since that time, the proceeds have been moved to other investments, resulting in the significant decrease in the average federal funds sold balance.

Interest Expense. Interest expense increased by $871,000 or 14.8%, from $5.9 million for the nine months ended September 30, 2006 to $6.8 million for the nine months ended September 30, 2007. The interest paid on deposits increased by $989,000 from $4.2 million for the nine months ended September 30, 2006 to $5.2 million for the nine months ended September 30, 2007. This was due to an increase in the average yield paid on interest-bearing deposits from 2.47% for the nine months ended September 30, 2006 to 3.04% for the nine months ended September 30, 2007. The interest expense related to advances from the Federal Home Loan Bank of New York decreased by $95,000 from $1.5 million for the nine months ended September 30, 2006 to $1.4 million for the nine months ended September 30, 2007. While the average yield on these borrowings increased from 4.12% for the nine months ending September 30, 2006 to 4.44% for the nine months ending September 30, 2007, the average balance decreased from $49.9 million as of September 30, 2006 to $43.6 million as of September 30, 2007.

Provision for Loan Losses. For the nine months ended September 30, 2007 and 2006, a provision for loan losses of $45,000 and $56,000 was recorded, respectively. The decrease during the nine months ended September 30, 2007 was based on management s evaluation of various factors, including trends in loan volume, type and volume of loans, and collection efforts. Management will continue to evaluate its allowance for loan losses on a quarterly basis.

We establish provisions for loan losses, which are charged to operations, in order to maintain the allowance for loan losses at a level management considers necessary to absorb probable incurred credit losses in the loan portfolio. The amount of allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or later events occur. Management assesses the allowance for loan losses on a quarterly basis and makes provisions for loan losses in order to maintain the adequacy of the allowance.

***Non-interest Income*.** For the nine months ended September 30, 2007, non-interest income, which is a total of service charges and fees, earnings on bank-owned life insurance, and other income totaled $1.5 million, which was an increase of $175,000 in comparison to the corresponding period in the prior year. $166,000 of the increase is due to increased earnings on bank owned life insurance, resulting from our purchase of an additional $3.8 million of bank owned life insurance in the fourth quarter of 2006 to fund supplemental employee retirement plans.

***Non-interest Expense*.** Non-interest expense increased by $392,000 or 6.0% from $6.5 million for the nine months ended September 30, 2006 to $6.9 million for the nine months ended September 30, 2007. Non-interest expense includes the expense of salaries and employee benefits, occupancy and equipment, data processing and other items not related to expenses on deposits or borrowings. Salaries and employee benefits increased by $226,000, or 6.5%, due to annual raises and $301,000 in additional expenses for stock-based incentive plans that were implemented after being approved by shareholders in October 2006. Professional service fees increased by $232,000, or 33.5%, due to increased expenses for legal and other services related to being a public company. In addition, $93,000 was accrued for payment to an outside consultant during the nine months ending September 30, 2007 for services relating to enhancement of fee income. As a result of these services, we project fee income to increase during the remainder of 2007 and into 2008. Occupancy and equipment expenses decreased by $60,000, or 5.7%, due to assets being fully depreciated during the nine months ended September 30, 2007, whereas in the same period last year, these assets were still on the depreciation schedule.

***Income Tax Expense*.** Income taxes decreased by $401,000, or 56.0%, from $716,000 for the nine months ended September 30, 2006 to $315,000 for the nine months ended September 30, 2007. This was partially attributable to lower income before income taxes during the nine month period ended September 30, 2007 as compared to the same period in the prior year. During the nine months ended September 30, 2007, our tax-exempt income on our municipal bond portfolio and bank-owned life insurance increased in total as well as a percentage of pre-tax income in comparison to the same period in the prior year. Our municipal bond portfolio has more than doubled since September 30, 2006 and income on bank-owned life insurance has increased due to an additional purchase during the fourth quarter of 2006. As a result, our effective tax rate was reduced from 33.2% for the nine months ended September 30, 2006 to 21.6% for the nine months ended September 30, 2007.

Liquidity and Capital Resources

Liquidity describes our ability to meet the financial obligations that arise during the ordinary course of business. Liquidity is primarily needed to meet the lending and deposit withdrawal requirements of our customers and to fund current and planned expenditures. Our primary sources of funds consist of deposits, scheduled amortization and prepayments of loans and mortgage-backed and asset-backed securities, maturities and sales of other investments, interest bearing deposits at other financial institutions and funds provided from operations. We have written agreements with the Federal Home Loan Bank of New York, which as of September 30, 2007, allowed us to borrow up to $31.5 million on an overnight line of credit and $31.5 million on a one-month overnight repricing line of credit As of September 30, 2007 we had borrowed $12.2 million on the overnight line of credit. We had no borrowings on the one-month overnight repricing line of credit. We also have a third agreement to obtain advances from the Federal Home Loan Bank collateralized by a pledge of our mortgage loans. At September 30, 2007, we had outstanding advances on this agreement totaling $44.7 million.

Loan repayments and maturing investment securities are a relatively predictable source of funds. However, deposit flows, calls of investment securities, and prepayments of loans and mortgage-backed securities are strongly influenced by interest rates, general and local economic conditions, and competition in the marketplace. These factors reduce the predictability of the timing of these sources of funds.

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Our primary investing activities include the origination of loans and, to a lesser extent, the purchase of investment securities. For the nine months ended September 30, 2007 and 2006, we originated loans of approximately $37.0 million and $29.9 million, respectively. Purchases of investment securities totaled $13.4 million in the nine months ended September 30, 2007 and $22.0 million in the nine months ended September 30, 2006.

At September 30, 2007, we had loan commitments to borrowers of approximately $8.0 million and overdraft lines of protection and unused home equity lines of credit of approximately $21.1 million.

Total deposits were $240.2 million at September 30, 2007, as compared to $249.6 million at December 31, 2006. Time deposit accounts scheduled to mature within one year were $123.9 million at September 30, 2007. The decrease in total deposits occurred when management decided not to match high interest rates being offered by competitors in our market area, as it would have had a negative effect on our net interest margin and earnings. Recently, competitor rates have moved in line with the rates we are offering. As a result, we do not anticipate additional losses in our deposit portfolio. We also anticipate that a significant portion of the time deposits that are scheduled to mature within one year will remain with us.

We are committed to maintaining a strong liquidity position; therefore, we monitor our liquidity position on a daily basis. We anticipate that we will have sufficient funds to meet our current funding commitments. The marginal cost of new funding, however, whether from deposits or borrowings from the Federal Home Loan Bank, will be carefully considered as we monitor our liquidity needs. Therefore, in order to minimize our cost of funds, we may consider additional borrowings from the Federal Home Loan Bank in the future.

Loans Past Due and Non-performing Assets. We define non-performing loans as loans that are either non-accruing or accruing whose payments are 90 days or more past due. Non-performing assets, including non-performing loans and foreclosed real estate, totaled $1.6 million at September 30, 2007 and $1.5 million at December 31, 2006.

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The following table presents information regarding our non-accrual loans, accruing loans delinquent 90 days or more, and foreclosed real estate as of the dates indicated.

	At September 30, 2007 (Unaudited)	At December 31, 2006
	(Dollars in thousands)	
Loans past due 90 days or more but still accruing:		
Mortgage loans on real estate:		
One-to-four family	$ 189	$ 503
Construction		
Commercial real estate	198	133
Home equity loans and lines of credit	95	83
Other loans:		
Commercial loans	37	
Consumer loans		
Total	$ 519	$ 719
Loans accounted for on a nonaccrual basis:		
Mortgage loans on real estate:		
One-to-four family	$ 886	$ 579
Construction		
Commercial real estate		
Home equity loans and lines of credit	119	4
Other loans:		
Commercial loans		
Consumer loans	12	7
Total non-accrual loans	1,017	590
Total nonperforming loans	1,536	1,309
Foreclosed real estate	34	183
Restructured loans		
Total nonperforming assets	$ 1,570	$ 1,492
Ratios:		
Nonperforming loans as a percent of gross loans:	0.71%	0.64%
Nonperforming assets as a percent of total assets:	0.44%	0.42%

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The following table sets forth activity in our allowance for loan losses and other ratios at or for the dates indicated.

	At or For the Nine Months Ended September 30, 2007 (Unaudited)	At or For the Year Ended December 31, 2006
	(Dollars in thousands)	
Balance at beginning of period:	$ 1,257	$ 1,240
Provision for loan losses	45	158
Charge-offs:		
Mortgage loans on real estate:		
One-to-four family		49
Construction loans		
Commercial real estate		
Home equity loans and lines of credit		
Other loans:		
Commercial loans	19	86
Consumer loans	6	35
Total charge-offs	25	170
Recoveries:		
Mortgage loans on real estate:		
One-to-four family		
Construction		
Commercial real estate		
Home equity loans and lines of credit		
Other loans:		
Commercial loans		28
Consumer loans	3	1
Total Recoveries	3	29
Net charge-offs	22	141
Balance at end of period	$ 1,280	$ 1,257
Average loans outstanding	208,259	205,419
Ratio of net charge-offs to average loans outstanding	0.01%	0.07%

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Off-Balance Sheet Arrangements

Other than loan commitments, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors. Refer to Note 7 of the Notes to Consolidated Financial Statements for a summary of loan commitments outstanding as of September 30, 2007.

Item 3. Quantitative and Qualitative Disclosures about Market Risk
Management of Market Risk

There have been no material changes in information regarding quantitative and qualitative disclosures about market risk at September 30, 2007 from the information presented in the Company s Form 10-K for the year ended December 31, 2006.

Regulatory Capital

We are subject to various regulatory capital requirements administered by the federal banking agencies. The Bank is a federal stock savings bank regulated by the Office of Thrift Supervision. The Company is a federal stock holding company corporation and is regulated as a savings and loan holding company by the Office of Thrift Supervision.

The Company s ability to pay dividends is primarily dependent upon the ability of its subsidiary bank to pay dividends to the Company. The payment of dividends is subject to continued compliance with minimum regulatory capital requirements. In addition, regulatory approval is generally required prior to declaring dividends in an amount in excess of net income for that year plus net income retained in the preceding two years. During the nine months ending September 30, 2007, Lake Shore, MHC which owns 56% of the Company s outstanding common stock elected to waive its right to receive cash dividends of approximately $327,000. The total dividends waived by Lake Shore, MHC were $436,000 cumulatively as of September 30, 2007. The dividends waived by Lake Shore, MHC are considered a restriction on the retained earnings of the Company.

Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk weighted assets, tangible equity to tangible assets and Tier 1 capital to adjusted total assets. Management believes, as of September 30, 2007, that the Bank meets all capital adequacy requirements to which it is subject.

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The Company, as a savings and loan holding company, is not subject to formula based capital requirements at the holding company level. However, the Company is required by Office of Thrift Supervision regulation to maintain adequate capital to support its business activities.

The Bank s actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)					
As of September 30, 2007:						
Total capital (to risk-weighted assets)	$ 44,450	23.77%	$ ≥14,958	≥ 8.0%	$ ≥18,697	≥10.0%
Tier 1 capital (to adjusted total assets)	42,590	12.13%	≥14,044	≥ 4.0%	≥17,556	≥5.0%
Tangible equity (to tangible assets)	42,590	12.13%	≥5,267	≥ 1.5%		
Tier 1 capital (to risk-weighted assets)	42,590	22.78%			≥11,218	≥6.0%

Item 4. Controls and Procedures.

Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective, as of September 30, 2007, to ensure that information relating to us, which is required to be disclosed in the reports we file with the Securities and Exchange Commission under the Exchange Act, is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

There has been no change in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

Item 4T. Controls and Procedures.

Not applicable.

PART II

Item 1. Legal Proceedings

We are not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. We believe that these routine legal proceedings, in the aggregate, are immaterial to our financial condition and results of operations.

Item 1A. Risk Factors

There have been no material changes to the risk factors that are included in our Annual Report on Form 10-K for the year ended December 31, 2006 that could affect our business, results of operations or financial condition.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We did not repurchase any securities during the quarter ended September 30, 2007.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information.

None.

Item 6. Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certifications

32.1 Section 1350 Certifications

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	LAKE SHORE BANCORP, INC. (Registrant)
November 14, 2007	/s/ David C. Mancuso By: David C. Mancuso President and Chief Executive Officer (Principal Executive Officer)
November 14, 2007	/s/ Rachel A. Foley By: Rachel A. Foley Chief Financial Officer (Principal Financial and Accounting Officer)