

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

**AMENDMENT NO. 1 TO
FORM S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

LAKE SHORE BANCORP, INC.
(exact name of registrant as specified in its charter)

United States
(state or other jurisdiction of
incorporation or organization)

6035
(Primary Standard
Classification Code Number)
**125 East Fourth Street
Dunkirk, New York 14048**
(Address, including zip code, and telephone number,
including area code, of registrant's principal executive offices)

To Be Applied For
(IRS Employer Identification No.)

David C. Mancuso
President and Chief Executive Officer
Lake Shore Bancorp, Inc.
**125 East Fourth Street
Dunkirk, New York 14048**
(716) 366-4070
(Name, address, including zip code, and telephone number,
including area code, of agent for service)

Copies to:

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Approximate date of commencement of proposed sale to public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box ☐

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

CALCULATION OF REGISTRATION FEE

Title of each Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price Per Share (2)	Proposed Maximum Aggregate Offering Price (2)	Amount of Registration Fee(2)(3)
Common Stock, \$0.01 par value	3,107,875	\$ 10.00	\$ 31,078,750	\$3,657.97

-
- (1) Includes the maximum number of shares that may be issued or exchanged in connection with this offering.
 - (2) Estimated solely for the purpose of calculating the registration fee.
 - (3) Registration fee of \$3,657.97 previously paid with the filing of the initial registration statement on November 4, 2005.
-

The Registrant hereby amends this Registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to Section 8(a), may determine.

PRELIMINARY PROSPECTUS

[LOGO] LAKE SHORE BANCORP, INC.
(Proposed Holding Company for Lake Shore Savings Bank)
Up to 2,587,500 Shares of Common Stock

Lake Shore Bancorp, Inc. is offering common stock for sale in connection with the reorganization of Lake Shore Savings and Loan Association into the mutual holding company form of organization. The shares we are offering for sale represent 45% of the to-be outstanding common stock of Lake Shore Bancorp. In connection with the reorganization, Lake Shore Savings and Loan Association will convert its New York State mutual savings and loan charter to a federal stock savings bank charter and change its name to Lake Shore Savings Bank. In addition, Lake Shore Savings Bank will form Lake Shore Bancorp, which will own 100% of Lake Shore Savings Bank upon completion of the reorganization. Lake Shore, MHC, the federally-chartered mutual holding company to be formed by Lake Shore Savings Bank, will own 53% of the outstanding common stock of Lake Shore Bancorp. In connection with the reorganization, we will also form The Lake Shore Charitable Foundation. We intend to contribute to the charitable foundation an amount of authorized but unissued shares that will equal 2% of the Lake Shore Bancorp common stock outstanding after the reorganization. We have applied to have our common stock quoted on the Nasdaq National Market under the symbol “LSBK.”

We are offering up to 2,587,500 shares of common stock for sale on a best efforts basis, subject to certain conditions. We must sell a minimum of 1,912,500 shares to complete the offering. We may sell up to 2,975,625 shares without resoliciting subscribers due to of regulatory considerations, demand for our shares or changes in market conditions. The offering is expected to terminate at 11:00 a.m., Eastern Time, on [Date 1, 2006]. We may extend this expiration date without notice to you until [Date 2, 2006], unless the Office of Thrift Supervision approves a later date.

Ryan Beck & Co., Inc. will use its best efforts to assist us in our selling efforts, but is not required to purchase any shares of the common stock being offered for sale. Purchasers will not pay a commission to purchase shares of common stock in the offering. All shares are offered for sale at a price of \$10.00 per share.

If you are or were a depositor of Lake Shore Savings you may have a priority right to purchase shares of common stock. The minimum purchase is 25 shares. Once submitted, orders are irrevocable unless the offering is terminated or extended beyond [Date 2, 2006]. If the offering is extended beyond [Date 2, 2006], subscribers will be resolicited and given the right to modify or rescind their purchase orders. Funds received before completion of the offering will be held in a segregated account at Lake Shore Savings, or at our discretion at another insured depository institution, and will earn interest at our passbook savings rate. If we terminate the offering, or if we extend the offering beyond [Date 2, 2006] and you rescind or modify your order, we will promptly return applicable funds with interest at our passbook savings rate.

We expect our directors and executive officers, together with their associates, to subscribe for 89,600 shares, which equals 3.8% of the shares that will be sold in the offering at the midpoint of the offering range plus shares issued to our charitable foundation.

OFFERING SUMMARY
Price Per Share: \$10.00

	Minimum	Maximum	Maximum, As Adjusted
Number of shares	1,912,500	2,587,500	2,975,625
Gross offering proceeds	\$19,125,000	\$25,875,000	\$29,756,250
Estimated offering expenses	\$ 1,392,000	\$ 1,453,000	\$ 1,489,000
Estimated net proceeds	\$17,733,000	\$24,422,000	\$28,267,250
Estimated net proceeds per share	\$ 9.27	\$ 9.44	\$ 9.50

This investment involves a degree of risk, including the possible loss of principal.
Please read “Risk Factors” beginning on page 24.

These securities are not deposits or savings accounts and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Neither the Securities and Exchange Commission, the Office of Thrift Supervision nor any state securities regulator has approved or disapproved of these securities or determined if this prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

For assistance, please contact the Stock Information Center, toll-free, at (800) 806-8430.

Ryan Beck & Co.

The date of this prospectus is _____.

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[Map showing office locations of Lake Shore Savings and Loan Association appears here.]

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QUESTIONS AND ANSWERS ABOUT THE OFFERING

The following are answers to frequently asked questions. You should read this entire prospectus, including “*Risk Factors*” beginning on page 24. The sections entitled “*Summary*” and “*The Reorganization and Offering*” beginning on page 5 and page 109, respectively, provide detailed information about the offering and placing stock orders.

Q: What will happen as a result of the reorganization of Lake Shore Savings and Loan Association?

A: Lake Shore Savings is undertaking a transaction referred to as a mutual holding company reorganization. As part of the reorganization, Lake Shore Savings will convert from a New York-chartered mutual savings and loan association to a federal stock savings bank. Currently, Lake Shore Savings is a New York-chartered mutual (meaning no stockholders) savings and loan association. As a result of the charter conversion and reorganization, Lake Shore Savings and Loan Association will change its name to Lake Shore Savings Bank and become a federally-chartered stock savings bank in a mutual holding company structure with two holding companies. Lake Shore Savings will form a new federally-chartered stock holding company, Lake Shore Bancorp. It will sell 45% of its common stock to the public and will issue 53% of its common stock to Lake Shore, MHC, a federal mutual holding company. In connection with the reorganization, we will also form The Lake Shore Charitable Foundation. We intend to contribute to the charitable foundation an amount of authorized but unissued shares that will equal 2% of the Lake Shore Bancorp common stock outstanding after the reorganization and offering. After the reorganization and offering, Lake Shore Bancorp will own 100% of Lake Shore Savings Bank’s outstanding common stock.

Q: Will the reorganization affect my deposit accounts or loans?

A: No. The reorganization is an internal change to our corporate structure. It will not affect the balance or terms of deposit or loan accounts, and deposits will continue to be federally insured by the Federal Deposit Insurance Corporation up to the maximum legal limits. Deposit accounts are not being converted to stock.

Q: How many shares of common stock are being offered for sale and at what price?

A: We are offering for sale up to 2,587,500 shares of common stock at a price of \$10.00 per share. In order to complete the offering, we must sell at least 1,912,500 shares of common stock. If, as a result of regulatory considerations, demand for our shares or changes in market conditions, the independent appraiser determines our market value has increased, we may sell up to 2,975,625 shares without giving you further notice or the opportunity to modify or cancel your stock order.

Q: Who may purchase shares of common stock in the offering?

A: Rights to subscribe for common stock in a subscription offering have been granted under our plan of reorganization to the following persons in the following descending order of priority:

1. Lake Shore Savings’ depositors with deposit balances aggregating \$50 or more as of June 30, 2004 (“eligible account holders”);
2. Our tax-qualified employee benefit plans;
3. Lake Shore Savings’ depositors with deposit balances aggregating \$50 or more as of December 31, 2005 (“supplemental eligible account holders”); and

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4. Lake Shore Savings' depositors as of January ___, 2006.

In the event that the above do not subscribe for all of the shares of common stock being offered for sale, we may offer shares in a community offering to the general public, giving a purchase preference to natural persons who reside in Chautauqua, Erie and Cattaraugus Counties, New York.

Q: What factors should I consider when deciding whether to purchase shares of common stock in this offering?

A: There are many important factors for you to consider before making an investment decision. You should read this entire prospectus, including the "Risk Factors" section, before making your investment decision.

Q: Will I be charged a commission if I purchase shares of common stock in the offering?

A: No. You will not be charged a commission or fee to purchase shares in the offering.

Q: How many shares of common stock may I buy?

A: The minimum order is 25 shares. The individual purchase limitation is \$200,000 of common stock (which equals 20,000 shares) in the offering. Furthermore, no person, together with associates and persons acting in concert with such person, may purchase more than \$400,000 of common stock (which equals 40,000 shares) in all categories of the offering combined.

Q: Will my common stock be insured by deposit insurance or guaranteed by any government agency?

A: No. Unlike insured deposit accounts at Lake Shore Savings, our common stock, like all common stock, will not be insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Q: When is the deadline for subscribing for common stock?

A: We must receive at our Stock Information Center a properly signed and completed stock order form with the required payment no later than 11:00 a.m., Eastern Time, on [Date 1, 2006]. Delivery of a stock order form may be made by:

- mail, using the order reply envelope provided;
- overnight delivery to the Stock Information Center address on the stock order form; or
- hand-delivery to the Stock Information Center located at our administrative office at 31 East Fourth Street, Dunkirk, New York. Stock order forms may not be hand-delivered to our main banking office in Dunkirk or to any Lake Shore Savings branches.

Q: Can I change my mind after I place a stock order?

A: No. Once we receive your stock order, you cannot cancel or change it, unless we are required to resolicit subscribers.

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Q: How can I pay for the common stock?

A: You have two payment options as described on the stock order form:

- you can pay by personal or bank check or money order made payable to Lake Shore Bancorp, Inc., which will be cashed upon receipt (please do not submit a third party check); or
- you can authorize a withdrawal from certain types of Lake Shore Savings deposit accounts as explained on the stock order form. There will be no penalty for early withdrawal from certificate accounts.

The amount(s) designated by you for withdrawal must be available within your account(s) at the time we receive the stock order form. Funds will not be withdrawn prior to completion of the offering period, but a hold will be placed on the dollar amounts designated, so the amounts will not be available to you during the offering period.

Q: May I obtain a loan from Lake Shore Savings to pay for my common stock?

A: No. Federal law prohibits Lake Shore Savings from knowingly loaning funds to purchase shares of common stock in the offering. You may not submit a check drawn on a Lake Shore Savings line of credit as payment for shares.

Q: Can I subscribe for common stock using funds in my individual retirement account at Lake Shore Savings?

A: You might be able to use individual retirement account funds, however you may not authorize direct withdrawal from a Lake Shore Savings individual retirement account. Furthermore, using individual retirement account funds for this type of purchase requires special arrangements and additional processing time. Federal law requires that such funds first be transferred to a self-directed retirement account with a trustee other than Lake Shore Savings. If you are interested in using individual retirement account funds held at Lake Shore Savings or elsewhere, please promptly call the Stock Information Center for assistance, preferably at least two weeks before the _____, 2006 offering expiration date. We cannot guarantee that you will be able to use retirement funds held at Lake Shore Savings or elsewhere for this purchase. Your ability to use these funds may depend on timing constraints and, possibly, limitations imposed by the individual retirement account trustee.

Q: Does Lake Shore Bancorp intend to pay dividends on the common stock?

A: Yes. After the offering, we expect to adopt a policy of paying cash dividends, but we have not yet decided on the amount or frequency of payments or when payments, if any, may begin.

Q: What happens if there are not enough shares of common stock to fill all orders?

A: If there is an oversubscription, you might not receive any or all of the shares you ordered. We will allocate shares in the order of priority established in our plan of reorganization. Orders received in the subscription offering will have priority. If we are unable to fill your order, or can only fill your order in part, you will receive an appropriate refund, with interest. If you paid by check or money order, we will issue you a refund/interest check. If you paid by authorizing a withdrawal from your Lake Shore Savings deposit account(s), we will only withdraw the funds necessary to pay for the shares you receive. Unused funds, along with accrued interest, will remain in your account(s).

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Q: How do I sell my common stock after I purchase it?

A: Upon completion of the reorganization and offering, when our shares have begun trading, you may contact a firm offering investment services in order to buy or sell our shares. We have applied to have our common stock quoted on the Nasdaq National Market under the trading symbol “LSBK.” We cannot assure you that you will be able to sell your shares at or above the \$10.00 per share offering price.

Q: Who can help answer any other questions I might have about the offering?

A: We encourage you to read this entire prospectus. You may direct questions to our Stock Information Center at (800) 806-8430. You may also visit our Stock Information Center, which is located at our administrative office (not our main banking office in Dunkirk). This is the only location that will accept stock order forms and have supplies of offering materials. The Stock Information Center is located at 31 East Fourth Street, Dunkirk, New York. The Stock Information Center is open Monday through Friday, except for bank holidays, from 10:00 a.m. to 4:00 p.m., Eastern Time.

SUMMARY

This summary highlights selected information from this document and may not contain all the information that is important to you. To fully understand the offering, you should read this entire document carefully. In certain instances where appropriate, the terms “we,” “us” and “our” refer collectively to Lake Shore, MHC, Lake Shore Bancorp and Lake Shore Savings, or any one of these entities, depending on the context. For assistance, please contact our Stock Information Center at (800) 806-8430.

THE COMPANIES

Lake Shore, MHC

Lake Shore, MHC will be formed upon completion of the reorganization. Upon completion of the reorganization, Lake Shore, MHC will become our federally-chartered mutual holding company parent and will own 53% of Lake Shore Bancorp’s outstanding common stock. So long as Lake Shore, MHC exists, it will own a majority of the voting stock of Lake Shore Bancorp. Lake Shore, MHC is not currently an operating company. Lake Shore, MHC will have no stockholders and current and future depositors of Lake Shore Savings will become the members of Lake Shore, MHC. We do not expect that Lake Shore, MHC will engage in any business activity other than owning a majority of the common stock of Lake Shore Bancorp.

The corporate headquarters of Lake Shore, MHC, will be the same as Lake Shore Savings, which are located at 125 East Fourth Street, Dunkirk, New York 14048. The telephone number at this address is (716) 366-4070.

Lake Shore Bancorp, Inc.

This offering is made by Lake Shore Bancorp, Inc. Lake Shore Bancorp is not currently an operating company. Lake Shore Bancorp will be formed upon completion of the reorganization as a federally-chartered mid-tier stock holding company. After the reorganization, Lake Shore Bancorp will own all of Lake Shore Savings’ outstanding common stock and will direct, plan and coordinate Lake Shore Savings’ business activities. In the future, Lake Shore Bancorp might also acquire or organize other operating subsidiaries, including other financial institutions, although it currently has no specific plans to do so.

The corporate headquarters of Lake Shore Bancorp will be the same as Lake Shore Savings, which are located at 125 East Fourth Street, Dunkirk, New York 14048. The telephone number at this address is (716) 366-4070.

Lake Shore Savings and Loan Association

Lake Shore Savings and Loan Association, or Lake Shore Savings, is a savings and loan association, chartered in New York in 1891. As a community-oriented financial institution, Lake Shore Savings is dedicated to serving the financial service needs of consumers and businesses within its market area. We engage primarily in the business of attracting deposits from the general public and using such funds to originate loans. We emphasize the origination of loans secured by first mortgages on owner-occupied, residential real estate. To a lesser extent, we originate other types of real estate loans, commercial loans and consumer loans. As of September 30, 2005, we had total assets of \$334.1 million, deposits of \$251.6 million and total equity of \$27.7 million.

Our corporate headquarters are located at 125 East Fourth Street, Dunkirk, New York 14048. The telephone number at this address is (716) 366-4070. Our website is www.lakeshoresavings.com.

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The Lake Shore Charitable Foundation

In 1993, Lake Shore Savings created a grant program to give back to the communities where our branch offices were located. Our Community Re-investment Fund provides funds to local non-profit organizations, such as sports organizations, civic groups, hospitals, schools, and charitable organizations. Since 1993, we have awarded in excess of \$650,000 in grants from this fund. Large donations which have been awarded include \$150,000 to Brooks Memorial Hospital, \$75,000 to the Dunkirk Library, and \$125,000 to the State University of Fredonia Alumni Foundation. All funds granted were derived from earnings in the year the grant was awarded.

To continue our long-standing commitment to our local communities, we intend to establish a charitable foundation, The Lake Shore Charitable Foundation, as a non-stock Delaware corporation in connection with the reorganization. We will fund the charitable foundation with an amount of stock equal to 2% of the shares of Lake Shore Bancorp common stock outstanding after the reorganization. Based on the purchase price of \$10.00 per share, we would fund the charitable foundation with 100,000 shares of our common stock at the midpoint of the offering range. Our contribution to the charitable foundation would reduce net earnings by \$615,000, after tax, in the year in which the charitable foundation is established, which is expected to be fiscal 2006. The Lake Shore Charitable Foundation will make grants and donations to non-profit and community groups and projects located within our market area. It is anticipated that the Lake Shore Charitable Foundation will distribute at least 5% of its net investment assets each year. The distributions will be made based on the following priorities:

- potential impact and the number of people who will benefit;
- programs which represent innovative, efficient approaches to serving community needs;
- requests that will assist those citizens whose needs are not met by existing programs or services;
- organizations that work cooperatively with other agencies in the community to encourage efficient use of community resources and eliminate duplicated services;
- projects which promote volunteer participation and citizen involvement; and
- projects and activities that expect to test or demonstrate new approaches and techniques in the solutions of community problems.

Except in unusual circumstances, contributions will not exceed \$2,500. Contributions will not usually be made to capital campaigns, to establish or add to endowment funds, general operating budgets of existing organizations, publications of books or programs, conferences, or annual fund-raising campaigns. Contributions will not normally be made to supplant tax funds for projects or activities that would ordinarily receive public support. Contributions will be made for one year at a time with no commitment for ongoing projects. Special projects that are sponsored by educational or religious institutions will be considered only if they benefit the community as a whole. Careful consideration will be given to the commitment and composition of the requesting organization's board members, officers, and project leaders. The organizations the charitable foundation contributes to must be able to demonstrate fiscal responsibility, management qualifications, and the ability to complete, deliver, or provide the services or programs for which the contribution is requested.

Currently, there are no plans to make further contributions to the charitable foundation in the future. Lake Shore Savings will review additional contribution considerations from time to time. The amount of common stock that we would offer for sale in the offering would be greater if the offering were

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to be completed without the contribution to The Lake Shore Charitable Foundation. The establishment of the charitable foundation requires the affirmative vote of a majority of the votes eligible to be cast by Lake Shore Savings' depositors. For a further discussion of the financial impact of the charitable foundation, including its effect on those who purchase shares in the offering, see “ *Comparison of Valuation and Pro Forma Information With and Without Charitable Foundation* ” on page 45.

Our Market Area

We conduct operations from eight full service branch offices and twelve ATMs in Chautauqua and Erie Counties, which are located on the western border of New York State. Chautauqua County contains multiple prime industrial and building sites and a skilled and productive labor force. Erie County is a metropolitan center and is home to Buffalo, the second largest city in New York. Both Chautauqua and Erie Counties exhibit slower rates of population growth, have lower per capita income and slower growth in per capita income than the United States and New York State averages. Notwithstanding these demographic characteristics, our primary market area has historically been stable, with a diversified base of employers and employment sectors and is not dependent on one key employer.

Our Operating Strategy

Our mission is to operate and grow a profitable community-oriented financial institution serving primarily retail customers and small businesses in our market area. After the reorganization and offering, we plan to continue our strategy of:

- operating as an independent community-oriented financial institution;
- expanding our branch network and upgrading our existing branches;
- pursuing opportunities to increase residential and commercial real estate lending in our market area, particularly in Erie County, New York;
- increasing core deposits, particularly in Erie County, New York; and
- managing our net interest margin and interest rate risk.

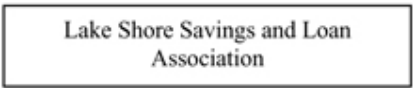
THE REORGANIZATION

Description of the Reorganization

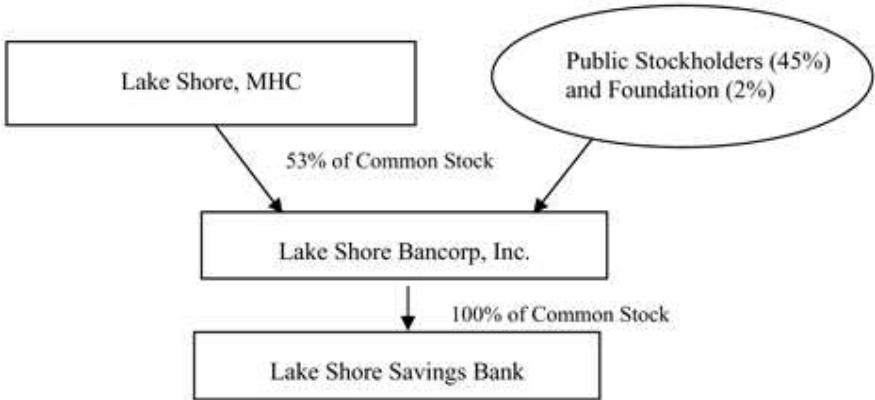
Currently, we are a New York-chartered mutual savings and loan association with no stockholders. Our depositors currently have the right to vote on certain matters such as the election of directors. The mutual holding company reorganization and charter conversion process that we are now undertaking involves a series of transactions by which we will convert from the state-chartered mutual form of organization to the federally-chartered mutual holding company form of organization. In the process, we will change our name from Lake Shore Savings and Loan Association to Lake Shore Savings Bank. In the mutual holding company structure, Lake Shore Savings will be a federally-chartered stock savings bank and all of its outstanding common stock will be owned by newly-formed Lake Shore Bancorp. In addition, 45% of Lake Shore Bancorp’s common stock will be owned by the public and our tax-qualified employee benefit plans, 2% will be owned by our charitable foundation and 53% will be owned by our newly-formed federal mutual holding company, Lake Shore, MHC. Our depositors on the closing date of the reorganization will become the members of Lake Shore, MHC and will have similar voting rights in Lake Shore, MHC as our depositors currently have in Lake Shore Savings.

The following diagrams show our current organizational structure and our organizational structure after completion of the reorganization and offering.

Our current organizational structure:



After the reorganization is completed, our ownership structure will be as follows:



Our normal business operations will continue without interruption during the reorganization and the same officers and directors who currently serve us will continue to serve us after completion of the reorganization and offering.

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Reasons for the Reorganization

Our primary reasons for the reorganization and offering are to permit us to control the amount of capital being raised and prudently deploy the proceeds, while enabling us to:

- support future lending and operational growth including branch activities and acquisition of other financial institutions, although we have no such acquisition plans at this time;
- increase our ability to serve our communities;
- enhance existing products and services and support the development of new products and services;
- compete more effectively with other financial institutions for new business opportunities;
- enhance our ability to attract and retain qualified directors, management and other employees through stock-based incentive plans;
- form a charitable foundation to benefit the communities in which we maintain our corporate headquarters or a branch office; and
- structure our business in a form that will enable us to access capital markets.

Although we are interested in finding new possible branch locations, we do not have any specific plans or arrangements for further branch expansion, other than the branch expansion plans discussed in “*Our Business*” that are already underway, and which are not contingent on the reorganization or the offering.

Terms of the Offering

We are offering between 1,912,500 and 2,587,500 shares of common stock of Lake Shore Bancorp for sale at an offering price of \$10.00 per share. The subscription offering is made to Lake Shore Savings’ eligible depositors and our tax-qualified employee plans. Shares not sold to these persons may be made available to the public in a community offering, and shares not purchased in the subscription offering or the community offering may be offered for sale through a syndicated community offering. The maximum number of shares that we sell in the offering may increase by up to 15%, to 2,975,625 shares, as a result of demand for the shares in the offering, positive changes in financial markets in general and with respect to financial institution stocks in particular or regulatory considerations. Unless the number of shares of common stock to be offered is increased to more than 2,975,625 or decreased to less than 1,912,500, or the offering is extended beyond _____, subscribers will not have the opportunity to modify or cancel their stock orders. In addition, we intend to contribute shares of our authorized but unissued common stock to The Lake Shore Charitable Foundation, a new charitable foundation to be established, in an amount equal to 2% of the number of shares we issue in the reorganization.

All investors will pay \$10.00 per share; no commission will be charged to purchase shares of common stock. Ryan Beck & Co., Inc., our selling agent in the offering, will use its best efforts to assist us in selling shares of our common stock. Ryan Beck & Co., Inc. is not obligated to purchase any shares of common stock in the offering.

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How We Determined the Offering Range and the \$10.00 Price Per Share

The decision to offer between 1,912,500 shares and 2,587,500 shares, which is our offering range, is based on an independent appraisal of our pro forma market value prepared by RP Financial, L.C., a firm experienced in appraisals of financial institutions. RP Financial, L.C. is of the opinion that as of December 22, 2005, the estimated pro forma market value of our common stock on a fully converted basis was between \$42.5 million and \$57.5 million, with a midpoint of \$50.0 million. This is our established valuation range. The term “fully converted” means that RP Financial, L.C. assumed that 100% of our shares of common stock had been sold to the public, as opposed to the 45% that will be sold in the offering. The \$10.00 per share price was selected primarily because it is the price most commonly used in mutual to stock conversions and reorganizations of financial institutions.

In preparing its appraisal, RP Financial, L.C. considered the information contained in this prospectus, including Lake Shore Savings’ financial statements. RP Financial, L.C. also considered the following factors, among others:

- the present and projected operating results and financial condition of Lake Shore Bancorp and Lake Shore Savings, and the economic and demographic conditions in Lake Shore Savings’ existing market areas;
- historical, financial and other information relating to Lake Shore Bancorp and Lake Shore Savings;
- a comparative evaluation of the operating and financial statistics of Lake Shore Bancorp and Lake Shore Savings with those of other similarly situated publicly-traded thrifts and mutual holding companies;
- the impact of the offering on Lake Shore Bancorp’s consolidated net worth and earnings potential; and
- the trading market for securities of comparable institutions and general conditions in the market for such securities.

In reviewing the appraisal prepared by RP Financial, L.C., the board of directors considered the methodologies and the appropriateness of the assumptions used by RP Financial, L.C. in addition to the factors listed above, and the board of directors believes that these assumptions were reasonable.

The board of directors determined that the shares of common stock should be sold at \$10.00 per share, that 45% of the to-be outstanding shares of Lake Shore Bancorp common stock should be offered for sale in the offering, that 53% should be issued to Lake Shore, MHC and 2% issued to our charitable foundation. We chose to sell 45% of our to-be outstanding shares of common stock in the offering, rather than a smaller portion, because we believe that we will be able to deploy the capital raised in an offering of this size and because the sale of a smaller number of shares would make it less likely that an active trading market for the shares would develop. Based on the estimated valuation range and the per share purchase price, the number of shares of our common stock that will be outstanding upon completion of the offering will range from 4,250,000 shares to 5,750,000 shares (subject to adjustment to 6,612,500 shares), and the number of shares of our common stock that will be sold in the offering will range from 1,912,500 shares to 2,587,500 shares (subject to adjustment to 2,975,625 shares), with a midpoint of 2,250,000 shares. The number of shares of our common stock that Lake Shore, MHC will own after the offering will range from 2,252,500 to 3,047,500 (subject to adjustment to 3,504,625 shares). The number of shares of common stock to be issued to our charitable foundation will range from 85,000 to 115,000 (subject to adjustment to 132,250 shares). The estimated valuation range may be amended with the approval of the Office of Thrift Supervision.

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The appraisal will be updated before we complete the offering. If the estimated valuation range of the common stock at that time is either below \$42.5 million or above \$66.125 million, then, after consulting with the Office of Thrift Supervision, we may:

- terminate the plan of reorganization and return all funds promptly;
- hold a new offering;
- return all funds and terminate the plan of reorganization;
- establish a new offering range and commence a resolicitation of subscribers; or
- take such other actions as may be permitted by the Office of Thrift Supervision.

If we conduct a resolicitation, we will notify you, and you will have the opportunity to modify or cancel your order. Unless we receive an affirmative response from an investor in a designated period of time, all funds delivered to us to purchase shares of common stock in the offering will be returned promptly to the subscriber, with interest at Lake Shore Savings' passbook savings rate, and deposit account withdrawal authorizations will be cancelled. See "*The Reorganization and Offering – How We Determined the Offering Range and the \$10.00 Purchase Price*." In any event, the offering must be completed by no later than [final date].

Two measures that some investors use to analyze whether a stock might be a good investment are the ratio of the offering price to the issuer's "book value" and the ratio of the offering price to the issuer's annual net income. RP Financial considered these ratios, among other factors, in preparing its appraisal. Book value is the same as total equity and represents the difference between the issuer's assets and liabilities. RP Financial's appraisal also incorporates an analysis of a peer group of publicly-traded mutual holding companies that RP Financial considered to be comparable to us. As mutual holding companies, the peer group is comprised of companies that operate under the same form of public ownership as Lake Shore Bancorp will be operating after the offering. Under the mutual holding company form of ownership, the majority of the common stock outstanding is owned by the mutual holding company and the remaining shares, which constitute a minority of the common stock, are owned by the public stockholders.

The following table presents a summary of selected pricing ratios for the peer group companies analyzed by RP Financial, and the pro forma pricing ratios for Lake Shore Bancorp as calculated by RP Financial in its independent appraisal. These ratios are based on earnings for the twelve months ended September 30, 2005 and book value as of September 30, 2005.

	<u>Price To Earnings Multiple</u>	<u>Price To Book Value Ratio</u>
Lake Shore Bancorp (pro forma):		
Maximum	24.88x	116.96%
Minimum	18.78x	98.23%
Peer group companies as of December 22, 2005:		
Average	27.64x	162.56%
Median	25.33x	147.47%

The following table presents pro forma pricing ratios for the peer group of companies, assuming they had completed a second-step conversion, and for Lake Shore Bancorp, assuming it had also fully converted. RP Financial's calculations of the fully-converted pricing multiples for the peer group companies assume the pro forma impact of selling the mutual holding company shares of each of the peer group companies at their respective trading prices on December 22, 2005. RP Financial's calculation of the fully-converted pricing multiples for Lake Shore Bancorp assumes the pro forma impact of selling

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100% of the shares of common stock to be issued to the public at \$10.00 per share. Compared to the average fully-converted pricing ratios of the peer group, Lake Shore Bancorp's pro forma fully-converted pricing ratios at the maximum of the offering range indicated a discount of 21.0% on a price-to-earnings basis and a discount of 13.3% on a price-to-book basis. At the minimum and maximum of the valuation range, a share of common stock is priced at 17.29 times and 22.44 times Lake Shore Bancorp's earnings. The peer group companies, as of December 22, 2005, traded on average at 28.41 times earnings. The median trading price of the peer group common stock was at 27.37 times earnings. At the minimum and maximum of the valuation range, the common stock is valued at 67.24% and 75.93% respectively, of Lake Shore Bancorp's pro forma book value. This represents a discount to the average trading price to book value of peer group companies, which as of December 22, 2005, averaged 87.62%. As of December 22, 2005, the median trading price of peer group companies was 86.43% of the book value of these companies.

	Fully Converted Equivalent at Pro Forma Price to Earnings Multiple	Fully Converted Equivalent Pro Forma Price to Book Value Ratio
Lake Shore Bancorp		
Maximum	22.44x	75.93%
Minimum	17.29x	67.24%
Valuation of peer group companies as of December 22, 2005:		
Average	28.41x	87.62%
Medians	27.37x	86.43%

In preparing the fully-converted pricing ratio analysis, RP Financial assumed offering expenses equal to 2.0% of the gross proceeds, a pre-tax reinvestment rate of 4.01% of the net proceeds of the offering, a tax rate of 38.50%, purchases by the employee stock ownership plan equal to 8.0% of the offered shares, funded with a loan from Lake Shore Bancorp with a 30-year term, purchases by the management recognition plan of an amount of shares equal to 1.96% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation) with a five-year vesting schedule and the adoption of a stock option plan equal to 4.90% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation). Shares of common stock purchased by the management recognition plan were assumed at \$10.00 per share. The stock options were assumed to be granted with an exercise price of \$10.00 per share, vest over a five-year period and have a term of 10 years.

The independent appraisal does not indicate stock market value. Do not assume or expect that Lake Shore Bancorp's valuation as indicated above means that the common stock will trade at or above the \$10.00 purchase price after the offering.

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After-Market Performance of Mutual Holding Company Reorganizations

The following table provides information regarding the after market performance of the mutual holding company initial public offerings completed from January 1, 2004 through December 22, 2005. As part of its appraisal of our pro forma market value, RP Financial considered the after market performance of mutual holding company reorganizations completed in the three months prior to December 22, 2005, which was the date of its appraisal report. RP Financial considered information regarding the new issue market for converting thrifts as part of its consideration of the market for thrift stocks.

Mutual Holding Company Initial Public Offerings with Completed Closing Dates between January 1, 2004 and December 22, 2005

Company Name	Ticker	IPO Date	Price Performance from Initial Trading Date			
			1 Day	1 Week	1 Month	Through December 22, 2005
Equitable Financial Corp.	EQFC	11/10/05	0.0%	0.0%	-5.5%	-7.5%
Investors Bancorp, Inc.	ISBC	10/11/05	0.2%	1.0%	5.2%	10.2%
Wauwatosa Holdings, Inc.	WAUW	10/05/05	12.5%	7.3%	9.5%	16.8%
Ottawa Savings Bancorp, Inc.	OTTW	07/14/05	4.0%	5.0%	7.0%	3.0%
United Financial Bancorp, Inc.	UBNK	07/13/05	17.5%	16.0%	17.0%	18.0%
Heritage Financial Group	HBOS	06/30/05	7.5%	7.5%	9.3%	13.3%
Colonial Bancshares, Inc.	COBK	06/30/05	6.0%	9.9%	7.5%	5.6%
North Penn Bancorp, Inc.	NPEN	06/02/05	10.0%	2.5%	1.5%	3.0%
Rockville Financial, Inc.	RCKB	05/23/05	4.8%	10.5%	20.0%	35.5%
FedFirst Financial Corp.	FFCO	04/07/05	-6.6%	-9.3%	-14.5%	-11.5%
Brooklyn Federal Bancorp, Inc.	BFSB	04/06/05	-0.5%	-1.0%	-5.0%	11.1%
Prudential Bancorp of PA Inc.	PBIP	03/30/05	-1.5%	-6.5%	-12.5%	13.8%
Kentucky First Federal Bancorp	KFFB	03/03/05	7.9%	12.0%	12.4%	0.5%
Kearny Financial Corp.	KRNY	02/24/05	13.9%	15.0%	11.3%	25.5%
Home Federal Bancorp of LA	HFBL	01/21/05	-1.0%	0.5%	-0.8%	-2.5%
BV Financial, Inc.	BVFL	01/14/05	-6.5%	-5.0%	-0.7%	-14.0%
Georgetown Bancorp, Inc.	GTWN	01/06/05	2.0%	-0.5%	0.5%	-14.5%
SFSB, Inc.	SFBI	12/31/04	7.5%	-0.9%	-1.5%	-4.5%
Ocean Shore Holding Co.	OSHC	12/22/04	21.5%	22.0%	6.3%	13.5%
Lincoln-Park Bancorp, Inc.	LPBC	12/20/04	10.0%	12.5%	0.0%	-11.0%
Abington Community Bancorp, Inc.	ABBC	12/17/04	33.5%	33.0%	29.0%	31.2%
Home Federal Bancorp, Inc.	HOME	12/07/04	24.9%	26.8%	23.3%	26.2%
PSB Holdings, Inc.	PSBH	10/05/04	5.0%	6.0%	5.0%	6.0%
Atlantic Coast Federal Corp.	ACFC	10/05/04	17.5%	23.1%	30.0%	43.3%
Naugatuck Valley Financial Corp.	NVSL	10/01/04	8.0%	8.1%	8.0%	4.3%
SI Financial Group Inc.	SIFI	10/01/04	12.0%	10.6%	10.3%	8.1%
First Federal Financial Services, Inc.	FFFS	06/29/04	15.0%	22.5%	35.0%	29.2%
Monadnock Community Bancorp, Inc.	MNCK	06/29/04	3.8%	0.0%	-3.8%	25.0%
Osage Federal Financial, Inc.	OFFO	04/01/04	20.0%	22.5%	9.5%	45.4%
Wawel Savings Bank	WAWL	04/01/04	29.5%	25.0%	12.5%	1.5%
K-Fed Bancorp	KFED	03/31/04	34.9%	29.3%	15.9%	20.6%
Citizens Community Bancorp	CZWI	03/30/04	23.7%	27.5%	18.0%	30.0%
Clifton Savings Bancorp, Inc.	CSBK	03/04/04	22.5%	37.8%	32.9%	2.2%
Cheviot Financial Corp	CHEV	01/06/04	33.2%	33.5%	34.2%	12.2%
Average			11.6%	11.9%	9.6%	11.5%
Median			9.0%	10.2%	8.7%	10.7%

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This table is not intended to be indicative of how our stock may perform after the offering. Furthermore, this table presents only short-term price performance with respect to several companies that only recently completed their initial public offerings and may not be indicative of the longer-term stock price performance of these companies. Stock price appreciation is affected by many factors, including, but not limited to general market and economic conditions; the interest rate environment; the amount of proceeds a company raises in its offering; and numerous factors relating to the specific company, including the experience and ability of management, historical and anticipated operating results, the nature and quality of the company's assets, and the company's market area. The companies listed in the table above may not be similar to Lake Shore Bancorp, the pricing ratios for their offerings may be different from the pricing ratios for Lake Shore Bancorp common stock and the market conditions in which these offerings were completed may be different from current market conditions. Any or all of these differences may cause our stock to perform differently from these other offerings. Before you make an investment decision, we urge you to carefully read this entire prospectus, including, but not limited to, the section entitled “*Risk Factors*” beginning on page 24.

You should be aware that, in certain market conditions, common stock prices of initial public offerings have decreased. For example, as the table above illustrates, the common stock of 10 companies traded at or below their initial offering price at various times through December 22, 2005. We can give you no assurance that our common stock will not trade below the \$10.00 purchase price or that our stock will perform similarly to other recent mutual holding company initial public offerings.

Conditions to Completing the Reorganization Including the Charter Conversion

The reorganization will be conducted in accordance with the terms of the plan of reorganization. We cannot complete the reorganization and related offering unless:

- The charter conversion of Lake Shore Savings from a state-chartered mutual savings and loan association to a federally-chartered mutual savings bank is approved by the affirmative vote of either:
 - 66 ² / 3 % of the amount of book value or all Lake Shore Savings' outstanding deposits; or
 - 75% of the amount of all Lake Shore Savings' outstanding deposits represented at the special meeting of depositors.
- The plan of reorganization is approved by at least a majority of votes eligible to be cast by depositors of Lake Shore Savings at the special meeting of depositors;
- We receive all regulatory approvals necessary to complete the reorganization and offering; and
- We sell at least the minimum number of shares offered.

Our Officers, Directors and Employees Will Receive Additional Compensation and Benefit Programs After the Offering

We intend to adopt an employee stock ownership plan, which will award shares of our common stock to eligible employees primarily based on their compensation. It is expected that our employee stock ownership plan will purchase a number of shares equal to 8% of the shares sold in the offering plus shares issued to the charitable foundation. It is expected that the employee stock ownership plan will purchase such shares with the funds from a 30-year loan from Lake Shore Bancorp.

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Additionally, we may implement a stock option plan and a management recognition plan that will provide for grants of stock options and of restricted stock. If such stock-based incentive plans are implemented and approved by stockholders within one year of the completion of the offering, the number of options granted or shares awarded under the stock-based incentive plans may not exceed 4.90% and 1.96%, respectively, of the shares outstanding after the offering (including shares issued to the Lake Shore Charitable Foundation).

The employee stock ownership plan and the stock-based incentive plans will increase our future compensation costs, thereby reducing our earnings. The Financial Accounting Standards Board and the Securities and Exchange Commission recently finalized rules that require public companies to expense the grant-date fair value of stock options granted to officers, directors and employees by their first fiscal year beginning after June 15, 2005, which, for us, is the fiscal year beginning January 1, 2006. Since all stock options will be granted after January 1, 2006, we will expense the grant-date fair value of such stock options. Recognizing an expense equal to the grant-date fair value of stock options will increase our compensation costs over the vesting period of the options. Additionally, stockholders will experience a reduction in their ownership interest if we issue new shares of our common stock from our authorized but unissued shares of common stock to fund stock option grants and stock awards. See “*Risk Factors—Risks Related to the Offering—Our Stock-Based Incentive and Benefit Plans Will Increase Our Costs, Which Will Reduce Our Income*” and “*Management—Benefit Plans*.”

We may obtain the shares needed for the stock-based incentive plans by issuing additional shares of common stock or through stock repurchases. However, because Lake Shore, MHC must own a majority of our outstanding shares of common stock as long as it is in existence, we will fund the plans with treasury shares acquired from stock repurchases if the issuance of authorized but unissued shares under the plans would otherwise result in Lake Shore, MHC not owning a majority of our outstanding shares of common stock.

The stock-based incentive plans will comply with all applicable regulations of the Office of Thrift Supervision. The stock-based incentive plans cannot be established earlier than six months after the reorganization and offering and would require the approval of our stockholders by a majority of the votes of our outstanding shares of common stock eligible to be cast (excluding votes eligible to be cast by Lake Shore, MHC), unless we obtain a waiver from the Office of Thrift Supervision that would allow the approval of the stock-based incentive plans by our stockholders by a majority of voting shares (excluding shares voted by Lake Shore, MHC). Unless a waiver is obtained from the Office of Thrift Supervision, the following additional Office of Thrift Supervision restrictions would apply to our stock-based incentive plans:

- non-employee directors in the aggregate may not receive more than 30% of the options and restricted stock awards authorized under the plans;
- any one non-employee director may not receive more than 5% of the options and restricted stock awards authorized under the plans;
- any officer or employee may not receive more than 25% of the options and restricted stock awards authorized under the plans;
- the options and restricted stock awards may not vest more rapidly than 20% per year, beginning on the first anniversary of stockholder approval of the plans; and
- accelerated vesting is not permitted except for death, disability or upon a change in control of Lake Shore Savings or Lake Shore Bancorp.

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In the event the Office of Thrift Supervision changes its regulations or policies regarding stock-based incentive plans, including any regulations or policies restricting the size of awards and vesting of benefits as described above, the restrictions described above may not be applicable.

The following table summarizes the stock benefits that our officers, directors and employees may receive following the offering at the maximum of the offering range and assuming that we initially implement a stock option plan granting options to purchase 4.90% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation) and a management recognition plan awarding shares of common stock equal to 1.96% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation). In the table below, it is assumed that, at the maximum of the offering range, a total of 2,702,500 shares will be sold to the public and issued to the charitable foundation, and a total of 5,750,000 shares will be outstanding after the offering, including shares issued to Lake Shore, MHC and to the charitable foundation.

Number of Shares	Plan	Individuals Eligible to Receive Awards	Value of Benefits Based on Maximum of Offering Range (1)
			(In thousands)
216,200	Employee stock ownership plan	Officers and employees	\$ 2,162
112,700	Stock awards	Directors, officers and employees	1,127
281,750	Stock options	Directors, officers and employees	1,059

- (1) The actual value of the stock awards will be determined based on their fair value as of the date the grants are made. For purposes of this table, fair value is assumed to be the offering price of \$10.00 per share. The fair value of stock options has been estimated at \$3.76 per option using the Black-Scholes option pricing model with the following assumptions: a grant-date share price and option exercise price of \$10.00; dividend yield of zero; expected option life of 10 years; risk free interest rate of 4.34% (based on the 10 year Treasury Note rate); and a volatility rate of 12.87% based on an index of publicly-traded mutual holding company institutions. The actual expense of the stock options will be determined by the grant-date fair value of the options, which will depend on a number of factors, including the valuation assumptions used in the option pricing model ultimately adopted.

The value of the restricted shares of common stock will be based on the price of Lake Shore Bancorp's common stock at the time those shares are awarded, which, subject to stockholder approval, cannot occur until at least six months after the completion of the reorganization and offering. The following table presents the total value of all restricted shares to be available for grant under the management recognition plan, assuming the shares for the plan are purchased or issued in a range of market prices from \$8.00 per share to \$14.00 per share.

Share Price	83,300 Shares Awarded at Minimum of Range	98,000 Shares Awarded at Midpoint of Range	112,700 Shares Awarded at Maximum of Range	129,605 Shares Awarded at Maximum of Range, As Adjusted
(In thousands, except for per share price information)				
\$ 8.00	\$ 666	\$ 784	\$ 902	\$ 1,037
\$10.00	\$ 833	\$ 980	\$ 1,127	\$ 1,296
\$12.00	\$ 1,000	\$ 1,176	\$ 1,352	\$ 1,555
\$14.00	\$ 1,166	\$ 1,372	\$ 1,578	\$ 1,814

The grant-date fair value of the options granted under the stock option plan will be based in part on the price of Lake Shore Bancorp's common stock at the time the options are granted, which, subject to stockholder approval, cannot occur until at least six months after the completion of the reorganization and offering. The value will also depend on the various assumptions utilized in the Black-Scholes option pricing model. The following table presents the total estimated value of the options to be available for grant under the stock option plan, assuming the market price and exercise price for the stock options are equal and the range of market prices for the shares is \$8.00 per share to \$14.00 per share.

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Exercise Price	Grant-Date Fair Value Per Option	208,250 Options at Minimum of Range	245,000 Options at Midpoint of Range	281,750 Options at Maximum of Range	324,012 Options at Maximum of Range, As Adjusted
(In thousands, except for per share price information)					
\$ 8.00	\$ 3.01	\$ 627	\$ 737	\$ 848	\$ 975
\$ 10.00	\$ 3.76	\$ 783	\$ 921	\$ 1,059	\$ 1,218
\$ 12.00	\$ 4.51	\$ 939	\$ 1,105	\$ 1,271	\$ 1,461
\$ 14.00	\$ 5.26	\$ 1,095	\$ 1,289	\$ 1,482	\$ 1,704

Our Issuance of Shares of Common Stock to the Charitable Foundation

To further our commitment to our local community, we intend to establish and fund a charitable foundation as part of the reorganization and offering. We will issue shares of our common stock, ranging from 85,000 shares at the minimum of the estimated valuation range to 115,000 shares at the maximum of the estimated valuation range, which shares will have a value of \$850,000 at the minimum of the estimated valuation range and \$1.15 million at the maximum of the estimated valuation range, based on the \$10.00 per share offering price. As a result of the issuance of shares based on the \$10.00 per share offering price, we will record an after-tax expense of \$522,750 at the minimum of the valuation range and of \$707,250 at the maximum of the valuation range, during the quarter in which the offering is completed. The charitable foundation will be dedicated exclusively to supporting charitable causes and community development activities in the communities in which we operate.

Issuing shares of common stock to the charitable foundation will:

- dilute the voting interests of purchasers of shares of our common stock in the offering; and
- result in an expense, and a reduction in earnings, during the quarter in which the contribution is made, equal to the full amount of the contribution to the charitable foundation, offset in part by a corresponding tax benefit.

See “*Risk Factors—The Contribution of Shares to the Charitable Foundation Will Dilute Your Ownership Interests and Adversely Affect Net Income in Fiscal Year 2006*,” “*Comparison of Valuation and Pro Forma Information With and Without Charitable Foundation*” and “*The Lake Shore Charitable Foundation*.”

Tax Consequences of the Offering

The offering will result in no taxable gain or loss to Lake Shore, MHC, Lake Shore Bancorp or Lake Shore Savings, or to depositors who have a priority right to subscribe for shares of common stock in the offering, or to our employees, officers, directors or members, except to the extent that the nontransferable subscription rights to purchase shares of common stock in the offering may be determined to have value. Thacher Proffitt & Wood LLP has opined, as to the United States federal income tax consequences, that it is more likely than not that the fair market value of such subscription rights is zero. In that case, there will be no taxable gain or loss to depositors who receive nontransferable subscription rights.

THE OFFERING

Persons Who Can Order Common Stock in the Offering

We have granted rights to subscribe for our shares of common stock in a “subscription offering” to the following persons in the following order of priority:

1. Persons with deposits at Lake Shore Savings with balances aggregating \$50 or more as of June 30, 2004, “eligible account holders”;
2. Our tax-qualified employee benefit plans;
3. Persons with deposits at Lake Shore Savings with balances aggregating \$50 or more as of December 31, 2005, “supplemental eligible account holders”; and
4. Lake Shore Savings’ depositors as of January ___, 2006.

In the event that the above persons do not subscribe for all the shares of common stock being offered for sale, we may offer shares for sale in a community offering. Natural persons and trusts of natural persons who are residents of Chautauqua, Erie and Cattaraugus Counties, New York, will have a purchase preference in any community offering. Shares may also be offered to the general public. The community offering, if any, may begin concurrently with, during or immediately after the subscription offering. We also may offer shares of common stock not purchased in the subscription offering or the community offering through a syndicate of broker-dealers in what is referred to as a syndicated community offering. The syndicated community offering, if any, would be managed by Ryan Beck & Co., Inc. We have the right to accept or reject, in our sole discretion, any orders received in the community offering or the syndicated community offering.

If we receive subscriptions for more shares than are to be sold in this offering, we may be unable to fill or partially fill your order. Shares will be allocated first to categories in the subscription offering under a formula outlined in the plan of reorganization and as described in *“The Reorganization and Offering.”*

Minimum and Maximum Purchase Limitations

Our plan of reorganization establishes certain limitations on the purchase of common stock in the offering. These limitations include the following:

- The minimum purchase is 25 shares of common stock; and
- No individual may purchase more than \$200,000 of common stock (20,000 shares). If any of the following persons purchase stock, their purchases when combined with your purchases cannot exceed \$400,000 of common stock (40,000 shares):
 - Your spouse, or relatives of you or your spouse, living in your house;
 - Companies, trusts or other entities in which you have a controlling interest or hold a management position; and
 - Other persons who may be acting together with you (including, but not limited to, persons who file jointly a Schedule 13G or Schedule 13D Beneficial Ownership Report with the Securities and Exchange Commission).

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All persons sharing a qualifying joint deposit account will be counted as a single depositor for purposes of determining the maximum amount that may be subscribed for by an individual, and, unless we determine otherwise, persons having the same address and persons exercising subscription rights through qualifying accounts registered to the same address will be subject to the overall purchase limitation.

A detailed discussion of the limitations on purchases of common stock by an individual and persons acting together is set forth under the caption “*The Offering—Limitations on Purchase of Shares .*”

Subject to Office of Thrift Supervision approval, we may increase or decrease the purchase limitations in the offering at any time. Our tax-qualified benefit plans, including our employee stock ownership plan, are authorized to purchase up to 10% of the shares sold in the offering plus issued to the charitable foundation without regard to the above purchase limitations.

How to Purchase Shares of Common Stock

If you want to place an order for shares in the subscription or community offering, you must complete an original stock order form and send it to us together with full payment. Once we receive your order, you cannot cancel or change it. You may pay for shares in the subscription offering or the community offering in the following ways:

- By personal check, bank check or money order made payable to Lake Shore Bancorp, Inc. Funds submitted by personal check must be available in the account when the stock order is received; or
- By authorizing us to withdraw from your deposit account(s) maintained at Lake Shore Savings. You may not authorize direct withdrawal from Lake Shore Savings checking or NOW accounts. Please submit a check instead. You may, however, authorize withdrawal from all types of money market accounts, savings accounts and certificates of deposit.

Checks and money orders received by Lake Shore Savings will be cashed immediately and placed in a segregated account at Lake Shore Savings or, at our discretion at another insured depository institution. We will pay interest on your funds submitted by check or money order at the rate we pay on our passbook savings accounts, from the date we receive your funds until the offering is completed or terminated. All funds authorized for withdrawal from deposit accounts must be available in the account when the stock order form is received. Funds will remain in the accounts and continue to earn interest at the applicable account rate and will be withdrawn upon completion of the offering. A hold will be placed on those funds when your stock order is received, making the designated funds otherwise unavailable to you during the offering period. If, as a result of a withdrawal from a certificate account, the balance falls below the minimum balance requirement, the remaining funds will earn interest at our passbook savings rate. There will be no early withdrawal penalty for withdrawals from certificate accounts used to pay for common stock.

Federal law prohibits us from knowingly loaning funds to purchase shares in the offering. You may not submit a check drawn on a Lake Shore Savings line of credit. Additionally, cash, wire transfers and third party checks may not be remitted. You may submit your stock order form by mail using the return envelope provided, by overnight courier to the indicated address on the stock order form, or by bringing your stock order form to our Stock Information Center, located at our administrative office (not our main banking office in Dunkirk). The Stock Information Center is located at 31 East Fourth Street, Dunkirk, New York. Stock order forms may not be delivered to our main banking office in Dunkirk or to any Lake Shore Savings branches.

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After we receive an order, the order cannot be revoked or changed, except with our consent. We are not required to accept copies or facsimiles of stock order forms.

For a further discussion regarding the stock ordering procedures, see “ *The Reorganization and Offering – Procedure for Purchasing Shares in the Subscription and Community Offerings* .”

Using Individual Retirement Account Funds

You may not authorize direct withdrawal from a Lake Shore Savings individual retirement account. If you wish to use funds in your Lake Shore Savings individual retirement account to pay for shares of our common stock, please be aware that federal law requires that such funds first be transferred to a self-directed retirement account with a trustee other than Lake Shore Savings. The transfer of such funds to a new trustee takes time. If you would like to use your individual retirement account funds held at Lake Shore Savings or elsewhere, we recommend that you contact our Stock Information Center promptly, preferably at least two weeks before the _____, 2006 offering expiration date, for assistance. We cannot guarantee that you will be able to use retirement funds held at Lake Shore Savings or elsewhere, for this purchase. Your ability to use these retirement funds may depend on time constraints and, possibly, limitations imposed by the individual retirement account trustee.

Subscription Rights are Not Transferable

Pursuant to federal law, you are not permitted to transfer or sell your subscription rights and we will act to ensure that you do not do so. We will not accept any stock orders that we believe involve the transfer of subscription rights. For a further discussion of subscription rights, see “ *The Reorganization and Offering – Subscription Offering and Subscription Rights* .”

Deadline for Orders of Common Stock

If you wish to purchase shares of common stock, your properly completed and signed stock order form, together with payment for the shares, must be *received* (not postmarked) no later than _____ a.m., Eastern Time, on _____, unless we extend this deadline.

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Delivery of Prospectus

To ensure that you receive a prospectus at least 48 hours before _____, 2006, we may not mail prospectuses any later than five days before such date, or hand-deliver any prospectuses later than two days before that date. Stock order forms may only be distributed with or preceded by a prospectus.

Once Submitted, Your Purchase Order May Not Be Revoked Unless the Offering is Terminated or Extended Beyond [_____] or We Amend the Offering Range Below 1,912,500 Shares or Above 2,975,625 Shares.

The Office of Thrift Supervision approved the offering on _____, 2006; however, because completion of the offering will be subject to an update of the independent appraisal, among other factors, there may be one or more delays in the completion of the offering. Any orders that you submit to purchase shares of our common stock in the offering are irrevocable, and you will not have access to subscription funds unless the offering is terminated, or extended beyond [_____] or we amend the offering range as described above.

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Expiration of the Offering

The subscription offering will expire at 11:00 a.m., Eastern Time, on _____. The community offering, if any, is expected to terminate at the same time. We may extend this expiration date without notice to you, until [extension date], unless the Office of Thrift Supervision approves a later date. If the offering extends beyond _____, we will be required to resolicit subscribers allowing them an opportunity to modify, cancel or maintain their stock orders, before proceeding with the offering. Unless we receive an affirmative response from an investor in a designated period of time, all funds delivered to us to purchase shares of common stock in the offering will be returned promptly to the subscriber, with interest at Lake Shore Savings' passbook savings rate, and deposit account withdrawal authorizations will be cancelled. In no event may we extend the offering beyond _____.

Steps We May Take If We Do Not Receive Orders for at Least the Minimum Number of Shares

If we do not receive orders for at least 1,912,500 shares of common stock in the subscription offering, we may take several steps in order to sell the minimum number of shares of common stock in the offering range.

Specifically, we may do one or a combination of the following:

- make shares available to the public in a community offering;
- offer shares for sale through a syndicated community offering;
- increase the maximum number of shares that subscribers may purchase; and/or
- seek regulatory approval to extend the offering beyond the [extension date] expiration date, provided that any such extension will require us to resolicit subscriptions received in the offering. If you do not respond, we will cancel your stock order and return your subscription funds, with interest, and cancel any authorization to withdraw funds from your deposit accounts for the purchase of shares of common stock.

Alternatively, we may terminate the offering, returning subscription funds with interest and canceling deposit account withdrawal authorizations.

Delivery of Stock Certificates

Certificates representing shares of common stock sold in the offering will be mailed to the persons entitled to the certificates at the certificate registration address noted by them on the stock order form as soon as practicable following consummation of the offering and receipt of all regulatory approvals. **It is possible that, until certificates for the common stock are delivered to purchasers, purchasers might not be able to sell the shares of common stock which they ordered, even though the common stock will have begun trading.**

Market for Common Stock

We have applied to have our common stock quoted on the Nasdaq National Market under the trading symbol "LSBK." Ryan Beck & Co., Inc. currently intends to become a market maker in our common stock, but is under no obligation to do so, and will assist us in obtaining additional market makers. After shares of the common stock begin trading, you may contact a firm offering investment services in order to buy or sell shares.

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How We Intend to Use the Proceeds We Raise from this Offering

The following table summarizes how we intend to distribute the net proceeds from this offering, based on the sale of shares at the minimum and maximum of the offering range.

	1,912,500 Shares at \$10.00 Per Share	2,587,500 Shares at \$10.00 Per Share
	(Dollars in thousands)	
Gross offering proceeds	\$ 19,125	\$ 25,875
Less: offering expenses	1,392	1,453
Net offering proceeds	17,733	24,422
Less:		
Proceeds contributed to Lake Shore Savings	8,867	12,211
Proceeds used for loan to the employee stock ownership plan	1,598	2,162
Proceeds to Lake Shore, MHC	100	100
Proceeds remaining for Lake Shore Bancorp	\$ 7,168	\$ 9,949

We may use the portion of the net proceeds that we do not contribute to Lake Shore Savings to, among other things, invest in securities, pay cash dividends or repurchase shares of common stock, subject to regulatory restrictions or for other general corporate purposes. Lake Shore Savings may use the portion of the proceeds that it receives to fund new loans, open or acquire new branches, invest in securities, expand its business activities or for other general corporate purposes. We may also use the proceeds of the offering to diversify our business and acquire other companies, although we have no such specific plans this time.

Due to the difficult economic environment in our market area, it may take a significant amount of time for us to deploy the offering proceeds to our best advantage. For example, due to intense competition and market rates, our borrower demand may be limited. We plan to initially apply the net proceeds we receive from the offering to qualified investments in accordance with our investment policy. It is expected that the investments will include asset-backed securities, collateralized mortgage obligations, and mortgage-back securities with terms that will range from one to four years in average lives and maturities up to ten years.

Directors and Executive Officers Intend to Subscribe for 89,600 Shares

Our directors and executive officers, together with their associates, are expected to subscribe for 89,600 shares, which represents 3.8% of the shares that would be sold in the offering and 1.8% of the total shares to be outstanding at the midpoint of the offering range, plus shares issued to our charitable foundation. Directors and executive officers will pay \$10.00 per share, as will everyone else who purchases shares in the offering.

Lake Shore Bancorp's Dividend Policy

After the reorganization, we intend to adopt a policy of paying regular cash dividends, but have not yet decided on the amount or frequency of payments or when payments, if any, may begin. Based upon our estimate of offering expenses and other assumptions described in "Pro Forma Data," we expect to have between \$17.7 million and \$24.4 million in net proceeds, at the minimum and the maximum of the offering, respectively, that, subject to annual earnings and expenses, we could potentially use to pay dividends.

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Possible Conversion of Lake Shore, MHC to Stock Form

In the future, Lake Shore, MHC may convert from the mutual (meaning no stockholders) to capital stock form of organization (fully-owned by stockholders), in a transaction commonly known as a “second-step conversion.” In a second-step conversion, members of Lake Shore, MHC (eligible depositors of Lake Shore Savings) would have subscription rights to purchase common stock of Lake Shore Bancorp, or its successor, and our public stockholders would be entitled to exchange their shares of common stock for an equal percentage of shares of the stock holding company resulting from the conversion. This percentage may be adjusted to reflect any assets owned by Lake Shore, MHC. As a result of the second-step conversion, Lake Shore, MHC would cease to exist and our public stockholders would own approximately the same percentage of Lake Shore Bancorp as they owned immediately prior to the second-step conversion. As a result of a second-step transaction, our stock’s liquidity would increase and we would have additional capital that could be used to facilitate business growth. In addition, as a fully-converted stock holding company, we would have greater flexibility in structuring mergers and acquisitions. A second-step conversion would also eliminate the anti-takeover effect inherent in the mutual holding company structure because Lake Shore, MHC would no longer have voting control since it would no longer exist.

The Board of Directors of Lake Shore, MHC has no current plan to undertake a second-step conversion transaction. Any second-step conversion transaction would require the approval of holders of a majority of the outstanding shares of our common stock (excluding shares held by Lake Shore, MHC) and approval of a majority of the votes held by depositors of Lake Shore Savings.

Restrictions on the Acquisition of Lake Shore Bancorp, Inc. and Lake Shore Savings Bank

Federal regulations, as well as provisions contained in the charter and bylaws of Lake Shore Savings, restrict the ability of any person, firm or entity to acquire Lake Shore Bancorp, Lake Shore Savings, or their respective capital stock. These restrictions include the requirement that a potential acquirer of common stock obtain the prior approval of the Office of Thrift Supervision before acquiring in excess of 10% of the outstanding capital stock of Lake Shore Bancorp or Lake Shore Savings. Because a majority of our outstanding shares of common stock must be owned by Lake Shore, MHC, any acquisition of Lake Shore Bancorp must be approved by Lake Shore, MHC, and Lake Shore, MHC would not be required to pursue or approve a sale of Lake Shore Bancorp even if such a sale were favored by a majority of our public stockholders.

Stock Information Center

If you have any questions regarding the offering or the reorganization, please call the Stock Information Center at (800) 806-8430. You may also visit our Stock Information Center, which is located at our administrative office (not our main banking office). The Stock Information Center is located at 31 East Fourth Street, Dunkirk, New York. This is the only location that will accept stock order forms and have supplies of offering materials. The Stock Information Center is open Monday through Friday, except for bank holidays, from 10:00 a.m. to 4:00 p.m., Eastern Time.

RISK FACTORS

You should consider carefully the following risk factors before deciding whether to invest in our common stock. Our business could be harmed by any of these risks. In assessing these risks you should also refer to the other information contained in this prospectus, including our financial statements and related notes.

Risks Related To Our Business

We Have Recently Opened New Branches And Expect To Open Additional New Branches In The Near Future. Opening New Branches Reduces Our Short-Term Profitability Due To One-time Fixed Expenses Coupled With Low Levels Of Income Earned By The Branches Until Their Customer Bases Are Built. We opened two new branches in Orchard Park and East Amherst, New York in 2003 and one more in Hamburg, New York in December 2005. We intend to continue to expand through de novo branching. The expense associated with building and staffing new branches will significantly increase our noninterest expense, with compensation and occupancy costs constituting the largest amount of increased costs. Losses are expected from the proposed new branch for some time as the expenses associated with it are largely fixed and is typically greater than the income earned as a branch builds up its customer base. Our management has projected that it will take approximately 36 to 48 months for the Hamburg branch to become profitable. The branch we opened in East Amherst in 2003 is not yet profitable. We expect it to be profitable by the end of 2006. All of our other full-service branches are individually profitable. There can be no assurance that our branch expansion strategy will result in increased earnings, or that it will result in increased earnings within a reasonable period of time. We expect that the success of our branching strategy will depend largely on the ability of our staff to market the deposit and loan products offered by us. Depending upon locating acceptable sites, we anticipate opening one or two branches in each of the next several years.

Our Loan Portfolio Includes Loans With A Higher Risk Of Loss. We originate commercial mortgage loans, commercial loans, consumer loans, and residential mortgage loans primarily within our market area. Commercial mortgage, commercial, and consumer loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. In addition, commercial real estate and commercial business loans may also involve relatively large loan balances to individual borrowers or groups of borrowers. These loans also have greater credit risk than residential real estate for the following reasons:

- ***Commercial Mortgage Loans.*** Repayment is dependent upon income being generated in amounts sufficient to cover operating expenses and debt service.
- ***Commercial Loans.*** Repayment is generally dependent upon the successful operation of the borrower's business.
- ***Consumer Loans.*** Consumer loans (such as personal lines of credit) may or may not be collateralized with assets that provide an adequate source of payment of the loan due to depreciation, damage, or loss.

Any downturn in the real estate market or local economy could adversely affect the value of the properties securing the loans or revenues from the borrower's business thereby increasing the risk of non-performing loans. At this time, however, there is no downturn in the local economy or real estate market and we are not aware of any adverse effects in property values or business declines as a result of the local economy.

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If Our Allowance For Loan Losses Is Not Sufficient To Cover Actual Loan Losses, Our Earnings Could Decrease. Our loan customers may not repay their loans according to their terms and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. We therefore may experience significant loan losses, which could have a material adverse effect on our operating results.

Material additions to our allowance for loan losses also would materially decrease our net income, and the charge-off of loans may cause us to increase the allowance. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. We rely on our loan quality reviews, our experience and our evaluation of economic conditions, among other factors, in determining the amount of the allowance for loan losses. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance.

The high percentage of traditional real estate loans in our loan portfolio has been one of the more significant factors we have taken into account in evaluating our allowance for loan losses and provision for loan losses. If we were to further increase the amount of loans in our portfolio other than traditional real estate loans, we may decide to make increased provisions for loan losses. In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, which may have a material adverse effect on our financial condition and results of operations. We believe that the current amount of allowance for loan losses is sufficient to absorb reasonably anticipated losses in our loan portfolio.

Low Demand For Real Estate Loans May Lower Our Profitability. Making loans secured by real estate, including one-to-four family and commercial real estate, is our primary business and primary source of revenue. If customer demand for real estate loans decreases, our profits may decrease because our alternative investments, primarily securities, generally earn less income than real estate loans. Customer demand for loans secured by real estate could be reduced due to weaker economic conditions, an increase in unemployment, a decrease in real estate values or an increase in interest rates. For example, customer demand for loans secured by real estate has decreased in our market area as a result of interest rate increases during 2004 and 2005.

We Depend On Our Executive Officers And Key Personnel To Implement Our Business Strategy And Could Be Harmed By The Loss Of Their Services. We believe that our growth and future success will depend in large part upon the skills of our management team. The competition for qualified personnel in the financial services industry is intense, and the loss of our key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect our business. We cannot assure you that we will be able to retain our existing key personnel or attract additional qualified personnel. Although we have an employment agreement with our President and Chief Executive Officer that contains a non-compete provision, the loss of the services of one or more of our executive officers and key personnel could impair our ability to continue to develop our business strategy.

The Implementation Of Stock-Based Benefits Will Increase Our Future Compensation Expense And Reduce Our Earnings, And May Dilute Your Ownership Interest In Lake Shore Bancorp. We intend to adopt a stock option plan that will provide for grants to eligible officers, directors and employees of options to purchase common stock of up to 4.90% of the shares of common stock outstanding after the offering (including shares issued to the Lake Shore Charitable Foundation). We also intend to adopt a management recognition plan that will provide for awards of common stock to eligible officers, directors and employees of up to 1.96% of the shares of common stock outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation). We will fund these plans through either open market purchases, if permitted, or from the issuance of authorized but unissued

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shares. These plans will increase our future costs of compensating our officers and directors, thereby reducing our earnings. In addition, stockholders will experience a 1.9% reduction or dilution in ownership interest in the event newly-issued shares are used to fund restricted stock awards and a 4.7% reduction or dilution in ownership interest in the event newly-issued shares are used to fund the stock options.

After The Offering, Our Return On Equity Will Be Low Compared To Other Companies. This Could Hurt The Price Of Your Common Stock. We will not be able to immediately deploy all of the new capital generated from this offering into high-yielding earning assets, and due to the difficult economic environment in our market area, deployment of the new capital may take a significant amount of time. For example, due to intense competition and market rates, our borrower demand may be limited. Our ability to leverage our new capital profitably will be significantly affected by industry competition for loans and deposits. Initially, we intend to invest the net proceeds in short-term investments and mortgage-backed securities, which generally have lower yields than loans. This will reduce our return on average equity to a level that will be lower than our historical ratios.

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Our Ability To Grow May Be Limited If We Cannot Make Acquisitions. In an effort to fully deploy the capital we raise in the offering, we intend to seek to expand our banking franchise, internally and by acquiring other financial institutions or branches and other financial services providers. However, we have no specific plans for expansion or acquisitions at this time. Our ability to grow through selective acquisitions of other financial institutions or branches will depend on successfully identifying, acquiring and integrating those institutions or branches. We cannot assure you that we will be able to generate internal growth or identify attractive acquisition candidates, make acquisitions on favorable terms or successfully integrate any acquired institutions or branches.

Risks Related To The Offering

There Can Be No Assurance Of An Active And Liquid Market For Our Common Stock. As a mutual institution, Lake Shore Savings has never issued capital stock. We have applied for, and expect to receive, approval to have Lake Shore Bancorp's common stock quoted on the Nasdaq National Market under the symbol "LSBK" subject to the completion of the reorganization and offering and compliance with the initial listing qualifications. An active trading market depends on the existence of willing buyers and sellers, the presence of which is not within our control. The number of active buyers and sellers of the common stock at any particular time may be limited. Under such circumstances, you could have difficulty selling your shares on short notice and, therefore, you should not view the common stock as a short-term investment. We cannot assure you of an active trading market for the common stock. Nor can we assure you that, if you purchase shares, you will be able to sell them at or above \$10.00 per share, or at all.

Our Management Will Have Substantial Discretion Over Investment Of The Offering Proceeds And May Make Investments With Which You Disagree. The net offering proceeds are estimated to range from \$17.7 million to \$24.4 million at the minimum and the maximum of the offering range, respectively, and management intends to use these funds for general business purposes, giving management substantial discretion over their investment. You may disagree with investments that management makes. See "*How We Intend to Use the Proceeds From the Offering*."

Our Charter, Bylaws And Certain Laws And Regulations May Prevent Transactions You Might Favor, Including A Sale Or Merger Of Lake Shore Bancorp. Provisions of our Charter and Bylaws, federal regulations and various other factors may make it more difficult for companies or persons to acquire control of us without the consent of our Board of Directors. It is possible, however, that you would want a takeover attempt to succeed because, for example, a potential buyer could offer a premium

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over the then prevailing price of our common stock. The factors that may discourage takeover attempts or make them more difficult include:

- *Office of Thrift Supervision regulations* . Office of Thrift Supervision regulations prohibit, for three years following the completion of a mutual-to-stock conversion, the offer to acquire or the acquisition of more than 10% of any class of equity security of a converted institution without the prior approval of the Office of Thrift Supervision. In addition, the Office of Thrift Supervision has required, as a condition to approval of the conversion, that Lake Shore Savings maintain a federal thrift charter for a period of three years.
- *Charter, Bylaws and statutory provisions* . Provisions of our Charter and Bylaws and of Federal law may make it more difficult and expensive to pursue a takeover attempt that management opposes. These provisions also make more difficult the removal of our current directors or management, or the election of new directors. These provisions include:
 - limitations on voting rights of the beneficial owners of more than 10% of our common stock;
 - supermajority voting requirements for certain business combinations and changes to certain provisions of our Charter and Bylaws;
 - the election of directors to staggered terms of three years; and
 - provisions regarding the timing and content of stockholder proposals and nominations.

Risks Related to the Formation of Our Charitable Foundation

The Contribution To The Lake Shore Charitable Foundation Will Hurt Our Profits For Fiscal Year 2006 And Dilute Your Ownership Interest. We intend to contribute 2% of the shares of our common stock issued in the reorganization to The Lake Shore Charitable Foundation. This contribution will be an additional operating expense and will reduce net income during the fiscal year in which The Lake Shore Charitable Foundation is established, which is expected to be the year ending December 31, 2006. Based on the pro forma assumptions, the contribution to The Lake Shore Charitable Foundation would reduce net earnings by \$615,000 at the midpoint of the offering, after tax, in fiscal year 2006. In addition, purchasers of shares in the offering will have their ownership and voting interests diluted by up to 4.3% at the close of the offering when we contribute the shares of our common stock to The Lake Shore Charitable Foundation. For a further discussion regarding the effect of the contribution to the charitable foundation, see “*Pro Forma Data*” and “*Comparison of Valuation and Pro Forma Information With and Without Charitable Foundation.*”

Our Contribution To The Lake Shore Charitable Foundation May Not Be Tax Deductible, Which Could Hurt Our Profits. We believe that our contribution to The Lake Shore Charitable Foundation, valued at \$1.0 million at the midpoint of the offering, pre-tax, will be deductible for federal income tax purposes. However, we do not have any assurance that the Internal Revenue Service will grant tax-exempt status to the charitable foundation. If the contribution is not deductible, we would not receive any tax benefit from the contribution. In addition, even if the contribution is tax deductible, we may not have sufficient profits to be able to use the deduction fully.

Risks Related To The Banking Industry

Competition In Our Primary Market Area May Reduce Our Ability To Attract And Retain Deposits And Originate Loans. We operate in a competitive market for both attracting deposits, which is our primary source of funds, and originating loans. Historically, our most direct competition for savings deposits has come from credit unions, community banks, large commercial banks and thrift institutions in our primary market area. Particularly in times of extremely low or extremely high interest rates, we have faced additional significant competition for investors' funds from brokerage firms and other firms' short-term money market securities and corporate and government securities. Our competition for loans comes principally from mortgage brokers, commercial banks, other thrift institutions, and insurance companies. Such competition for the origination of loans may limit our future growth and earnings prospects. Competition for loan originations and deposits may limit our future growth and earnings prospects.

Changes In Interest Rates Could Adversely Affect Our Results Of Operations And Financial Condition. Our results of operations and financial condition are significantly affected by changes in interest rates. Our results of operations depend substantially on our net interest income, which is the difference between the interest income earned on our interest-earning assets and the interest expense paid on our interest-bearing liabilities. Increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans.

We also are subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities.

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 while a majority of our interest-bearing liabilities are expected to reprice as interest rates increase. Therefore, in an increasing interest 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 narrowing of our net interest rate spread and a decrease in our net interest income.

FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business, plans, prospects, growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors that could affect the actual outcome of future events:

- significantly increased competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- general economic conditions, either nationally or in our market areas, that are worse than expected;
- adverse changes in the securities markets;
- legislative or regulatory changes that adversely affect our business;
- our ability to enter new markets successfully and take advantage of growth opportunities;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the Financial Accounting Standards Board; and
- changes in our organization, compensation and benefit plans.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. We discuss these and other uncertainties in “*Risk Factors*” beginning on page 24.

SELECTED FINANCIAL AND OTHER DATA

The summary information presented below at December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 and 2002 is derived in part from and should be read in conjunction with the financial statements of Lake Shore Savings and the notes thereto presented elsewhere in this prospectus. The information at December 31, 2002, 2001 and 2000 and for the years ended December 31, 2001 and 2000 is derived from the audited financial statements of Lake Shore Savings which are not included herewith. The information at September 30, 2005 and for the nine months ended September 30, 2005 and 2004 is derived from unaudited financial data but in the opinion of management, reflects all adjustments necessary for a fair presentation of the results for such periods. All such adjustments are of a normal and recurring nature. The results for the nine-month period ended September 30, 2005 are not necessarily indicative of the results that may be expected for the entire year.

	At September 30,		At December 31,				
	2005	2004	2003	2002	2001	2000	
	(Unaudited)	(Dollars in thousands)					
Selected financial condition data:							
Total assets	\$ 334,074	\$329,841	\$303,511	\$238,056	\$214,086	\$201,759	
Loans, net	202,417	199,525	187,138	156,740	144,600	128,991	
Securities available for sale	96,420	99,170	83,027	52,225	41,934	46,892	
Securities held to maturity	2,299	2,359	371	765	1,118	1,432	
Federal Home Loan Bank stock	2,504	2,709	2,167	1,420	1,162	1,034	
Total cash and cash equivalents	15,483	11,577	16,753	16,238	14,269	13,415	
Total deposits	251,576	243,554	230,495	195,092	182,066	172,062	
Short-term borrowings	9,425	11,725	11,800	4,005	1,115	475	
Long-term debt	40,660	42,260	31,535	11,535	5,540	6,665	
Total equity	27,732	26,915	24,947	23,942	21,705	19,405	
Allowance for loan losses	1,267	1,288	1,293	1,217	924	797	
Non-performing loans	1,001	792	1,052	1,408	1,402	880	
Non-performing assets	1,195	934	1,538	1,524	1,510	891	
	For the nine months ended September 30,		For the year ended December 31,				
	2005	2004	2004	2003	2002	2001	2000
	(Unaudited)	(Dollars in thousands)					
Selected operating data:							
Interest income	\$11,846	\$10,875	\$14,744	\$12,780	\$13,182	\$14,215	\$13,862
Interest expense	4,651	3,903	5,332	4,694	4,946	7,053	6,860
Net interest income	7,195	6,972	9,412	8,086	8,236	7,162	7,002
Provision for loan losses	20	207	267	345	360	325	201
Net interest income after provision for loan losses	7,175	6,765	9,145	7,741	7,876	6,837	6,801
Total non-interest income	1,401	1,378	1,875	1,728	1,646	1,820	1,339
Total non-interest expense	6,129	5,869	7,939	7,218	6,201	5,576	5,449
Income before income taxes	2,447	2,274	3,081	2,251	3,321	3,081	2,691
Income taxes	873	683	902	744	1,085	1,018	898
Net income	\$ 1,574	\$ 1,591	\$ 2,179	\$ 1,507	\$ 2,236	\$ 2,063	\$ 1,793

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	For the nine months ended September 30,		For the year ended December 31,				
	2005	2004	2004	2003	2002	2001	2000
Selected financial ratios and other data(1)							
Performance ratios:							
Return on average assets	0.64%	0.67%	0.68%	0.58%	1.00%	0.99%	0.92%
Return on average equity	7.62%	8.32%	8.45%	6.24%	9.97%	10.37%	10.92%
Interest rate spread(2)	2.95%	3.03%	3.03%	3.18%	3.68%	3.25%	3.58%
Net interest margin(3)	3.10%	3.14%	3.15%	3.32%	3.95%	3.70%	3.91%
Efficiency ratio(4)	71.30%	70.29%	70.34%	73.55%	62.75%	62.08%	65.33%
Non interest expense to average total assets	2.47%	2.47%	2.48%	2.76%	2.77%	2.67%	2.80%
Average interest-earning assets to average interest-bearing liabilities	107.38%	106.09%	106.35%	107.49%	111.21%	112.40%	108.69%
Capital ratios:							
Total risk-based capital to risk weighted assets	16.74%	16.01%	16.34%	16.41%	18.47%	17.84%	15.57%
Tier 1 risk-based capital to risk weighted assets	15.71%	14.82%	15.18%	15.23%	17.10%	16.75%	14.41%
Tangible capital to tangible assets	8.32%	7.74%	7.99%	7.99%	9.56%	9.53%	9.12%
Tier 1 leverage (core) capital to adjustable tangible assets	8.32%	7.74%	7.99%	7.99%	9.56%	9.53%	9.12%
Equity to total assets	8.30%	7.93%	8.16%	8.22%	10.06%	10.14%	9.62%
Asset quality ratios:							
Non-performing loans as a percent of loans	0.49%	0.54%	0.40%	0.56%	0.90%	0.97%	0.68%
Non-performing assets as a percent of total assets	0.36%	0.35%	0.28%	0.50%	0.64%	0.71%	0.44%
Allowance for loan losses as a percent of total net loans	0.63%	0.71%	0.65%	0.69%	0.78%	0.64%	0.62%
Allowance for loan losses as a percent of non-performing loans	126.57%	131.83%	162.63%	122.91%	86.43%	65.91%	90.57%
Other data:							
Number of full service offices	7	7	7	7	5	5	5

(1) Nine-month ratios have been annualized.

(2) Represents the difference between the weighted-average yield on interest-earning assets and the weighted-average cost of interest-bearing liabilities for the period.

(3) The net interest margin represents the net interest income as a percent of average interest-earning assets for the period.

(4) The efficiency ratio represents non-interest expense divided by the sum of net interest income and non-interest income.

HOW WE INTEND TO USE THE PROCEEDS FROM THE OFFERING

The net proceeds will depend on the total number of shares of common stock sold in the offering, which will in turn depend on RP Financial's appraisal, regulatory and market considerations, and the expenses incurred in connection with the reorganization and offering. Although we will not be able to determine the actual net proceeds from the sale of the common stock until we complete the offering, we estimate the net proceeds to be between \$17.7 million and \$24.4 million, or \$28.3 million if the offering is increased by 15%.

We intend to distribute the net proceeds from the offering as follows:

	1,912,500 Shares at \$10.00 per Share at Minimum of Offering Range		2,250,000 Shares at \$10.00 per Share at Midpoint of Offering Range		2,587,500 Shares at \$10.00 per Share at Maximum of Offering Range		2,975,625 Shares at \$10.00 per Share at Adjusted Maximum of Offering Range	
	Percent of Net Proceeds		Percent of Net Proceeds		Percent of Net Proceeds		Percent of Net Proceeds	
	Amount		Amount		Amount		Amount	
(Dollars in thousands)								
Gross offering proceeds	\$19,125		\$22,500		\$25,875		\$29,756	
Less:								
Estimated commissions and expenses and expenses	217		247		278		314	
Other estimated offering expenses	1,175		1,175		1,175		1,175	
Total estimated offering expenses	1,392		1,422		1,453		1,489	
Net offering proceeds	17,733	100.0%	21,078	100.0%	24,422	100.0%	28,267	100.0%
Less:								
Proceeds contributed to Lake Shore Savings	8,867	50.0%	10,539	50.0%	12,211	50.0%	14,134	50.0%
Proceeds used for loan to employee stock ownership plan	1,598	9.0%	1,880	8.9%	2,162	8.9%	2,486	8.8%
Proceeds used to capitalize Lake Shore, MHC	100	0.6%	100	0.5%	100	0.4%	100	0.4%
Proceeds retained by Lake Shore Bancorp	\$ 7,168	40.4%	\$ 8,559	40.6%	\$ 9,949	40.7%	\$11,547	40.8%

The net proceeds may vary because total expenses relating to the reorganization and offering may be more or less than our estimates. For example, our expenses would increase if a syndicated community offering is used to sell shares not purchased in the subscription offering and community offering. The net proceeds will also vary if the number of shares to be sold in the offering are adjusted to reflect a change in the estimated pro forma market value of Lake Shore Bancorp. Payments for shares made through withdrawals from existing deposit accounts will not result in the receipt of new funds for investment but will result in a reduction of Lake Shore Savings' deposits and interest expense as funds are transferred from interest bearing certificates of deposit or other deposit accounts.

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How We May Use The Proceeds We Retain From The Offering

Funds raised in the offering will allow us to:

- invest in permissible investment securities;
- finance acquisitions of other financial institutions and branches or other businesses related to financial services, although no mergers or acquisitions are planned at the present time;
- pay dividends to our stockholders;
- repurchase shares of our common stock;
- fund management and employee stock benefit plans; and
- have capital for general corporate purposes.

Under current Office of Thrift Supervision regulations, we may not repurchase shares of our common stock during the first year following the offering, except when extraordinary circumstances exist and with prior regulatory approval.

The net proceeds raised in the offering will allow Lake Shore Savings to better serve the needs of our community by:

- funding increased residential and commercial lending, particularly in Erie County, New York;
- potentially expanding the products and services it currently offers;
- expanding its retail banking franchise by establishing new branches or by acquiring other financial institutions or financial services companies, although no acquisitions are specifically being considered at this time; and
- investing in the physical structures of our corporate office, branch offices and ATMs.

Due to the difficult economic environment in our market area, it may take a significant amount of time to deploy the net offering proceeds to our best advantage. For example, due to intense competition and market rates, our borrower demand may be limited. Initially, both Lake Shore Bancorp and Lake Shore Savings intend to invest the net proceeds from the offering in short-term investments and mortgage-backed and asset-backed securities until these proceeds can be deployed for other purposes discussed above.

OUR POLICY REGARDING DIVIDENDS

After the reorganization, we intend to pay dividends depending upon our capital structure, earnings and financial condition, need for capital in connection with possible future acquisitions, and other factors, including economic conditions, regulatory restrictions, and tax considerations. No assurances can be given that any dividends will be paid or that, if paid, will not be reduced or eliminated in the future.

If we pay dividends, we also will be required to pay dividends to Lake Shore, MHC. Pursuant to Office of Thrift Supervision regulations, Lake Shore, MHC may elect to waive the receipt of dividends.

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We anticipate that Lake Shore, MHC will waive receipt of any dividends that we may pay. Any decision to waive dividends will be subject to regulatory approval. Under Office of Thrift Supervision regulations, public shareholders would not be diluted in a “second-step conversion” transaction by Lake Shore, MHC as a result of any dividends waived by Lake Shore, MHC.

The only funds available for the payment of dividends on our common stock will be cash and cash equivalents held by us, earnings from the investment of proceeds from the sale of common stock retained by us, dividends paid by Lake Shore Savings to us, and borrowings. Lake Shore Savings will be prohibited from paying cash dividends to us to the extent that any such payment would reduce Lake Shore Savings’ capital below required capital levels. See “*The Reorganization and Offering—Effects of Conversion on Depositors, Borrowers and Members—Effect on Liquidation Rights*.”

Pursuant to our charter, we are authorized to issue preferred stock. If we issue preferred stock, the holders of the preferred stock may have dividend preferences over the holders of common stock.

Lake Shore Savings’ ability to pay dividends will be governed by the Home Owners’ Loan Act and the regulations of the Office of Thrift Supervision. Under such statute and regulations, all dividends by a federal savings bank must be paid out of current or retained net profits. In addition, the prior approval of the Office of Thrift Supervision is required for the payment of a dividend if the total of all dividends declared by a federal savings bank in any calendar year would exceed the total of its net profits for the year combined with its net profits for the two preceding years, less any required transfers to surplus or a fund for the retirement of any preferred stock.

MARKET FOR THE COMMON STOCK

We have not previously issued any capital stock and there is no established market for it. We have applied to have our common stock quoted on the Nasdaq National Market under the symbol “LSBK” subject to completion of the offering, and in compliance with certain conditions, including the presence of at least three registered market makers. Ryan Beck & Co., Inc. intends to become a market maker in our common stock following the offering, but is under no obligation to do so. Ryan Beck & Co., Inc. also plans on assisting us to obtain other market makers for our common stock. We cannot assure you that other market makers will agree to make a market in our common stock, or that if any market develops it can or will be sustained.

The development and maintenance of an active trading market depends on the existence of willing buyers and sellers, the presence of which is not within our control or that of any market maker. The number of active buyers and sellers of the common stock at any particular time may be limited. Under such circumstances, you could have difficulty selling your shares on short notice and, therefore, you should not view the common stock as a short-term investment. We cannot assure you that an active trading market for the common stock will develop or that, if it develops, it will continue. Nor can we assure you that, if you purchase shares, you will be able to sell them at or above \$10.00 per share. You should have a long-term investment intent if you purchase shares of our common stock and you should recognize that there may be a limited trading market in our common stock.

REGULATORY CAPITAL COMPLIANCE

At September 30, 2005, Lake Shore Savings exceeded all regulatory capital requirements. Set forth below is a summary of our capital computed under accounting principles generally accepted in the United States of America (“GAAP”) and our compliance with regulatory capital standards at September 30, 2005, on a historical and pro forma basis under Office of Thrift Supervision regulations. We have assumed that the indicated number of shares were sold as of September 30, 2005 and that Lake Shore Savings received 50% of the net proceeds from the offering. For purposes of the table below, the amount expected to be loaned to the employee stock ownership plan and the cost of shares expected to be acquired by the management recognition plan and used to fund a stock option plan is deducted from pro forma regulatory capital. For a discussion of the capital requirements applicable to Lake Shore Savings, see “*Regulation—Regulation of Lake Shore Savings –Capital Requirements*.”

Pro Forma at September 30, 2005

	Actual, As of September 30, 2005		Minimum 1,912,500 shares at \$10.00 per share		Midpoint 2,250,000 shares at \$10.00 per share		Maximum 2,587,500 shares at \$10.00 per share		Maximum as adjusted 2,975,625 shares at \$10.00 per share(1)	
	Amount	Percent of Assets(2)	Amount	Percent of Assets(2)	Amount	Percent of Assets(2)	Amount	Percent of Assets(2)	Amount	Percent of Assets(2)
(Dollars in thousands)										
Total GAAP Equity	\$27,732	8.29%	\$34,167	9.97%	\$35,411	10.29%	\$36,654	10.60%	\$38,083	10.96%
Tangible Capital (3)	\$27,846	8.32%	\$34,283	10.00%	\$35,527	10.32%	\$36,770	10.63%	\$38,199	10.99%
Requirement	5,022	1.50%	5,143	1.50%	5,166	1.50%	5,189	1.50%	5,215	1.50%
Excess	\$22,826	6.82%	\$29,140	8.50%	\$30,361	8.82%	\$31,581	9.13%	\$32,984	9.49%
Tier 1 (Leverage)(4)	\$27,846	8.32%	\$34,283	10.00%	\$35,527	10.32%	\$36,770	10.63%	\$38,199	10.99%
Requirement	13,393	4.00%	13,715	4.00%	13,776	4.00%	13,837	4.00%	13,907	4.00%
Excess	\$14,455	4.32%	\$20,568	6.00%	\$21,751	6.32%	\$22,933	6.63%	\$24,292	6.99%
Tier 1 Risk Based (5)	\$27,846	15.71%	\$34,283	18.92%	\$35,527	19.52%	\$36,770	20.12%	\$38,199	20.80%
Requirement	7,089	4.00%	7,250	4.00%	7,280	4.00%	7,311	4.00%	7,346	4.00%
Excess	\$20,759	11.71%	\$27,033	14.92%	\$28,247	15.52%	\$29,459	16.12%	\$30,853	16.80%
Total Risk-Based	\$29,667	16.74%	\$36,104	19.92%	\$37,348	20.52%	\$38,591	21.11%	\$40,020	21.79%
Risk-Based Requirement	14,178	8.00%	14,499	8.00%	14,561	8.00%	14,622	8.00%	14,692	8.00%
Excess	\$15,489	8.74%	\$21,605	11.92%	\$22,787	12.52%	\$23,969	13.11%	\$25,328	13.79%

- (1) As adjusted to give effect to an increase in the number of shares, which could occur due to an increase in the estimated price range of up to 15% as a result of changes in market conditions or general financial and economic conditions following the commencement of the offering.
- (2) Core capital levels are shown as a percentage of “total assets,” and risk-based capital levels are calculated on the basis of a percentage of “risk-weighted assets,” each as defined in the Office of Thrift Supervision regulations.
- (3) Pro forma capital levels assume receipt by Lake Shore Savings of 50% of the net proceeds from the shares of common stock sold at the minimum, midpoint, maximum and 15% above maximum of the offering range.
- (4) The current core capital requirement for savings banks is 3% of total adjusted assets for savings banks that receive the highest supervisory ratings for safety and soundness and that are not experiencing or anticipating significant growth. The current core capital ratio applicable to all other savings banks is 4%.
- (5) Assumes net proceeds are invested in assets that carry a 50% risk-weighting.

CAPITALIZATION

The following table presents the historical capitalization of Lake Shore Savings at September 30, 2005, and the pro forma capitalization of Lake Shore Bancorp after giving effect to the reorganization and offering, based upon the sale of the number of shares shown below and the other assumptions set forth under “Pro Forma Data.” A change in the number of shares to be sold in the offering may materially affect our capitalization.

		Pro Forma as of September 30, 2005			
	Actual, As of September 30, 2005	Minimum 1,912,500 shares at \$10.00 per share	Midpoint 2,250,000 shares at \$10.00 per share	Maximum 2,587,500 shares at \$10.00 per share	Maximum as adjusted 2,975,625 shares at \$10.00 per share(1)
		(Dollars in thousands)			
Deposits (2)	\$ 251,576	\$251,576	\$251,576	\$251,576	\$ 251,576
Short-term borrowings	9,425	9,425	9,425	9,425	9,425
Long-term debt	40,660	40,660	40,660	40,660	40,660
Total deposits and borrowed funds.	\$ 301,661	\$301,661	\$301,661	\$301,661	\$ 301,661
Stockholders' equity:					
Common stock, \$0.01 par value, 25,000,000 shares authorized; shares to be issued as reflected(3)	0	43	50	58	66
Additional paid-in capital (4).	0	18,440	21,928	25,414	29,424
Retained earnings (5)	27,846	27,846	27,846	27,846	27,846
Less:					
Expense of stock contribution to foundation	—	(850)	(1,000)	(1,150)	(1,323)
Expense of cash contribution to foundation	—	0	0	0	0
Plus:					
Tax benefit of contribution to foundation	—	327	385	443	509
Accumulated other comprehensive income (6)	(114)	(114)	(114)	(114)	(114)
Less:					
Common stock acquired by the employee stock ownership plan (7)	—	(1,598)	(1,880)	(2,162)	(2,486)
Common stock acquired by the management recognition plan (8)	—	(833)	(980)	(1,127)	(1,296)
Total stockholders' equity	\$ 27,732	\$ 43,261	\$ 46,235	\$ 49,208	\$ 52,626

- (1) As adjusted to give effect to an increase in the number of shares, which could occur due to an increase in the offering of up to 15% as a result of regulatory considerations or changes in market or general financial and economic conditions following the start of the offering.
- (2) Does not reflect withdrawals from deposit accounts for the purchase of common stock in the offering. Such withdrawals would reduce pro forma deposits by the amount of such withdrawals.
- (3) Reflects the total shares to be outstanding after the reorganization and offering: 4,250,000 shares at the minimum of the estimated valuation range, 5,000,000 shares at the midpoint, 5,750,000 shares at the maximum, and 6,612,500 at 15% above the maximum.
- (4) The sum of the par value and additional paid-in capital equals the net offering proceeds plus the value of shares contributed to the charitable foundation less the proceeds contributed to capitalize Lake Shore, MHC. No effect has been given to the issuance of additional shares of common stock pursuant to our proposed stock option plan intended to be adopted by our Board of Directors and presented for approval of stockholders at a meeting of the stockholders to be held at least six months following completion of the offering.
- (5) The retained earnings of Lake Shore Savings will be substantially restricted after the offering.
- (6) Represents the unrealized gain (loss) on securities classified as available-for-sale, net of related taxes.

(footnotes continue on next page)

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- (7) Assumes that the employee stock ownership plan purchases 8.0% of our shares of common stock sold in the offering plus issued to the charitable foundation with funds borrowed from us. The loan will be repaid principally from Lake Shore Savings' contributions to the employee stock ownership plan. Since we will finance the employee stock ownership plan debt, this debt will be eliminated through consolidation and no liability will be reflected on our consolidated financial statements. Accordingly, the amount of shares acquired by the employee stock ownership plan is shown in this table as a reduction of total stockholders' equity.
- (8) Assumes that, subsequent to the offering, an amount equal to 1.96% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation), is purchased by a management recognition plan through open market purchases with funds provided by us. The new management recognition plan is intended to be adopted by our Board of Directors and presented for approval of stockholders at a meeting to be held at least six months following completion of the offering. The common stock purchased by the management recognition plan is reflected as a reduction of stockholders' equity.

PRO FORMA DATA

We cannot determine the actual net proceeds from the sale of the common stock until the offering is completed. However, we estimate that net proceeds will be between \$17.7 million and \$24.4 million, or \$28.3 million if the offering range is increased by 15%, based upon the following assumptions:

- we will sell all shares of common stock in the subscription offering;
- our to-be-formed employee stock ownership plan will purchase 8% of the aggregate of shares of common stock both sold in the offering and contributed to the charitable foundation, with a loan from Lake Shore Bancorp. The loan will be repaid in substantially equal principal and interest payments over a period of 30 years;
- total expenses of the offering, excluding fees and expenses paid to Ryan Beck & Co., Inc., will be approximately \$1.2 million;
- 89,600 shares of our common stock will be purchased by our executive officers and directors and their immediate families; and
- Ryan Beck & Co., Inc. will receive a reorganization and proxy vote and advisory services fee of \$50,000 and 1.0% of the aggregate dollar amount of our common stock sold in the offering, excluding shares purchased by the employee stock ownership plan, our officers and directors and their immediate family members.

We calculated the pro forma consolidated net income and stockholders' equity of Lake Shore Bancorp for the nine months ended September 30, 2005 and the year ended December 31, 2004, as if the common stock had been sold at the beginning of each such period and the net proceeds had been invested at 4.01% for the nine months ended September 30, 2005 and 2.75% for the year ended December 31, 2004. These yields represent the yield on one-year U.S. Treasury securities at September 30, 2005 and December 31, 2004, respectively (which we consider to more accurately reflect the pro forma investment rate than an arithmetic average method in light of current market interest rates). This rate is used because we believe it reflects the yield that we will receive on the net proceeds of the offering. We assumed a combined federal and state effective tax rate of 38.5% for both periods. This results in annualized after-tax yields of 2.47% for the nine months ended September 30, 2005 and 1.69% for the year ended December 31, 2004.

We calculated historical and pro forma per share amounts by dividing historical and pro forma amounts of consolidated net income and stockholders' equity by the indicated number of shares of common stock. We adjusted these figures to give effect to the shares of common stock purchased by the employee stock ownership plan. We computed per share amounts for each period as if the common stock was outstanding at the beginning of the periods, but we did not adjust per share historical stockholders' equity to reflect the earnings on the estimated net proceeds. The loan to the employee stock ownership plan is assumed to be repaid in substantially equal principal and interest payments over a period of thirty years.

An increase in the number of shares of common stock outstanding as a result of an increase in the estimated pro forma market value of the common stock would decrease both the percentage of outstanding shares owned by a subscriber and the pro forma net income and stockholders' equity on a per share basis while increasing pro forma net income and stockholders' equity on an aggregate basis. A decrease in the number of shares of common stock outstanding would increase both a subscriber's ownership interest and the pro forma net income and stockholders' equity on a per share basis while decreasing pro forma net income and stockholders' equity on an aggregate basis.

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The following pro forma tables do not give effect to:

- withdrawals from deposit accounts to purchase common stock in the offering;
- our results of operations after the reorganization and offering; or
- changes in the market price of the common stock after the reorganization and offering.

The following pro forma information may not represent the financial effects of the offering at the date on which the offering actually occurs and you should not use the table as an indicator of future results of operations. Pro forma stockholders' equity represents the difference between the stated amount of assets and liabilities of Lake Shore Bancorp computed in accordance with generally accepted accounting principles generally accepted in the United States. We did not increase or decrease stockholders' equity to reflect the difference between the carrying value of loans and other assets and their market value. Stockholders' equity does not reflect the effect of bad debt reserves in the event of liquidation. Pro forma stockholders' equity is not intended to represent the fair market value of the common stock and may be different than amounts that would be available for distribution to stockholders if we liquidated.

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	At or for the nine months ended September 30, 2005			
	Minimum 1,912,500 shares at \$10.00 per share	Midpoint 2,250,000 shares at \$10.00 per share	Maximum 2,587,500 shares at \$10.00 per share	Maximum, as Adjusted 2,975,625 shares at \$10.00 per share(1)
	(Dollars in thousands, except per share amounts)			
Gross proceeds of offering	\$ 19,125	\$ 22,500	\$ 25,875	\$ 29,756
Plus: shares issued to the foundation	850	1,000	1,150	1,323
Pro forma market capitalization	\$ 19,975	\$ 23,500	\$ 27,025	\$ 31,079
Gross proceeds of offering	19,125	22,500	25,875	29,756
Less: expenses.	(1,392)	(1,422)	(1,453)	(1,489)
Estimated net proceeds	\$ 17,733	\$ 21,078	\$ 24,422	\$ 28,267
Less: common stock purchased by the employee stock ownership plan (2)	(1,598)	(1,880)	(2,162)	(2,486)
Less: common stock purchased by the management recognition plan (3)	(833)	(980)	(1,127)	(1,296)
Less: capitalization of Lake Shore, MHC	(100)	(100)	(100)	(100)
Estimated net proceeds, as adjusted	\$ 15,202	\$ 18,118	\$ 21,033	\$ 24,385
For the nine months ended September 30, 2005:				
Consolidated net income				
Historical	\$ 1,574	\$ 1,574	\$ 1,574	\$ 1,574
Pro forma income on net proceeds	281	335	389	451
Pro forma employee stock ownership plan adjustment (2)	(25)	(29)	(33)	(38)
Pro forma management recognition plan adjustment (3)	(77)	(91)	(104)	(120)
Pro forma options adjustment (4)	(104)	(122)	(140)	(162)
Pro forma net income	\$ 1,649	\$ 1,667	\$ 1,686	\$ 1,705
Per share net income (reflects SOP 93-6):				
Historical	\$ 0.38	\$ 0.33	\$ 0.28	\$ 0.25
Pro forma income on net proceeds, as adjusted	0.07	0.07	0.07	0.07
Pro forma employee stock ownership plan adjustment (2)	(0.01)	(0.01)	(0.01)	(0.01)
Pro forma management recognition plan adjustment (3)	(0.02)	(0.02)	(0.02)	(0.02)
Pro forma stock option adjustment(4)	(0.03)	(0.03)	(0.03)	(0.03)
Pro forma net income per share	\$ 0.39	\$ 0.34	\$ 0.29	\$ 0.26
Offering price as a multiple of pro forma net income per share	19.23	22.06	25.86	28.85
Number of shares outstanding for pro forma net income per share calculations	4,092,198	4,814,350	5,536,503	6,366,978

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At or for the nine months ended September 30, 2005				
	Minimum 1,912,500 shares at \$10.00 per share	Midpoint 2,250,000 shares at \$10.00 per share	Maximum 2,587,500 shares at \$10.00 per share	Maximum, as Adjusted 2,975,625 shares at \$10.00 per share(1)
(Dollars in thousands, except per share amounts)				
<u>At September 30, 2005 :</u>				
Stockholders' equity:				
Historical	\$ 27,732	\$ 27,732	\$ 27,732	\$ 27,732
Estimated net proceeds	17,733	21,078	24,422	28,267
Less: capitalization of Lake Shore, MHC	(100)	(100)	(100)	(100)
Plus: shares issued to foundation	850	1,000	1,150	1,323
Less: shares issued to foundation	(850)	(1,000)	(1,150)	(1,323)
Plus: tax benefit of the contribution to the foundation	327	385	443	509
Less: common stock acquired by employee stock ownership plan (2)	(1,598)	(1,880)	(2,162)	(2,486)
Less: common stock acquired by management recognition plan (3)	(833)	(980)	(1,127)	(1,296)
Pro forma stockholders' equity	\$ 43,261	\$ 46,235	\$ 49,208	\$ 52,626
Stockholders' equity per share (does not reflect SOP 93-6)				
Historical	\$ 6.53	\$ 5.55	\$ 4.82	\$ 4.19
Estimated net proceeds	4.17	4.22	4.25	4.27
Less: capitalization of Lake Shore, MHC	(0.02)	(0.02)	(0.02)	(0.02)
Plus: shares issued to foundation	0.20	0.20	0.20	0.20
Less: shares issued to foundation	(0.20)	(0.20)	(0.20)	(0.20)
Plus: tax benefit of the contribution to the foundation	0.08	0.08	0.08	0.08
Less: common stock acquired by employee stock ownership plan (2)	(0.38)	(0.38)	(0.38)	(0.38)
Less: common stock acquired by management recognition plan (3)	(0.20)	(0.20)	(0.20)	(0.20)
Pro forma stockholders' equity per share	\$ 10.18	\$ 9.25	\$ 8.55	\$ 7.94
Offering price as a percentage of pro forma stockholders' equity per share	98.23%	108.11%	116.96%	125.95%
Number of shares outstanding for pro forma book value per share calculations	4,250,000	5,000,000	5,750,000	6,612,500
(1) As adjusted to give effect to a 15% increase in the number of shares outstanding which could occur due to an increase in the maximum of the independent valuation as a result of regulatory considerations, demand for the shares or changes in market conditions or general financial and economic conditions following the commencement of the offering.				

(footnotes continue on next page)

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- (2) We have assumed that 8% of the aggregate shares of common stock sold in the offering (including shares issued to the charitable foundation) will be purchased by the employee stock ownership plan. For purposes of this table, the funds used to acquire such shares are assumed to have been borrowed by the employee stock ownership plan from us. The amount to be borrowed is reflected as a reduction of stockholders' equity. The employee stock ownership plan expense is based upon generally accepted accounting principles as described in accounting Statement of Position 93-6 ("SOP 93-6"). Generally accepted accounting principles require that as and when shares pledged as security for an employee stock ownership plan loan are committed to be released from the loan (i.e., as the loan is repaid), employee stock ownership plan expense is recorded based upon the fair value of the shares at the time. Lake Shore Savings intends to make annual contributions to the employee stock ownership plan in an amount at least equal to the principal and interest requirement of the debt. Lake Shore Savings' total annual payment of the employee stock ownership plan debt is based upon 30 equal annual installments of principal and interest. The pro forma net income assumes that (i) that Lake Shore Savings' contribution to the employee stock ownership plan is equivalent to the debt service requirement for the nine months ended September 30, 2005, and was made at the end of the period; (ii) 3,995 shares at the minimum of the offering range, 4,700 shares at the midpoint of the offering range, 5,405 shares at the maximum of the offering range and 6,216 shares at the 15% above the maximum of the offering range (based upon a 30-year loan term), were committed to be released during the nine months ended September 30, 2005 at an average fair value of \$10.00 per share in accordance with SOP 93-6; and (iii) the employee stock ownership plan shares committed to be released were considered outstanding for the entire period for purposes of the net income per share calculations.
- (3) We have assumed that 1.96% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation) will be awarded by a management recognition plan either through open market purchases or from authorized but unissued shares of common stock of Lake Shore Bancorp, if any. Before the management recognition plan is implemented, it must be approved by our stockholders. The dollar amount of the common stock to be purchased by the management recognition plan is based on \$10.00 per share and represents unearned compensation and is reflected as a reduction of capital, which could increase or decrease our capital. Such amount does not reflect possible increases or decreases in the price per share after the offering. Funds used by the management recognition plan to purchase the shares will initially be contributed by Lake Shore Bancorp. As we accrue compensation expenses to reflect the vesting of such shares over five years pursuant to the management recognition plan, the charge against capital will be reduced accordingly. In the event the shares issued under the management recognition plan consist of our authorized but unissued shares of common stock at the price per share in the offering, the per share financial condition and result of operations of Lake Shore Bancorp would be proportionally reduced and to the extent the interest of existing public and charitable foundation stockholders would be diluted by approximately 1.9%.
- (4) We have assumed that 4.9% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation) will be awarded pursuant to the stock option plan. In calculating the pro forma effect of the stock option expense, it is assumed that the exercise price of the stock options and trading price of the stock at the date of grant were \$10.00 per share, the estimated grant-date fair value pursuant to the application of the Black-Scholes option pricing model was \$3.76 for each option, the aggregate grant-date fair value of the stock options was amortized to expense on a straight-line basis over a five year vesting period of the options and that 30.0% of the amortization expense (or the assumed portion relating to options granted to directors) resulted in a tax benefit using an assumed federal and state combined tax rate of 38.5%. Under the above assumption, the adoption of the stock option plan will result in no additional shares under the treasury stock method for purposes of calculating earnings per share. There can be no assurance that the actual exercise price of the stock options will be equal to the \$10.00 per share price. If a portion of the shares to satisfy the exercise of options under the stock option plan are obtained from the issuance of authorized but unissued shares, our net income per share and stockholders' equity per share may decrease. This will also have a dilutive effect of up to 4.7% on the ownership interests of existing public and charitable foundation stockholders.

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At or for the year ended December 31, 2004				
	Minimum 1,912,500 shares at \$10.00 per share	Midpoint 2,250,000 shares at \$10.00 per share	Maximum 2,587,500 shares at \$10.00 per share	Maximum, as adjusted 2,975,625 shares at \$10.00 per share(1)
(Dollars in thousands, except per share amounts)				
Gross proceeds of offering	\$ 19,125	\$ 22,500	\$ 25,875	\$ 29,756
Plus: shares issued to the foundation	850	1,000	1,150	1,323
Pro forma market capitalization	\$ 19,975	\$ 23,500	\$ 27,025	\$ 31,079
Gross proceeds of offering	19,125	22,500	25,875	29,756
Less: expenses	1,392	1,422	(1,453)	(1,489)
Estimated net proceeds	\$ 17,733	\$ 21,078	\$ 24,422	\$ 28,267
Less: common stock purchased by employee stock ownership plan (2)	(1,598)	(1,880)	(2,162)	(2,486)
Less: common stock purchased by management recognition plan (3)	(833)	(980)	(1,127)	(1,296)
Less: capitalization of Lake Shore, MHC	(100)	(100)	(100)	(100)
Estimated net proceeds, as adjusted	\$ 15,202	\$ 18,118	\$ 21,033	\$ 24,385
For the year ended December 31, 2004 :				
Consolidated net income				
Historical income	\$ 2,179	\$ 2,179	\$ 2,179	\$ 2,179
Pro forma income on net proceeds, as adjusted	257	306	356	412
Pro forma employee stock ownership plan adjustment (2)	(33)	(39)	(44)	(51)
Pro forma management recognition plan adjustment (3)	(102)	(121)	(139)	(159)
Pro forma stock option adjustment(4)	(139)	(163)	(187)	(216)
Pro forma net income	\$ 2,162	\$ 2,162	\$ 2,165	\$ 2,165
Per share net income (reflects SOP 93-6)				
Historical Income	\$ 0.53	\$ 0.45	\$ 0.39	\$ 0.34
Pro forma income on net proceeds	0.06	0.06	0.06	0.06
Pro forma employee stock ownership plan adjustment (2)	(0.01)	(0.01)	(0.01)	(0.01)
Pro forma management recognition plan adjustment (3)	(0.02)	(0.02)	(0.02)	(0.02)
Pro forma stock option adjustment(4)	(0.03)	(0.03)	(0.03)	(0.03)
Pro forma net income per share	\$ 0.53	\$ 0.45	\$ 0.39	\$ 0.34
Offering price as a multiple of pro forma net income per share	18.87	22.22	25.64	29.41
Number of shares outstanding for pro forma net income per share calculations	4,092,863	4,815,133	5,537,403	6,368,014
At December 31, 2004 :				
Stockholders' equity:				
Historical	\$ 26,915	\$ 26,915	\$ 26,915	\$ 26,915
Estimated net proceeds	17,733	21,078	24,422	28,267
Less: capitalization of Lake Shore, MHC	(100)	(100)	(100)	(100)
Plus: shares issued to foundation	850	1,000	1,150	1,323
Less: shares issued to foundation	(850)	(1,000)	(1,150)	(1,323)
Plus: tax benefit of the contribution to the foundation	327	385	443	509
Less: common stock acquired by employee stock ownership plan (2)	(1,598)	(1,880)	(2,162)	(2,486)
Less: common stock acquired by management recognition plan (3)	(833)	(980)	(1,127)	(1,296)
Pro forma stockholders' equity	\$ 42,444	\$ 45,418	\$ 48,391	\$ 51,809

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	At or for the year ended December 31, 2004			
	Minimum 1,912,500 shares at \$10.00 per share	Midpoint 2,250,000 shares at \$10.00 per share	Maximum 2,587,500 shares at \$10.00 per share	Maximum, as adjusted 2,975,625 shares at \$10.00 per share(1)
Stockholders' equity per share (does not reflect SOP 93-6):				
Historical	\$ 6.33	\$ 5.38	\$ 4.68	\$ 4.07
Estimated net proceeds	4.17	4.22	4.25	4.27
Less: capitalization of Lake Shore, MHC	(0.02)	(0.02)	(0.02)	(0.02)
Plus: shares issued to foundation	0.20	0.20	0.20	0.20
Less: shares issued to foundation	(0.20)	(0.20)	(0.20)	(0.20)
Plus: tax benefit of contribution to the foundation	0.08	0.08	0.08	0.08
Less: common stock acquired by employee stock ownership plan (2)	(0.38)	(0.38)	(0.38)	(0.38)
Less: common stock acquired by management recognition plan (3)	(0.20)	(0.20)	(0.20)	(0.20)
Pro forma stockholders' equity per share	\$ 9.98	\$ 9.08	\$ 8.41	\$ 7.82
Offering price as a percentage of pro forma stockholders' equity per share	100.20%	110.13%	118.91%	127.88%
Number of shares outstanding for pro forma equity per share calculations	4,250,000	5,000,000	5,750,000	6,612,500

- (1) As adjusted to give effect to a 15% increase in the number of shares outstanding which could occur due to an increase in the maximum of the independent valuation as a result of regulatory considerations, demand for the shares or changes in market conditions or general financial and economic conditions following the commencement of the offering.
- (2) We have assumed that 8% of the aggregate shares of common stock sold in the offering (including shares issued to the charitable foundation) will be purchased by the employee stock ownership plan. For purposes of this table, the funds used to acquire such shares are assumed to have been borrowed by the employee stock ownership plan from us. The amount to be borrowed is reflected as a reduction of stockholders' equity. The employee stock ownership plan expense is based upon generally accepted accounting principles as described in accounting Statement of Position 93-6 ("SOP 93-6"). Generally accepted accounting principles require that as and when shares pledged as security for an ESOP loan are committed to be released from the loan (i.e., as the loan is repaid), employee stock ownership plan expense is recorded based upon the fair value of the shares at the time. Lake Shore Savings intends to make annual contributions to the employee stock ownership plan in an amount at least equal to the principal and interest requirement of the debt. Lake Shore Savings' total annual payment of the ESOP debt is based upon 30 equal annual installments of principal and interest. The pro forma net income assumes that (i) that Lake Shore Savings' contribution to the employee stock ownership plan is equivalent to the debt service requirement for the year ended December 31, 2004, and was made at the end of the period; (ii) 5,327 shares at the minimum of the offering range, 6,267 shares at the midpoint of the offering range, 7,207 shares at the maximum of the offering range and 8,288 shares at the 15% above the maximum of the offering range (based upon a 30-year loan term), were committed to be released during the year ended December 31, 2004 at an average fair value of \$10.00 per share in accordance with SOP 93-6; and (iii) the employee stock ownership plan shares committed to be released were considered outstanding for the entire period for purposes of the net income per share calculations.
- (3) We have assumed that 1.96% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation) will be awarded by a management recognition plan either through open market purchases or from authorized but unissued shares of common stock of Lake Shore Bancorp, if any. Before the management recognition plan is implemented, it must be approved by our stockholders. The dollar amount of the common stock to be purchased by the management recognition plan is based on \$10.00 per share and represents unearned compensation and is reflected as a reduction of capital, which could increase or decrease our capital. Such amount does not reflect possible increases or decreases in the price per share after the offering. Funds used by the management recognition plan to purchase the shares will initially be contributed by Lake Shore Bancorp. As we accrue compensation expenses to reflect the vesting of such shares over five years pursuant to the management recognition plan, the charge against capital will be reduced accordingly. In the event the shares issued under the management recognition plan consist of our authorized but unissued shares of common stock at the price per share in the offering, the per share financial condition and result of operations of Lake Shore Bancorp would be proportionally reduced and to the extent the interest of existing public and charitable foundation stockholders would be diluted by approximately 1.9%.

(footnotes continued on next page)

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- (4) We have assumed that 4.9% of the shares outstanding after the offering (including shares issued to The Lake Shore Charitable Foundation) will be awarded pursuant to the stock option plan. In calculating the pro forma effect of the stock option expense, it is assumed that the exercise price of the stock options and trading price of the stock at the date of grant were \$10.00 per share, the estimated grant-date fair value pursuant to the application of the Black-Scholes option pricing model was \$3.76 for each option, the aggregate grant-date fair value of the stock options was amortized to expense on a straight-line basis over a five year vesting period of the options and that 30.0% of the amortization expense (or the assumed portion relating to options granted to directors) resulted in a tax benefit using an assumed federal and state combined tax rate of 38.5%. Under the above assumption, the adoption of the stock option plan will result in no additional shares under the treasury stock method for purposes of calculating earnings per share. There can be no assurance that the actual exercise price of the stock options will be equal to the \$10.00 per share price. If a portion of the shares to satisfy the exercise of options under the stock option plan are obtained from the issuance of authorized but unissued shares, our net income per share and stockholders' equity per share may decrease. This will also have a dilutive effect of up to 4.7% on the ownership interests of existing public and charitable foundation stockholders.

COMPARISON OF VALUATION AND PRO FORMA INFORMATION WITH AND WITHOUT CHARITABLE FOUNDATION

As set forth in the following table, if we did not make a contribution to The Lake Shore Charitable Foundation as part of the offering, RP Financial estimates that our pro forma valuation would be greater, which would increase the amount of common stock offered for sale. Without the charitable foundation, the amount of common stock offered for sale at the midpoint of the offering would be \$24.0 million. If The Lake Shore Charitable Foundation were not established, there is no assurance that the updated appraisal that RP Financial will prepare at the closing of the reorganization would conclude that our pro forma market value would be the same as the estimate set forth in the table below. The updated appraisal will be based on the facts and circumstances existing at closing time, including, among other things, market and economic conditions. The offering amounts referred to in the table below relate to the value of the shares sold to the public.

	At the Minimum of the Offering Range (1,912,500 Shares)		At the Midpoint of the Offering Range (2,250,000 Shares)		At the Maximum of the Offering Range (2,587,500 Shares)		At the Maximum, As Adjusted, of the Offering Range (2,975,625 Shares)	
	With Foundation	No Foundation	With Foundation	No Foundation	With Foundation	No Foundation	With Foundation	No Foundation
(Dollars in thousands, except per share amounts)								
Estimated offering amount	\$ 19,125	\$ 20,375	\$ 22,500	\$ 23,970	\$ 25,875	\$ 27,566	\$ 29,756	\$ 31,700
Pro forma market capitalization	\$ 19,975	\$ 20,375	\$ 23,500	\$ 23,970	\$ 27,025	\$ 27,566	\$ 31,079	\$ 31,700
Estimated full value	\$ 42,500	\$ 43,350	\$ 50,000	\$ 51,000	\$ 57,500	\$ 58,650	\$ 66,125	\$ 67,448
Total assets	\$349,603	\$350,465	\$352,577	\$353,590	\$355,550	\$356,715	\$358,968	\$360,308
Total liabilities	\$306,342	\$306,342	\$306,342	\$306,342	\$306,342	\$306,342	\$306,342	\$306,342
Pro forma stockholders' equity	\$ 43,261	\$ 44,123	\$ 46,235	\$ 47,248	\$ 49,208	\$ 50,373	\$ 52,626	\$ 53,966
Pro forma net income (nine months ended September 30, 2005)	\$ 1,650	\$ 1,668	\$ 1,667	\$ 1,689	\$ 1,686	\$ 1,710	\$ 1,705	\$ 1,733
Pro forma stockholders' equity per share	\$ 10.18	\$ 10.18	\$ 9.25	\$ 9.26	\$ 8.55	\$ 8.58	\$ 7.94	\$ 8.00
Pro forma net income per share (nine months ended September 30, 2005)	\$ 0.39	\$ 0.39	\$ 0.34	\$ 0.33	\$ 0.29	\$ 0.29	\$ 0.26	\$ 0.25
Pro Forma Pricing Ratios								
Offering price as a percentage of pro forma stockholders' equity per share	98.23%	98.23%	108.11%	107.99%	116.96%	116.55%	125.94%	125.00%
Offering price to pro forma net income per share	19.23	19.23	22.06	22.73	25.86	25.86	28.85	30.00
Pro Forma Financial Ratios								
Return on assets (annualized)	0.63%	0.63%	0.63%	0.64%	0.63%	0.64%	0.63%	0.64%
Return on equity (annualized)	5.08%	5.04%	4.81%	4.77%	4.57%	4.53%	4.32%	4.28%
Equity/assets	12.37%	12.59%	13.11%	13.36%	13.84%	14.12%	14.66%	14.98%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis reflects Lake Shore Savings' financial statements and other relevant statistical data and is intended to enhance your understanding of Lake Shore Savings' financial condition and results of operations. You should read the information in this section in conjunction with Lake Shore Savings financial statements and accompanying notes to financial statements beginning on page F-1 of this prospectus, and the other statistical data provided in this prospectus. **Upon completion of the reorganization, Lake Shore Savings will become the wholly-owned subsidiary of Lake Shore Bancorp. At that time, the financial information presented herein will be part of the consolidated financial information for Lake Shore Bancorp. Prior to completion of the reorganization, Lake Shore Bancorp will not exist.**

General

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. For the nine months ended September 30, 2005 and the year ended December 31, 2004, our net income was \$1.6 million and \$2.2 million, respectively.

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, in general, 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. Since 1993, following the appointment of our current chief executive officer, and despite the fact that the Western New York market area has been economically stagnant, we have tripled in asset size and gone from being a two office institution to having eight branches. Since 1998 our asset size has more than doubled and we have opened three new branches.

Management Strategy

Our Reputation. Our primary management strategy has been to retain our perceived image as one of the most respected and recognized community banks in Western New York with 115 years of service to our community. Our management strives 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 \$29.2 million and \$19.2 million as of September 30, 2005, respectively. We opened an additional new branch office in Hamburg, New York in December 2005. 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.

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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 present staff is one of our competitive strengths and thus the retention of such persons and our ability to continue to attract high quality personnel are high priorities. The offering will be a means to compensate and reward employees by aligning their compensation to our financial performance, business goals and objectives.

Residential Mortgage and Other Lending. Historically, our lending portfolio has been composed predominantly of residential mortgage loans. At September 30, 2005, December 31, 2004 and December 31, 2003, we held \$145.7 million, \$142.2 million and \$135.3 million of residential mortgage loans, respectively, which constituted 71.9%, 71.1% and 72.1% of our total loan portfolio, at such respective dates. Due to the historically low interest rates in recent past years, we experienced an increase of mortgage lending and refinancing in 2003 and 2002. Mortgage lending and refinancing has slowed in the past year as interest rates have risen and the competition for residential mortgage loans, which had previously increased to meet the higher number of loans being generated and refinanced, remained strong. We originate commercial real estate loans to finance the purchase of real property, which generally consists of developed real estate. At September 30, 2005 and December 31, 2004, our commercial real estate loan portfolio consisted of loans totaling \$14.9 million and \$15.3 million respectively, or 7.4% and 7.7%, 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. 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. At September 30, 2005 and December 31, 2004, our commercial loan portfolio consisted of loans totaling \$8.1 million and \$8.6 million, respectively, or 4.0% and 4.3%, respectively, of total 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, 2005, our investment securities totaled \$101.2 million. Investment securities available for sale, which constituted approximately 95% of investment securities, totaled \$96.4 million at September 30, 2005.

Flattening Yield Curve . As with all community banks, we face a challenge in monitoring our interest rate risk with a “flattening 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. Banks try to match interest-earning assets and interest-paying liabilities against one another. As the Federal Reserve Board has increased the federal funds rate, short-term interest rates have risen; however, long-term rates, which are generally responsive to the bond market, have not been increasing, and have even decreased. Thus, the margin between interest earning assets and interest bearing liabilities is shrinking resulting in reduced net interest income. Our strategy of maintaining and increasing our interest income in a flattening yield curve environment is two-fold. First, we seek protection by locking in lower long-term rates with advances from the Federal Home Loan Bank of New York. At September 30, 2005, we had total Federal Home Loan Bank borrowings of \$50.1 million with an average interest rate of 3.63%. Second, we have engaged a third party financial advisor to assist us in investing such borrowed funds in attractive permissible investment securities. At September 30,

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2005, we had \$96.4 million in investment in securities available for sale, the majority of which are mortgage-backed or asset backed securities.

Expected Increases In Non-interest Expenses. Following completion of the reorganization and offering, our non-interest expenses will increase.

- To have publicly-traded common stock, Lake Shore Bancorp must register as a public company with the Securities and Exchange Commission and under the Securities and Exchange Act of 1934, as amended, and will thus be subject to periodic reporting requirements and associated disclosure controls and procedures and internal control over financial reporting standards. It is expected that in complying with these requirements, we will incur additional costs in preparing the necessary filings. It is also expected that our common stock will be quoted on the Nasdaq National Market. To commence and to maintain such listing we must pay fees. Additionally, as a publicly-held stock corporation structure, Lake Shore Bancorp will retain a stock transfer agent and will incur miscellaneous operating expenses such as stockholder communications expenses, all of which will be new and recurring costs.
- As part of the reorganization, we plan to convert Lake Shore Savings from a New York-chartered mutual savings and loan association to a federal stock savings bank. Lake Shore Bancorp and Lake Shore, MHC are also expected to have federal charters. As a result, the Office of Thrift Supervision will be the primary federal regulator for all three entities. As a state-chartered savings and loan association, Lake Shore Savings has been subject to the regulation of and assessments by each of the New York State Banking Department, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision. We expect cost savings by having the Office of Thrift Supervision as our primary regulator; however, these cost savings may be diminished by having three regulated entities rather than just a mutual savings bank.
- As discussed in greater detail in “Pro Forma Data,” “Management-Stock Benefits” and “Foundation,” as part of the reorganization and offering, we intend to: (i) make a loan to an employee stock ownership plan to purchase up to 8% of the shares sold in the offering plus issued to the charitable foundation, (ii) establish a charitable foundation to which will be issued an amount of authorized but unissued shares that will equal 2% of the Lake Shore Bancorp common stock outstanding after the offering and reorganization and (iii) no earlier than six months after the closing of the offering, subject to stockholder approval, reserve for issuance up to 1.96% and 4.90% of the shares outstanding after the offering (including shares issued to charitable foundation) for a management recognition plan and a stock option plan, respectively. The funding of each of these intentions, will cause Lake Shore Bancorp to recognize additional expenses on a consolidated basis.

After completion of the reorganization and offering, we expect to continue to grow our base of interest-earning assets by expanding our loan portfolio and by using borrowings, where appropriate, to supplement deposits as a funding source. We also intend to grow by adding new branch offices. We may also use proceeds from the offering to establish or acquire branch offices, to fund the building of new offices and to make other acquisitions, although no acquisitions or new branches are being specifically considered at this time. See “*How We Intend to Use the Proceeds from the Offering*.”

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

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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.

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 the Audit Committee and the Board of Directors. All accounting policies are important, and as such, we encourage the reader to review each of the policies included in Note 2 to the Notes to the Financial Statements to better understand how our financial performance is reported.

Management Of Market Risk

The majority of our assets and liabilities are monetary in nature. Consequently, interest rate risk is our most significant market risk. Other types of market risk, such as movements in foreign currency exchange rates and commodity prices, do not arise in the normal course of our business operations. Interest rate risk can be defined as an exposure to a movement in interest rates that could have an adverse effect on our net interest income. Interest rate risk arises naturally from the imbalance in the repricing, maturity, and/or cash flow characteristics of assets and liabilities. In periods of falling interest rates, prepayments of loans typically increase, which would lead to reduced net interest income if such proceeds could not be reinvested at a comparable spread. Also in a falling interest rate environment, certain categories of deposits may reach a point where market forces prevent further reduction in the interest rate paid on those instruments. Generally, during extended periods when short-term and long-term interest rates are relatively close, a flat yield curve may lead to smaller net interest margins thereby reducing net interest income. The net effect of these circumstances is reduced net interest income, offset only by a nominal decrease in interest expense, thereby narrowing the net interest margin.

Managing interest rate risk is of primary importance to us. The responsibility for interest rate risk management is the function of our Asset/Liability Committee, which includes our Chief Executive Officer and President, Chief Financial Officer and certain members of our Board of Directors. Our Asset/Liability Committee meets every other month to review our asset/liability policies and identify and measure potential risks to earnings due to changes in interest rates. The primary goal of our interest rate risk management is to minimize the potential loss in net interest income that could arise from changes in interest rates given our business strategy, operating environment, capital, liquidity and performance objectives. Our Chief Financial Officer also receives recommendations from a third party financial advisor regarding permissible investment securities, the use of which are part of our management of interest rate risk.

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Net Interest Income At Risk

In past years, many savings banks have measured interest rate sensitivity by computing the “gap” between the assets and liabilities which are expected to mature or reprice within certain time periods, based on assumptions regarding loan prepayment and deposit decay rates formerly provided by the Office of Thrift Supervision. However, the Office of Thrift Supervision now requires the computation of amounts by which the net present value of an institution’s cash flow from assets, liabilities and off balance sheet items (the institution’s net portfolio value) would change in the event of a range of assumed changes in market interest rates. The Office of Thrift Supervision provides all institutions that file a Consolidated Maturity/Rate Schedule as part of their quarterly Thrift Financial Report with an interest rate sensitivity report of net portfolio value. The Office of Thrift Supervision’s simulation model uses discounted cash flow analysis and an option-based pricing approach to measure the interest rate sensitivity of net portfolio value. Historically, the Office of Thrift Supervision model estimated the economic value of each type of asset, liability and off-balance sheet contract under the assumption that the United States Treasury yield curve increases or decreases instantaneously by 100 to 300 basis points in 100 basis point increments. However, given the current low level of market interest rates, we did not prepare a net portfolio value calculation for an interest rate decrease of greater than 100 basis points. A basis point equals one-hundredth of one percent, and 100 basis points equals one percent. An increase in interest rates from 3% to 4% would mean, for example, a 100 basis point increase in the “Change in Interest Rates” column below.

The table below sets forth as of September 30, 2005 and December 31, 2004, the estimated changes in our net portfolio value that would result from designated instantaneous changes in the United States Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points) (1)	As of September 30, 2005			As of December 31, 2004		
	Amount	Dollar Change from Base	Percentage Change from Base	Amount	Dollar Change From Base	Percentage Change from Base
	(Dollars in thousands)					
+300	\$22,746	\$(17,401)	(43)%	\$21,985	\$(17,304)	(44)%
+200	28,786	(11,361)	(28)%	28,435	(10,854)	(28)%
+100	34,893	(5,254)	(13)%	34,441	(4,848)	(12)%
0	40,147	—	—	39,289	—	—
-100	42,863	2,716	7%	40,957	1,668	4%

(1) Assumes an instantaneous uniform change in interest rates. A basis point equals 0.01%.

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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, while a majority of our interest-bearing liabilities are expected to reprice. At September 30, 2005, 78.0% of our loans with contractual maturities of greater than one year had fixed rates of interest, and 95.7% of our total loans had contractual maturities of five or more years. Overall, at September 30, 2005, 90.7% of our total interest-earning assets had contractual maturities of more than five years. Conversely, our interest-bearing liabilities generally have much shorter contractual maturities. A significant portion of our deposits have no contractual maturities and are likely to reprice quickly as short-term interest rates increase. In addition, 63.9% of our certificates of deposit will mature within one year, and 35.3% of our borrowed funds contractually mature within one year. 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 narrowing of our net interest rate spread and a decrease in our earnings.

We anticipate short-term market interest rates will continue to increase in 2006, and long-term market interest rates will begin to increase, but not as fast as short-term interest rates. This potential market interest rate scenario would cause the spread between long-term interest rates and short-term interest rates to decrease. If this occurs, the resulting interest rate environment is expected to have a negative impact on our results of operations as our interest-bearing liabilities, both deposits and borrowed funds, generally price off short-term interest rates, while our interest-earning assets, both mortgage loans and securities, generally price off long-term interest rates.

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 table sets forth certain information relating to our average balance sheets and reflects the average yield on interest-earning 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 include a tax equivalent adjustment for bank qualified municipals.

	At September 30, 2005			For the nine months ended September 30, 2005			For the nine months ended September 30, 2004			For the Year ended December 31, 2004			For the Year ended December 31, 2003			For the Year ended December 31, 2002		
				Interest			Interest			Interest			Interest			Interest		
	Actual Balance	Yield/ Rate		Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
(Dollars in thousands)																		
Interest-earning assets:																		
Interest-bearing deposits	\$ 2,632	—		\$ 2,286	—	—	\$ 1,364	—	—	\$ 1,142	—	—	\$ 1,709	—	—	\$ 1,463	—	—
Federal funds sold	4,675	3.41%		5,278	120	3.02%	10,005	86	1.14%	8,251	101	1.22%	10,651	122	1.15%	10,909	183	1.68%
Securities	101,223	3.92%		101,669	2,981	3.90%	92,875	2,552	3.65%	96,075	3,541	3.69%	68,026	2,586	3.80%	46,692	2,513	5.38%
Loans	202,417	5.74%		199,453	8,745	5.83%	191,364	8,237	5.72%	193,435	11,102	5.74%	162,886	10,072	6.18%	149,418	10,486	7.02%
Total interest-earning assets	310,947	5.07%		308,686	11,846	5.10%	295,608	10,875	4.89%	298,903	14,744	4.93%	243,272	12,780	5.25%	208,482	13,182	6.32%
Other assets	23,127			20,772			20,777			20,681			17,965			15,600		
Total assets	\$334,074			\$329,458			\$316,385			\$319,584			\$261,237			\$224,082		
Interest-bearing liabilities:																		
Demand and NOW accounts	\$ 37,957	0.37%		\$ 38,019	106	0.37%	\$ 38,348	79	0.27%	\$ 38,344	110	0.29%	\$ 36,099	176	0.49%	\$ 31,587	297	0.94%
Money market accounts	27,099	1.00%		29,941	203	0.90%	30,785	202	0.87%	30,922	275	0.89%	24,404	276	1.13%	22,564	364	1.61%
Savings accounts	29,942	0.51%		30,275	115	0.51%	31,595	120	0.51%	31,391	159	0.51%	30,951	287	0.93%	28,084	417	1.48%
Time deposits	139,687	2.69%		134,982	2,823	2.78%	126,399	2,306	2.43%	127,658	3,130	2.45%	111,908	3,148	2.81%	95,722	3,426	3.58%
Borrowed funds	50,085	3.59%		51,979	1,351	3.46%	49,518	1,147	3.08%	50,760	1,593	3.14%	21,447	747	3.48%	8,095	403	4.98%
Advances from borrowers on taxes and insurance	1,240	3.65%		1,902	34	2.38%	1,624	30	2.46%	1,610	40	2.48%	1,342	35	2.61%	1,410	39	2.77%
Other interest-bearing liabilities	361	6.63%		366	19	6.90%	381	19	6.63%	379	25	6.60%	164	25	15.24%	—	—	—
Total interest bearing liabilities	286,371	2.16%		287,464	4,651	2.15%	278,650	3,903	1.86%	281,064	5,332	1.90%	226,315	4,694	2.07%	187,462	4,946	2.64%
Other non-interest bearing liabilities	19,971			14,529			12,289			12,737			10,764			14,190		
Equity	27,732			27,465			25,446			25,783			24,158			22,430		
Total liabilities and equity	\$334,074			\$329,458			\$316,385			\$319,584			\$261,237			\$224,082		
Net interest income				\$ 7,195			\$ 6,972			\$ 9,412			\$ 8,086			\$ 8,236		
Interest rate spread						2.95%			3.03%			3.03%			3.18%			3.68%
Net interest margin						3.10%			3.14%			3.15%			3.32%			3.95%

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Rate Volume Analysis. The following table 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.

	Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004			Year Ended December 31, 2004 Compared to Year Ended December 31, 2003			Year Ended December 31, 2003 Compared to Year Ended December 31, 2002		
	Rate	Volume	Net Change	Rate	Volume	Net Change	Rate	Volume	Net Change
(Dollars in thousands)									
Interest-earning assets:									
Federal funds sold and other interest-bearing deposits	\$ 70	\$ (36)	\$ 34	\$ 10	\$ (31)	\$ (21)	\$ (61)	\$ —	\$ (61)
Securities	178	251	429	(81)	1,036	955	(870)	943	73
Loans deposits, including fees	155	353	508	(761)	1,791	1,030	(1,311)	897	(414)
Total interest-earning assets	403	568	971	(832)	2,796	1,964	(2,242)	1,840	(402)
Interest-bearing liabilities:									
Demand and NOW accounts	28	(1)	27	(76)	10	(66)	(159)	38	(121)
Money market accounts	7	(6)	1	(66)	65	(1)	(116)	28	(88)
Savings accounts	—	(5)	(5)	(132)	4	(128)	(169)	39	(130)
Time deposits	353	164	517	(431)	413	(18)	(803)	525	(278)
Total deposits	388	152	540	(705)	492	(213)	(1,247)	630	(617)
Other interest-bearing liabilities:									
Borrowed funds	146	59	205	(81)	927	846	(152)	496	344
Advances from borrowers on taxes and insurance and other interest-bearing liabilities	(1)	4	3	(22)	27	5	11	10	21
Total interest-bearing liabilities	533	215	748	(808)	1,446	638	(1,388)	1,136	(252)
Net change in interest income	\$ (130)	\$ 353	\$ 223	\$ (24)	\$ 1,350	\$ 1,326	\$ (854)	\$ 704	\$ (150)

Comparison Of Financial Condition at September 30, 2005 and December 31, 2004

Total assets at September 30, 2005 were \$334.1 million, an increase of \$4.3 million from \$329.8 million at December 31, 2004. The increase in total assets is predominantly the result of an increase in cash and cash equivalents, offset by a decrease in investment securities.

Our cash and cash equivalents increased by \$3.9 million to \$15.5 million at September 30, 2005, from \$11.6 million at December 31, 2004. This is due to an increase in federal funds sold of \$1.9 million from \$2.8 million at December 31, 2004 to \$4.7 million at September 30, 2005, an increase in our interest-bearing deposits from \$1.6 million at December 31, 2004, to \$2.6 million at September 30, 2005, and an increase of \$1.0 million in cash and due from banks from \$7.2 million at December 31, 2004 to \$8.2 million at September 30, 2005. All of our cash and cash equivalent balances reflect our liquid funds until they are deployed into lending or investment securities.

Investment securities decreased by \$3.0 million to \$101.2 million at September 30, 2005 from \$104.2 million at December 31, 2004. More specifically, investment securities available for sale, which constituted approximately 95% of investment securities, decreased by \$2.8 million to \$96.4 million at September 30, 2005 as compared to \$99.2 million at December 31, 2004. The decrease is attributable to the paydown of our borrowings at the Federal Home Loan Bank of New York of \$3.9 million.

Loans receivable, net increased by \$2.9 million to a total of \$202.4 million at September 30, 2005 from \$199.5 million at December 31, 2004. Home equity loans increased by \$780,000 from December 31, 2004 to September 30, 2005. As interest rates on mortgages have steadily risen during the last twelve to 24 months, more homeowners have been using home equity loans to tap into the equity in their homes as an additional source of funds. Home equity loans represented 14.4% of our loan portfolio at September 30, 2005. Commercial real estate loans decreased by \$394,000 from December 31, 2004 to September 30, 2005 while residential mortgage loans increased by \$3.4 million. The decrease in commercial real estate loans is attributable to the increase in the prime rate during the same period. The majority of our commercial real estate loans are tied to the prime rate and demand for this product is sensitive to rate changes. Mortgage loans and commercial real estate loans represented 71.9% and 7.4%, respectively, of the loan portfolio at September 30, 2005. Deferred loan fees increased by \$186,000 from \$891,000 at December 31, 2004 to \$1.1 million at September 30, 2005 due to an increase in our loan volume. The allowance for loan losses decreased slightly by \$21,000 during the period from December 31, 2004 to September 30, 2005. The remainder of the portfolio consists of commercial, consumer and construction loans.

Total deposits grew by \$8.0 million, or 3.3%, to \$251.6 million at September 30, 2005, as compared to \$243.6 million at December 31, 2004, primarily due to an increase in time deposits and non-interest bearing deposits. The increase is attributable to our branch expansion in Erie County, New York.

Our borrowings, consisting of advances from the Federal Home Loan Bank of New York, decreased by \$3.9 million from \$54.0 million at December 31, 2004 to \$50.1 million at September 30, 2005. We have used these funds as a source of liquidity for loans and investment securities. The use of such funds has been particularly important to our management of our interest rate risk as we have been able to lock in longer-terms rates with such borrowings.

Total equity increased by \$817,000 from \$26.9 million at December 31, 2004 to \$27.7 million at September 30, 2005. The increase in total equity was primarily due to net

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income of \$1.6 million for the nine months ended September 30, 2005 and to changes in the mark-to-market value of our available for sale investment securities for the nine months ended September 30, 2005.

Comparison of Results of Operations for the Nine Months Ended September 30, 2005 and 2004

General. Net income was \$1.6 million for the nine months ended September 30, 2005, a decrease of \$17,000, or 1.1%, compared with net income for the nine months ended September 30, 2004. The decrease in net income is attributable to increased interest expense, non-interest expense and increased income taxes, offset in part by an increase in net interest income and a decrease in the provision for loan losses.

Net Interest Income . Net interest income increased by \$223,000, or 3.2%, to \$7.2 million for the nine months ended September 30, 2005 as compared to \$7.0 million for the nine months ended September 30, 2004. This increase reflects increased interest income of \$971,000 for the nine months ended September 30, 2005, partially offset by an increase in interest expense of \$748,000.

Interest Income . Interest income increased \$971,000, or 8.9%, from \$10.9 million for the nine months ended September 30, 2004 to \$11.8 million for the nine months ended September 30, 2005. Approximately \$508,000 of this increase was attributable to an increase in interest on loans, the average balance of which increased by \$8.1 million over the year and had an average yield of 5.83% as compared to an average yield of 5.72% in the prior year. \$429,000 of the increase was attributable to an increase from interest on investment securities, the average balance of which increased by \$8.8 million over the year and had an average yield of 3.90% as compared to an average yield of 3.65% in the prior year.

Interest Expense . Interest expense increased by \$748,000, or 19.2%, from \$3.9 million for the nine months ended September 30, 2004 to \$4.7 million for the nine months ended September 30, 2005. The interest paid on deposits increased by \$540,000 from \$2.7 million for the nine months ended September 30, 2004 to \$3.2 million for the nine months ended September 30, 2005. This was due to an increase in the average yield paid on interest-bearing deposits over the year of 0.48% and an increase in the average balance of interest-bearing deposits of \$6.1 million over the year. The interest expense related to advances from the Federal Home Loan Bank of New York increased by \$204,000 from \$1.2 million for the nine months ended September 30, 2004 to \$1.4 million for the nine months ended September 30, 2005, as our borrowings increased in comparison to the prior year's nine month period.

Provision for Loan Losses . For the nine months ended September 30, 2005, the provision for loan losses was \$20,000, a \$187,000 decrease as compared to the provision for loan losses for the corresponding period in the prior year which was \$207,000. Despite increasing our loan portfolio, we were able to decrease the provision for loan losses based on the quality of our loan portfolio and the amount of allowance for loan losses already in place. Management has determined this based on a detailed review of our existing loan portfolio, historical charge-off rates and non-performing loans.

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 the 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.

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Non-interest Income . For the nine months ended September 30, 2005, non-interest income, which is a total of service charges and fees, net gains or losses on sales of available for sale securities and loans, as well as other income, not including interest and dividends, totaled \$1.4 million, which was an increase of \$23,000 in comparison to the corresponding period in the prior year.

Non-interest Expense . Non-interest expense increased \$260,000 from \$5.9 million for the nine months ended September 30, 2004 to \$6.1 million for the nine months ended September 30, 2005. Non-interest expense includes the expense of salaries and employee benefits, occupancy and equipment costs, data processing and other items not related to expenses on deposits or borrowings. The majority of the increase in non-interest expense was attributable to advertising expenditures, which increased \$83,000, or 60.1%, and salaries and employee benefits which increased \$85,000, or 2.7%. The increase in salaries and employee benefits was primarily due to annual salary increases.

Income Tax Expense . Income tax expense increased by \$190,000 from \$683,000 for the nine months ended September 30, 2004 to \$873,000 for the nine months ended September 30, 2005 due to increased net income.

Comparison Of Financial Condition at December 31, 2004 and December 31, 2003

Total assets at December 31, 2004 were \$329.8 million, an increase of \$26.3 million or 8.7% from \$303.5 million at December 31, 2003. The increase in total assets is predominantly the result of increases in our investment securities and our loan portfolio, which is composed primarily of residential mortgage loans.

Our cash and cash equivalents decreased by \$5.2 million to \$11.6 million at December 31, 2004, from \$16.8 million at December 31, 2003. This is due to a decrease in federal funds sold of \$5.9 million from \$8.7 million at December 31, 2003 to \$2.8 million at December 31, 2004, offset by an increase in our interest-bearing deposits from \$71,000 at December 31, 2003, to \$1.6 million at December 31, 2004. Since the federal funds rate was low at December 31, 2004, as compared to December 31, 2003, we endeavored to invest funds into investment securities as rapidly as sound investments practices allowed. All of our cash and cash equivalent balances at year-end reflect our liquid funds until deployed into lending or investment securities.

Investment securities increased by \$18.6 million to \$104.2 million at December 31, 2004 from \$85.6 million at December 31, 2003. More specifically, investment securities available for sale, which constituted approximately 95% of investment securities, increased by \$16.2 million to \$99.2 million at December 31, 2004 as compared to \$83.0 million at December 31, 2003. The increase in the balance of investment securities is a result of our management electing to invest borrowed funds, deposits and income from loans in such securities, as lending opportunities became less available.

Loans receivable, net increased by \$12.4 million, or 6.6%, to \$199.5 million at December 31, 2004 from \$187.1 million at December 31, 2003. Approximately \$6.9 million of this increase was attributable to residential mortgage loans. Mortgage loans represented 71.3% of the loan portfolio as of December 31, 2004. Home equity loans increased by \$2.5 million from \$25.9 million at December 31, 2003, to \$28.4 million at December 31, 2004. The increase can be attributable to interest rates rising from

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historic lows in 2003. The rising interest rate environment influenced homeowners to use home equity loans as a source of funds instead of refinancing their mortgages at higher rates. Home equity loans represented 14.2% of the loan portfolio at December 31, 2004. Commercial real estate loans increased by \$682,000 from \$14.6 million at December 31, 2003 to \$15.3 million at December 31, 2004, representing 7.7% of the loan portfolio. The increase is due to our expansion into Erie County, New York. The remainder of the portfolio consists of commercial and consumer loans.

Deposits grew by \$13.1 million, or 5.7%, to \$243.6 million at December 31, 2004, as compared to \$230.5 million at December 31, 2003. This increase was primarily due to the opening of the two new branch offices in East Amherst and Orchard Park, New York in 2003. In addition, all of our offices generated additional deposits.

Our advances from the Federal Home Loan Bank of New York increased by \$10.7 million from an outstanding balance of \$43.3 million at December 31, 2003 to a balance of \$54.0 million at December 31, 2004. We have used these funds as a source of liquidity for loans and investment securities. The use of such funds has been an important tool in managing our interest rate risk as we have been able to lock in rates with such borrowings.

Total equity increased by \$2.0 million from \$24.9 million at December 31, 2003 to \$26.9 million at December 31, 2004. The increase in total equity was primarily due to net income of \$2.2 million and to changes in the mark-to-market value of our available for sale investment securities for the year ended December 31, 2004.

Comparison of Results of Operations for the Years Ended December 31, 2004 and 2003

General. Net income was \$2.2 million for the year ended December 31, 2004, an increase of \$672,000, or 44.6%, compared with net income of \$1.5 million for the year ended December 31, 2003. The increase in net income is attributable to two new branch offices that we opened in 2003. Operating expenses associated with the new branches were recorded during 2003.

Net Interest Income . Net interest income increased by \$1.3 million, or 16.4%, to \$9.4 million for the year ended December 31, 2004 as compared to \$8.1 million for the year ended December 31, 2003. This increase reflects increased interest income of \$1.9 million for the year ended December 31, 2004 as compared to the prior year, partially offset by an increase in interest expense of \$638,000 over the same period.

Interest Income . Interest income increased \$1.9 million, or 15.4%, from \$12.8 million for the year ended December 31, 2003 to \$14.7 million for the year ended December 31, 2004. Approximately \$1.0 million of this increase was attributable to an increase in interest on loans, the average balance of which increased by \$30.6 million over the year and had an average yield of 5.74% as compared to an average yield of 6.18% in the prior year. The remaining \$1.0 million of the increase was attributable to an increase from interest on investment securities, the average balance of which increased by \$28.0 million over the year and had an average yield of 3.69% as compared to an average yield of 3.80% in the prior year.

Interest Expense . Interest expense increased by \$638,000, or 13.6%, from \$4.7 million for the year ended December 31, 2003 to \$5.3 million for the year ended December 31, 2004. The interest paid on deposits decreased by \$213,000 from \$3.9 million for the year ended December 31, 2003 to \$3.7 million for the year ended December 31, 2004. This was due to a decrease in the average yield paid on deposits over the year of 1.22% off-set by an increase in the average balance of deposits of \$25.0 million over the year. The interest expense related to advances from the Federal Home Loan Bank of New York increased from \$747,000 for the year ended December 31, 2003 to \$1.6 million for the year ended December 31, 2004 as our borrowings increased.

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Provision for Loan Losses . For the year ended December 31, 2004, the provision for loan losses was \$267,000, a decrease as compared to the provision for loan losses for the prior year which was \$345,000. Despite increasing our loan portfolio, we were able to decrease the provision for loan losses based on the quality of the loan portfolio and the amount of allowance for loan losses already in place. Management has determined this based on a detailed review of our existing loan portfolio, historical charge-off rates and non-performing loans.

Non-interest Income . Non-interest income increased by \$147,000 between the years ended December 31, 2004 and 2003. For the year ended December 31, 2004, non-interest income totaled \$1.9 million, whereas for the prior year it totaled \$1.7 million. The increase is attributable to increased overdraft service charges and increased gains on sales of available for sale securities, offset in part by decreased net gains on sales of loans and decreased other income.

Non-interest Expense . Non-interest expense increased \$721,000 from \$7.2 million for the year ended December 31, 2003 to \$7.9 million for the year ended December 31, 2004. The majority of the increase in non-interest expense was attributable to salaries and employee benefits which increased \$614,000, or 15.9%, from \$3.9 million for the year ended December 31, 2003 to \$4.5 million for the year ended December 31, 2004. The increase in salaries and employee benefits was primarily due to annual salary increases and hiring additional personnel to staff new branch offices opened during 2003 in Erie County.

Income Tax Expense . Income tax expense increased by \$158,000 from \$744,000 for the year ended December 31, 2003 to \$902,000 for the year ended December 31, 2004. The increase reflects an increase in our pretax income from \$2.3 million in 2003 to \$3.1 million in 2004.

Comparison of Results of Operations For the Years Ended December 31, 2003 and 2002

General. Net income was \$1.5 million for the year ended December 31, 2003, a decrease of \$729,000, or 32.6%, compared with net income of \$2.2 million for the year ended December 31, 2002. This decrease was primarily a result of a decrease in net interest income of \$150,000 and a \$1.0 million increase in non-interest expense offset in part by lower income taxes. Non-interest expense increased largely due to the expenses associated with the opening of two new branch offices and their lack of operating income for a part of the year in which such expenses were incurred.

Net Interest Income . Net interest income decreased by \$150,000 from \$8.2 million for the year ended December 31, 2002 to \$8.1 million for the year ended December 31, 2003. This decrease reflects a decrease in interest income only partially offset by a decrease in interest expense on deposits as we on average offered lower yields on our core deposits. Furthermore, there was an increase in interest paid on borrowings as we increased our borrowings through advances from the Federal Home Loan Bank of New York. In 2003, we sold \$4.0 million in residential mortgage loans to the Federal Home Loan Mortgage Corporation and retained servicing rights on these loans. The rationale for the sale of loans was due to anticipated increased speed of pre-payments of higher rate mortgages in the portfolio. The impact of such loan servicing fee income, which we include in "other non-interest income" was minimal.

Interest Income . Interest income decreased by \$402,000, or 3.1%, from \$13.2 million at December 31, 2002 to \$12.8 million at December 31, 2003. Almost all of this decrease can be attributed to a decline in income from loans receivable from \$10.5 million for the year ended December 31, 2002 to \$10.1 million for the year ended December 31, 2003. This decline was a result of a decline in rates due to both refinancings as our customers sought lower rates on their mortgage loans and reduced yields on our adjustable rate mortgages also due to the lower rates.

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Interest Expense . Interest expense decreased by \$252,000, or 5.1%, from \$5.0 million for the year ended December 31, 2002 to \$4.7 million for the year ended December 31, 2003. The interest paid on deposits decreased \$617,000 between comparable years while the interest paid on borrowings increased by \$344,000 between the years ended 2003 and 2002. The decrease in interest paid on deposits is attributable to a decrease on the average yield on deposits to 1.92% as compared to 2.54% for the prior year, while the average balance of deposits for the year ended December 31, 2003 increased by \$25.4 million. Our increase in borrowing expense was due to an increase in the average balance of our advances from the Federal Home Loan Bank of New York at an average yield of 3.48% for the year ended 2003, compared to an average yield of 4.98% in 2002.

Provision for Loan Losses . For the year ended December 31, 2003 the provision for loan losses was \$345,000, a decrease from the provision of \$360,000 for the year ended December 31, 2002. Despite increasing our loan portfolio, we were able to decrease the provision for loan losses based on the equity of the loan portfolio and the amount of allowance for loan losses already in place. Management has determined this based on a detailed review of our existing loan portfolio, historical charge-off rates and non-performing loans.

Non-interest Income . Non-interest income remained relatively constant at approximately \$1.7 million in both 2003 and 2002. For the year ended December 31, 2003, we experienced a loss of \$9,000 from sales of securities. In the prior year, we realized \$176,000 from the sale of securities. In 2003, we realized \$129,000 from the sale of both residential mortgage and student loans as compared to only \$2,000 from the sale of student loans in 2002.

In November 2002, we established and funded a 50% interest in the Lake Shore Title & Abstract, LLC, a third party title agency for the purpose of providing abstracting and title services in connection with real estate transactions. There was no income or loss attributed to this venture in 2002. In 2003, the net income generated by this joint venture was \$62,000.

Non-interest Expense . Non-interest expense increased by \$1.0 million from \$6.2 million for the year ended December 31, 2002 to \$7.2 million for the year ended December 31, 2003. This increase was largely the result of expenses attributable to the opening of the new branches in Orchard Park and East Amherst New York, including the retention of additional employees. Also contributing to this increase were salary expenses and employee benefits, including health care expenses, which increased by \$607,000 from \$3.3 million for the year ended December 31, 2002 to \$3.9 million for the year ended December 31, 2003. Increased non-interest expense was, to a lesser extent, attributable to an increase in advertising expenses to \$338,000 for the year ended December 31, 2003 in comparison to \$147,000 for the year ended December 31, 2002. The \$191,000 increase in advertising expense was due to the opening of our two new branches in Erie County, New York during 2003. The branch expansion was in a new market area and additional advertising was necessary to establish name recognition and visibility.

Income Tax Expense . Income tax expense decreased by \$341,000 from \$1.1 million for the year ended December 31, 2002 to \$744,000 for the year ended December 31, 2003. This reduction is due to the fact that taxable income was less in 2003 than in 2002.

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

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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, 2005, allowed us to borrow up to \$23.4 million on an overnight line of credit and \$23.4 million on a one-month overnight repricing line of credit. We have no borrowings through either of these agreements. 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, 2005, we had outstanding advances totaling \$50.1 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.

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, 2005, we originated loans of approximately \$29.9 million in comparison to approximately \$41.0 million of loans originated in the nine months ended September 30, 2004. In 2004, we originated approximately \$49.6 million in loans compared to approximately \$91.7 million in 2003. Purchases of investment securities totaled \$16.8 million in the nine months ended September 30, 2005 and \$42.8 million in the year ended December 31, 2004.

At September 30, 2005, we had loan commitments to borrowers of approximately \$7.9 million and overdraft lines of protection and unused home equity lines of credit of approximately \$20.3 million.

Total deposits were \$251.6 million at September 30, 2005, as compared to \$243.6 million at December 31, 2004. Time deposit accounts scheduled to mature within one year were \$33.9 million at September 30, 2005. Based on our deposit retention experience, current pricing strategy, and competitive pricing policies, we anticipate that a significant portion of these time deposits 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.

We do not anticipate any material capital expenditures in 2005 other than \$150,000 for the Hamburg branch that opened in December 2005 and a projected expense of \$200,000 for a new phone system and upgraded computer software. We do not have any balloon or other payments due on any long-term obligations or any off-balance sheet items other than debt as described in Note 8 to the Financial Statements and the commitments and unused lines and letters of credit noted above.

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We are contractually obligated to make payments as of September 30, 2005 as follows:

	Payments due by Period:				
	Total	1 year	1-3 years	3-5 years	5 years
	(Dollars in thousands)				
Long term debt	\$40,660	\$8,280	\$17,000	\$11,880	\$3,500
Capital Leases	3,290	124	285	304	2,577
Operating Leases	870	88	167	159	456
Data processing contract	902	261	641	—	—
Total contractual obligations	\$45,722	\$8,753	\$18,093	\$12,343	\$6,533

The net proceeds raised in the offering will significantly increase our liquidity and capital resources. Over time, the initial level of liquidity will be reduced as net proceeds from the offering are used for general corporate purposes, including the funding of lending activities. In addition, the large increase in equity resulting from the capital raised in the offering will, initially, have an adverse impact on our return on equity. See “*Risk Factors - After The Offering, Our Return On Equity Will Be Low Compared To Other Companies. This Could Hurt The Price Of Your Common Stock .*”

Off-Balance Sheet Arrangements

Other than loan commitments, the Lake Shore Savings does 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 14 of the financial statements beginning at page F-1 for a summary of loan commitments outstanding as of September 30, 2005.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), “Shared-Based Payment.” Statement No. 123(R) addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise’s equity instruments or that may be settled by the issuance of such equity instruments. Statement No. 123(R) requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised Statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates the intrinsic value method of accounting in APB Opinion No. 25, “Accounting for Stock Issued to Employees,” which was permitted under Statement 123, as originally issued. The revised Statement also requires entities to disclose information about the nature of the share-based payment transactions and the effects of those transactions on the financial statements. At present, Lake Shore Savings and Loan Association has not issued any stock options or other equity-based compensation.

In March 2004, the SEC released Staff Accounting Bulletin (SAB) No. 105, “Application of Accounting Principles to Loan Commitments.” SAB 105 provides guidance about the measurements of loan commitments recognized at fair value under FASB Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities.” SAB 105 Also requires companies to disclose their accounting policy for those loan commitments including methods and assumptions used to estimate fair value and associated hedging strategies. SAB 105 is effective for all loan commitments accounted for as derivatives that are entered into after March 31, 2004. The adoption of SAB 105 did not have any effect on Lake Shore Savings and Loan Association’s financial statements.

BUSINESS OF LAKE SHORE BANCORP

Lake Shore Bancorp has not engaged in any business to date. Upon completion of the reorganization, Lake Shore Bancorp will own Lake Shore Savings Bank. Lake Shore Bancorp will retain up to 50% of the net proceeds from the offering. We will invest our initial capital as discussed in “How We Intend to Use the Proceeds from the Offering.”

In the future, Lake Shore Bancorp may pursue other business activities, including the acquisition of other financial institutions or other entities, borrowing funds for investment in Lake Shore Savings and diversification of Lake Shore Bancorp’s operations. Lake Shore Bancorp has no current plans for such activities. Our cash flow will depend upon earnings from the investment of the portion of net proceeds we retain and any dividends Lake Shore Bancorp receives from Lake Shore Savings. Initially, Lake Shore Bancorp will neither own nor lease any property, but will instead use the premises, equipment and furniture of Lake Shore Savings. At the present time, we intend to employ only persons who are officers of Lake Shore Savings, to serve as officers of Lake Shore Bancorp. However, we will use the support staff of Lake Shore Savings from time to time. Lake Shore Bancorp will not separately compensate these employees, Lake Shore Bancorp will hire additional employees, as appropriate, to the extent it expands its business in the future. See “*How We Intend to Use the Proceeds from the Offering*.”

BUSINESS OF LAKE SHORE SAVINGS BANK

General

Our principal business consists of attracting retail deposits from the general public in the areas surrounding our corporate headquarters in Dunkirk, New York and eight branch offices in Chautauqua and Erie Counties, New York and investing those deposits, together with funds generated from operations, primarily in one- to four-family residential mortgage loans, home equity loans and lines of credit and commercial real estate loans and, to a lesser extent, commercial business loans, consumer loans, and investment securities. Our revenues are derived principally from interest on loans and securities. We also generate revenues from fees and service charges and other income. Our primary sources of funds are deposits, borrowings and principal and interest payments on loans and securities.

For 115 years we have served the local community of Dunkirk, New York. Lake Shore Savings was chartered as a New York savings and loan association in 1891. In 1987, we opened our second office in Fredonia, New York. Since 1993, we have tripled our asset-size and expanded to eight branch offices. In addition, we have added three administrative office buildings which comprise our corporate headquarters in Dunkirk, New York.

We are a community and customer oriented savings bank that offers residential real estate mortgage loans, including home equity loans, consumer loans, commercial real estate loans, and commercial loans as well as traditional deposit products. We purchase securities issued by the U.S. Government and government agencies, municipal securities, mortgage-backed and asset-backed securities and other investments permitted by applicable laws and regulations. Our revenues are derived principally from interest generated from our loans and interest earned and dividends paid on our investment securities. Our primary sources of funds for lending and investments are deposits, payments of loan principal payments on mortgage-backed and asset-backed securities, maturities and calls of investment securities and income resulting from operations in prior periods.

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Market Area

Our operations are conducted out of our corporate headquarters in Dunkirk, New York and eight branch offices. Our branches are located in Dunkirk, Fredonia, Jamestown, Lakewood and Westfield in Chautauqua County, New York. In Erie County, New York our branch offices are located in Orchard Park, East Amherst and Hamburg, which opened in April and August of 2003 and December of 2005, respectively. We also have four stand-alone ATMs. The opening of the Orchard Park, East Amherst and Hamburg offices demonstrates the implementation of our growth strategy which is focused on expansion within Erie County while preserving our market share in Chautauqua County. We believe we are among the top residential mortgage lenders in Chautauqua County.

Our geographic market area for loans and deposits is principally Chautauqua and Erie Counties, New York. Additionally, Cattaraugus County, New York is part of our designated lending area, although we have no branches in the market area. Northern Chautauqua County is located on Lake Erie in the western portion of New York and is approximately 45 miles from Buffalo, New York. There are multiple prime industrial and building sites in this county and a skilled and productive labor force. Northern Chautauqua County is served by three accredited hospitals and offers higher education opportunities. We have lending and deposit relationships with such institutions. Southern Chautauqua County is more of a tourist attraction, featuring Chautauqua Lake, but it also hosts a broad diversity of industry, commercial establishments and financial institutions as well as a skilled and productive workforce. Jamestown, New York, where we opened the first of two branch offices in 1996, is the most populous city in Chautauqua County. It is also the ninth largest metropolitan region in the State of New York.

Erie County is a metropolitan center located on the Western border of New York covering 1,058 square miles. Located within Erie County is the city of Buffalo, the second largest city in the State of New York. As the city of Buffalo has redeveloped, so too have its suburbs throughout Erie County, which also host the Buffalo Niagara International Airport in Cheektowaga, New York and professional sports franchises. One of the main commercial thorough-fares in Erie County is Transit Road, which has experienced robust development in recent years and is the location of our most recent branch office. Our newest branch office, which opened in December 2005, is in Hamburg, New York, also located in Erie County.

The demographic characteristics of our market area are less attractive than national and state measures. Both Chautauqua and Erie Counties exhibit slower rates of population growth when compared to the United States and New York State averages. In addition, both Chautauqua and Erie Counties have lower per capita income and slower growth in per capita income when compared to the United States and the New York State averages. Since Chautauqua County has historically exhibited less attractive demographic characteristics, Lake Shore Savings may have limited growth opportunities in Chautauqua County. However, Erie County displays a stronger housing market and Erie County's population base is five times larger than Chautauqua County, which may offer Lake Shore a new source of customers in the form of deposit and lending opportunities. Notwithstanding these demographic characteristics, our primary market area has historically been stable, with a diversified base of employers and employment sectors. The local economies that we serve are not dependent on one key employer. Transportation equipment is the largest manufacturing industry in the Buffalo area, as well as production of component parts. The principal employment sectors are service-related (excluding financial), wholesale and retail trade, and durable-goods manufacturing. Similar to national trends, most of the job growth currently realized in Chautauqua and Erie Counties has been in service-related industries, and service jobs now account for the largest portion of the workforce.

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The following table compares the historical population and per capita income levels and growth rates for Chautauqua and Erie Counties, New York State and the United States.

	Year		Growth Rate
	2000	2005	2000-2005
Population (in thousands)			
United States	281,422	298,728	1.2%
New York State	18,976	19,412	0.5%
Chautauqua County	140	139	-0.1%
Erie County	950	948	0.0%
Per Capita Income			
United States	\$ 21,586	\$ 26,228	4.0%
New York State	23,389	28,677	4.2%
Chautauqua County	16,840	20,058	3.6%
Erie County	20,357	24,506	3.8%

Sources: SNL Financial, L.C. and ESRI Business Information Solutions

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

Competition

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

Our competition for loans comes principally from commercial banks, savings institutions, mortgage banking firms, credit unions, finance companies, insurance companies, and brokerage and investment banking firms. The most direct competition for deposits has historically come from credit unions, commercial banks, savings banks and savings and loan associations. Specifically, we compete with regional financial institutions such as Greater Buffalo Savings Bank, Jamestown Savings Bank and Evans National Bank; state-wide financial institutions such as Manufacturers and Traders’ Trust Company (M&T Bank) and Key Bank; and nation-wide financial institutions such as HSBC Bank USA and Bank of America. We are significantly smaller than institutions like Bank of America, HSBC Bank USA and Key Bank. We face additional competition for deposits from short-term money market funds, corporate and government securities funds, and from brokerage firms, mutual funds and insurance companies.

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

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

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- In 1999, we began offering a Direct Access Secure Hotline (“DASH”) with 24 hour 7 days a week access to all customer accounts via telephone access.
- In 2001, we added a Secure Account Management (“SAM”) on-line banking website allowing customers instant access via the internet. We have continued to upgrade our on-line banking as technology evolves and now offer check imaging through our website.
- Customers with a Smart Account, which is a checking account, Free & Easy Checking or Money Market Checking, may have a “Navigator Card,” our no-annual fee ATM/Debit card which may be used at ATM machines throughout Chautauqua and Erie Counties for deposits and withdrawals and as a debit card anywhere MasterCard is accepted.
- In 2003, we entered into alliances with Key Bank, NA and Evans National Bank to provide customers free access to their accounts with us through the ATMs of these institutions as well as our own.
- We have continued to upgrade our corporate headquarters and established branches, our ATMs and drive-through facilities to ensure that we are providing a high level of customer satisfaction.
- Recently, we have added six new mortgage loan products: 5/1, 7/1 and 7/23 adjustable rate mortgages, an 80/10/10 loan, which is a combined mortgage and home equity product, a construction end loan and an FHA 203(b) loan product.
- In our last three Community Reinvestment Act evaluations by the Office of Thrift Supervision, most recently concluding on November 17, 2004, we consistently received an “Outstanding” rating.
- During 2005, online bill pay was added as a new service for our customers.

Lending Activities

General. We have a long-standing commitment to the origination of residential mortgage loans, including home equity loans, and we also originate commercial real estate, commercial and consumer loans. We currently retain substantially all of the loans that we originate; however, we have sold and may in the future sell residential mortgage and student loans into the secondary market, retaining servicing rights for the residential mortgage loans. At September 30, 2005, we had total loans of \$202.6 million, of which \$145.7 million, or 71.9%, were one-to-four family residential mortgages. Of residential mortgage loans outstanding at that date, 6.0% were adjustable-rate mortgage loans and 94.0% were fixed rate loans. At September 30, 2005, 14.4% of the loan portfolio was comprised of home equity loans, of which 80.0% were adjustable rate mortgage loans and 20.0% which were fixed rate loans. The remainder of our loans at September 30, 2005, amounting to \$27.7 million, or 13.7% of total loans, consisted of 7.4% commercial real estate loans, 1.0% construction loans, 4.0% commercial loans and 1.3% consumer loans, which includes personal loans, home improvement loans, overdraft lines of credit, automobile loans and guaranteed student loans.

Our loans are subject to federal and state laws and regulations. The Office of Thrift Supervision has been and will continue to be our primary federal regulator. We have also been subject to regulation by the New York State Banking Department, which will cease once we have completed the reorganization to a federal savings bank charter. The interest rates we offer for loans are affected principally by the demand for loans, the supply of money available for lending purposes and the interest rates offered by our competitors. These factors are, in turn, affected by general and local economic conditions, monetary policies of the federal government, including the Federal Reserve Board and legislative tax policies.

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Loan Portfolio. The following table sets forth the composition of our loan portfolio, by type of loan, in dollar amounts and in percentages at the dates indicated.

	At September 30,		At December 31,									
	2005		2004		2003		2002		2001		2000	
	Percent of		Percent of		Percent of		Percent of		Percent of		Percent of	
	Amount	Total	Amount	Total	Amount	Total	Amount	Total	Amount	Total	Amount	Total
(Dollars in thousands)												
Mortgage loans:												
One-to-four family	\$145,653	71.89%	\$142,222	71.14%	\$135,293	72.12%	\$107,115	68.01%	\$ 99,542	68.51%	\$ 88,427	68.13%
Commercial real estate	14,916	7.36	15,310	7.66	14,628	7.80	13,628	8.65	10,866	7.48	9,149	7.05
Construction loans	2,002	0.99	2,463	1.23	2,531	1.35	3,300	2.10	2,739	1.88	2,539	1.96
Home equity loans and lines of credit	29,222	14.42	28,442	14.23	25,876	13.79	23,742	15.07	21,085	14.51	21,042	16.21
	<u>191,793</u>	<u>94.66</u>	<u>188,437</u>	<u>94.26</u>	<u>178,328</u>	<u>95.06</u>	<u>147,785</u>	<u>93.83</u>	<u>134,232</u>	<u>92.38</u>	<u>121,157</u>	<u>93.35</u>
Other loans:												
Commercial loans	8,081	3.99	8,615	4.30	5,957	3.18	6,229	3.96	7,338	5.05	4,798	3.70
Consumer loans	2,733	1.35	2,870	1.44	3,310	1.76	3,482	2.21	3,734	2.57	3,833	2.95
	<u>10,814</u>	<u>5.34</u>	<u>11,485</u>	<u>5.74</u>	<u>9,267</u>	<u>4.94</u>	<u>9,711</u>	<u>6.17</u>	<u>11,072</u>	<u>7.62</u>	<u>8,631</u>	<u>6.65</u>
Total loans	<u>202,607</u>	<u>100.00%</u>	<u>199,922</u>	<u>100.00%</u>	<u>187,595</u>	<u>100.00%</u>	<u>157,496</u>	<u>100.00%</u>	<u>145,304</u>	<u>100.00%</u>	<u>129,788</u>	<u>100.00%</u>
Less:												
Deferred loan costs (fees) (1)	1,077		891		836		461		220		—	
Allowance for loan losses	(1,267)		(1,288)		(1,293)		(1,217)		(924)		(797)	
Loans, net	<u>\$202,417</u>		<u>\$199,525</u>		<u>\$187,138</u>		<u>\$156,740</u>		<u>\$144,600</u>		<u>\$128,991</u>	

(1) Prior to February 2001, Lake Shore Savings did not record deferred loan costs in accordance with FASB 91, as the effect on financial statements was immaterial.

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Loan Maturity. The following table presents the contractual maturity of our loans at December 31, 2004. The table does not include the effect of prepayments or scheduled principal amortization. Loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

	Real Estate One-to-Four Family	Real Estate Commercial	Home Equity	Construction	Commercial	Consumer	Total
(In thousands)							
Amounts due in:							
One year or less	\$ 77	\$ 3	\$ 17	\$ —	\$ 113	\$ 806	\$ 1,016
After one year through five years	2,577	835	2,341	—	2,699	814	9,266
Beyond five years	139,568	14,472	26,084	2,463	5,803	1,250	189,640
Total	\$ 142,222	\$ 15,310	\$28,442	\$ 2,463	\$ 8,615	\$ 2,870	\$199,922
Interest rate terms on amounts due after one year:							
Fixed rate	\$ 133,952	\$ 5,684	\$ 5,694	\$ 2,463	\$ 6,131	\$ 1,694	\$155,618
Adjustable rate	8,193	9,623	22,731	—	2,371	370	43,288
Total	\$ 142,145	\$ 15,307	\$28,425	\$ 2,463	\$ 8,502	\$ 2,064	\$198,906

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

	For the Nine Months Ended September 30,		For the Year Ended December 31,				
	2005	2004	2004	2003	2002	2001	2000
(Dollars in thousands)							
Total loans:							
Balance outstanding at beginning of period	\$ 199,922	\$ 187,595	\$187,595	\$157,957	\$145,524	\$129,788	\$116,067
Originations:							
Mortgage loans	25,217	33,951	40,737	85,146	52,320	43,921	34,472
Commercial and consumer loans	4,680	7,061	8,819	6,595	4,049	7,717	5,197
Total originations	29,897	41,012	49,556	91,741	56,369	51,638	39,669
Deduct:							
Principal repayments:							
Mortgage loans	22,453	23,183	31,235	48,338	39,609	29,535	22,925
Commercial and consumer loans	4,189	3,424	4,724	8,080	3,541	5,447	1,539
Total principal payments	26,642	26,607	35,959	56,418	43,150	34,982	24,464
Transfers to foreclosed real estate	118	150	374	761	302	373	238
Loan sales – Sonyma(1) and Freddie Mac	—	—	—	4,046	—	—	—
Loan sales – guaranteed student loans	396	511	592	603	405	354	1,128
Loans charged off	56	94	304	275	79	193	118
Total deductions	27,212	27,362	37,229	62,103	43,936	35,902	25,948
Balance outstanding at end of period	\$ 202,607	\$ 201,245	\$199,922	\$187,595	\$157,957	\$145,524	\$129,788

(1) State of New York Mortgage Agency.

Residential Mortgage Lending. We emphasize the origination of residential mortgage loans secured by one-to-four family properties. At September 30, 2005, loans on one-to-four family residential properties accounted for \$145.7 million, or 71.9%, of our total loan portfolio. Of residential mortgage loans outstanding on that date and at December 31, 2004, 6.0% and 5.7%, respectively of our loans were adjustable rate mortgage loans and 94.0 and 94.3%, respectively, were fixed rate loans. At September 30, 2005, approximately 84% of our residential mortgage portfolio was secured by property located in Chautauqua County, 14% by property located in Erie County and 2% by property located elsewhere. Approximately 9% of all residential loan originations during fiscal 2004 were refinancings of loans already in our portfolio.

Our loan originations are from customers, residents of our local communities or referrals from local real estate agents, attorneys and builders. Management believes that the Erie County branch offices could be a significant source of new loan generation. Following the reorganization, we may seek to

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expand residential lending activities with the proceeds received in the offering primarily through the origination of residential mortgage and commercial real estate loans. Management believes that expanding our residential mortgage lending will continue to enhance our reputation as a service-oriented institution particularly in Erie County, where we are actively developing and expanding our market presence.

Residential mortgage loan originations are generally for terms of 15, 20 or 30 years, amortized on a monthly basis with interest and principal due either bi-weekly or monthly. Residential real estate loans may remain outstanding for significantly shorter periods than their contractual terms as borrowers may refinance or prepay loans at their option without penalty. Conventional residential mortgage loans originated by us customarily contain “due-on-sale” clauses that permit us to accelerate the indebtedness of the loan upon transfer of ownership of the mortgaged property. We do not offer 40-year mortgage loans, “interest only” mortgage loans or “negative amortization” mortgage loans.

Our residential lending policies and procedures ensure that our residential mortgage loans generally conform to secondary market guidelines. We originate residential mortgage loans with a loan to value ratio up to 97%. Mortgages originated with a loan-to-value ratio exceeding 80% normally require private mortgage insurance. Private mortgage insurance is not required on loans with an 80% or less loan to value ratio.

We offer adjustable rate mortgage loans with a maximum term of 30 years. Our adjustable rate mortgage loans include loans that provide for an interest rate based on the interest paid on U.S. treasury securities of varying maturities plus varying margins. We currently offer adjustable rate mortgage loans with initial rates below those which would prevail under the foregoing computation, based upon a determination of market factors and competitive rates for adjustable-rate loans in our market area. For adjustable rate mortgage loans, borrowers are qualified at the initial fully indexed rate.

Our adjustable rate mortgage loans include limits on increases or decreases in the interest rate of the loan. The interest rate may increase or decrease by a maximum of 2% or 5% per adjustment period with a ceiling rate of 6% over the life of the loan. The retention of adjustable rate mortgage loans in our loan portfolio helps reduce exposure to changes in interest rates. However, there are unquantifiable credit risks resulting from potential increased costs to the borrower as a result of the pricing of adjustable rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable rate mortgage loans may increase due to the increase of interest cost to the borrower.

We regularly provide a loan product to our customers that is underwritten using the same criteria required by the State of New York Mortgage Agency for its own loan products. After a loan is originated and funded, we may sell the loan to the State of New York Mortgage Agency. We have also sold loans to the Federal Home Loan Mortgage Corporation in the past and may do so again, from time to time. We retain all servicing rights for residential mortgage loans that we sell.

Home Equity Loans and Lines of Credit. We provide home equity loans and home equity lines of credit to our customers. We offer a home equity loan or line of credit with a minimum balance of \$5,000 up to a maximum of 90% of the total loan to value ratio. Home equity lines of credit products, which have interest rates tied to prime, generally have a 15 year draw period and a 15 year payback period. Fixed rate home equity loans range from terms of 5 to 15 years. These loans, as a group, totaled \$29.2 million and \$28.4 million at September 30, 2005 and December 31, 2004, respectively. Approximately 80.0% of such loans have adjustable rates and 20.0% have fixed rates. At September 30, 2005 and December 31, 2004, such loans constituted 14.4% and 14.2% of our total loan portfolio.

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Commercial Real Estate Loans. We originate commercial real estate loans to finance the purchase of real property, which generally consists of developed real estate. In underwriting commercial real estate loans, consideration is given to the property's historic cash flow, current and projected occupancy, location, and physical condition. At September 30, 2005 and December 31, 2004, our commercial real estate loan portfolio consisted of loans totaling \$14.9 million and \$15.3 million respectively, or 7.4% and 7.7%, respectively, of total loans. Of the commercial real estate portfolio at September 30, 2005, approximately 95% consisted of loans that are collateralized by properties in Chautauqua County and 5% by properties in Erie County. Our commercial real estate loan portfolio is diverse and does not have any significant loan concentration by type of industry or borrower. We lend up to a maximum loan-to-value ratio of 80% on commercial properties and require a minimum debt coverage ratio of 1.2 to 1. Commercial real estate lending involves additional risks compared with one-to-four family residential lending. Because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, and/or the collateral value of the commercial real estate securing the loan, repayment of such loans may be subject, to a greater extent, to adverse conditions in the real estate market or economic conditions. Also, commercial real estate loans typically involve large loan balances to single borrowers or groups of related borrowers. Our loan policies limit the amount of loans to a single borrower or group of borrowers to reduce this risk and are designed to set such limits within those prescribed by applicable federal and state statutes and regulations.

Construction Loans . We originate loans to finance the construction of both one-to-four family homes and commercial real estate. These loans typically have a one-year construction period, whereby draws are taken and interest only payments are made. As part of the draw process, inspection and lien checks are required prior to the disbursement of the proceeds. At the end of the construction period, the loan automatically converts to either a conventional or commercial mortgage, as applicable. At September 30, 2005 and December 31, 2004, our construction loan portfolio consisted of loans totaling \$2.0 million and \$2.5 million, respectively, or 1.0% and 1.2%, respectively, of total loans.

Commercial 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. We have fewer than 10 loans with balances in excess of \$1.0 million and the average commercial loan is for a principal amount ranging from \$100,000 to \$300,000. At September 30, 2005 and December 31, 2004, our commercial loan portfolio consisted of loans totaling \$8.1 million and \$8.6 million, respectively, or 4.0% and 4.3%, respectively, of total loans. Many commercial loans have variable interest rates tied to the prime rate, and are for terms generally not in excess of 15 years. Whenever possible, we collateralize these loans with a lien on business assets and equipment and the personal guarantees from principals of the borrower. Interest rates on commercial loans generally have higher yields than residential mortgages. We offer commercial loan services designed to give business owners borrowing opportunities for modernization, inventory, equipment, construction, consolidation, real estate, working capital, vehicle purchases, and the refinancing of existing corporate debt.

Commercial loans are generally considered to involve a higher degree of risk than residential mortgage loans because the collateral underlying the loans may be in the form of intangible assets and/or inventory subject to market obsolescence. Commercial loans may also involve relatively large loan balances to single borrowers or groups of related borrowers, with the repayment of such loans typically dependent on the successful operation and income stream of the borrower. Such risks can be significantly affected by economic conditions. In addition, commercial business lending generally requires substantially greater oversight efforts compared to residential real estate lending. We conduct on-site reviews of the commercial loan portfolio to ensure adherence to our underwriting standards and policy requirements.

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Consumer Loans. We offer a variety of consumer loans. At September 30, 2005 and December 31, 2004, our consumer loan portfolio totaled \$2.7 million and \$2.9 million, respectively, or 1.4% and 1.4%, respectively, of total loans. The largest component of our consumer loan portfolio are personal consumer loans and overdraft lines of credit, which are available for amounts up to \$5,000 for unsecured loans and greater amounts for secured loans depending on the type of loan and value of the collateral. Consumer loans, excluding overdraft lines of protection, generally are offered for terms of up to 10 years, depending on the collateral, at fixed interest rates. Our consumer loan portfolio also consists of:

- new and used automobile loans;
- recreational vehicle loans;
- motorcycle loans;
- guaranteed student loans;
- other unsecured consumer loans up to \$3,500;
- secured and unsecured property improvement loans; and
- other secured loans.

Generally, the volume of consumer lending has declined as borrowers have opted for home equity lines, where a mortgage-interest federal tax deduction is available, as compared to unsecured loans or loans secured by property other than residential real estate. We continue to make automobile loans directly to the borrowers and primarily on used vehicles. We also maintain a portfolio of guaranteed student loans. Our student loans are typically resold to the Student Loan Marketing Association, Sallie Mae, when the loans go into repayment. We make other consumer loans, which may or may not be secured. The terms of such loans vary depending on the collateral.

Consumer loans are generally originated at higher interest rates than residential mortgage loans but also tend to have a higher credit risk due to the loans being either unsecured or secured by rapidly depreciable assets. Despite these risks, our level of consumer loan delinquencies generally has been low. No assurance can be given, however, that our delinquency rate or losses will continue to remain low in the future.

Loan Approval Procedures and Authority. Our lending policies are established by our Board of Directors. Currently, our President and Chief Executive Officer and Executive Vice President, Chief Operating and Commercial Officer have authority to approve loans for principal amounts of up to \$100,000. Loans in excess of \$100,000 in principal amount, but less than \$500,000 must be approved by the Executive Committee of our Board of Directors, which meets once a month. Loans with principal amounts in excess of \$500,000 must be reviewed and approved by a vote of our Board of Directors, which meets once a month. Additionally, branch managers are granted authority to approve loans, mainly consumer loans, in smaller amounts deemed appropriate by our Board of Directors.

Current Lending Procedures. Upon receipt of a completed loan application from a prospective borrower, we order a credit report and verify certain other information. If necessary, we obtain additional financial or credit related information. We require an appraisal for all mortgage loans, including loans made to refinance existing mortgage loans. Appraisals are performed by licensed third-party appraisal firms that have been approved by our Board of Directors. We require title insurance on all secondary market mortgage loans and certain other loans. We also require borrowers to obtain hazard insurance,

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and if applicable, we may require borrowers to obtain flood insurance prior to closing. Based on loan to value ratios and lending guidelines, escrow accounts may be required for such items as real estate taxes, hazard insurance, flood insurance, and private mortgage insurance premiums.

Asset Quality

One of our key operating objectives has been, and continues to be, maintaining a high level of asset quality. Our high proportion of one-to-four family mortgage loans, the maintenance of sound credit standards for new loan originations and loan administration procedures have resulted in historically low delinquency ratios and, in recent years, a reduction in non-performing assets. These factors have contributed to our strong financial condition.

Collection Procedures. We have adopted a loan collection policy to maintain adequate control on the status of delinquent loans and to ensure compliance with the Fair Debt Collection Practices Act. When a borrower fails to make required payments on a residential or commercial loan, we take a number of steps to induce the borrower to cure the delinquency and restore the loan to a current status. Our collections department documents every time a borrower is contacted either by phone or in writing and maintains records of all collection efforts. Once an account becomes delinquent for 15 days, a late notice is mailed to the borrower and any guarantors on a loan. A second notice is mailed following the 30th day of delinquency. At this time, we also directly contact the borrower. Such contact may be repeated if a loan is delinquent between 60-89 days. Once a loan has been delinquent for 90 days or more, the loan is deemed a “classified asset” and is reported to our board of directors. A final letter is sent to the borrower demanding payment in full by a certain date. Failure to pay after 90 days of the original due date generally results in legal action, notwithstanding ongoing collection. In the case of a secured loan, the collateral is reviewed to determine whether its possession would be cost-effective for us. In cases where the collateral fails to fully secure the loan, we may also sue on the note and not just repossess any collateral.

The collection procedures for consumer loans include the sending of periodic late notices and letters to a borrower once a loan is past due. On a monthly basis, a review is made of all consumer loans which are 30 days or more past due. Consumer loans that are 180 days delinquent, where the borrowers have failed to demonstrate repayment ability, are classified as loss and charged-off. Once a charge-off decision has been made, the collections manager or management pursues legal action such as small claims court, judgments, salary garnishment, repossessions and attempt to collect the deficiency from the borrower.

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 \$1.2 million at September 30, 2005 and \$934,000 at December 31, 2004.

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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, 2005	At December 31,				
		2004	2003	2002	2001	2000
(Dollars in thousands)						
Loans past due 90 days or more but still accruing:						
Mortgage loans on real estate:						
One-to-four family	\$ 339	\$ 419	\$ 368	\$ 417	\$ 733	\$ 462
Construction	—	—	—	—	—	—
Commercial real estate	227	101	55	—	—	—
Home equity loans and lines of credit	11	106	31	81	151	16
Other loans:						
Commercial loans	32	—	—	7	—	—
Consumer loans	8	24	14	—	5	1
Total	\$ 617	\$ 650	\$ 468	\$ 505	\$ 889	\$ 479
Loans accounted for on a nonaccrual basis:						
Mortgage loans on real estate:						
One-to-four family	\$ 299	\$ 127	\$ 230	\$ 674	\$ 237	\$ 120
Construction	—	—	194	—	90	—
Commercial real estate	40	—	—	—	—	268
Home equity loans and lines of credit	34	6	8	118	—	—
Other loans:						
Commercial loans	—	—	126	94	161	—
Consumer loans	11	9	26	17	25	13
Total non-accrual loans	384	142	584	903	513	401
Total nonperforming loans	1,001	792	1,052	1,408	1,402	880
Foreclosed real estate	194	142	486	116	108	11
Restructured loans	—	—	—	—	—	—
Total nonperforming assets	\$ 1,195	\$ 934	\$1,538	\$1,524	\$1,510	\$ 891
Ratios:						
Nonperforming loans as a percent of gross loans:	0.49%	0.40%	0.56%	0.89%	0.97%	0.68%
Nonperforming assets as a percent of total assets:	0.36%	0.28%	0.51%	0.64%	0.71%	0.44%

Loans are placed on non-accrual status either when reasonable doubt exists as to the full timely collection of interest and principal, or when a loan becomes 90 days past due, unless an evaluation by the Asset Classification Committee indicates that the loan is well-secured or in the process of collection. Our Asset Classification Committee designates loans on which we stop accruing interest income as non-accrual loans and we reverse outstanding interest income that was previously credited. We may again recognize income in the period that we collect such income, when the ultimate collectibility of principal is no longer in doubt. We return a non-accrual loan to accrual status when factors indicating doubtful collection no longer exist.

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Our recorded investment in non-accrual loans totaled \$384,000 and \$142,000 at September 30, 2005 and December 31, 2004, respectively. If all non-accrual loans had been current in accordance with their terms during the nine months ended September 30, 2005 and the years ended December 31, 2004 and 2003, interest income on such loans would have amounted to \$44,000, \$19,000 and \$51,000, respectively. At September 30, 2005, we did not have any loans not included above which are “troubled debt restructurings” as defined in SFAS No. 15.

Real estate acquired as a result of foreclosure is classified as other real estate owned until such time as it is sold. We carry foreclosed real estate at its fair market value less estimated selling costs. If a foreclosure action is commenced and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, we either sell the real property securing the loan at a foreclosure sale or sell the property as soon thereafter as practical.

Classification of Assets . Federal regulations require us to regularly review and classify our assets. In addition, our regulators have the authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. “Substandard assets” must have one or more defined weaknesses and are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. “Doubtful assets” have all the weaknesses inherent in substandard assets with the additional characteristic that the weaknesses present make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified “loss” is considered uncollectible and continuance as an asset of the institution is not warranted. The regulations also provide for a “special mention” category, described as assets which do not currently expose us to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving our close attention.

When we classify assets as either substandard or doubtful, we allocate a portion of the related general loss allowances to such assets as we deem prudent. The allowance for loan losses represents amounts that have been established to recognize losses inherent in the loan portfolio that are both probable and reasonably estimable at the date of the financial statements. When we classify problem assets as loss, we charge-off such amount. Our determination as to the classification of our assets and the amount of our loss allowances are subject to review by our regulatory agencies, which can require that we establish additional loss allowances. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of our review of our assets at September 30, 2005, classified assets consisted of special mention assets of \$1.2 million, substandard assets of \$2.1 million, doubtful assets of \$16,000 and loans classified as loss assets of \$1,000. The classified assets total includes \$1.0 million of nonperforming loans.

The following table shows the aggregate amounts of our classified assets at the dates indicated.

	At September 30,	At December 31,		
	2005	2004	2003	2002
	(Dollars in thousands)			
Special mention assets	\$ 1,228	\$ 680	\$1,089	\$1,287
Substandard assets	2,146	1,522	1,618	2,056
Doubtful assets	16	13	337	465
Loss assets	1	—	—	—
Total classified assets	\$ 3,391	\$2,215	\$3,044	\$3,808

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Delinquencies . The following table provides information about delinquencies in our loan portfolios at the dates indicated.

	At September 30, 2005		At December 31,					
			2004		2003		2002	
	60-89 Days Past Due	90 + Days Past Due	60-89 Days Past Due	90 + Days Past Due	60-89 Days Past Due	90 + Days Past Due	60-89 Days Past Due	90 + Days Past Due
	(Dollars in thousands)							
Residential real estate(1)	\$ 742	\$ 683	\$524	\$658	\$230	\$ 637	\$184	\$1,290
Commercial real estate	54	266	111	101	—	249	—	7
Commercial business	1	32	39	—	39	126	—	94
Consumer loans	13	8	18	33	26	40	18	17
Total	\$ 810	\$ 989	\$692	\$792	\$295	\$1,052	\$202	\$1,408

(1) Includes home equity loans and lines of credit and construction loans.

Allowance for Loan Losses . The allowance for loan losses is a valuation account that reflects our evaluation of the losses inherent in our loan portfolio. We maintain the allowance through provisions for loan losses that we charge to income. We charge losses on loans against the allowance for loan losses when we believe the collection of the loan is unlikely.

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; known and inherent risks in the loan portfolio; the estimated value of the underlying collateral; and current economic and market trends. 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 at adequate levels, based on its evaluation of risk, future additions may be necessary if economic and other conditions differ substantially from the current operating environment.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. These agencies, including the Office of Thrift Supervision, may require us to increase the allowance for loan losses or the valuation allowance for foreclosed real estate based on their evaluation of the information available to them at the time of their examination, thereby adversely affecting our results of operations.

The allowance consists of allocated, general and unallocated components. The allocated component relates to loans that are classified as either doubtful, substandard, or special mention. See “*Asset Quality – Classification of Assets* .” For such loans that are also classified as impaired, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of the loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors such as the type of loan. For example, commercial loans may not have a significant “historical loss,” but a loss from a commercial loan is generally large and the allocation must be adjusted accordingly. Other qualitative

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factors include past loss experience, type and volume of loans, changes in lending policies and procedures, underwriting standards, collections, chargeoffs and recoveries, national and local economic conditions, concentrations of credit and the effect of external factors on the level of estimated credit losses in the current portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses, such as downturns in the local economy. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that we will not be able to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payment when due. Impairment is measured on a loan-by-loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual consumer and residential loans for impairment disclosures. At September 30, 2005, we did not have any impaired loans.

For the nine months ended September 30, 2005, a significant increase to our allowance for loan losses through a provision for loan losses was not deemed necessary based on our evaluation of the items discussed above. We believe that the allowance for loan losses accurately reflects the level of risk in the loan portfolio and the risk of lending in our community.

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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 At September 30,		At or for the Year Ended December 31,				
	2005	2004	2004	2003	2002	2001	2000
	(Dollars in thousands)						
Balance at beginning of period:	\$ 1,288	\$ 1,293	\$ 1,293	\$ 1,217	\$ 924	\$ 797	\$ 708
Provision for loan losses	20	207	267	345	360	325	201
Charge-offs:							
Mortgage loans on real estate:							
One-to-four family	24	72	24	200	43	34	24
Construction	—	—	—	—	—	—	—
Commercial real estate	—	—	117	—	—	—	—
Home equity loans and lines of credit	—	—	—	—	8	—	12
Other loans:							
Commercial loans	12	—	126	17	5	141	49
Consumer loans	19	25	37	58	23	43	46
Total charge-offs:	55	97	304	275	79	218	131
Recoveries:							
Mortgage loans on real estate:							
One-to-four family	—	23	23	4	4	6	—
Construction	—	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—	—
Home equity loans and lines of credit	—	—	—	—	1	4	3
Other loans:							
Commercial loans	13	—	—	—	—	1	8
Consumer loans	1	3	9	2	7	9	8
Total Recoveries	14	26	32	6	12	20	19
Net charge-offs	41	71	272	269	67	198	112
Balance at end of period	\$ 1,267	\$ 1,429	\$ 1,288	\$ 1,293	\$ 1,217	\$ 924	\$ 797
Average loans outstanding	\$ 199,453	\$ 191,364	\$193,428	\$162,810	\$149,260	\$145,524	\$122,411
Ratio of net charge-offs to average loans outstanding	0.02%	0.04%	0.14%	0.17%	0.04%	0.14%	0.09%

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The following table presents our allocation of the allowance for loan losses by loan category and the percentage of loans in each category to total loans at the periods indicated. The allowance for loan losses allocated to each category is not necessarily indicative of inherent losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	At September 30, 2005			At December 31,					
				2004			2003		
	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans
(Dollars in thousands)									
Mortgage loans									
One-to-four family	\$ 310	24.5%	71.9%	\$ 239	18.6%	71.2%	\$ 174	13.5%	72.1%
Home equity loans and lines of credit	59	4.7%	14.4%	62	4.8%	14.2%	30	2.3%	13.8%
Commercial real estate	218	17.2%	7.4%	160	12.4%	7.7%	395	30.5%	7.8%
Construction	—	—	1.0%	—	—	1.2%	—	—	1.3%
	587	46.4%	94.7%	461	35.8%	94.3%	599	46.3%	95.0%
Other loans:									
Commercial loans	90	7.1%	4.0%	98	7.6%	4.3%	156	12.1%	3.2%
Consumer loans	27	2.1%	1.3%	28	2.2%	1.4%	35	2.7%	1.8%
	117	9.2%	5.3%	126	9.8%	5.7%	191	14.8%	5.0%
Total allocated	\$ 704	55.6%	100.0%	\$ 587	45.6%	100.0%	\$ 790	61.1%	100.0%
Total unallocated	\$ 563	44.4%		\$ 701	54.4%		\$ 503	38.9%	
Balance at end of period	\$1,267	100.0%		\$1,288	100.0%		\$1,293	100.0%	

At December 31,

	2002			2001			2000		
	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans
(Dollars in thousands)									
Mortgage loans									
One-to-four family	\$ 447	36.7%	68.0%	\$ 353	38.2%	68.5%	\$ 352	44.2%	68.1%
Home equity loans and lines of credit	90	7.4%	15.0%	86	9.3%	14.5%	46	5.8%	16.2%
Commercial real estate	157	12.9%	8.7%	143	15.5%	7.5%	249	31.2%	7.0%
Construction	—	—	2.1%	—	—	1.8%	—	—	2.0%
	694	57.0%	93.8%	582	63.0%	92.3%	647	81.2%	93.3%
Other loans:									
Commercial loans	144	11.8%	4.0%	119	12.9%	5.1%	88	11.0%	3.7%
Consumer loans	25	2.1%	2.2%	43	4.6%	2.6%	47	5.9%	3.0%
	169	13.9%	6.2%	162	17.5%	7.7%	135	16.9%	6.7%
Total allocated	\$ 863	70.9%	100.0%	\$ 744	80.5%	100.0%	\$ 782	98.1%	100.0%
Total unallocated	\$ 354	29.1%		\$ 180	19.5%		\$ 15	1.9%	
Balance at end of period	\$1,217	100.0%		\$ 924	100.0%		\$ 797	100.0%	

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The amount of future charge-offs and provisions for loan losses will be affected by, among other things, changes in economic conditions in Western New York State, particularly Chautauqua and Erie Counties. Such changes in economic conditions could affect the financial strength of our borrowers or the value of real estate collateral securing our mortgage loans. Loans secured by real estate represent approximately 95% of Lake Shore Savings' total loans as of September 30, 2005. Most of our loans secured by real estate were made to borrowers domiciled in Chautauqua County and are secured by properties located in Chautauqua County. In recent years, economic conditions in Chautauqua County have been stagnant, with limited opportunities for business expansion, minimal growth in real estate values and limited job growth. In the event that these economic conditions decline in the future, some of our borrowers may be unable to make the required contractual payment on their loans. As a result, Lake Shore Savings may be unable to realize the full carrying value of such loans through foreclosure. , Lake Shore Savings has set aside funds in the "unallocated" portion of the allowance to protect against such losses. If we were to allocate the unallocated portion among the loan types, we would allocate a substantial portion to our real estate loans.

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Investment Activities

General. Our Board of Directors reviews and approves our investment policy on an annual basis. This policy dictates that investment decisions be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our interest rate risk management strategy. The Board of Directors has delegated primary responsibility for ensuring that the guidelines in the investment policy are followed by the President and the Chief Financial Officer. Our Chief Executive Officer and Chief Financial Officer are responsible for making securities portfolio decisions in accordance with established policies and have the authority to purchase and sell securities within the specific guidelines established by the investment policy. In addition, all transactions are reviewed by the Asset/Liability Committee which meets every other month.

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 or credit risk, to complement our lending activities and to provide and maintain liquidity within established guidelines. In establishing our investment strategies, we consider our interest rate sensitivity, the types of securities to be held, liquidity and other factors. We have also engaged an independent financial advisor to recommend investment securities according to a plan which has been approved by the Asset/Liability Committee and the Board of Directors. Federal savings banks have authority to invest in various types of assets, including U.S. Government obligations, securities of various federal agencies, obligations of states and municipalities, mortgage-backed and asset-backed securities, collateralized-mortgage obligations, certain time deposits of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements, loans of federal funds, and, subject to certain limits, corporate debt and commercial paper.

Nearly our entire portfolio is classified as "available for sale" and is reported at fair market value. Our portfolio consists of collateralized mortgage obligations, U.S. Government agency backed securities, asset-backed securities, U.S. Government obligations and municipal bonds. Nearly all our mortgage backed securities are directly or indirectly insured or guaranteed by the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association or the Federal Home Loan Mortgage Association.

Beginning in 2005, we also invested in privately insured state and municipal obligations with maturities of twenty years or less. We invest in these securities because of their favorable after tax yields in comparison to U.S. Government and U.S. Government Agency securities of comparable maturity. These securities are classified as available for sale. Finally, we have investments in Federal Home Loan Bank of New York stock, which must be held as a condition of membership in the Federal Home Loan Bank system.

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The following table presents the composition of our securities portfolio (excluding Federal Home Loan Mortgage Corporation common stock) in dollar amount of each investment type at the dates indicated.

	At September 30, 2005		At December 31,					
			2004		2003		2002	
	Amortized Cost	Fair Value	Amortized Cost	(Dollars in thousands) Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale:								
U.S. Government agencies	\$ —	\$ —	\$ —	\$ —	\$ 1,000	\$ 1,063	\$ 1,000	\$ 1,109
U.S. Government obligations	2,115	2,241	2,118	2,162	2,123	2,084	—	—
State and municipal obligations	2,006	1,992	—	—	—	—	—	—
Mortgage-backed securities:								
Collateralized mortgage obligations	49,932	49,113	47,306	46,933	34,160	33,879	16,443	16,530
Federal Home Loan Mortgage Association	7,467	7,377	9,158	9,175	6,322	6,398	3,985	4,099
Federal Home Loan Mortgage Corporation	16,670	16,249	19,151	18,923	14,193	14,201	5,169	5,287
Asset-backed securities:	18,390	18,186	20,395	20,328	23,828	24,097	23,454	23,879
Total available for sale	\$ 96,580	\$ 95,158	\$ 98,128	\$ 97,521	\$ 81,626	\$ 81,722	\$ 50,051	\$ 50,904
Securities held to maturity:								
Mortgage-backed securities:								
Government National Mortgage Association	\$ 73	\$ 79	\$ 80	\$ 88	\$ 86	\$ 95	\$ 144	\$ 158
Federal Home Loan Mortgage Association	113	114	136	139	176	182	414	439
Federal Home Loan Mortgage Corporation	54	55	76	80	109	112	207	221
U.S. Government obligations:	2,059	2,264	2,067	2,196	—	—	—	—
Total held to maturity	2,299	2,512	2,359	2,503	371	389	765	818
Total investment securities	\$ 98,879	\$ 97,670	\$ 100,487	\$100,024	\$ 81,997	\$ 82,111	\$ 50,816	\$ 51,722

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At September 30, 2005, non-U.S. Government and Government agency securities that exceeded 10.0% of equity were as follows:

Issuer	Book Value	Fair Value
	(In thousands)	
Asset backed securities		
Countrywide Asset Backed Certificates	\$ 4,500	\$ 4,462
Chase Funding Mortgage Asset Backed Residential Asset Securities Corporation	\$ 3,589	\$ 3,545
	5,673	5,599
Total	\$ 13,762	\$ 13,606

Investment Securities Portfolio, Maturities and Yields. The following table sets forth the scheduled maturities, amortized cost and weighted average yields for our investment portfolio, with the exception of equity securities, at September 30, 2005. Due to repayments of the underlying loans, the average life maturities of mortgage-backed and asset-backed securities generally are substantially less than the final maturities.

	One year or less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
(Dollars in thousands)											
Available for Sale Securities:											
U.S. Government agencies	\$ —	—	\$ —	—	\$ —	—	\$ 2,115	4.96%	\$ 2,115	\$ 2,241	4.96%
State and municipal obligations(1)	—	—	—	—	1,604	3.61%	402	3.82%	2,006	1,992	3.65%
Mortgage-backed securities	59	6.25%	12,222	3.82%	13,857	3.95%	47,931	4.02%	74,069	72,739	3.98%
Asset-backed securities	—	—	654	3.64%	—	—	17,736	3.94%	18,390	18,186	3.93%
Held to Maturity securities:											
U.S. Government securities	\$ —	—	\$ —	—	—	—	\$ 2,059	5.44%	2,059	2,264	5.44%
Mortgage-backed securities	—	—	\$ 32	8.41%	22	6.49%	\$ 186	7.69%	240	248	7.68%
Total debt securities:	\$ 59	6.25%	\$ 12,908	3.82%	\$ 15,483	3.92%	\$ 70,429	4.08%	\$ 98,879	\$ 97,670	4.02%

(1) Yields are presented on a tax-equivalent basis.

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Sources Of Funds

General. Deposits, borrowings, repayments and prepayments of loans and securities principal, proceeds from the sale of securities, proceeds from maturing securities, and cash flows provided by operations are our primary sources of funds for use in lending, investing and for other general purposes. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources*.”

Deposits . We offer a variety of deposit accounts having a range of interest rates and terms. We currently offer regular savings deposits (consisting of a Christmas Club, passbook and statement savings accounts), money market accounts, interest bearing and non-interest bearing checking accounts, retirement accounts, time deposits and Interest on Lawyer Accounts.

Deposit balances in our NOW account constituted over 75% of our checking account balances at September 30, 2005 and December 31, 2004. These accounts provide interest-earning checking, with a weighted average rate at September 30, 2005 of 0.40%.

Deposit flows are influenced significantly by general and local economic conditions, changes in prevailing interest rates, pricing of deposits, and competition. Our deposits are primarily obtained from communities surrounding our offices and we rely primarily on paying competitive rates, service, and long-standing relationships with customers to attract and retain these deposits. We normally do not use brokers to obtain deposits.

When we determine our deposit rates, we consider local competition, U.S. Treasury securities offerings, and the rates charged on other sources of funds. Core deposits (defined as savings deposits, money market accounts, demand accounts and other interest bearing accounts) represented 44.5% and 45.6% of total deposits on September 30, 2005 and December 31, 2004, respectively. At September 30, 2005 and December 31, 2004, time deposits with remaining terms to maturity of less than one year amounted to \$89.2 million and \$76.6 million, respectively.

The following table presents our time deposit accounts categorized by interest rates which mature during each of the periods set forth below and the amounts of such time deposits by interest rate at each of September 30, 2005, December 31, 2004 and 2003.

Interest Rate Range	Period to maturity from September 30, 2005				At September 30,		At December 31,	
	Less than One Year	More than One Year to Two Years	More Than Two Years to Three Years	More than Three Years	2005	2004	2003	
(Dollars in thousands)								
1.99% and below	\$11,646	\$ 1,050	\$ 73	\$ 4	\$ 12,773	\$ 36,591	\$ 48,497	
2.00% to 2.99%	39,495	6,955	148	144	46,742	66,497	41,299	
3.00% to 3.99%	36,575	23,784	7,777	2,645	70,780	27,226	19,740	
4.00% to 4.99%	1,402	5,569	1,483	354	8,808	1,141	14,233	
5.00% to 5.99%	100	331	—	153	584	572	773	
6.00% and above	—	—	—	—	—	59	182	
Total	\$89,218	\$ 37,689	\$ 9,481	\$ 3,300	\$ 139,687	\$132,086	\$124,724	

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The following table presents the distribution of our deposit accounts at the dates indicated by dollar amount and percent of portfolio:

	At September 30, 2005		At December 31,					
			2004		2003		2002	
	Percent of		Percent of		Percent of		Percent of	
	Amount	total deposits	Amount	total deposits	Amount	total deposits	Amount	total deposits
(Dollars in thousands)								
Deposit type:								
Savings	\$ 29,942	11.91%	\$ 30,007	12.32%	\$ 31,483	13.66%	\$ 28,546	14.63%
Money market	27,099	10.77%	30,765	12.63%	26,219	11.38%	23,448	12.02%
Interest bearing demand	37,957	15.09%	39,488	16.21%	37,076	16.09%	32,771	16.80%
Noninterest bearing demand	16,891	6.71%	11,208	4.60%	10,993	4.77%	9,869	5.06%
Total core deposits	111,889	44.48%	111,468	45.76%	105,771	45.90%	94,634	48.51%
Time deposits with original maturities of:								
Three months or less	2,152	0.85%	1,861	0.76%	2,763	1.20%	2,614	1.34%
Over three months to twelve months	31,718	12.60%	31,069	12.77%	35,889	15.57%	42,425	21.75%
Over twelve months to twenty-four months	57,305	22.78%	57,634	23.66%	70,934	30.77%	49,480	25.36%
Over twenty-four months to thirty-six months	41,578	16.53%	35,692	14.66%	12,283	5.33%	3,465	1.78%
Over thirty-six months to forty-eight months	5,335	2.12%	4,416	1.81%	1,568	0.68%	1,309	0.67%
Over forty-eight months to sixty months	1,078	0.43%	1,100	0.45%	1,258	0.54%	1,137	0.58%
Over sixty months	521	0.21%	314	0.13%	29	0.01%	28	0.01%
Total time deposits	139,687	55.52%	132,086	54.24%	124,724	54.10%	100,458	51.49%
Total deposits	\$251,576	100.00%	\$243,554	100.00%	\$230,495	100.00%	\$195,092	100.00%

At September 30, 2005, we had \$31.6 million in time deposits with balances of \$100,000 or more maturing as follows:

Maturity Period	Amount
	(In thousands)
Three months or less	\$ 7,720
Over three months through six months	7,877
Over six months through twelve months	6,137
Over twelve months	9,906
Total	\$ 31,640

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Borrowings. Our borrowings consist of short-term Federal Home Loan Bank advances. The following table sets forth information concerning balances and interest rates on our borrowings at the dates and for the periods indicated. We have an available line of credit of \$23.4 million at September 30, 2005 and a one month overnight repricing line of credit of \$23.4 million. We did not have any outstanding borrowings on the lines of credit as of September 30, 2005.

	At September 30, 2005	At December 31,		
		2004	2003	2002
(Dollars in thousands)				
At December 31 or September 30				
Amount outstanding	\$ 9,425	\$11,725	\$11,800	\$3,000
Weighted average interest rate	3.74%	2.30%	1.35%	1.50%
For the period ended December 31 or September 30				
Highest amount at a month-end	\$ 11,025	\$13,700	\$12,100	\$3,000
Daily average amount outstanding	10,224	12,501	4,073	1,005
Weighted average interest rate	3.03%	2.24%	2.90%	1.74%

Subsidiary Activities

Upon completion of the reorganization, Lake Shore Savings will be the only subsidiary of Lake Shore Bancorp. Lake Shore Savings has no subsidiaries.

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Properties

We conduct our business through our corporate headquarters, administrative offices, and eight branch offices. At December 31, 2004, the net book value of the computer equipment and other furniture, fixtures, and equipment of our offices totaled \$1.7 million. For more information, see Note 5 of Notes to our Financial Statements.

Location	Leased or Owned	Original Date Acquired	Net Book Value December 31, 2004 (In thousands)
Corporate Headquarters			
125 East Fourth Street Dunkirk, NY 14048	Owned	1995	\$ 99
Branch Offices:			
<u>Chautauqua County</u>			
128 East Fourth Street Dunkirk, NY 14048	Owned	1930	855
30 East Main Street Fredonia, NY 14063	Owned	1996	853
1 Green Avenue Jamestown, NY 14701	Owned/Leased(1)	1996	808
115 East Fourth Street Jamestown, NY 14701	Owned	1997	355
106 East Main Street Westfield, NY 14787	Leased(2)	1998	360
<u>Erie County</u>			
5751 Transit Road East Amherst, NY 14051	Owned	2003	1,233
3111 Union Road Orchard Park, NY 14127	Leased(3)	2003	217
59 Main Street Hamburg, NY 14075	Leased(4)	2005	0
Administrative Offices:			
31 East Fourth Street Dunkirk, NY 14048	Owned	2003	324
123 East Fourth Street Dunkirk, NY 14048	Owned	1995	107

(1) The building is owned. The land is leased. The lease expires in September 2015.

(2) The building is owned. Parking is leased on a monthly basis.

(3) The lease expires in January 2017.

(4) The lease expires in 2028.

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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.

Personnel

As of September 30, 2005, we had 96 full-time employees and 9 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

REGULATION

General

Lake Shore Savings is currently a New York-chartered savings and loan association. It is currently subject to regulation, examination, and supervision by the New York State Banking Department and pursuant to the Federal Deposit Insurance Act, as a state-chartered savings association, Lake Shore Savings is also currently subject to the regulation, examination and supervision of the Office of Thrift Supervision and the Federal Deposit Insurance Corporation as its deposit insurer. As a result of the reorganization, Lake Shore Savings will convert to a federal stock savings bank and will thereby become subject solely to the regulation, examination and supervision of the Office of Thrift Supervision with the Federal Deposit Insurance Corporation as its deposit insurer.

Lake Shore Savings is a member of the Savings Association Insurance Fund, and its deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation. All of the deposit premiums paid by Lake Shore Savings to the Federal Deposit Insurance Corporation for deposit insurance are currently paid to the Savings Association Insurance Fund. Lake Shore Savings is also a member of the Federal Home Loan Bank of New York, which is one of the 12 regional Federal Home Loan Banks. Lake Shore Savings must file reports with the Office of Thrift Supervision concerning its activities and financial condition, and it must obtain regulatory approvals prior to entering into certain transactions, such as mergers with, or acquisitions of, other depository institutions. The Office of Thrift Supervision conducts periodic examinations to assess Lake Shore Savings' compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which a savings association can engage and is intended primarily for the protection of the insurance fund and depositors. As a savings and loan holding company, Lake Shore Bancorp will be required to file certain reports with, and otherwise comply with, the rules and regulations of the Office of Thrift Supervision and of the Securities and Exchange Commission under the federal securities laws.

The Office of Thrift Supervision and the Federal Deposit Insurance Corporation have significant discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such policies, whether by the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission or the United States Congress, could have a material adverse impact on us, Lake Shore Savings, and our operations and stockholders.

The following discussion is intended to be a summary of the material statutes and regulations applicable to savings associations and their savings and loan holding companies, and it does not purport to be a comprehensive description of all such statutes and regulations.

Regulation of Federal Savings Associations

Business Activities . Lake Shore Savings derives its lending and investment powers from the Home Owners' Loan Act, as amended, and Office of Thrift Supervision regulations. Under these laws and regulations, Lake Shore Savings may invest in mortgage loans secured by residential and commercial real estate, commercial and consumer loans, certain types of debt securities, and certain other assets. Lake Shore Savings may also establish service corporations that may engage in activities not otherwise permissible for Lake Shore Savings, including certain real estate equity investments and securities and insurance brokerage. Lake Shore Savings' authority to invest in certain types of loans or other investments is limited by federal law.

Liquidity. A federal savings bank is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation.

Loans to One Borrower. Lake Shore Savings is generally subject to the same limits on loans to one borrower as is a national bank. With specified exceptions, Lake Shore Savings' total loans or extensions of credit to a single borrower cannot exceed 15% of Lake Shore Savings' unimpaired capital and surplus, which does not include accumulated other comprehensive income. Lake Shore Savings may lend additional amounts up to 10% of its unimpaired capital and surplus which does not include accumulated other comprehensive income, if the loans or extensions of credit are fully-secured by readily-marketable collateral. Lake Shore Savings currently complies with applicable loans-to-one borrower limitations.

Qualified Thrift Lender Test. The Home Owners' Loan Act requires that Lake Shore Savings, as a savings association, to comply with the qualified thrift lender test. Under the qualified thrift lender test, Lake Shore Savings is required to maintain at least 65% of its portfolio assets in certain "qualified thrift investments" for at least nine months of the most recent twelve-month period. "Portfolio assets" means, in general, Lake Shore Savings' total assets less the sum of:

- specified liquid assets up to 20% of total assets;
- goodwill and other intangible assets; and
- the value of property used to conduct Lake Shore Savings' business.

Lake Shore Savings may also satisfy the qualified thrift lender test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code of 1986, as amended. Lake Shore Savings met the qualified thrift lender test at September 30, 2005 and in each of the prior 12 months, and, therefore, qualified as a thrift lender. If Lake Shore Savings fails the qualified thrift lender test, it must either operate under certain restrictions on its activities or convert to a national bank charter.

Capital Requirements. The Office of Thrift Supervision regulations require savings associations to meet three minimum capital standards: (i) a tangible capital ratio requirement of 1.5% of total assets as adjusted under the Office of Thrift Supervision regulations; (ii) a leverage ratio requirement of 3.0% of core capital to such adjusted total assets, if a savings association has been assigned the highest composite rating of 1 under the Uniform Financial Institutions Rating System; and (iii) a risk-based capital ratio requirement of 8.0% of core and supplementary capital to total risk-based assets. The minimum leverage capital ratio for any other depository institution that does not have a composite rating of 1 will be 4%, unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution. In determining the amount of risk-weighted assets for purposes of the risk-based

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capital requirement, a savings association must compute its risk-based assets by multiplying its assets and certain off-balance sheet items by risk-weights, which range from 0% for cash and obligations issued by the United States Government or its agencies to 100% for consumer and commercial loans, as assigned by the Office of Thrift Supervision capital regulation based on the risks found by the Office of Thrift Supervision to be inherent in the type of asset.

Tangible capital is defined, generally, as common stockholders' equity (including retained earnings), certain non-cumulative perpetual preferred stock and related earnings, minority interests in equity accounts of fully consolidated subsidiaries, less intangibles (other than certain mortgage servicing rights), and investments in and loans to subsidiaries engaged in activities not permissible for a national bank. Core capital is defined similarly to tangible capital, but core capital also includes certain qualifying supervisory goodwill and certain purchased credit card relationships. Supplementary capital currently includes cumulative and other preferred stock, mandatory convertible debt securities, subordinated debt and intermediate preferred stock and the allowance for loan and lease losses. In addition, up to 45% of unrealized gains on available-for-sale equity securities with a readily determinable fair value may be included in tier 2 capital. The allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets, and the amount of supplementary capital that may be included as total capital cannot exceed the amount of core capital.

At September 30, 2005, Lake Shore Savings met each of its capital requirements, in each case on a fully phased-in basis.

Capital Distributions. The Office of Thrift Supervision imposes various restrictions or requirements on Lake Shore Savings' ability to make capital distributions, including cash dividends. A savings institution that is the subsidiary of a savings and loan holding company must file a notice with the Office of Thrift Supervision at least 30 days before making a capital distribution. Lake Shore Savings must file an application for prior approval if the total amount of its capital distributions, including the proposed distribution, for the applicable calendar year would exceed an amount equal to Lake Shore Savings' net income for that year plus Lake Shore Savings' retained net income for the previous two years.

The Office of Thrift Supervision may disapprove of a notice of application if:

- Lake Shore Savings would be undercapitalized following the distribution;
- the proposed capital distribution raises safety and soundness concerns;
- the capital distribution would violate a prohibition contained in any statute, regulation, or agreement; or
- our ability to pay dividends, service our debt obligations, and repurchase our common stock is dependent upon receipt of dividend payments from Lake Shore Savings.

Branching . Subject to certain limitations, Home Owners' Loan Act and Office of Thrift Supervision regulations permit federally-chartered savings associations to establish branches in any State of the United States. The authority to establish such a branch is available: (i) in States that expressly authorize branches of savings associations located in another State; and (ii) to an association that qualifies as a "domestic building and loan association" under the Internal Revenue Code, which imposes qualification requirements similar to those for a qualified thrift lender under the Home Owners' Loan Act. See "—*Qualified Thrift Lender Test* ." The authority for a federal savings association to establish an interstate branch network would facilitate a geographic diversification of the association's activities. This authority under the Home Owners' Loan Act and Office of Thrift Supervision regulations preempts any State law purporting to regulate branching by federal savings associations.

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Community Reinvestment and Fair Lending Laws. Under the Community Reinvestment Act, as implemented by Office of Thrift Supervision regulations, a savings association has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the Community Reinvestment Act. The Community Reinvestment Act requires the Office of Thrift Supervision, in connection with its examination of a savings association, to assess the association's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such association. The Community Reinvestment Act also requires all institutions to publicly disclose their Community Reinvestment Act ratings.

The Community Reinvestment Act regulations establish an assessment system that bases an association's rating on its actual performance in meeting community needs. In particular, the assessment system focuses on three tests: (i) a lending test, to evaluate the institution's record of making loans in its assessment areas; (ii) an investment test, to evaluate the institution's record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and (iii) a service test, to evaluate the institution's delivery of services through its branches, ATMs, and other offices.

Lake Shore Savings has an on-going commitment to work with the Chautauqua Home Rehabilitation and Improvement Corporation in obtaining Federal Home Loan Bank grants to assist with community improvement efforts. There are many homes in Chautauqua County that are in need of repairs to enable such homes to be in compliance with applicable housing codes. Lake Shore Savings works with the Chautauqua Home Rehabilitation and Improvement Corporation to locate blighted properties and apply for grant assistance for repairs. Lake Shore Savings also participates in the Chautauqua Home Rehabilitation and Improvement Corporation Family Loan program which is a consumer lending program. Through this program, it makes secured and insured consumer loans at below market rates to lower and moderate income borrowers who have been qualified by this agency and who are trying to improve their credit score. The agency guarantees these loans and will make the final \$1,000 payment on a loan if the borrower is current and in good standing with us. These commitments are ways Lake Shore Savings strives to improve its community and which has contributed to its receiving an "Outstanding" Community Reinvestment Act rating on its last three evaluations the most recent being as of November 17, 2004.

Transactions with Related Parties. Lake Shore Savings' authority to engage in transactions with its Affiliates@ is limited by the Office of Thrift Supervision regulations and by Sections 23A and 23B of the Federal Reserve Act. In general, these transactions must be on terms which are as favorable to Lake Shore Savings as comparable transactions with non-affiliates. In addition, certain types of these transactions are restricted to an aggregate percentage of Lake Shore Savings' capital. Collateral in specified amounts must usually be provided by affiliates in order to receive loans from Lake Shore Savings. In addition, the Office of Thrift Supervision regulations prohibit a savings association from lending to any of its affiliates that engage in activities that are not permissible for bank holding companies and from purchasing the securities of any affiliate, other than a subsidiary.

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Effective April 1, 2003, the Federal Reserve Board rescinded its interpretations of Sections 23A and 23B of the Federal Reserve Act and replaced these interpretations with Regulation W. In addition, Regulation W makes various changes to existing law regarding Sections 23A and 23B, including expanding the definition of what constitutes an affiliate subject to Sections 23A and 23B and exempting certain subsidiaries of state-chartered banks from the restrictions of Sections 23A and 23B. Under Regulation W, all transactions entered into on or before December 12, 2002, which either became subject to Sections 23A and 23B solely because of Regulation W, and all transactions covered by Sections 23A and 23B, the treatment of which will change solely because of Regulation W, became subject to Regulation W on July 1, 2003. All other covered affiliate transactions become subject to Regulation W on April 1, 2003. The Federal Reserve Board expects each depository institution that is subject to Sections 23A and 23B to implement policies and procedures to ensure compliance with Regulation W.

Lake Shore Savings' authority to extend credit to its directors, executive officers and 10% stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, these provisions require that extensions of credit to insiders: (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features; and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Lake Shore Savings' capital. The regulations allow small discounts on fees on residential mortgages for directors, officers and employees. In addition, extensions for credit in excess of certain limits must be approved by Lake Shore Savings' Board of Directors.

Section 402 of the Sarbanes-Oxley Act of 2002 prohibits the extension of personal loans to directors and executive officers of issuers (as defined in Sarbanes-Oxley). The prohibition, however, does not apply to mortgages advanced by an insured depository institution, such as Lake Shore Savings, that are subject to the insider lending restrictions of Section 22(h) of the Federal Reserve Act.

Enforcement. The Office of Thrift Supervision has primary enforcement responsibility over savings associations, including Lake Shore Savings. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist orders and to remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and to unsafe or unsound practices.

Standards for Safety and Soundness . Under federal law, the Office of Thrift Supervision has adopted a set of guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings standards, compensation, fees and benefits. In general, the guidelines require appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. In addition, the Office of Thrift Supervision adopted regulations that authorize, but do not require, the Office of Thrift Supervision to order an institution that has been given notice that it is not satisfying these safety and soundness standards to submit a compliance plan. If, after being notified, an institution fails to submit an acceptable plan of compliance or fails in any material respect to implement an accepted plan, the Office of Thrift Supervision must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized association is subject under the "prompt corrective action" provisions of federal law. If an institution fails to comply with such an order, the Office of Thrift Supervision may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Real Estate Lending Standards . The Office of Thrift Supervision and the other federal banking agencies adopted regulations to prescribe standards for extensions of credit that: (i) are secured by real

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estate; or (ii) are made for the purpose of financing the construction of improvements on real estate. The Office of Thrift Supervision regulations require each savings association to establish and maintain written internal real estate lending standards that are consistent with safe and sound banking practices and appropriate to the size of the association and the nature and scope of its real estate lending activities. The standards also must be consistent with accompanying Office of Thrift Supervision guidelines, which include loan-to-value ratios for the different types of real estate loans. Associations are also permitted to make a limited amount of loans that do not conform to the proposed loan-to-value limitations so long as such exceptions are reviewed and justified appropriately. The guidelines also list a number of lending situations in which exceptions to the loan-to-value standards are justified.

Prompt Corrective Regulatory Action. Under the Office of Thrift Supervision prompt corrective action regulations, the Office of Thrift Supervision is required to take certain, and is authorized to take other, supervisory actions against undercapitalized savings associations. For this purpose, a savings association would be placed in one of the following four categories based on the association's capital:

- well-capitalized;
- adequately capitalized;
- undercapitalized; or
- critically undercapitalized.

At September 30, 2005, Lake Shore Savings met the criteria for being considered "well-capitalized." When appropriate, the Office of Thrift Supervision can require corrective action by a savings association holding company under the "prompt corrective action" provision of federal law.

Insurance of Deposit Accounts . Lake Shore Savings is a member of the Savings Association Insurance Fund. Under federal law, the Federal Deposit Insurance Corporation established a risk based assessment system for determining the deposit insurance assessments to be paid by insured depository institutions. Under the assessment system, the Federal Deposit Insurance Corporation assigns an institution to one of three capital categories based on the institution's financial information as of the quarter ending three months before the beginning of the assessment period. An institution's assessment rate depends on the capital category and supervisory category to which it is assigned. Under the regulation, there are nine risk assessment classifications (*i.e.* , combinations of capital groups and supervisory subgroups) to which different assessment rates are applied. Assessment rates currently range from 0.0% of deposits for an institution in the highest category (*i.e.* , well-capitalized and financially sound, with no more than a few minor weaknesses) to 0.27% of deposits for an institution in the lowest category (*i.e.* , undercapitalized and substantial supervisory concern). The Federal Deposit Insurance Corporation is authorized to raise the assessment rates as necessary to maintain the required reserve ratio of 1.25%.

In addition, all Federal Deposit Insurance Corporation-insured institutions are required to pay assessments to the Federal Deposit Insurance Corporation at an annual rate of approximately 0.0168% of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017.

Federal Home Loan Bank System. Lake Shore Savings is a member of the Federal Home Loan Bank of New York, which is one of the regional Federal Home Loan Banks composing the Federal Home Loan Bank System. Each Federal Home Loan Bank provides a central credit facility primarily for its member institutions: (i) the greater of \$1,000 or 0.20% of the member's mortgage-related assets; and (ii)

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4.50% of the dollar amount of any outstanding advances under such member's advances, collateral pledge and security agreement with the Federal Home Loan Bank of New York. Lake Shore Savings, as a member of the Federal Home Loan Bank of New York, is required to acquire and hold shares of capital stock in the Federal Home Loan Bank of New York in an amount at least equal to 0.12% of the total assets of Lake Shore Savings. Lake Shore Savings is also required to own activity based stock, which is based on 4.45% of Lake Shore Savings' outstanding advances. These percentages are subject to change by the Federal Home Loan Bank. Lake Shore Savings was in compliance with this requirement with an investment in Federal Home Loan Bank of New York stock at September 30, 2005 of \$2.5 million. Any advances from a Federal Home Loan Bank must be secured by specified types of collateral, and all long-term advances may be obtained only for the purpose of providing funds for residential housing finance.

The Federal Home Loan Banks are required to provide funds for the resolution of insolvent thrifts and to contribute funds for affordable housing programs. These requirements could reduce the amount of earnings that the Federal Home Loan Banks can pay as dividends to their members and could also result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future Federal Home Loan Bank advances increased, Lake Shore Savings' net interest income would be affected.

Under the Gramm-Leach-Bliley Act, membership in the Federal Home Loan Bank is now voluntary for all federally-chartered savings associations, such as Lake Shore Savings. The Gramm-Leach-Bliley Act also replaces the existing redeemable stock structure of the Federal Home Loan Bank System with a capital structure that requires each Federal Home Loan Bank to meet a leverage limit and a risk-based permanent capital requirement. Two classes of stock are authorized: Class A (redeemable on six-months notice) and Class B (redeemable on five-years notice).

Privacy Regulations . Pursuant to the Gramm-Leach-Bliley Act, the Office of Thrift Supervision has published final regulations implementing the privacy protection provisions of the Gramm-Leach-Bliley Act. The new regulations generally require that Lake Shore Savings disclose its privacy policy, including identifying with whom it shares a customer's "non-public personal information," to customers at the time of establishing the customer relationship and annually thereafter. In addition, Lake Shore Savings is required to provide its customers with the ability to "opt-out" of having their personal information shared with unaffiliated third parties and not to disclose account numbers or access codes to non-affiliated third parties for marketing purposes. Lake Shore Savings currently has a privacy protection policy in place and believes that such policy is in compliance with the regulations.

Prohibitions Against Tying Arrangements. Federal savings banks are subject to the prohibitions of 12 U.S.C. § 1972 on certain tying arrangements. A depository institution is prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

Federal Reserve System

Lake Shore Savings is subject to provisions of the Federal Reserve Act and the Federal Reserve Board's regulations pursuant to which depository institutions may be required to maintain non-interest-earning reserves against their deposit accounts and certain other liabilities. Currently, reserves must be maintained against transaction accounts (primarily NOW and regular checking accounts). The Federal Reserve Board regulations generally require that reserves be maintained in the amount of 3.0% of the aggregate of transaction accounts up to \$42.1 million. The amount of aggregate transaction accounts in excess of \$42.1 million are currently subject to a reserve ratio of 10.0%. The Federal Reserve Board regulations currently exempt \$6.0 million of otherwise reservable balances from

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the reserve requirements, which exemption is adjusted by the Federal Reserve Board at the end of each year. Lake Shore Savings is in compliance with the foregoing reserve requirements. Because required reserves must be maintained in the form of either vault cash, a non interest-bearing account at a Federal Reserve Bank, or a pass-through account as defined by the Federal Reserve Board, the effect of this reserve requirement is to reduce Lake Shore Savings' interest-earning assets. The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy liquidity requirements imposed by the Office of Thrift Supervision. Federal Home Loan Bank System members are also authorized to borrow from the Federal Reserve discount window, but Federal Reserve Board regulations require such institutions to exhaust all Federal Home Loan Bank sources before borrowing from a Federal Reserve Bank.

The USA PATRIOT Act

Lake Shore Savings is subject to the USA PATRIOT Act, which gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents, and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

- Pursuant to Section 352, *all* financial institutions must establish anti-money laundering programs that include, at minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.
- Pursuant to Section 326, on May 9, 2003, the Secretary of the Department of Treasury, in conjunction with other bank regulators, issued Joint Final Rules that provide for minimum standards with respect to customer identification and verification. These rules became effective on October 1, 2003.
- Section 312 requires financial institutions that establish, maintain, administer, or manage private banking accounts or correspondent accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) to establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- Effective December 25, 2001, financial institutions are prohibited from establishing, maintaining, administering, or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.
- Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

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Holding Company Regulation

Lake Shore Bancorp and Lake Shore, MHC will be savings and loan holding companies regulated by the Office of Thrift Supervision. As such, Lake Shore Bancorp and Lake Shore, MHC will be registered with and subject to Office of Thrift Supervision examination and supervision, as well as certain reporting requirements. In addition, the Office of Thrift Supervision will have enforcement authority over Lake Shore Bancorp and Lake Shore, MHC and any of their non-savings institution subsidiaries. Among other things, this authority permits the Office of Thrift Supervision to restrict or prohibit activities that are determined to be a serious risk to the financial safety, soundness or stability of a subsidiary savings institution. Unlike bank holding companies, federal savings and loan holding companies are not subject to any regulatory capital requirements or to supervision by the Federal Reserve System.

Restrictions Applicable to Lake Shore Bancorp. Because Lake Shore Savings will have been acquired after May 4, 1999, under the Gramm-Leach-Bliley Act, its holding companies will be prohibited from engaging in non-financial activities. Lake Shore Bancorp's activities will be restricted to:

- furnishing or performing management services for a savings institution subsidiary of such holding company;
- conducting an insurance agency or escrow business;
- holding, managing, or liquidating assets owned or acquired from a savings institution subsidiary of such company;
- holding or managing properties used or occupied by a savings institution subsidiary of such company;
- acting as trustee under a deed of trust;
- any other activity (i) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Director of the Office of Thrift Supervision, by regulation, prohibits or limits any such activity for savings and loan holding companies, or (ii) in which multiple savings and loan holding companies were authorized by regulation to directly engage in on March 5, 1987;
- purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such holding company is approved by the Director of the Office of Thrift Supervision; and
- any activity permissible for financial holding companies under section 4(k) of the Bank Holding Company Act.

Permissible activities which are deemed to be financial in nature or incidental thereto under section 4(k) of the Bank Holding Company Act include:

- lending, exchanging, transferring, investing for others, or safeguarding money or securities;
- insurance activities or providing and issuing annuities, and acting as principal, agent, or broker;

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- financial, investment, or economic advisory services;
- issuing or selling instruments representing interests in pools of assets that a bank is permitted to hold directly;
- underwriting, dealing in, or making a market in securities;
- activities previously determined by the Federal Reserve Board to be closely related to banking;
- activities that bank holding companies are permitted to engage in outside of the U.S.; and
- portfolio investments made by an insurance company.

In addition, Lake Shore Bancorp will not be permitted to be acquired unless the acquirer is engaged solely in financial activities or to acquire a company unless the company is engaged solely in financial activities.

Restrictions Applicable to Activities of Mutual Holding Companies. Under federal law, a mutual holding company may engage only in the following activities:

- investing in the stock of a savings institution;
- acquiring a mutual association through the merger of such association into a savings institution subsidiary of such holding company or an interim savings institution subsidiary of such holding company;
- merging with or acquiring another holding company, one of whose subsidiaries is a savings institution;
- investing in a corporation the capital stock of which is available for purchase by a savings institution under federal law or under the law of any state where the subsidiary savings institution or association is located; and
- the permissible activities described above for non-grandfathered savings and loan holding companies.

If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in the activities listed above, and it has a period of two years to cease any non-conforming activities and divest any non-conforming investments.

Restrictions Applicable to All Savings and Loan Holding Companies. Federal law prohibits a savings and loan holding company, which will include Lake Shore Bancorp and Lake Shore, MHC, directly or indirectly, from acquiring:

- control (as defined under the Home Owners' Loan Act) of another savings institution (or a holding company parent) without prior Office of Thrift Supervision approval;
- through merger, consolidation, or purchase of assets, another savings institution or a holding company thereof, or acquiring all or substantially all of the assets of such institution (or a holding company) without prior Office of Thrift Supervision approval; or

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- control of any depository institution not insured by the Federal Deposit Insurance Corporation (except through a merger with and into the holding company's savings institution subsidiary that is approved by the Office of Thrift Supervision).

A savings and loan holding company may not acquire as a separate subsidiary an insured institution that has a principal office outside of the state where the principal office of its subsidiary institution is located, except:

- in the case of certain emergency acquisitions approved by the Federal Deposit Insurance Corporation;
- if such holding company controls a savings institution subsidiary that operated a home or branch office in such additional state as of March 5, 1987; or
- if the laws of the state in which the savings institution to be acquired is located specifically authorize a savings institution chartered by that state to be acquired by a savings institution chartered by the state where the acquiring savings institution or savings and loan holding company is located or by a holding company that controls such a state-chartered association.

If the savings institution subsidiary of a federal mutual holding company fails to meet the qualified thrift lender test set forth in Section 10(m) of the Home Owners' Loan Act and regulations of the Office of Thrift Supervision, the holding company must register with the Federal Reserve Board as a bank holding company under the BHC Act within one year of the savings institution's failure to so qualify.

Waivers of Dividends by Lake Shore, MHC . Office of Thrift Supervision regulations will require Lake Shore, MHC to notify the Office of Thrift Supervision of any proposed waiver of its receipt of dividends from Lake Shore Bancorp. The Office of Thrift Supervision reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to any such waiver if:

- the waiver would not be detrimental to the safe and sound operation of the subsidiary savings association; and
- the mutual holding company's board of directors determines that such waiver is consistent with such directors' fiduciary duties to the mutual holding company's members.
- In the event Lake Shore, MHC waives dividends, under Office of Thrift Supervision regulations, our public stockholders would not be diluted because of any dividends waived by Lake Shore, MHC (and waived dividends would not be considered in determining an appropriate exchange ratio) in the event Lake Shore, MHC converts to stock form.

Conversion of Lake Shore, MHC to Stock Form . Office of Thrift Supervision regulations will permit Lake Shore, MHC to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur, and the board of directors has no current intention or plan to undertake a Conversion Transaction. In a Conversion Transaction a new stock holding company would be formed as the successor to Lake Shore Bancorp (the "New Holding Company"), Lake Shore, MHC's corporate existence would end, and certain depositors and borrowers of Lake Shore Savings would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share

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of common stock held by stockholders other than Lake Shore, MHC (“Minority Stockholders”) would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant an exchange ratio that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in Lake Shore Bancorp immediately prior to the Conversion Transaction. Under Office of Thrift Supervision regulations, Minority Stockholders would not be diluted because of any dividends waived by Lake Shore, MHC (and waived dividends would not be considered in determining an appropriate exchange ratio), in the event Lake Shore, MHC converts to stock form. The total number of shares held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the offering conducted as part of the Conversion Transaction.

Any Conversion Transaction would require the approval of a majority of the outstanding shares of common stock of Lake Shore Bancorp held by Minority Stockholders and by two thirds of the total outstanding shares of common stock of Lake Shore Bancorp. Any second-step conversion transaction also would require the approval of a majority of the eligible votes of members of Lake Shore, MHC.

Federal Securities Laws . Our common stock will be registered with the Securities and Exchange Commission under Section 12(g) of the Securities Exchange Act of 1934, as amended. We will be subject to information, proxy solicitation, insider trading restrictions, and other requirements under the Securities Exchange Act of 1934.

The Sarbanes-Oxley Act . As a public company, we will be subject to the Sarbanes-Oxley Act, which implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Sarbanes-Oxley Act’s principal legislation and the derivative regulation and rule making promulgated by the Securities and Exchange Commission includes:

- the creation of an independent accounting oversight board;
- auditor independence provisions that restrict non-audit services that accountants may provide to their audit clients;
- additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer certify financial statements;
- a requirement that companies establish and maintain a system of internal control over financial reporting and that a company’s management provide an annual report regarding its assessment of the effectiveness of such internal control over financial reporting to the company’s independent accountants and that such accountants provide an attestation report with respect to management’s assessment of the effectiveness of the company’s internal control over financial reporting;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;
- an increase in the oversight of, and enhancement of certain requirements relating to audit committees of public companies and how they interact with the company’s independent auditors;
- the requirement that audit committee members must be independent and are absolutely barred from accepting consulting, advisory or other compensatory fees from the issuer;

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- the requirement that companies disclose whether at least one member of the committee is a “financial expert” (as such term is defined by the Securities and Exchange Commission) and if not, why not;
- expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods;
- a prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions;
- disclosure of a code of ethics and the requirement of filing of a Form 8-K for a change or waiver of such code;
- mandatory disclosure by analysts of potential conflicts of interest; and
- a range of enhanced penalties for fraud and other violations.

Although we anticipate that we will incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

Quotation on Nasdaq . We expect our common stock to be quoted on The Nasdaq Stock Market. In order to maintain such quotation, we will be subject to certain corporate governance requirements, including:

- a majority of our board must be composed of independent directors;
- we are required to have an audit committee composed of at least three directors, each of whom is an independent director, as such term is defined by both the rules of the National Association of Securities Dealers and by Securities Exchange Act of 1934 regulations;
- our nominating committee and compensation committee must also be composed entirely of independent directors; and
- our audit committee and our nominating committee must have publicly available written charters.

TAXATION

Federal Taxation

General . The following discussion is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to Lake Shore, MHC, Lake Shore Bancorp and Lake Shore Savings. For federal income tax purposes, Lake Shore Savings reports its income on the basis of a taxable year ending December 31, using the accrual method of accounting, and is generally subject to U.S. federal income taxation in the same manner as other banks. Following the reorganization, Lake Shore Bancorp and Lake Shore Savings will constitute an affiliated group of corporations and, therefore, will be eligible to report their income on a consolidated basis. Because Lake Shore, MHC will own less than 80% of the common stock of Lake Shore Bancorp, it will not be a member of such affiliated group and will report its income on a separate return. Lake Shore Savings’ 2003 corporate tax return is currently under audit by the Internal Revenue Service. The audit is expected to be completed by the end of the first quarter of 2006 and we do not anticipate any material changes in our income tax liability.

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Bad Debt Reserves . Lake Shore Savings, as a “small bank” (one with assets having an adjusted tax basis of \$500 million or less) is permitted to maintain a tax reserve for bad debts based on the six-year average experience method. Pursuant to the Small Business Job Protection Act of 1996, the Bank is now recapturing (taking into income) over a multi-year period a portion of the balance of its tax bad debt reserve as of December 31, 1995. The tax liability associated with the recapture has been adequately provided for in the Lake Shore Savings’ financial statements.

Distributions. To the extent that Lake Shore Savings makes “non-dividend distributions” to stockholders, such distributions will be considered to result in distributions from Lake Shore Savings’ unrecaptured tax bad debt reserve “base year reserve,” *i.e.* , its reserve as of December 31, 1987, to the extent thereof and then from its supplemental reserve for losses on loans, and an amount based on the amount distributed will be included in Lake Shore Savings’ taxable income. Non-dividend distributions include distributions in excess of Lake Shore Savings’ current and accumulated earnings and profits, distributions in redemption of stock and distributions in partial or complete liquidation. However, dividends paid out of Lake Shore Savings’ current or accumulated earnings and profits, as calculated for federal income tax purposes, will not constitute non-dividend distributions and, therefore, will not be included in Lake Shore Savings’ income.

The amount of additional taxable income created from a non-dividend distribution is equal to the lesser of Lake Shore Savings’ base year reserve and supplemental reserve for losses on loans or an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Thus, in certain situations, approximately one and one-half times the non-dividend distribution would be includable in gross income for federal income tax purposes, assuming a 34% federal corporate income tax rate. Lake Shore Savings does not intend to pay dividends that would result in the recapture of any portion of its bad debt reserves.

Corporate Alternative Minimum Tax. The alternative minimum tax rules have been devised to ensure that at least a minimum amount of income tax is paid by high-income corporate taxpayers who take advantage of substantial tax savings due to the use of certain tax deductions and exemptions. In essence, the alternative minimum tax functions as a recapture mechanism, reclaiming some of the tax deductions and credits utilized by these taxpayers when calculating their regular federal income tax liability. In general, a corporation’s alternative minimum taxable income is equal to its regular taxable income, increased by its preference items for the year and adjusted by computing certain items under special rules that negate the acceleration of certain tax benefits which are available under the regular tax rules. The alternative minimum tax rate is 20%. Such preference items include adjustments for tax exempt interest, excess bad debt deductions, accelerated depreciation deductions and net operating loss carry-forwards. Lake Shore Savings is subject to the alternative minimum tax.

Elimination of Dividends; Dividends Received Deduction. Lake Shore Bancorp may exclude from its income 100% of dividends received from Lake Shore Savings as a member of the same affiliated group of corporations. Because, following the reorganization, Lake Shore, MHC will not be a member of such affiliated group, it will not qualify for such 100% dividends exclusion, but will be entitled to deduct 80% of the dividends it receives from Lake Shore Bancorp so long as it owns more than 20% of the common stock.

State Taxation

New York State Taxation . Lake Shore Savings is subject to the New York State Franchise Tax on Banking Corporations in an annual amount equal to the greater of (1) 7.5% of its “entire net income” allocable to New York State during the taxable year, or (2) the applicable alternative minimum tax. The alternative minimum tax is generally the greatest of (a) 0.01% of the value of the taxable assets allocable to New York State with certain modifications, (b) 3% of its “alternative entire net income” allocable to

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New York State or (c) \$250. Entire net income is similar to federal taxable income, subject to certain modifications, and alternative entire net income is equal to entire net income without certain adjustments. For purposes of computing its entire net income, Lake Shore Savings is permitted a deduction for an addition to the reserve for losses on qualifying real property loans. Lake Shore Savings is currently using a six-year average experience method, similar to the federal method to compute their New York State bad debt deduction .

New York State passed legislation in August 1996 that incorporated into New York State tax law provisions for the continued use of bad debt reserves in a manner substantially similar to the provisions that applied under federal law prior to the enactment of the 1996 Act discussed above. This legislation enabled the Bank to avoid the recapture of the New York State tax bad debt reserves that otherwise would have occurred as a result of the changes in federal law and to continue to utilize the reserve method for computing its bad debt deduction. However, the New York bad debt reserve is subject to recapture for “non-dividend distributions” in a manner similar to the recapture of federal bad debt reserves for such distributions. See “ — *Federal Taxation — Distributions* .” Also, the New York bad debt reserve is subject to recapture in the event that the Bank fails to satisfy certain definitional tests relating to its assets and the nature of its business.

MANAGEMENT

Our Directors

Upon consummation of the reorganization, Lake Shore Bancorp will have eight directors. Our Charter will provide that the Board of Directors shall be divided into three classes, as nearly equal in number as possible. At each Lake Shore Bancorp annual meeting of stockholders, directors will be elected to fill the seats of those directors whose terms are expiring in that year and any vacant seats. It is expected that Lake Shore, MHC, as the majority stockholder of Lake Shore Bancorp, will be able to control the outcome of director elections. Lake Shore Bancorp, as the sole stockholder of Lake Shore Savings, will elect Lake Shore Savings’ directors.

Lake Shore Savings currently has eight directors. Upon the consummation of the reorganization, the directors of Lake Shore Savings will be divided into three classes with staggered three-year terms of office, similar to Lake Shore Bancorp’s Board of Directors and will be eligible to serve until age 75. We expect that Lake Shore Bancorp and Lake Shore Savings will continue to have common directors and common executive officers until there is a business reason to establish separate management structures.

Upon consummation of the reorganization, the current directors of Lake Shore Savings will become the directors of Lake Shore Bancorp. The following table states such directors’ names, their ages as of September 30, 2005, their positions, the years they began serving as directors and the years their terms as directors of Lake Shore Bancorp will expire:

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Name	Age	Positions	Bank Director Since	Bancorp Term Expires
Sharon E. Brautigam	49	Director	2004	2007
Michael E. Brunecz	67	Chairman of the Board	1984	2007
James P. Foley DDS	67	Director	1983	2008
David C. Mancuso	59	President and Chief Executive Officer	1998	2006
Thomas E. Reed	63	Director	1988	2008
Daniel P. Reininga	46	Vice Chairman of the Board	1994	2008
Gary W. Winger	61	Director	1997	2006
Nancy L. Yocum	58	Director	1995	2006

Business Experience of Directors

The principal occupation and business experience for the last five years of each of director is set forth below. All directors have held their current positions for five years unless otherwise stated.

Sharon E. Brautigam is a partner in the law firm of Brautigam & Brautigam, LLP in Fredonia, New York where her practice is concentrated in real estate transactions, estates, trusts and elder law.

Michael E. Brunecz is the Chairman of the Board of Directors of Lake Shore Bancorp and Lake Shore Savings. Mr. Brunecz is the President of Office Concepts, Inc. in Dunkirk, New York, a company involved in the retailing and wholesaling of office furniture.

James P. Foley DDS is a dentist in private practice in Dunkirk, New York. He is a retired commander of the U.S. Naval Reserve.

David C. Mancuso is the President and Chief Executive Officer of Lake Shore Bancorp and Lake Shore Savings. Mr. Mancuso has been employed in various positions by Lake Shore Savings since 1965. He became President and Chief Executive Officer of Lake Shore Savings in 1993. Mr. Mancuso was a member of the New York State Banking Board from 2001 through November 2005.

Thomas E. Reed is the Chairman of the Board of ECR International, Inc., a manufacturer of heating and cooling products headquartered in Utica, New York.

Daniel P. Reininga is Vice Chairman of the Board of Directors of Lake Shore Bancorp and Lake Shore Savings. Mr. Reininga is the President of G.H. Graf Realty Corporation, Inc., a real estate investment company located in Dunkirk, New York.

Gary W. Winger has been a principal of Compass Consulting, Inc. in Auburn and Jamestown, New York and Venice, Florida, a firm that provides consulting services in the area of higher education, since July, 2002. From 1975 until June 2002, Mr. Winger was the Dean of Administration and Development and Chief Financial and Development Officer of Jamestown Community College in Jamestown, New York.

Nancy L. Yocum is a practicing certified public accountant. She is a partner in the firm of Brumfield & Associates in Fredonia, New York where her practice is concentrated in estates and trusts.

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Our Executive Officers

Our initial senior executive officers will be the same as those who currently serve as executive officers of Lake Shore Savings. In addition to Mr. Mancuso, we will have the following executive officers:

Beverley J. Mulkin is the Secretary/Treasurer of Lake Shore Bancorp. She has also been the Secretary of Lake Shore Savings since 1984 and its Treasurer since 2002.

Reginald S. Corsi is the Executive Vice President of Lake Shore Bancorp. He has also been the Executive Vice President of Lake Shore Savings since 1994. Prior to joining Lake Shore Savings, Mr. Corsi was Vice President of M&T Bank.

Robert L. Smith is the Chief Financial Officer of Lake Shore Bancorp. He has also been the Chief Financial Officer of Lake Shore Savings since July 2004. Prior to joining Lake Shore Savings, Mr. Smith served in various financial positions for Nestlé Purina Petcare Company from June 1976 to June 2004. Mr. Smith was a member of the Board of Directors of Lake Shore Savings from January 2003 to June 2004.

The Board of Directors will annually elect our executive officers and those of Lake Shore Savings. The elected officers will hold office until their respective successors have been elected and qualified, or until death, resignation or removal by the Board of Directors.

Meetings of the Boards of Directors

Regular meetings of the board of directors of Lake Shore Savings are held monthly. Following the completion of the stock offering, regular meetings of the board of directors of Lake Shore Bancorp will also be held monthly. Special meetings of these boards are and will be held as needed.

Committees of the Board of Directors

Upon consummation of the reorganization, the Board of Directors of Lake Shore Bancorp will establish the following committees.

Executive Committee . The Executive Committee of the Board of Directors of Lake Shore Bancorp will exercise the powers of the Board of Directors in between Board meetings.

Compensation Committee . The Compensation Committee will assess the structure of the management team and the overall performance of Lake Shore Bancorp. It will oversee executive compensation by approving salary increases and review general personnel matters such as staff performance evaluations.

Audit Committee . The Audit Committee of Lake Shore Bancorp will be comprised of the following three directors: Mr. Brunecz, Mr. Reed and Ms. Yocum. Ms. Yocum will serve as Chairperson of the Committee. It will oversee and monitor our financial reporting process and internal control system, review and evaluate the audit performed by our independent auditors, and report any substantive issues found during the audit to the Board. The Audit Committee will be directly responsible for the appointment, compensation, and oversight of the work of our independent auditors. The Audit Committee will also review and approve all transactions with affiliated parties. The Board of Directors will adopt a written charter for the Audit Committee.

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Nominating and Corporate Governance Committee . The Nominating and Corporate Governance Committee will meet to recommend the nomination of Directors to the full Board of Directors to fill the terms for the upcoming year or to fill vacancies during a term. The Nominating and Corporate Governance Committee will consider recommendations from stockholders if submitted in a timely manner in accordance with the procedures established in the Bylaws and will apply the same criteria to all persons being considered.

Each of the Audit, Compensation and Nominating and Corporate Governance Committees will be composed entirely of directors who are independent as such term is defined by Rule 4200(a)(15) of the National Association of Securities Dealers' Manual and Rule 10A-3 of the Securities Exchange Act of 1934, as amended.

Director Compensation

Meeting Fees . Lake Shore Savings pays a fee to each of the non-employee directors for attendance at each board meeting and each meeting of a committee of which they are members. Members receive \$975 for each Board meeting attended in person and half of that amount for each Board meeting attended telephonically. Board members also receive fees for membership on the Board's committees. The Chairman of the Executive Committee receives an annual fee of \$23,000 and its Vice Chairman receives an annual fee of \$7,500. All other non-employee members of the Executive Committee receive annual fees of \$5,000. The Chairpersons of the other committees receive annual fees of \$4,000 and their other members receive annual fees of \$2,500. Members of the Board of Directors who are also employees do not receive directors' fees.

Lake Shore Savings and Loan Association paid fees totaling \$124,892 to its non-employee directors for the year ended December 31, 2004.

Directors' Deferred Compensation Plan. Lake Shore Savings previously maintained a deferred compensation plan for non-employee directors under which each non-employee director could defer receipt of his or her directors fees and have such amounts credited with a market-rate investment return. This plan was terminated in October 2005 with all vested amounts paid to the plan participants pursuant to the requirements of the American Jobs Creation Act of 2004.

Supplemental Benefit Plan for Non-Employee Directors . Lake Shore Savings has entered into separate supplemental benefit plans in 1999 and 2001 with each of its current non-employee directors except for Ms. Brautigam. Under the 1999 plan, each participant is guaranteed monthly payments over a period of fifteen years commencing at age 70 equal to \$18,105 per year based upon twenty-one years of service as a director to Lake Shore Savings (or an earlier retirement age if twenty-one years of service is attained prior to age 70) with the annual benefit payable reduced proportionately for each year of service as a director less than twenty-one years attained at age 70. Under the 2001 plan, each participant is guaranteed monthly payments over a period of fifteen years commencing at age 72 equal to \$12,000 per year based upon twenty-one years of service to Lake Shore Savings with the annual benefit payable reduced proportionately for each year of service less than twenty-one years attained at age 72.

Executive Officer Compensation

The following table provides information about the compensation paid for 2004 to our Chief Executive Officer and our Executive Vice President. No other officer's total annual salary and bonus for 2004 was in excess of \$100,000.

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Name and Principal Positions	Summary Compensation Table Annual Compensation				All Other Compensation (\$) (1)
	Year	Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	
David Mancuso, President and Chief Executive Officer	2004	160,000	9,077	—	20,966
Reginald S. Corsi, Executive Vice President	2004	104,471	5,971	—	13,695

- (1) Reflects (i) matching contributions of \$4,058 and \$2,651 credited under the 401(k) plan to the accounts of Messrs. Mancuso and Corsi, respectively; and (ii) profit-sharing contributions of \$16,908 and \$11,044 credited under the 401(k) plan to the accounts of Messrs. Mancuso and Corsi.

Employment Agreement

Effective as of the reorganization, Lake Shore Bancorp and Lake Shore Savings will each have entered into parallel employment agreements with Mr. David C. Mancuso to secure his services as President and Chief Executive Officer. The employment agreements will have a fixed term of three years beginning as of the effective date of the reorganization and may be renewed annually after a review of the executive's performance. These agreements provide for a minimum annual salary of \$213,550, discretionary cash bonuses, and participation on generally applicable terms and conditions in other compensation and fringe benefit plans. The agreements will also guarantee customary corporate indemnification and errors and omissions insurance coverage throughout the employment term and for six years after termination.

Lake Shore Bancorp and Lake Shore Savings may terminate the executive's employment, and the executive may resign, at any time with or without cause. However, in the event of termination during the term without cause, they will owe the executive severance benefits generally equal to the value of the cash compensation and fringe benefits that the executive would have received if he had continued working for the remaining unexpired term of the employment agreements. The same severance benefits would be payable if the executive resigns during the term following:

- a loss of title, office or membership on the board of directors;
- material reduction in duties, functions, compensation or responsibilities; involuntary relocation of the executive's principal place of employment to a location over 35 miles in distance from Lake Shore Savings' principal office in Dunkirk, New York and over 35 miles from the executive's principal residence; or
- other material breach of contract by Lake Shore Bancorp and Lake Shore Savings which is not cured within 30 days.

The employment agreements will also provide uninsured death and disability benefits and provides that any severance payable after a change of control shall be computed as if the remaining unexpired term of the agreements was three years.

If Lake Shore Bancorp and Lake Shore Savings experience a change in ownership, a change in effective ownership or control or a change in the ownership of a substantial portion of their assets as contemplated by section 280G of the Internal Revenue Code, a portion of any severance payments under the employment agreements might constitute an "excess parachute payment" under current federal tax

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laws. Pursuant to the employment agreements, any severance payments made which are subject to section 280G of the Internal Revenue Code would be reduced to the extent necessary to avoid the imposition of an excise tax and related non-deductibility under section 280G of the Internal Revenue Code.

Change of Control Agreements

Effective as of the reorganization, Lake Shore Savings will enter into one-year change of control agreements with Reginald S. Corsi, our Executive Vice President and Robert L. Smith, our Chief Financial Officer. These agreements will be guaranteed by Lake Shore Bancorp. The term of these agreements is perpetual until Lake Shore Savings gives notice of non-extension, at which time the term is fixed for one year.

Generally, Lake Shore Savings may terminate the employment of any officer covered by these agreements, with or without cause, at any time prior to a change of control without obligation for severance benefits. However, if Lake Shore Savings or Lake Shore Bancorp, Inc. signs a merger or other business combination agreement, or if a third party makes a tender offer or initiates a proxy contest, it could not terminate an officer's employment without cause without liability for severance benefits. The severance benefits would generally be equal to the value of the cash compensation and fringe benefits that the officer would have received if he or she had continued working for an additional year. Lake Shore Savings would pay the same severance benefits if the officer resigns after a change of control following a loss of title or office, material reduction in duties, functions, compensation or responsibilities, involuntary relocation of his or her principal place of employment to a location over 35 miles from Lake Shore Savings' principal office on the day before the change of control and over 35 miles from the officer's principal residence or other material breach of contract which is not cured within 30 days. These agreements also provide uninsured death and disability benefits.

If Lake Shore Bancorp and Lake Shore Savings experiences a change in ownership, a change in effective ownership or control or a change in the ownership of a substantial portion of their assets as contemplated by section 280G of the Internal Revenue Code, a portion of any severance payments under the change of control agreements might constitute an "excess parachute payment" under current federal tax laws. Pursuant to the change of control agreements, any severance payments made which are subject to section 280G of the Internal Revenue Code would be reduced to the extent necessary to avoid the imposition of an excise tax and related non-deductibility under section 280G of the Internal Revenue Code.

Benefit Plans

Incentive Compensation Program. Lake Shore Savings maintains an incentive compensation plan for employees to earn bonuses based on the achievement of objective, pre-established performance goals. This plan is a short term incentive program which rewards short term performance based on the achievement of key operating goals. All executive officers and certain exempt employees are eligible to participate. These short term incentive payments are made annually. For 2005, the maximum bonus to be paid to Mr. Mancuso is 20% of his base salary and the maximum bonus to be paid to Mr. Corsi is 15% of his base salary (depending upon the achievement of certain pre-established performance goals).

Supplemental Benefit Plans for Executives. Lake Shore Savings has entered into separate executive supplemental benefits plans in 1999 and 2001 with each of Messrs. Mancuso and Corsi. In addition, Lake Shore Savings has entered into an executive supplemental benefit plan in 2001 with four other officers. Pursuant to these plans, each executive is entitled to receive a monthly payment over a period of fifteen years commencing on the first day of the month following the executive's attainment of his benefit age (age 63 under the 1999 plan, and age 65 under the 2001 plan) as set forth in the plans.

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Under the 1999 plan, Mr. Mancuso and Mr. Corsi shall be entitled to an annual retirement benefit of \$87,093, and \$19,639, respectively. Under the 2001 plan, Mr. Mancuso and Mr. Corsi shall be entitled to an annual retirement benefit of \$55,000 and \$24,000, respectively. Amounts payable under the plans are subject to reduction in the event of the executive's voluntary or involuntary termination of employment prior to attaining his benefit age.

401(k) Plan. Lake Shore Savings maintains a tax-qualified 401(k) defined contribution plan for employees who have attained age 21 and have at least three months of service. Eligible employees may make pre-tax contributions to the plan through salary reduction elections up to 75% of annual compensation, subject to limitations of the Internal Revenue Code (for 2005, the annual limit is \$14,000). Lake Shore Savings also makes a discretionary contribution to the plan on behalf of eligible employees who have attained age 21 and have at least one year of service.

Severance Pay Plan. Effective as of the reorganization, Lake Shore Savings will implement a Severance Pay Plan that provides severance benefits to employees and officers, other than those individuals covered by a separate employment or change in control agreement, whose employment is terminated without "cause" or by the employee or officer following a forced relocation, forced reduction in annual base salary, or a material adverse change in the employee's or officer's title, position or responsibilities during the period commencing three months prior to a change in control and ending one year following the change in control. An employee or officer whose employment terminates under these circumstances is entitled to a lump sum payment equal to three weeks' annual cash compensation in the case of eligible officers and one week's annual cash compensation in the case of eligible employees multiplied by the employee's or officer's whole years of service, but such severance payment will not exceed fifty-two weeks of compensation for officers and twenty-six weeks of compensation for eligible employees nor shall it be less than twelve weeks of compensation for eligible officers and two weeks of compensation for eligible employees. For the purposes of the Severance Pay Plan, officers are those employees designated as such by the Board of Directors.

Future Stock Benefit Plans

Employee Stock Ownership Plan . This plan is a tax-qualified plan that covers substantially all employees who have at least one year of service and have attained age 21 and will take effect at the completion of the reorganization.

Lake Shore Bancorp intends to lend this plan enough money to purchase 8% of the shares issued in the offering. The plan will purchase these shares from Lake Shore Bancorp to the extent that shares are available after filling the subscriptions of eligible account holders. Otherwise, the plan will purchase these shares on the open market after completion of the reorganization and offering to the extent that shares are available for purchase on reasonable terms. If this plan cannot purchase the shares that it wants directly from Lake Shore Bancorp in the offering, there is no assurance that it will purchase shares after the reorganization and offering, or that such purchases will occur during any particular time period or at any particular price.

Although contributions to this plan will be discretionary, Lake Shore Savings intends to contribute enough money each year to make the required principal and interest payments on the loan. It is expected that this loan will be for a term of 30 years and will call for level annual payments of principal and interest. The plan will initially pledge the shares it purchases as collateral for the loan and hold them in a suspense account.

The plan will not distribute the pledged shares right away. Instead, it will release a portion of the pledged shares annually. The number of shares released is determined pursuant to a formula where the number of unallocated shares is multiplied by a fraction, the numerator of which is the amount of

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principal and interest paid for the plan year, and the denominator of which is the sum of the numerator plus all principal and interest to be paid in all future years. The plan will allocate the shares released each year among the accounts of participants in proportion to their salary for the year. For example, if a participant's salary for a year represents 1% of the total salaries of all participants for the year, the plan would allocate to that participant 1% of the shares released for the year. Participants direct the voting of shares allocated to their accounts. Shares in the suspense account will usually be voted in a way that mirrors the votes which participants cast for shares in their individual accounts.

This plan may purchase additional shares in the future, and may do so using borrowed funds, cash dividends, periodic employer contributions or other cash flow.

Stock Option Plan. We intend to implement a stock option plan for our directors and officers after the reorganization and offering. Applicable regulations prohibit us from implementing this plan until six months after the reorganization and offering and require that we obtain the approval of the holders of a majority of the outstanding shares of Lake Shore Bancorp that are not owned by Lake Shore, MHC.

We expect to adopt a stock option plan that will authorize our Compensation Committee to grant options to purchase up to 4.90% of the shares outstanding after the offering (including shares issued to the Lake Shore Charitable Foundation). The Compensation Committee will decide which directors and officers will receive options and what the terms of those options will be. However, no stock option will permit its recipient to purchase shares at a price that is less than the fair market value of a share on the date such option is granted, and no option will have a term that is longer than ten years. If we implement a stock option plan before the first anniversary of the reorganization and offering, applicable regulations will require that we observe the following restrictions:

- We must limit the total number of shares that are optioned to outside directors to 30% of the shares authorized for the plan.
- We must also limit the number of shares that are optioned to any one outside director to 5% of the shares authorized for the plan and the number of shares that are optioned to any executive officer to 25% of the shares that are authorized for the plan.
- We must not permit the options to become vested at a more rapid rate than 20% per year beginning on the first anniversary of stockholder approval of the plan.
- We must not permit accelerated vesting for any reason other than death, disability or a change of control.

After the first anniversary of the reorganization and offering, we may amend the plan to change or remove these restrictions. If we adopt a stock option plan within one year after the reorganization and offering, we expect to amend the plan later to remove these restrictions and to provide for accelerated vesting in case of retirement. We will have to recognize compensation expense for accounting purposes ratably over the vesting period, equal to the fair value of the options on the original grant date.

We expect the stock option plan will permit the Compensation Committee to grant either incentive stock options that qualify for special federal income tax treatment or non-qualified stock options that do not qualify for special treatment. Incentive stock options may be granted only to employees and will not create federal income tax consequences when they are granted. If they are exercised during employment or within three months after termination of employment, the exercise will not create federal income tax consequences. When the shares acquired on exercise of an incentive stock option are resold, the seller must pay federal income taxes on the amount by which the sales price exceeds the purchase

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price. This amount will be taxed at capital gains rates if the sale occurs at least two years after the option was granted and at least one year after the option was exercised. Otherwise, it is taxed as ordinary income.

Non-qualified stock options may be granted to either employees or non-employees such as directors, consultants and other service providers. Incentive stock options that are exercised more than three months after termination of employment are treated as non-qualified stock options. Non-qualified stock options will not create federal income tax consequences when they are granted. When they are exercised, federal income taxes must be paid on the amount by which the fair market value of the shares acquired by exercising the option exceeds the exercise price. When the shares acquired on exercise of a non-qualified stock option are resold, the seller must pay federal income taxes on the amount by which the sales price exceeds the purchase price plus the amount included in ordinary income when the option was exercised. This amount will be taxed at capital gains rates, which will vary depending upon the time that has elapsed since the exercise of the option.

When a non-qualified stock option is exercised, Lake Shore Bancorp and Lake Shore Savings may be allowed a federal income tax deduction for the same amount that the option holder includes in his or her ordinary income. This amount may be the same as the related compensation expense or it may be different. When an incentive stock option is exercised, there is no tax deduction unless the shares acquired are resold sooner than two years after the option was granted or one year after the option was exercised.

Management Recognition Plan. We intend to implement a management recognition plan for our directors and officers after the reorganization and offering. Applicable regulations prohibit us from implementing this plan until six months after the reorganization and offering and that we obtain the approval of the holders of a majority of the outstanding shares of Lake Shore Bancorp that are not owned by Lake Shore, MHC.

We expect to adopt a management recognition plan that will authorize our Compensation Committee to make restricted stock awards of up to 1.96% of the shares outstanding after the offering (including shares issued to the Lake Shore Charitable Foundation). The Compensation Committee will decide which directors and officers will receive restricted stock and what the terms of those awards will be. If we implement a management recognition plan before the first anniversary of the reorganization, applicable regulations will require that we observe the following restrictions:

- We must limit the total number of shares that are awarded to outside directors to 30% of the shares authorized for the plan.
- We must also limit the number of shares that are awarded to any one outside director to 5% of the shares authorized for the plan and the number of shares that are awarded to any executive officer to 25% of the shares that are authorized for the plan.
- We must not permit the awards to become vested at a more rapid rate than 20% per year beginning on the first anniversary of stockholder approval of the plan.
- We must not permit accelerated vesting for any reason other than death, disability or a change of control.

After the first anniversary of the reorganization and offering, we may amend the plan to change or remove these restrictions. If we adopt a management recognition plan within one year after the reorganization, we expect to amend the plan later to remove these restrictions and to provide for accelerated vesting in case of retirement.

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Restricted stock awards under this plan may feature employment restrictions that require continued employment for a period of time for the award to be vested. They may feature restrictions that require the achievement of specified corporate or individual performance goals for the award to be vested. Or, they may feature a combination of employment and performance restrictions. Awards will not be vested unless the specified employment restrictions and performance goals are met. However, pending vesting, the award recipient may have voting and dividend rights. When an award becomes vested, the recipient must include the current fair market value of the vested shares in his or her income for federal income tax purposes. Lake Shore Bancorp and Lake Shore Savings may be allowed a federal income tax deduction in the same amount. Depending on the nature of the restrictions attached to the restricted stock award, Lake Shore Bancorp and Lake Shore Savings may have to recognize a compensation expense for accounting purposes ratably over the vesting period or in a single charge when the performance conditions are satisfied.

Certain Transactions with Management

Lake Shore Savings has outstanding loans to its directors and executive officers and the directors and executive officers of Lake Shore Bancorp and Lake Shore, MHC. These loans: (A) were made in the ordinary course of business; (B) were made on substantially the same terms, including interest rates and collateral as those prevailing at the time for comparable transactions with other persons and (C) did not involve more than the normal risk of collectability or present other unfavorable features. A majority of the independent, disinterested members of our board of directors must approve future affiliated transactions and forgiveness of loans.

PROPOSED PURCHASES OF COMMON STOCK BY MANAGEMENT

The following table presents, for each of our directors and executive officers, the amount of stock they wish to purchase in the offering. We have assumed that a sufficient number of shares will be available to satisfy their subscriptions. The amounts include shares that may be purchased through individual retirement accounts and by associates of the directors and executive officers. None of our directors or executive officers expects to purchase more than 1.0% of our common stock. Collectively our directors and executive officers expect to purchase a total of 89,600 shares, or 3.8% of shares we sell in the offering, including shares issued to the charitable foundation (assuming a total of 2,350,000 shares of common stock are sold in the offering and issued to the charitable foundation). These shares do not include shares expected to be issued under any stock benefit plans of Lake Shore Bancorp. If all shares issuable under such stock benefit plans were issued to directors and executive officers of Lake Shore Bancorp, Lake Shore Bancorp directors and executive officers would own 432,600 shares, or 18.4% of the shares we sell in the offering (assuming a total of 2,350,000 shares of common stock are sold in the offering and issued to the charitable foundation).

Name	Amount	Number of Shares
<i>Directors:</i>		
Sharon E. Brautigam	\$ 10,000	1,000
Michael E. Brunecz	100,000	10,000
James P. Foley, DDS	25,000	2,500
David C. Mancuso	100,000	10,000
Thomas E. Reed	60,000	6,000
Daniel P. Reininga	250,000	25,000
Gary W. Winger	50,000	5,000
Nancy L. Yocum	50,000	5,000
<i>Other Executive Officers:</i>		
Beverley J. Mulkin	1,000	100
Reginald S. Corsi	50,000	5,000
Robert L. Smith	200,000	20,000
<i>Total:</i>	896,000	89,600

It should be noted that the above subscriptions by our directors and executive officers are expected to be made in the subscription offering based only on their deposits with Lake Shore Savings as deposit account holders. This aspect of the offering could make it difficult for insiders to purchase stock for the explicit purpose of meeting the minimum of the offering. However, if any such purchases are made for the explicit purpose of meeting the minimum of the offering, they will be made for investment purposes only, and not with a view towards redistribution. Furthermore, Office of Thrift Supervision regulations restrict the sale of common stock purchased in this offering by directors and executive officers for a period of one year following the offering.

THE REORGANIZATION AND OFFERING

The Board of Directors of Lake Shore Savings and Loan Association has approved the plan of reorganization. The plan of reorganization also must be approved by the depositors of Lake Shore Savings and Loan Association. A special meeting of depositors has been called for this purpose. The Office of Thrift Supervision has conditionally approved the plan of reorganization; however, such approval does not constitute a recommendation or endorsement of the plan of reorganization by the agency.

General

On August 9, 2005, the Board of Directors of Lake Shore Savings and Loan Association unanimously adopted the plan of reorganization and minority stock issuance, pursuant to which Lake Shore Savings and Loan Association will change its name to Lake Shore Savings Bank and reorganize from a New York-chartered savings and loan association into a federally-chartered mutual holding company with a federally-chartered mid-tier holding corporation and a federally-chartered stock savings bank. After the reorganization, Lake Shore Bancorp will be the mid-tier stock holding company and Lake Shore, MHC will be the top-tier mutual holding company. Under the terms of the plan of reorganization, Lake Shore Bancorp will own all of the stock of Lake Shore Savings and Lake Shore, MHC will own at least a majority of Lake Shore Bancorp's stock. Lake Shore, MHC will have no stockholders, and depositors of Lake Shore Savings will become members of Lake Shore, MHC.

The reorganization also includes the offering by Lake Shore Bancorp of 45% of its common stock to eligible depositors of Lake Shore Savings in a subscription offering and, possibly, to members of the general public through a community offering and/or a syndicate community offering. The completion of the offering depends on market conditions and other factors beyond our control. We can give no assurance as to the length of time that will be required to complete the sale of the common stock. If we experience delays, significant changes may occur in the independent appraisal, which would require a change in the offering range. A change in the offering range would result in a change in the net proceeds realized from the sale of the common stock. If the reorganization is terminated, Lake Shore Savings would be required to charge all reorganization expenses against current income. The Office of Thrift Supervision approved the plan of reorganization, subject to, among other things, approval of the plan of reorganization by Lake Shore Savings' depositors. The plan of reorganization also provides for the establishment of The Lake Shore Charitable Foundation and our funding of the charitable foundation with an amount that will equal 2% of the shares of our common stock outstanding after the reorganization. The establishment of The Lake Shore Charitable Foundation is subject to a separate vote of Lake Shore Savings' depositors. Finally, the reorganization incorporates a conversion of Lake Shore Savings' charter from a New York mutual savings and loan association to a federally-chartered mutual savings bank (which will then convert to stock form in the reorganization). The conversion from a New York mutual savings association to a federally-chartered mutual savings bank must be approved by an affirmative vote of either (i) 66 2/3% in amount of the book value of all outstanding deposits of Lake Shore Savings, or (ii) at least 75 % in amount of all outstanding deposits of Lake Shore Savings represented at the special meeting. A special meeting of Lake Shore Savings' depositors will be called to vote on these three matters on _____, 2006.

The following is a brief summary of the pertinent aspects of the reorganization. A copy of the plan of reorganization is available from Lake Shore Savings upon request and is available for inspection at the offices of Lake Shore Savings and at the Office of Thrift Supervision. The plan of reorganization is also filed as an exhibit to the registration statement that we have filed with the Securities and Exchange Commission. See "*Where You Can Find More Information*."

Reasons for the Reorganization

After considering the advantages and disadvantages of the reorganization, the Board of Directors of Lake Shore Savings unanimously approved the reorganization as being in the best interest of Lake Shore Savings and its depositors. The Board of Directors concluded that the reorganization offers a number of advantages that will be important to our future growth and performance and that outweigh the disadvantages of the reorganization.

The reorganization will result in the raising of additional capital, which will support our future lending and operational growth and may also support future branching activities or the acquisition of other financial institutions or their assets. As a mutual holding company with a mid-tier stock holding company, we will have greater flexibility in structuring mergers and acquisitions, including giving us the ability to use stock as a form of merger consideration. Our current mutual structure, by its nature, precludes us from offering any common stock as consideration in a merger or acquisition. Our new mutual holding company structure will enhance our ability to compete with other bidders when acquisition opportunities arise by better enabling us to offer stock or cash consideration, or a combination of the two. Since we will not be offering all of our common stock for sale in the offering, the reorganization will result in less capital raised in comparison to a standard mutual-to-stock conversion, where 100% of our common stock would be sold. Therefore, the reorganization permits us to control the amount of capital being raised and helps us to prudently deploy the proceeds of the offering. The reorganization, however, also will allow us to raise additional capital in the future in the event of a conversion of Lake Shore, MHC to stock form in a second-step conversion.

Our directors, officers and employees will have the opportunity to become stockholders, which we believe to be an effective performance incentive and an effective means of attracting and retaining qualified personnel. Our customers and local community members will also have an opportunity to acquire our stock.

The disadvantages of the reorganization considered by Lake Shore Savings' Board of Directors include the additional expense and effort of operating as a public company quoted on the Nasdaq Stock Market, the inability of public stockholders to obtain majority ownership of Lake Shore Bancorp, that Lake Shore, MHC must own greater than 50% of Lake Shore Bancorp's common stock, and the corporate ownership and regulatory policies relating to the mutual holding company structure that may be adopted periodically which may have an adverse impact on stockholders other than Lake Shore, MHC. A majority of Lake Shore Bancorp's voting stock will be owned by Lake Shore, MHC, which will be controlled by its Board of Directors, which will initially be the Board of Lake Shore Savings. While this structure will permit management to focus on our long-term business strategy for growth and capital redeployment without undue pressure from public stockholders, it will also serve to perpetuate our existing management and directors. Lake Shore, MHC will be able to elect all the members of Lake Shore Bancorp's Board of Directors, and will be able to control the outcome of most matters presented to Lake Shore Bancorp's stockholders for resolution by vote. The matters as to which stockholders other than Lake Shore, MHC will be able to exercise voting control are limited and include any proposal to implement a stock-based incentive plan. No assurance can be given that Lake Shore, MHC will not take action adverse to the interests of other stockholders. For example, Lake Shore, MHC could prevent the sale of control of Lake Shore Bancorp, or defeat a candidate for Lake Shore Bancorp's Board of Directors or other proposals put forth by stockholders.

The mutual holding company reorganization does not preclude the conversion of Lake Shore, MHC from the mutual to the fully stock form of organization in the future, in which case Lake Shore, MHC would cease to exist. No assurance can be given when, if ever, Lake Shore, MHC will conduct a second-step conversion or what conditions the Office of Thrift Supervision or other regulatory agencies may impose on such a transaction. See "*Risk Factors*" and "*Regulation-Conversion of Lake Shore, MHC to Stock Form*."

Description of the Plan of Reorganization

Following receipt of all required regulatory approvals and approval of the plan of reorganization by Lake Shore Savings' depositors, the reorganization will be effected as follows or in any other manner approved by the Office of Thrift Supervision that is consistent with the purposes of the plan of reorganization and applicable laws and regulations:

- Lake Shore Savings will exchange its charter for a federal mutual savings bank charter;
- Lake Shore Savings will organize Lake Shore, MHC, initially as an interim federal savings bank ("Interim One") as a wholly owned subsidiary;
- Interim One will organize Lake Shore Bancorp as a wholly-owned subsidiary;
- Interim One will then organize an interim federal savings bank ("Interim Two") as a wholly-owned subsidiary;
- Lake Shore Savings will exchange its federal mutual savings bank charter for a federal stock savings bank charter;
- Interim One will cancel its outstanding stock and exchange its charter for a federal mutual holding company (*i.e.* , Lake Shore, MHC);
- Interim Two will merge with and into Lake Shore Savings who will survive as a federal stock savings bank and a subsidiary of Lake Shore, MHC;
- former members of Lake Shore Savings will become members of Lake Shore, MHC; and
- Lake Shore, MHC will contribute 100% of the issued common stock of Lake Shore Savings to Lake Shore Bancorp.

Contemporaneously with the above steps of reorganization, Lake Shore Bancorp will offer for sale 45% of its common stock.

As a result of the reorganization, Lake Shore Savings will be organized in stock form and will be wholly owned by Lake Shore Bancorp. The legal existence of Lake Shore Savings will not terminate as a result of the reorganization. Instead, Lake Shore Savings in stock form will be a continuation of Lake Shore Savings in mutual form. All property of Lake Shore Savings, including its right, title and interest in all property of any kind and nature, interest and asset of every conceivable value or benefit then existing or pertaining to Lake Shore Savings, or which would inure to Lake Shore Savings immediately by operation of law and without the necessity of any conveyance or transfer and without any further act or deed, will vest in Lake Shore Savings in stock form. Lake Shore Savings in stock form will continue to have, succeed to and be responsible for all the rights, liabilities and obligations of Lake Shore Savings in the mutual form and will maintain its corporate headquarters and operations at Lake Shore Savings' present locations.

The plan of reorganization also provides that we will establish and fund The Lake Shore Charitable Foundation. See "*The Lake Shore Charitable Foundation.*"

Effects of Reorganization on Deposits, Borrowers and Members

Continuity. While the reorganization is being accomplished, the normal business of Lake Shore Savings will continue without interruption, including being regulated by the Office of Thrift Supervision, its primary federal regulator, and the Federal Deposit Insurance Corporation. After reorganization, Lake Shore Savings will continue to provide services for depositors and borrowers under current policies by its present management and staff.

The directors of Lake Shore Savings at the time of reorganization will serve as directors of Lake Shore Savings after the reorganization. The Board of Directors of Lake Shore Bancorp and Lake Shore, MHC will be composed solely of the individuals who serve on the Board of Directors of Lake Shore Savings. All officers of Lake Shore Savings at the time of reorganization will retain their positions after the reorganization.

Deposit Accounts and Loans . The reorganization will not affect any deposit accounts or borrower relationships with Lake Shore Savings. All deposit accounts in Lake Shore Savings after the reorganization will continue to be insured up to the legal maximum by the Federal Deposit Insurance Corporation in the same manner as such deposit accounts were insured immediately before the reorganization. The reorganization will not change the interest rate or the maturity of deposits at Lake Shore Savings.

After the reorganization, each depositor of Lake Shore Savings will have both a deposit account in Lake Shore Savings and a pro rata ownership interest in the equity of Lake Shore, MHC based upon the balance in the depositor's account. This ownership interest is tied to the depositor's account, has no tangible market value separate from the deposit account and may only be realized in the event of a liquidation of Lake Shore, MHC. Any depositor who opens a deposit account obtains a pro rata ownership interest in the equity of Lake Shore, MHC without any additional payment beyond the amount of the deposit. A depositor who reduces or closes his or her account receives the balance in the account but receives nothing for his or her ownership interest in the equity of Lake Shore, MHC, which is lost to the extent that the balance in the account is reduced. Consequently, depositors of Lake Shore, MHC have no way to realize the value of their ownership interest in Lake Shore, MHC, except in the unlikely event that Lake Shore, MHC is liquidated.

After the reorganization, all loans of Lake Shore Savings will retain the same status that they had before the reorganization. The amount, interest rate, maturity and security for each loan will remain as they were contractually fixed before the reorganization.

Effect on Voting Rights of Members . After the reorganization, direction of Lake Shore Savings will continue to be under the control of its Board of Directors. As the holder of all of the outstanding common stock of Lake Shore Savings, Lake Shore Bancorp, through its Board of Directors, will have exclusive voting rights with respect to any matters concerning Lake Shore Savings requiring stockholder approval, including the election of directors.

After the reorganization, Lake Shore Bancorp stockholders will have exclusive voting rights with respect to any matters concerning Lake Shore Bancorp that requires stockholder approval. By virtue of being the majority stockholder owing 53% of the outstanding shares of common stock of Lake Shore Bancorp, Lake Shore, MHC will be able to control the outcome of most matters presented to the stockholders for resolution by vote.

As a federally chartered mutual holding company, Lake Shore, MHC will have no authorized capital stock and, therefore, no stockholders. Holders of deposit accounts of Lake Shore Savings will become members of Lake Shore, MHC. Such persons will be entitled to vote on all questions requiring

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action by the members of Lake Shore, MHC, including the election of directors of Lake Shore, MHC. In addition, all persons who become depositors of Lake Shore Savings following the reorganization will have membership rights with respect to Lake Shore, MHC. Borrowers do not currently have membership rights in connection with any borrowings and will not receive any membership rights after the reorganization.

Effect on Liquidation Rights . In the unlikely event of a complete liquidation of Lake Shore Savings before the completion of the reorganization, each depositor would receive a pro rata share of any assets of Lake Shore Savings remaining after payment of expenses and satisfaction of claims of all creditors. Each depositor's pro rata share of such liquidating distribution would be in the same proportion as the value of such depositor's deposit account was to the total value of all deposit accounts in Lake Shore Savings at the time of liquidation.

Upon a complete liquidation of Lake Shore Savings after the reorganization, each depositor would have a claim as a creditor of the same general priority as the claims of all other general creditors of Lake Shore Savings. However, except as described below, a depositor's claim would be solely for the amount of the balance in such depositor's deposit account plus accrued interest. Such depositor would not have an interest in the value or assets of Lake Shore Savings above that amount. Instead, the holder of Lake Shore Savings' common stock (*i.e.* , Lake Shore Bancorp) would be entitled to any assets remaining upon a liquidation of Lake Shore Savings.

Upon a complete liquidation of Lake Shore Bancorp, our stockholders, including Lake Shore, MHC, would be entitled to receive our remaining assets, following payment of all debts, liabilities and all claims of greater priority.

If liquidation of Lake Shore, MHC occurs following completion of the reorganization, all depositors of Lake Shore Savings at that time will be entitled, pro rata, to the value of their deposit accounts, to a distribution of any assets of Lake Shore, MHC remaining after payment of all debts and claims of creditors.

There are no plans to liquidate Lake Shore Savings, Lake Shore Bancorp or Lake Shore, MHC in the future.

How We Determined the Offering Range and the \$10.00 Purchase Price

Federal regulations require that the aggregate purchase price of the stock sold in connection with the reorganization be based upon our estimated pro forma market value on a fully converted basis (*i.e.* , assuming that 100% of our common stock had been sold to the public in the offering, as opposed to the 45% that will be sold to the public), as determined by an independent appraisal. We have retained RP Financial, which is experienced in the evaluation and appraisal of financial institutions, to prepare the independent appraisal. RP Financial will receive fees totaling \$65,000 for its appraisal services, plus reasonable out-of-pocket expenses incurred in connection with the appraisal. We have agreed to indemnify RP Financial under certain circumstances against liabilities and expenses, including legal fees, arising out of, related to, or based upon the reorganization.

RP Financial prepared the appraisal taking into account the pro forma impact of the offering. For its analysis, RP Financial undertook substantial investigations to learn about our business and operations. We supplied financial information, including annual financial statements, information on the composition of assets and liabilities, and other financial schedules. In addition to this information, RP Financial reviewed our reorganization and stock issuance applications as filed with the Office of Thrift Supervision and our registration statement as filed with the Securities and Exchange Commission. Furthermore, RP Financial visited our facilities and had discussions with our management. RP Financial did not perform a detailed individual analysis of the separate components of our assets and liabilities. We did not impose any limitations on RP Financial in connection with its appraisal.

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In connection with its appraisal, RP Financial reviewed the following factors, among others:

- the economic make-up of our primary market area;
- our financial performance and condition in relation to publicly traded companies that RP Financial deemed comparable to us;
- the specific terms of the offering of our common stock;
- the pro forma impact of the additional capital raised in the offering;
- our proposed dividend policy;
- conditions of securities markets in general; and
- the market for thrift institution common stock in particular.

Consistent with Office of Thrift Supervision appraisal guidelines, RP Financial's analysis utilized three selected valuation procedures, the price/book method, the price earnings method, and price/assets method, all of which are described in its report. RP Financial's appraisal report is filed as an exhibit to the registration statement that we have filed with the Securities and Exchange Commission. See "*Where You Can Find More Information* ." RP Financial placed the greatest emphasis on the price earnings and price/book methods in estimating pro forma market value. RP Financial compared the pro forma price/book and price earnings ratios for Lake Shore Bancorp to the same ratios for a peer group of comparable companies. The peer group consisted of ten publicly traded companies operating in the mutual holding company form of ownership based in the New England, Mid-Atlantic and Midwestern United States. The peer group included companies with:

- average assets of \$291 million;
- average nonperforming assets of 0.37% of total assets;
- average loans of 64.2% of total assets;
- average equity of 14.7% of total assets; and
- average income of 0.68% of average assets.

On the basis of the analysis in its report, RP Financial has advised us that, in its opinion, as of December 22, 2005, our estimated pro forma market value on a fully converted basis was within the estimated valuation range of \$42.5 million and \$57.5 million with a midpoint of \$50.0 million. Based on our intention to contribute to the charitable foundation 2% of the to-be outstanding shares, to issue 53% of the shares to Lake Shore, MHC and to offer for sale to the public 45% of the shares outstanding, the offering range is \$19.125 million to \$25.875 million, with a midpoint of \$22.5 million. Our Board of Directors reviewed RP Financial's appraisal report, including the methodology and the assumptions used by RP Financial, and determined that the offering range was reasonable and adequate. Based on the \$10.00 per share offering price, the estimated number of shares issued in the reorganization will be between 4,250,000 and 5,750,000, with a midpoint of 5,000,000 and the estimated number of shares sold in the offering will be between 1,912,500 and 2,587,500 with a midpoint of 2,250,000. The \$10.00 per share purchase price was selected primarily because it is the price most commonly used in mutual to stock conversions and reorganizations of financial institutions.

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Since the outcome of the offering relates in large measure to market conditions at the time of sale, it is not possible for us to determine the exact number of shares that we will issue at this time. If, upon completion of the offering, at least the minimum number of shares are subscribed for, RP Financial, after taking into account factors similar to those involved in its prior appraisal, will update its estimate of our pro forma market value as of the expiration of the offering period. No shares will be sold unless RP Financial confirms that, to the best of its knowledge and judgment, nothing of a material nature has occurred that would cause it to conclude that the actual total price of the shares on an aggregate basis was materially incompatible with its original appraisal. If, however, the facts do not justify that statement, the offering may be canceled or it may be extended with a new offering range or new subscription, community and syndicated community offerings may be held. The maximum number of shares that we sell in the offering may increase by up to 15%, to 2,975,625 shares, as a result of demand for shares in the offering, positive changes in financial markets in general and with respect to financial institution stocks in particular or regulatory considerations. Unless the number of shares of common stock to be offered is increased to more than 2,975,625 or decreased to less than 1,912,500, subscribers will not have the opportunity to modify or rescind their stock orders. If the offering is extended due to a new offering range, subscribers would have the right to confirm, modify or cancel their subscriptions within a specified period of time. If a subscriber does not respond during the resolicitation period, his or her subscriptions will be cancelled and subscription funds will be returned promptly with interest, and holds on funds authorized for withdrawal from deposit accounts will be released.

In formulating its appraisal, RP Financial relied upon the truthfulness, accuracy and completeness of all documents we furnished to it. RP Financial also considered financial and other information from regulatory agencies, other financial institutions, and other public sources, as appropriate. While RP Financial believes this information to be reliable, RP Financial does not guarantee the accuracy or completeness of the information and did not independently verify the financial statements and other data provided by us or independently value our assets or liabilities. **The appraisal is not intended to be, and must not be interpreted as, a recommendation of any kind as to the advisability of voting to approve the plan of reorganization or of purchasing shares of common stock. Moreover, because the appraisal must be based on many factors that change periodically, there is no assurance that purchasers of shares in the offering will be able to sell shares after the reorganization at prices at or above the \$10.00 offering price per share.**

Copies of the appraisal report of RP Financial, including any amendments to the report, and the detailed memorandum of the appraiser setting forth the method and assumptions for such appraisal are available for inspection at our corporate headquarters and the other locations specified under *“Where You Can Find More Information.”*

Subscription Offering and Subscription Rights

Under the plan of reorganization, we have granted rights to subscribe for our common stock to the following persons in the following order of priority:

1. Persons with deposits at Lake Shore Savings with balances aggregating \$50 or more (“qualifying deposits”) as of June 30, 2004 (“eligible account holders”).
2. Our tax-qualified employee benefit plans.
3. Persons with qualifying deposits at Lake Shore Savings as of December 31, 2005 (“supplemental eligible account holders”).

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4. Persons with deposits at Lake Shore Savings as of January __, 2006 (“other members”).

The amount of common stock that any person may purchase will depend on the availability of the common stock after satisfaction of all subscriptions having prior rights in the subscription offering and to the maximum and minimum purchase limitations set forth in the plan of reorganization. See “–*Limitations on Purchases of Shares*.” All persons sharing a qualifying joint deposit account will be counted as a single depositor for purposes of determining the maximum amount that may be subscribed for by an individual, and persons exercising subscription rights through qualifying accounts registered to the same address will be subject to the overall purchase limitation.

Category 1: Eligible Account Holders . Subject to the \$400,000 overall purchase limitation as described below under “–*Limitations on Purchases of Shares*,” each eligible account holder has the right to subscribe for up to the greater of:

- \$200,000 of common stock (which equals 20,000 shares);
- one-tenth of 1% of the total offering of common stock for sale; or
- 15 times the product, rounded down to the nearest whole number, obtained by multiplying the total number of shares of common stock to be sold by a fraction, the numerator of which is the amount of qualifying deposits of the eligible account holder and the denominator of which is the total amount of qualifying deposits of all eligible account holders.

If there are insufficient shares to satisfy all subscriptions by eligible account holders, shares first will be allocated so as to permit each subscribing eligible account holder, if possible, to purchase a number of shares sufficient to make the person’s total allocation equal 100 shares or the number of shares actually subscribed for, whichever is less. After that, unallocated shares will be allocated to each remaining subscribing eligible account holder whose subscription remains unfilled in the proportion that the amounts of his or her respective qualifying deposits bear to the total qualifying deposits of all remaining eligible account holders whose subscriptions remain unfilled. Subscription rights of eligible account holders who are also executive officers or directors of Lake Shore Savings or their associates will be subordinated to the subscription rights of other eligible account holders to the extent attributable to increased deposits in Lake Shore Savings in the one-year period preceding June 30, 2004.

To ensure a proper allocation of stock, each eligible account holder must list on his or her stock order form all deposit accounts in which such eligible account holder had an ownership interest at June 30, 2004. Failure to list an account, or providing incorrect information, could result in the loss of all or part of a subscriber’s stock allocation in the event of oversubscription.

Category 2: Tax-Qualified Employee Benefit Plans . Our tax-qualified employee benefit plans have the right to purchase up to 10% of the aggregate shares of common stock sold in the offering plus issued to our charitable foundation. As a tax-qualified employee benefit plan, our employee stock ownership plan intends to purchase 8% of the aggregate shares of common stock sold in the offering plus issued to our charitable foundation. It is the only plan expected to participate in the offering. Subscriptions by the employee stock ownership plan will not be aggregated with shares of common stock purchased by any other participants in the offering, including subscriptions by our officers and directors, for the purpose of applying the purchase limitations in the plan of reorganization. If we increase the number of shares offered in the reorganization above the maximum of the offering range, the employee stock ownership plan will have a first priority right to purchase any shares exceeding that amount up to 10% of the common stock sold in the offering plus issued to our charitable foundation. Rather than purchase shares in the offering, the employee stock ownership plan may choose to make all or a portion of its intended purchase in the open market after the offering concludes.

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Category 3: Supplemental Eligible Account Holders . Subject to the \$400,000 overall purchase limitation as described below under “ – *Limitations on Purchases of Shares,* ” each supplemental eligible account holder has the right to subscribe for up to the greater of:

- \$200,000 of common stock (which equals 20,000 shares);
- one-tenth of 1% of the total offering of common stock for sale; or
- 15 times the product, rounded down to the nearest whole number, obtained by multiplying the total number of shares of common stock to be sold by a fraction, the numerator of which is the amount of qualifying deposits of the supplemental eligible account holder and the denominator of which is the total amount of qualifying deposits of all supplemental eligible account holders.

If eligible account holders and the employee stock ownership plan subscribe for all of the shares, no shares will be available for supplemental eligible account holders. If shares are available for supplemental eligible account holders but there are insufficient shares to satisfy all subscriptions by supplemental eligible account holders, shares first will be allocated so as to permit each subscribing supplemental eligible account holder, if possible, to purchase a number of shares sufficient to make the person’s total allocation equal 100 shares or the number of shares actually subscribed for, whichever is less. After that, unallocated shares will be allocated among each remaining subscribing supplemental eligible account holder whose subscription remains unfilled in the proportion that the amounts of his or her respective qualifying deposits bear to the total qualifying deposits of all remaining supplemental eligible account holders whose subscriptions remain unfilled.

To ensure a proper allocation of stock, each supplemental eligible account holder must list on his or her stock order form all deposit accounts in which such supplemental eligible account holder had an ownership interest at December 31, 2005. Failure to list an account, or providing incorrect information, could result in the loss of all or part of a subscriber’s stock allocation in the event of oversubscription.

Category 4: Other Members . Subject to the \$400,000 overall purchase limitation, each other member has the right to purchase up to the greater of \$200,000 of common stock (which equals 20,000 shares) or one-tenth of 1% of the total offering of common stock for sale. If eligible account holders, the employee stock ownership plan and supplemental eligible account holders subscribe for all of the shares, no shares will be available for other members. If shares are available for other members but there are not sufficient shares to satisfy all subscriptions by other members, shares first will be allocated so as to permit each subscribing other member, if possible, to purchase a number of shares sufficient to make the person’s total allocation equal 100 shares or the number of shares actually subscribed for, whichever is less. After that, unallocated shares will be allocated to each other member whose subscription remains unfilled in the proportion that each other member’s subscription bears to the total subscriptions of all such subscribing other members whose subscriptions remain unfilled.

To ensure a proper allocation of stock, each other member must list on his or her stock order form all deposit accounts in which such other member had an ownership interest at January __, 2006. Failure to list an account, or providing incorrect information, could result in the loss of all or part of a subscriber’s stock allocation in the event of oversubscription.

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Expiration Date for the Subscription Offering . The subscription offering is expected to terminate at 11:00 a.m., Eastern Time, on [Date 1, 2006]. We will make reasonable attempts to provide a prospectus and related offering materials to holders of subscription rights; however, all subscription rights will expire on the expiration date whether or not we have been able to locate each person entitled to subscription rights. We may extend the expiration date without notice to you until [Date 2, 200_], unless the Office of Thrift Supervision approves a later date, which will not be beyond August 9, 2007.

If the sale of the common stock is not completed by [Date 2, 200 _], all funds received will be returned promptly with interest at our passbook savings rate and all deposit account withdrawal authorizations will be canceled unless we receive approval of the Office of Thrift Supervision to extend the time for completing the offering. If regulatory approval of an extension of the time period beyond [Date 2, 200 _] has been granted, we will notify all subscribers of the duration of the extension that has been granted, and subscribers will have the right to modify or rescind their purchase orders. If we do not receive a response from a subscriber, the subscriber's order will be rescinded and all funds received will be returned promptly with interest at our passbook savings rate and deposit account withdrawal authorizations will be canceled. No single subsequent extension can exceed 90 days, and all extensions in the aggregate may not last beyond August 9, 2007.

Persons in Non-Qualified States . We will make reasonable efforts to comply with the securities laws of all states in the United States in which persons entitled to subscribe for stock under the plan of reorganization reside. However, we are not required to offer stock in the subscription offering to any person who resides in a foreign country or who resides in a state of the United States in which (1) only a small number of persons otherwise eligible to subscribe for shares of common stock reside; (2) the granting of subscription rights or the offer or sale of shares to such person would require that we or our officers or directors register as a broker, dealer, salesman or selling agent under the securities laws of the state, or register or otherwise qualify the subscription rights or common stock for sale or qualify as a foreign corporation or file a consent to service of process; or (3) we determine that compliance with that state's securities laws would be impracticable for reasons of cost or otherwise.

Restrictions on Transfer of Subscription Rights and Shares . Subscription rights are nontransferable. You may not transfer, or enter into any agreement or understanding to transfer, the legal or beneficial ownership of your subscription rights issued under the plan of reorganization or the shares of common stock to be issued upon exercise of your subscription rights. In addition, illegal transfers of subscription rights, including agreements made prior to completion of the reorganization and offering to transfer shares after the offering, have been subject to enforcement actions by the Securities and Exchange Commission as violation of Rule 10b-5 of the Securities Exchange Act. Your subscription rights may be exercised only by you and only for your own account. If you exercise your subscription rights, you will be required to affirm on the stock order form that you are purchasing shares solely for your own account and that you have no agreement or understanding regarding the sale or transfer of such shares. Federal regulations also prohibit any person from offering, or making an announcement of an offer or intent to make an offer, to purchase such subscription rights or shares of common stock before the completion of the reorganization.

If you sell or otherwise transfer your rights to subscribe for common stock in the subscription offering or subscribe for common stock on behalf of another person, you may forfeit those rights and face possible further sanctions and penalties imposed by the Office of Thrift Supervision, the Securities and Exchange Commission or another agency of the U.S. Government. We intend to report to the Office of Thrift Supervision and the Securities and Exchange Commission anyone who we believe sells or gives away their subscription rights. We will pursue any and all legal and equitable remedies in the event we become aware of the transfer of subscription rights and will not honor orders known by us to involve the transfer of such rights.

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Community Offering

To the extent that shares remain available for purchase after satisfaction of all subscriptions received in the subscription offering, we may offer shares in a community offering to the following persons in the following order of priority:

- Natural persons and trusts of natural persons who are residents of Chautauqua, Erie and Cattaraugus Counties, New York; and
- Members of the general public to whom we deliver a prospectus.

We will consider persons to be residents of one of the specified counties if they occupy a dwelling in the county and have established an ongoing physical presence in the county that is not merely transitory in nature. We may utilize depositor or loan records or other evidence provided to us to make a determination as to whether a person is a resident. In all cases, the determination of residence status will be made by us in our sole discretion.

Purchasers in the community offering are eligible to purchase up to \$200,000 of common stock (which equals 20,000 shares). If oversubscription occurs among natural persons and trusts of natural persons, the available shares will be allocated first to each such subscriber whose order we accept in an amount equal to the lesser of 100 shares or the number of shares subscribed for by each such subscriber, if possible. After that, unallocated shares will be allocated among subscribers whose orders remain unsatisfied in the same proportion that the unfilled order of each such subscriber bears to the total unfilled orders of all such subscribers. If oversubscription occurs among members of the general public, the allocation procedures described above will apply.

The community offering, if held, may commence concurrently with or subsequent to the subscription offering, is expected to terminate with the subscription offering and must terminate no later than 45 days after the expiration of the subscription offering unless extended by us, with approval of the Office of Thrift Supervision.

The opportunity to subscribe for shares of common stock in the community offering is subject to our right to reject orders, in whole or part, either at the time of receipt of an order or as soon as practicable following the expiration date of the offering. If your order is rejected in part, you will not have the right to cancel the remainder of your order.

Syndicated Community Offering

The plan of reorganization provides that shares of common stock not purchased in the subscription offering and any community offering may be offered for sale to the general public in a syndicated community offering through a syndicate of registered broker-dealers to be formed and managed by Ryan Beck & Co., Inc. acting as our agent. Neither Ryan Beck & Co., Inc. nor any other registered broker-dealer will have any obligation to take or purchase any shares of the common stock in the syndicated community offering; however, Ryan Beck & Co., Inc. has agreed to use its best efforts in the sale of shares in any syndicated community offering. We have not selected any particular broker-dealers to participate in a syndicated community offering. The syndicated community offering must terminate no later than 45 days after the expiration of the subscription offering, unless extended by us, with approval of the Office of Thrift Supervision.

The opportunity to subscribe for shares of common stock in the syndicated community offering is subject to our right to reject orders, in whole or part, either at the time of receipt of an order or as soon as practicable following the expiration date of the offering. If your order is rejected in part, you will not have the right to cancel the remainder of your order.

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Subject to the \$400,000 overall purchase limitation, purchasers in the syndicated community offering are eligible to purchase up to \$200,000 of common stock (which equals 20,000 shares).

The syndicated community offering, if any, will be conducted in accordance with certain Securities and Exchange Commission rules applicable to best efforts offerings. Generally under those rules, Ryan Beck & Co., Inc., a registered broker-dealer, will deposit funds it receives prior to closing from interested investors into a separate noninterest-bearing bank account. If and when all the conditions for the closing are met, funds for common stock sold in the syndicated community offering will be promptly delivered to us. If the offering is consummated, but some or all of an interested investor's funds are not accepted by us, those funds will be returned to the interested investor promptly, without interest. If the offering is not consummated, funds in the account will be promptly returned, without interest, to the potential investor. Normal customer ticketing will be used for order placement. In the syndicated community offering, stock order forms will not be used.

If we are unable to find purchasers from the general public to sell at least the minimum number of shares offered, we will make other purchase arrangements, if feasible. Other purchase arrangements must be approved by the Office of Thrift Supervision and may provide for purchases for investment purposes by directors, officers, their associates and other persons in excess of the limitations provided in the plan of reorganization and in excess of the proposed director purchases discussed earlier, although no such purchases are currently intended. If other purchase arrangements cannot be made, the plan of reorganization will terminate.

Marketing Arrangements

We have retained Ryan Beck & Co., Inc., a broker-dealer, as our financial and marketing advisor to consult with and to advise Lake Shore Bancorp, and to assist Lake Shore Bancorp, on a best efforts basis, in the distribution of the shares of common stock in the offering. The services that Ryan Beck & Co., Inc. will provide include, but are not limited to:

- managing the Stock Information Center and training the employees of Lake Shore Bancorp who will perform ministerial functions in the offering;
- soliciting orders for common stock and assisting interested stock subscribers; and
- assisting in soliciting proxy votes of depositors.

For its services, Ryan Beck & Co., Inc. will receive a reorganization and proxy vote advisory and administrative fee of \$50,000 and a marketing fee of 1% of the aggregate dollar amount of the common stock sold in the subscription and community offerings to persons other than the tax-qualified employee benefit plans and directors, officers and employees of Lake Shore Savings and their immediate families. If Ryan Beck & Co., Inc. sells common stock through a group of broker-dealers in a syndicated community offering, it will be paid a fee equal to 1.0% of the dollar amount of total shares sold in the syndicated community offering, which fee along with the fee payable to selected dealers (which may include Ryan Beck & Co., Inc.) for the shares they sell shall not exceed 6.0% of aggregate syndicated community offering sales. Ryan Beck & Co., Inc. will also be reimbursed for its allocable expenses not to exceed \$20,000 without our consent and its legal fees in an amount not to exceed \$100,000 without consent. Lake Shore Bancorp and Lake Shore Savings have agreed to indemnify Ryan Beck & Co., Inc. against certain claims or liabilities, including liabilities under the Securities Act of 1933, as amended, and will contribute to payments Ryan Beck & Co., Inc. may be required to make in connection with any such claims or liabilities.

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We will establish a Stock Information Center. We will rely on Rule 3a4-1 of the Securities Exchange Act of 1934 and sales of common stock will be conducted within the requirements of this rule, so as to permit officers, directors and employees to participate in the sale of common stock in those States where the law permits. Our officers, directors and employees will not be compensated directly or indirectly by the payment of commissions or other remuneration in connection with their participation in the sale of common stock. Ryan Beck & Co., Inc. has not prepared a report or opinion constituting recommendations or advice to us in connection with the offering. In addition, Ryan Beck & Co., Inc. has expressed no opinion as to the prices at which the common stock to be sold in the offering may trade thereafter.

Limitations on Purchases of Shares

The plan of reorganization provides for the following purchase limitations:

- The minimum purchase is 25 shares.
- The aggregate amount of Lake Shore Bancorp outstanding common stock owned or controlled by persons other than Lake Shore, MHC at the close of the offering shall be less than 50% of total outstanding common stock.
- No person may subscribe for more than \$200,000 of common stock in all categories of the offering, combined. In the subscription offering, no persons exercising subscription rights through a single qualifying deposit account held jointly may purchase more than this amount. This individual purchase limitation is subject to increase as described below.
- Except for our tax-qualified employee benefit plans, which may purchase up to 10% of the common stock sold in the offering plus issued to our charitable foundation, no person, together with associates of or persons acting in concert with such person, may purchase in the aggregate more than \$400,000 of common stock (which equals 40,000 shares), in all categories of the offering combined. Unless we determine otherwise, all persons having the same address and all persons exercising subscription rights through qualifying deposit accounts registered to the same address will be subject to the overall purchase limitation. This overall purchase limitation is subject to increase as described below.
- The aggregate amount of common stock acquired in the offering, plus in all prior issuances, by Lake Shore Bancorp by any non-tax-qualified employee plan or any management person and his or her associates, exclusive of any shares of common stock acquired by such plan or management person and his or her associates in the secondary market, shall not exceed 4.9% of the outstanding shares of common stock at the conclusion of the offering.
- The aggregate amount of common stock or preferred stock acquired in the offering, plus in all prior issuances, by Lake Shore Bancorp by any non-tax-qualified employee plan or any management person and his or her associates, exclusive of any common stock acquired by such plan or management person and his or her associates in the secondary market, shall not exceed 4.9% of our stockholders' equity at the conclusion of the offering.
- The aggregate amount of common stock acquired in the offering, plus in all prior issuances, by any one or more tax-qualified employee plans, exclusive of any shares of common stock acquired by such plans in the secondary market, shall not exceed 4.9% of the outstanding shares of common stock at the conclusion of the offering.
- The aggregate amount of common stock or preferred stock acquired in the offering, plus in all prior issuances, by one or more tax-qualified employee plans, exclusive of any shares of common stock acquired by such plans in the secondary market, shall not exceed 4.9% of our stockholders' equity at the conclusion of the offering.

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- The aggregate amount of common stock acquired in the offering, plus in all prior issuances, by all of our stock benefit plans, other than employee stock ownership plans, shall not exceed 25% of the outstanding common stock held by persons other than Lake Shore, MHC.
- The aggregate amount of common stock acquired in the offering, plus in all prior issuances, by all non-tax-qualified employee plans or management persons and their associates, exclusive of any common stock acquired by such plans or management persons and their associates in the secondary market, shall not exceed 31% of the outstanding shares of common stock held by persons other than Lake Shore, MHC at the conclusion of the offering.
- The aggregate amount of common stock acquired in the offering, plus in all prior issuances, by all non-tax-qualified employee plans or management persons and their associates, exclusive of any common stock acquired by such plans or management persons and their associates in the secondary market, shall not exceed 31% of our stockholders' equity held by persons other than Lake Shore, MHC at the conclusion of the offering.

We may, in our sole discretion, decrease the individual and/or overall purchase limitations or increase the individual and/or overall purchase limitations to up to 5% of the shares of common stock sold in the offering. We do not intend to increase the maximum purchase limitations unless market conditions warrant an increase in the maximum purchase limitations. If we decide to increase the purchase limitations, persons who subscribed for the maximum number of shares of common stock will be given the opportunity to increase their subscriptions accordingly, subject to the rights and preferences of any person who has priority subscription rights.

The plan of reorganization defines "acting in concert" to mean knowing participation in a joint activity or interdependent conscious parallel action towards a common goal whether or not pursuant to an express agreement or understanding; or a combination or pooling of voting or other interests in the securities of an issuer for a common purpose under any contract, understanding, relationship, agreement or other arrangement, whether written or otherwise. In general, a person who acts in concert with another party will also be deemed to be acting in concert with any person who is also acting in concert with that other party. We may presume that certain persons are acting in concert based upon, among other things, joint account relationships and the fact that persons may have filed joint Schedules 13D or 13G with the Securities and Exchange Commission with respect to other companies. For purposes of the plan of reorganization, our directors are not deemed to be acting in concert solely by reason of their Board membership.

The plan of reorganization defines "associate," with respect to a particular person, to mean:

- any corporation or organization other than Lake Shore, MHC, Lake Shore Bancorp or Lake Shore Savings or a majority-owned subsidiary of Lake Shore, MHC, Lake Shore Bancorp or Lake Shore Savings of which such person is a senior officer or partner or is, directly or indirectly, the beneficial owner of 10% or more of any class of equity securities;
- any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity; and

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- any relative or spouse of such person, or any relative of a spouse, who either has the same home as such person or who is a director or officer of Lake Shore, MHC, Lake Shore Bancorp or Lake Shore Savings or any of their subsidiaries.

For example, a corporation of which a person serves as an officer would be an associate of that person and, therefore, all shares purchased by the corporation would be included with the number of shares that the person could purchase individually under the purchase limitations described above. We have the right in our sole discretion to reject any order submitted by a person whose representations we believe to be false or who we otherwise believe, either alone or acting in concert with others, is violating or circumventing, or intends to violate or circumvent, the terms and conditions of the plan of reorganization. Directors and officers are not treated as associates of each other solely by virtue of holding such positions. We have the sole discretion to determine whether prospective purchasers are “associates” or “acting in concert.”

Description of Sales Activities; Stock Information Center

We will offer the common stock in the offering principally by the distribution of this prospectus and through activities conducted at our Stock Information Center located at our administrative office (not our main banking office in Dunkirk). The Stock Information Center is located at 31 East Fourth Street, Dunkirk, New York. At all times, registered representatives of Ryan Beck & Co., Inc. will manage the Stock Information Center. **The center is open Monday through Friday, except for bank holidays, from 10:00 a.m. to 4:00 p.m., Eastern Time. Questions about the offering and reorganization may be directed to the Stock Information Center at (800) 806-8430.**

Our officers and employees may participate in the offering in clerical capacities, providing administrative support in effecting sales transactions or, when permitted by state securities laws, answering questions of a mechanical nature relating to the proper execution of the stock order form. Our officers may answer questions regarding our business when permitted by state securities laws. Other questions of our depositors and other prospective purchasers, including questions as to the advisability or nature of the investment, will be directed to employees of Ryan Beck & Co., Inc. Our officers and employees have been instructed not to solicit offers to purchase common stock or provide advice regarding the purchase of common stock.

None of our personnel participating in the offering is registered or licensed as a broker or dealer or an agent of a broker or dealer. Our personnel will assist in the above-described sales activities under an exemption from registration as a broker or dealer provided by Rule 3a4-1 promulgated under the Securities Exchange Act of 1934. Rule 3a4-1 generally provides that an “associated person of an issuer” of securities will not be deemed a broker solely by reason of participation in the sale of securities of the issuer if the associated person meets certain conditions. These conditions include, but are not limited to, that the associated person participating in the sale of an issuer’s securities not be compensated in connection with the offering at the time of participation, that the person not be associated with a broker or dealer and that the person observe certain limitations on his or her participation in the sale of securities. For purposes of this exemption, “associated person of an issuer” is defined to include any person who is a director, officer or employee of the issuer or a company that controls, is controlled by or is under common control with the issuer.

Procedure for Purchasing Shares in the Subscription and Community Offerings

Use of Stock Order Forms . To purchase shares in the subscription offering and community offering, you must submit a properly completed and executed stock order form, to be *received* by us by 11:00 a.m., Eastern Time, on **[Date] 1, 2006** . Your stock order form must be accompanied by full payment for all of the shares subscribed for. Once tendered, a stock order form cannot be modified or

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revoked without our consent. You may submit your stock order form and payment by mail using the return envelope provided, by overnight delivery to the indicated address on the stock order form or by bringing your stock order form to our Stock Information Center, located at our administrative office, 31 East Fourth Street, Dunkirk. **Stock order forms may not be brought to our main banking office in Dunkirk or to Lake Shore Savings branches.** These offices will not have supplies of offering materials.

In order to ensure that your subscription offering stock purchase eligibility and priority are properly identified in the stock order form, you must list all deposit accounts on the stock order form as of your eligibility date, giving all names on each account and the account number. We will strive to identify your ownership in all accounts, but cannot guarantee we will identify all accounts in which you have an ownership interest.

We need not accept stock order forms that are executed defectively or that are received without full payment or without appropriate withdrawal instructions. In addition, we are not obligated to accept orders submitted on photocopied or facsimiled stock order forms. We have the right to waive or permit the correction of incomplete or improperly executed stock order forms, but do not represent that we will do so. Under the plan of reorganization, our interpretation of the terms and conditions of the plan of reorganization and of the stock order form will be final.

By executing and returning the stock order form, you will be certifying that you received this prospectus and acknowledging that the common stock is not a deposit account and is not insured or guaranteed by the federal government. You also will be acknowledging that you received disclosure concerning the risks involved in this offering. The stock order form could be used as support to show that you understand the nature of this investment.

To ensure that each purchaser receives a prospectus at least 48 hours before the expiration of the offering period, as required by Rule 15c2-8 under the Securities Exchange Act of 1934, no prospectus will be mailed any later than five days before that date or hand delivered any later than two days before that date. Execution of the stock order form will confirm receipt or delivery under Rule 15c2-8. Stock order forms will be distributed only when preceded or accompanied by a prospectus.

Payment for Shares . Payment for shares may be made by personal check, bank check or money order payable to Lake Shore Bancorp, Inc. or by authorization of withdrawal from certain types of Lake Shore Savings deposit accounts, as explained on the stock order form. No cash, wire transfers, Lake Shore Savings lines of credit checks or third party checks will be accepted. Payments made by personal check must be available in the account. Checks and money orders will be immediately cashed and placed in a segregated account at Lake Shore Savings, or at our discretion at another insured depository institution. Interest will be paid on funds at our passbook savings rate from the date payment is received at the Stock Information Center until the completion or termination of the reorganization. You may not authorize direct withdrawal from Lake Shore Savings individual retirement accounts. Please do not authorize withdrawal from checking or NOW accounts. Submit a check instead. You may, however authorize withdrawal from all types of money market accounts, savings accounts and certificates of deposit. If payment is made by authorization of withdrawal from deposit accounts, the funds authorized to be withdrawn from a deposit account must be available in the account when we receive your stock order form. The designated funds will remain in the accounts and will continue to accrue interest at the contractual rates until completion or termination of the reorganization, but a hold will be placed on the funds, making them unavailable to you during the offering period. When the reorganization is completed, deposit account withdrawals will be made for the purchase of shares.

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We will waive any applicable penalties for early withdrawal from Lake Shore Savings certificate accounts. If the remaining balance in a certificate account is reduced below the applicable minimum balance requirement at the time funds are withdrawn, the certificate will be canceled at the time of the withdrawal, without penalty, and the remaining balance will earn interest at our passbook savings rate.

The tax-qualified employee benefit plans will not be required to pay for the shares of common stock purchased until consummation of the offering, provided that there is a loan commitment to lend to the tax-qualified employee benefit plans the amount of funds necessary to purchase the number of share ordered.

Use of Individual Retirement Account Funds. You may not designate direct withdrawal of funds from a Lake Shore Savings individual retirement account. By regulation, our individual retirement accounts do not permit investment in our shares of common stock. Persons with individual retirement accounts maintained with Lake Shore Savings must transfer their accounts to a self-directed individual retirement account with an unaffiliated trustee (such as a brokerage firm) prior to placing an order to purchase shares of common stock in the offering. There will be no early withdrawal penalties or Internal Revenue Service interest penalties for transfers. The new trustee will hold the shares of common stock in a self-directed account. An annual administrative fee may be payable to the new trustee. Assistance on how to transfer individual retirement accounts maintained at Lake Shore Savings can be obtained by contacting the Stock Information Center.

Depositors interested in using funds in an individual retirement account maintained at Lake Shore Savings or elsewhere should contact the Stock Information Center promptly, preferably at least two weeks before _____, 2006, the offering expiration date. Whether such funds can be used may depend on time constraints and limitations imposed by the institutions where funds are currently held.

In addition, the provisions of the Employee Retirement Income Security Act and Internal Revenue Service regulations require that executive officers, directors and 10% stockholders who use self-directed individual retirement account funds to purchase shares of common stock in the offering make such purchase for the benefit of the individual retirement account participant.

Delivery of Certificates

Certificates representing shares of common stock issued in the offering will be mailed to persons entitled to the certificates at the certificate registration address noted by them on the stock order form as soon as practicable following consummation of the offering. Any certificates returned as undeliverable will be held by our transfer agent until claimed by the persons legally entitled to the certificates, or will be otherwise disposed of in accordance with applicable law. **Until certificates for common stock are available and delivered to purchasers, they may not be able to sell their shares, even though trading of the common stock will have commenced .**

Restrictions on Repurchase of Stock

Under Office of Thrift Supervision regulations, we may not for a period of one year from the date of the completion of the reorganization repurchase any of our common stock from any person, except (1) in an offer made to all stockholders to repurchase the common stock on a pro rata basis, approved by the Office of Thrift Supervision, (2) the repurchase of qualifying shares of a director, or (3) repurchases to fund restricted stock plans or tax-qualified employee stock benefit plans. Where extraordinary circumstances exist, the Office of Thrift Supervision may approve the open market repurchase of up to 5% of our common stock during the first year following the reorganization. To receive such approval, we must establish compelling and valid business purposes for the repurchase to the satisfaction of the Office of Thrift Supervision. Furthermore, repurchases of any common stock are prohibited if they would cause Lake Shore Savings' regulatory capital to be reduced below the amount required for reorganization the regulatory capital requirements imposed by the Office of Thrift Supervision.

Restrictions on Transfer of Shares After the Reorganization Applicable to Officers and Directors

Common stock purchased in the offering will be freely transferable, except for shares purchased by our directors and executive officers.

Shares of common stock purchased by our directors and executive officers may not be sold for a period of one year following the reorganization, except upon the death of the stockholder or unless approved by the Office of Thrift Supervision. Shares purchased by these persons in the open market after the reorganization will be free of this restriction. Shares of common stock issued to directors and executive officers will bear a legend giving appropriate notice of the restriction and, in addition, we will give appropriate instructions to our transfer agent with respect to the restriction on transfers. Any shares issued to directors and executive officers as a stock dividend, stock split or otherwise with respect to restricted common stock will be similarly restricted.

Purchases of outstanding shares of our common stock by directors, officers, or any person who becomes an executive officer or director after adoption of the plan of reorganization, and their associates, during the three-year period following the reorganization may be made only through a broker or dealer registered with the Securities and Exchange Commission, except with the prior written approval of the Office of Thrift Supervision. This restriction does not apply, however, to negotiated transactions involving more than 1% of our outstanding common stock or to the purchase of stock under stock benefit plans.

We have filed with the Securities and Exchange Commission a registration statement under the Securities Act of 1933 for the registration of the common stock to be sold in the offering and issued to our charitable foundation. This registration does not cover the resale of the shares. Shares of common stock purchased by persons who are not affiliates of us may be resold without registration. Shares purchased by an affiliate of us will have resale restrictions under Rule 144 of the Securities Act. If we meet the current public information requirements of Rule 144, each affiliate of us who complies with the other conditions of Rule 144, including those that require the affiliate's sale to be aggregated with those of certain other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of 1% of our outstanding shares or the average weekly volume of trading in the shares during the preceding four calendar weeks. We may make future provision to permit affiliates to have their shares registered for sale under the Securities Act of 1933 under certain circumstances.

Accounting Consequences

The reorganization will be accounted for at historical cost in accordance with accounting principles generally accepted in the United States of America. Accordingly, the carrying value of the assets, liabilities, and capital will be unaffected by the reorganization and will be reflected in Lake Shore, MHC's consolidated financial statements based on their historical amounts.

Tax Aspects. The reorganization may be effected in any manner approved by the Office of Thrift Supervision that is consistent with the purposes of the plan of reorganization and applicable law, regulations and policies. However, we intend to consummate the reorganization using a series of transactions as described below. This structure enables Lake Shore Savings to retain all of its historical tax attributes and produces significant savings to us because it simplifies regulatory approvals and conditions associated with the completion of the reorganization.

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The merger structure will be accomplished as follows:

(1) Lake Shore Savings will exchange its New York mutual savings and loan association charter for a federal mutual savings bank charter (the “Charter Conversion”);

(2) Lake Shore Savings will organize Lake Shore, MHC initially as an interim federal stock savings bank (“Interim One”) as its wholly-owned subsidiary;

(3) Interim One will organize a capital stock corporation under federal law (i.e., Lake Shore Bancorp) as its wholly-owned subsidiary that will subsequently hold 100% of Lake Shore Savings’ common stock;

(4) Interim One will also organize an interim federal stock savings bank as its wholly owned subsidiary (“Interim Two”) and the following transactions will occur simultaneously;

(5) Lake Shore Savings will exchange its federal mutual savings bank charter for a federal stock savings bank charter (the “Conversion”);

(6) Interim One will cancel its outstanding stock and exchange its charter for a federal mutual holding company charter (i.e., Lake Shore, MHC);

(7) Interim Two will merge with and into Lake Shore Savings with Lake Shore Savings being the surviving institution; and

(8) the initially issued stock of Lake Shore Savings (which will be constructively received by former Lake Shore Savings’ depositors when Lake Shore Savings becomes a stock savings bank pursuant to step (5)) will be issued to Lake Shore, MHC in exchange for liquidation interests in Lake Shore, MHC which will be held by Lake Shore Savings’ depositors (the “Exchange”). Lake Shore, MHC will then contribute 100% of the stock of Lake Shore Savings to Lake Shore Bancorp, which will be a wholly-owned subsidiary of Lake Shore, MHC. Lake Shore Bancorp will subsequently offer for sale 47% of its common stock pursuant to the Amended and Restated Plan of Reorganization. As a result of these transactions, (a) Lake Shore Savings will be a wholly-owned subsidiary of Lake Shore Bancorp; (b) Lake Shore Bancorp will be a majority-owned subsidiary of Lake Shore, MHC; and (c) the depositors of Lake Shore Savings will hold membership interests in Lake Shore, MHC.

Under this structure: (i) the Charter Conversion is intended to be a tax-free reorganization under Internal Revenue Code section 368(a)(1)(F); (ii) the Conversion is intended to be a tax-free reorganization under Section 368(a)(1)(F) of the Code; and (iii) the Exchange is intended to be a tax-free exchange under Internal Revenue Code section 351.

Under the plan of reorganization, consummation of the reorganization is conditioned upon, among other things, the prior receipt by Lake Shore Savings of either a private letter ruling from the IRS and from the New York taxing authorities or an opinion of Lake Shore Savings’ counsel as to the federal and New York State income tax consequences of the reorganization to Lake Shore Savings’ (in both its mutual and stock form), Lake Shore Bancorp and depositors. In Revenue Procedure 99-3, 1999-1 I.R.B. 103, the IRS announced that it will not rule on whether a transaction qualifies as a tax-free reorganization under Internal Revenue Code section 368(a)(1)(F) or as a tax-free exchange of stock for stock in the formation of a holding company under Internal Revenue Code section 351, but that it will rule on significant sub-issues that must be resolved to determine whether the transaction qualifies under either of these Internal Revenue Code sections.

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Based in part upon certain factual representations of Lake Shore Savings or its officers, Thacher Proffitt & Wood LLP has issued its opinion regarding all of the material federal income tax consequences of the reorganization.

In the following discussion, “Mutual Bank” refers to Lake Shore Savings before the reorganization and “Stock Bank” refers to Lake Shore Savings after the reorganization.

With regard to the Charter Conversion, Thacher Proffitt & Wood LLP has issued an opinion that:

- (1) the Charter Conversion will constitute a “reorganization” under Internal Revenue Code Section 368(a)(1)(F); and
- (2) the Mutual Bank will recognize no gain or loss as a result of the Charter Conversion.

With regard to the Conversion, Thacher Proffitt & Wood LLP has issued an opinion that:

(1) the Conversion will constitute a “reorganization” under Internal Revenue Code section 368(a)(1)(F), and Lake Shore Savings (in either its status as Mutual Bank or Stock Bank) will recognize no gain or loss as a result of the Conversion;

(2) the basis of each asset of Mutual Bank received by Stock Bank in the Conversion will be the same as Mutual Bank’s basis for such asset immediately prior to the Conversion;

(3) the holding period of each asset of Mutual Bank received by Stock Bank in the reorganization will include the period during which such asset was held by Mutual Bank prior to the Conversion;

(4) For purposes of Internal Revenue Code section 381(b), Stock Bank will be treated as if there had been no reorganization and, accordingly, the taxable year of the Mutual Bank will not end on the effective date and the tax attributes of Mutual Bank (subject to application of Internal Revenue Code sections 381, 382, and 384), including Mutual Bank’s tax bad debt reserves and earnings and profits, will be taken into account by Stock Bank as if there had been no conversion.

(5) Mutual Bank’s depositors will recognize no gain or loss upon their constructive receipt of shares of Stock Bank common stock solely in exchange for their membership interest in Mutual Bank;

(6) no gain or loss will be recognized by the depositors of Lake Shore Savings (formerly Mutual Bank) upon the transfer to Lake Shore, MHC of shares of Stock Bank common stock they constructively received in the Conversion in exchange for membership interests in Lake Shore, MHC; and

(7) no gain or loss will be recognized by depositors of Mutual Bank upon the issuance to them of deposits in Stock Bank in the same dollar amount as their deposits in the Mutual Bank.

With regard to the Exchange, Thacher Proffitt & Wood LLP has issued an opinion that:

(1) the Exchange will qualify as an exchange of property for stock under Code section 351;

(2) no shareholder of Stock Bank (i.e., a former member of Mutual Bank) will recognize gain or loss upon the transfer to Lake Shore, MHC of Stock Bank stock constructively received in the Conversion in exchange for membership interests in Lake Shore, MHC;

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(3) the basis of the membership interests in Lake Shore, MHC received by each shareholder of Stock Bank in exchange for such shareholder's shares of Stock Bank stock will be equal to the basis of such shares of Stock Bank stock;

(4) the holding period of the membership interests in Lake Shore, MHC received by each shareholder of Stock Bank will, as of the date of the Exchange, be equal to the holding period of the shares of Stock Bank stock transferred in exchange therefor, provided such shares of Stock Bank stock were held as a capital asset on the date of the Exchange;

(5) Lake Shore, MHC will recognize no gain or loss upon its receipt from the shareholders of Stock Bank of shares of Stock Bank stock in exchange for membership interests in the Lake Shore, MHC;

(6) Lake Shore, MHC's basis for each share of Stock Bank stock received from a shareholder of Stock Bank in exchange for membership interests in Lake Shore, MHC will be equal to the basis of such share of stock in the hands of such Stock Bank shareholder; and

(7) Lake Shore, MHC's holding period for each share of Stock Bank stock received from a shareholder of Stock Bank in exchange for membership interests in Lake Shore, MHC will, as the date of the Exchange, be the same as the holding period of such shares in the hands of such Stock Bank shareholder.

With regard the offering under the Plan, Thacher Proffitt & Wood LLP has issued an opinion that:

(1) no gain or loss will be recognized by Stock Bank upon the sale of shares of Stock Bank common stock under the Plan;

(2) it is more likely than not that the fair market value of the nontransferable subscription rights to purchase shares of common stock of the Stock Bank to be issued to members of Mutual Bank is zero and, accordingly, that no income will be recognized by members of Mutual Bank upon the issuance to them of subscription rights or upon the exercise of the subscription rights;

(3) it is more likely than not that the tax basis to the holders of shares of Stock Bank common stock purchased in the subscription offering pursuant to the exercise of subscription rights will be the amount paid therefor, and that the holding period for such shares of common stock will begin on the date of completion of the subscription offering.

The opinions set forth in (2) and (3) above are based on the position that the subscription rights do not have any market value at the time of distribution or at the time they are exercised. Although the Internal Revenue Service ("IRS") will not issue rulings on whether subscription rights have a market value, we are unaware of any instance in which the IRS has taken the position that nontransferable subscription rights issued by a converting financial institution have a market value. We understand that the subscription rights will be granted at no cost to the recipients, will be nontransferable and of short duration, and will afford the recipients the right only to purchase common stock of Stock Bank at a price equal to its estimated fair market value, which will be the same price as the purchase price for the unsubscribed shares of such common stock. Based on the foregoing, we believe that it is more likely than not (i.e., there is a more than a 50% likelihood) that the subscription rights have no market value for federal income tax purposes.

Unlike private rulings of the IRS, an opinion of counsel is not binding on the IRS and the IRS could disagree with conclusions reached in the opinion. If there is a disagreement, we can not guarantee that the IRS would not prevail in a judicial or administrative proceeding.

Interpretation, Amendment and Termination

To the extent permitted by law, all interpretations by us of the plan of reorganization will be final; however, such interpretations have no binding effect on the Office of Thrift Supervision. The plan of reorganization provides that, if deemed necessary or desirable, we may substantively amend the plan of reorganization as a result of comments from regulatory authorities or otherwise, without the further approval of our members.

Completion of the reorganization requires the sale of all shares of the common stock within 24 months following approval of the plan of reorganization by our members. If this condition is not satisfied, the plan of reorganization will be terminated and we will continue our business in the mutual form of organization. We may terminate the plan of reorganization at any time.

THE LAKE SHORE CHARITABLE FOUNDATION

General

In furtherance of our commitment to our local community, the plan of reorganization provides that we will establish The Lake Shore Charitable Foundation as a non-stock Delaware corporation in connection with the reorganization and offering. The charitable foundation will be funded with our common stock, as described below. By further enhancing our visibility and reputation in our local community, we believe that the charitable foundation will enhance the long-term value of our community banking franchise. The reorganization and offering presents us with a unique opportunity to provide a substantial and continuing benefit to our community and to receive the associated tax benefits, without any significant cash outlay by us.

Purpose of the Charitable Foundation

Although we intend to continue to emphasize community lending and community activities following the offering, such activities are not our sole corporate purpose. The Lake Shore Charitable Foundation will be dedicated completely to community activities and the promotion of charitable causes, and may be able to support such activities in manners that are not presently available to us. We believe that The Lake Shore Charitable Foundation will enable us to assist the communities within our market area in areas beyond community development and lending and will enhance our current activities under the Community Reinvestment Act.

We further believe that the funding of The Lake Shore Charitable Foundation with our common stock will allow our community to share in our potential growth and success long after the offering. The Lake Shore Charitable Foundation will accomplish that goal by providing for continued ties between it and us, thereby forming a partnership within the communities in which we operate.

We do not expect the contribution to The Lake Shore Charitable Foundation to take the place of our traditional community lending and charitable activities. For the nine months ended September 30, 2005, and the year ended December 31, 2004, we contributed \$80,000 and \$124,000, respectively, to community organizations. We expect to continue making charitable contributions within our community. In connection with the closing of the reorganization, we intend to contribute to The Lake Shore Charitable Foundation 100,000 shares of our common stock, at the midpoint of the offering, valued at \$1.0 million based on the offering price of \$10.00 per share.

Structure of the Charitable Foundation

The Lake Shore Charitable Foundation will be incorporated under Delaware law as a non-stock corporation. The Lake Shore Charitable Foundation's Certificate of Incorporation will provide that The Lake Shore Charitable Foundation is organized exclusively for charitable purposes as set forth in Section 501(c)(3) of the Internal Revenue Code. The Certificate of Incorporation will further provide that no part of the net earnings of the charitable foundation will inure to the benefit of, or be distributable to, its directors, officers or members.

We will select two of our current directors to serve on the initial Board of Directors of the charitable foundation. As required by Office of Thrift Supervision regulations, we also will select one additional person to serve on the initial Board of Directors of the charitable foundation who will not be one of our officers, directors or employees and who will have experience with local charitable organizations and grant making. While there are no plans to change the size of the initial Board of Directors during the year following the completion of the reorganization and offering, following the first anniversary of the reorganization and offering, the charitable foundation may alter the size and composition of its Board of Directors. For five years after the reorganization, one seat on the charitable foundation's Board of Directors will be reserved for a person from our local community who has experience with local community charitable organizations and grant making and who is not one of our or any of our affiliate's officers, directors or employees, and one seat on the charitable foundation's Board of Directors will be reserved for one of our directors.

The Board of Directors of The Lake Shore Charitable Foundation will be responsible for establishing its grant and donation policies, consistent with the purposes for which it was established. As directors of a nonprofit corporation, directors of The Lake Shore Charitable Foundation will always be bound by their fiduciary duty to advance the charitable foundation's charitable goals, to protect its assets and to act in a manner consistent with the charitable purposes for which the charitable foundation is established. The directors of The Lake Shore Charitable Foundation also will be responsible for directing the activities of the charitable foundation, including the management and voting of the common stock held by the charitable foundation. However, as required by Office of Thrift Supervision regulations, all shares of common stock held by The Lake Shore Charitable Foundation must be voted in the same ratio as all other shares of the common stock on all proposals considered by our stockholders.

The Lake Shore Charitable Foundation's place of business will be located at our administrative offices. The Board of Directors of The Lake Shore Charitable Foundation will appoint such officers and employees as may be necessary to manage its operations. To the extent applicable, we will comply with the affiliates restrictions set forth in Sections 23A and 23B of the Federal Reserve Act and the Office of Thrift Supervision regulations governing transactions between us and the charitable foundation.

The Lake Shore Charitable Foundation will receive working capital from:

- any dividends that may be paid on our common stock in the future;
- within the limits of applicable federal and state laws, loans collateralized by the common stock; or
- the proceeds of the sale of any of the common stock in the open market from time to time.

As a private foundation under Section 501(c)(3) of the Internal Revenue Code, The Lake Shore Charitable Foundation will be required to distribute annually in grants or donations a minimum of 5% of the average fair market value of its net investment assets. One of the conditions imposed on the gift of common stock

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by us is that the amount of common stock that may be sold by The Lake Shore Charitable Foundation in any one year shall not exceed 5% of the average market value of the assets held by The Lake Shore Charitable Foundation, except where the Board of Directors of the charitable foundation determines that the failure to sell an amount of common stock greater than such amount would result in a long-term reduction of the value of its assets and/or would otherwise jeopardize its capacity to carry out its charitable purposes.

Tax Considerations

Our independent tax advisor has advised us that an organization created for the above purposes should qualify as a Section 501(c)(3) exempt organization under the Internal Revenue Code and should be classified as a private foundation. The Lake Shore Charitable Foundation will submit a timely request to the Internal Revenue Service to be recognized as an exempt organization. As long as The Lake Shore Charitable Foundation files its application for tax-exempt status within 15 months from the date of its organization, and provided the Internal Revenue Service approves the application, its effective date as a Section 501(c)(3) organization will be the date of its organization. Our independent tax advisor, however, has not rendered any advice on whether The Lake Shore Charitable Foundation's tax exempt status will be affected by the regulatory requirement that all shares of our common stock held by The Lake Shore Charitable Foundation must be voted in the same ratio as all other outstanding shares of common stock on all proposals considered by our stockholders.

We are authorized under federal law to make charitable contributions. We believe that the offering presents a unique opportunity to establish and fund a charitable foundation given the substantial amount of additional capital being raised. In making such a determination, we considered the dilutive impact of the contribution of common stock to The Lake Shore Charitable Foundation on the amount of common stock to be sold in the offering. See *"Capitalization," "Regulatory Capital Compliance,"* and *"Comparison of Valuation and Pro Forma Information With and Without Charitable Foundation."* The amount of the contribution will not adversely impact our financial condition. We therefore believe that the amount of the charitable contribution is reasonable given our pro forma capital position and does not raise safety and soundness concerns.

We have received an opinion from our independent tax advisor that our contribution of our stock to The Lake Shore Charitable Foundation should not constitute an act of self-dealing and that we should be entitled to a deduction in the amount of the fair market value of the stock at the time of the contribution less the nominal amount that The Lake Shore Charitable Foundation is required to pay us for such stock. We are permitted to deduct only an amount equal to 10% of our annual taxable income in any one year. We are permitted under the Internal Revenue Code to carry the excess contribution over the five-year period following the contribution to The Lake Shore Charitable Foundation. We estimate that substantially all of the contribution should be deductible over the six-year period. However, we do not have any assurance that the Internal Revenue Service will grant tax-exempt status to the charitable foundation. Furthermore, even if the contribution is deductible, we may not have sufficient earnings to be able to use the deduction in full. We do not expect to make any further contributions to The Lake Shore Charitable Foundation within the first five years following the initial contribution, unless such contributions would be deductible under the Internal Revenue Code. Any such decisions would be based on an assessment of, among other factors, our financial condition at that time, the interests of our stockholders and depositors, and the financial condition and operations of the charitable foundation.

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Although we have received an opinion from our independent tax advisor that we should be entitled to a deduction for the charitable contribution, there can be no assurances that the Internal Revenue Service will recognize The Lake Shore Charitable Foundation as a Section 501(c)(3) exempt organization or that the deduction will be permitted. In such event, our contribution to The Lake Shore Charitable Foundation would be expensed without tax benefit, resulting in a reduction in earnings in the year in which the Internal Revenue Service makes such a determination.

As a private foundation, earnings and gains, if any, from the sale of common stock or other assets are exempt from federal and state income taxation. However, investment income, such as interest, dividends and capital gains, is generally taxed at a rate of 2.0%. Within four and one-half months after the close of its fiscal year, The Lake Shore Charitable Foundation will be required to make its annual return available for public inspection. The annual return for a private foundation includes, among other things, an itemized list of all grants made or approved, showing the amount of each grant, the recipient, any relationship between a grant recipient and the charitable foundation's managers and a concise statement of the purpose of each grant.

Regulatory Conditions Imposed on the Charitable Foundation

Office of Thrift Supervision regulations will impose the following conditions on the establishment of The Lake Shore Charitable Foundation:

- the Office of Thrift Supervision can examine the charitable foundation;
- the charitable foundation must comply with all supervisory directives imposed by the Office of Thrift Supervision;
- the charitable foundation must provide annually to the Office of Thrift Supervision a copy of the annual report that the charitable foundation submits to the IRS;
- the charitable foundation must operate according to written policies adopted by its Board of Directors, including a conflict of interest policy;
- the charitable foundation may not engage in self-dealing and must comply with all laws necessary to maintain its tax-exempt status under the Internal Revenue Code; and
- the charitable foundation must vote its shares in the same ratio as all of the other shares voted on each proposal considered by our stockholders.

In addition, within six months of completing the reorganization, The Lake Shore Charitable Foundation must submit to the Office of Thrift Supervision a three-year operating plan.

Additionally, the establishment and funding of The Lake Shore Charitable Foundation must be separately approved by at least a majority of the total number of votes eligible to be cast by depositors of Lake Shore Savings at the special meeting of members.

Consummation of the reorganization and related offering of common stock is not conditioned upon depositors' approval of the charitable foundation. Failure to approve the charitable foundation may, however, materially increase our pro forma market value. See "*Comparison of Valuation and Pro Forma Information With and Without Charitable Foundation.*"

RESTRICTIONS ON ACQUISITION OF LAKE SHORE BANCORP AND LAKE SHORE SAVINGS

General

Lake Shore Savings' plan of reorganization provides that Lake Shore Savings will be reorganized from a New York state-chartered mutual savings bank into a federal mutual holding company structure and includes the adoption of a federal stock charter and bylaws for Lake Shore Bancorp. Certain provisions in our charter and bylaws may have anti-takeover effects. In addition, provisions in Lake Shore Savings' charter and bylaws may also have anti-takeover effects. Finally, regulatory restrictions may make it more difficult for persons or companies to acquire control of us.

Mutual Holding Company Structure

Following the reorganization, we will own all of the issued and outstanding common stock of Lake Shore Savings. Lake Shore, MHC will own a majority of the issued and outstanding common stock of Lake Shore Bancorp. As a result, management of Lake Shore, MHC is able to exert voting control over Lake Shore Bancorp and Lake Shore Savings and will restrict the ability of our minority stockholders to effect a change of control of management. Lake Shore, MHC, as long as it remains in the mutual form of organization, will control a majority of our voting stock.

Charter and Bylaws of Lake Shore Bancorp

Although our Board of Directors is not aware of any effort that might be made to obtain control of us after the offering, the Board of Directors believed it appropriate to adopt certain provisions permitted by federal regulations that may have the effect of deterring a future takeover attempt that is not approved by our Board of Directors. The following description of these provisions is only a summary and does not provide all of the information contained in our charter and bylaws. See "*Additional Information*" as to where to obtain a copy of these documents.

Limitation on Voting Rights . Our charter provides that, for a period of five years from the date of the reorganization, no person, except Lake Shore, MHC or a tax-qualified employee stock benefit plan of ours, may directly or indirectly acquire the beneficial ownership of more than 10% of any class of an equity security of ours. If shares are acquired in excess of 10%, those shares will be considered "excess shares" and will not be counted as shares entitled to vote.

Board of Directors.

Classified Board. Our Board of Directors is divided into three classes, each of which contains approximately one-third of the number of directors. The stockholders elect one class of directors each year for a term of three years. The classified Board makes it more difficult and time consuming for a stockholder group to fully use its voting power to gain control of the Board of Directors without the consent of the incumbent Board of Directors.

Filling of Vacancies; Removal . The bylaws provide that any vacancy occurring in the Board of Directors, including a vacancy created by an increase in the number of directors, may be filled by a vote of a majority of the directors then in office. A person elected to fill a vacancy on the Board of Directors will serve until the next election of directors. Our bylaws provide that a director may be removed from the Board of Directors before the expiration of his or her term only for cause and only upon the vote of a majority of the outstanding shares of voting stock. These provisions make it more difficult for stockholders to remove directors and replace them with their own nominees.

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Qualification . The bylaws provide that no person will be eligible to serve on the Board of Directors who has in the past 10 years been subject to a supervisory action by a financial regulatory agency that involved dishonesty or breach of trust or other bad actions, has been convicted of a crime involving dishonesty or breach of trust that is punishable by a year or more in prison, or is currently charged with such a crime, or has been found by a regulatory agent or a court to have breached a fiduciary duty involving personal profit or committed a willful violation of any law governing banking securities or insurance. These provisions may prevent stockholders from nominating themselves or persons of their choosing for election to the Board of Directors.

Stockholder Action by Written Consent; Special Meetings of Stockholders . Our stockholders must act only through an annual or special meeting or by unanimous written consent. Our charter provides that special meetings of stockholders relating to a change in control of us or amendments to our charter may be called only upon direction of the Board of Directors. Subject to this restriction, the bylaws provide that holders of not less than 10% of our outstanding shares may request the calling of a special meeting. At a special meeting, stockholders may consider only the business specified in the notice of meeting given by us. The provisions of our charter and bylaws limiting stockholder action by written consent and calling of special meetings of stockholders may have the effect of delaying consideration of a stockholder proposal until the next annual meeting, unless a special meeting is called at the request of a majority of the Board of Directors or holders of not less than 10% of our outstanding shares. These provisions also would prevent the holders of a majority of common stock from unilaterally using the written consent procedure to take stockholder action.

Advance Notice Provisions for Stockholder Nominations and Proposals. Our bylaws establish an advance notice procedure for stockholders to nominate directors or bring other business before an annual meeting of stockholders. A person may not be nominated for election as a director unless that person is nominated by or at the direction of our Board of Directors or by a stockholder who has given appropriate notice to us before the meeting. Similarly, a stockholder may not bring business before an annual meeting unless the stockholder has given us appropriate notice of the stockholder's intention to bring that business before the meeting. Our Secretary must receive notice of the nomination or proposal not less than 30 days before the annual meeting. A stockholder who desires to raise new business must provide us with certain information concerning the nature of the new business, the stockholder and the stockholder's interest in the business matter. Similarly, a stockholder wishing to nominate any person for election as a director must provide us with certain information concerning the nominee and the proposing stockholder.

Advance notice of nominations or proposed business by stockholders gives our Board of Directors time to consider the qualifications of the proposed nominees, the merits of the proposals and, to the extent deemed necessary or desirable by our Board of Directors, to inform stockholders and make recommendations about those matters.

Authorized but Unissued Shares of Capital Stock . Following the reorganization, we will have authorized but unissued shares of common and preferred stock. Our charter authorizes the Board of Directors to establish one or more series of preferred stock and, for any series of preferred stock, to determine the terms and rights of the series, including voting rights, conversion rates, and liquidation preferences. Although such shares of common and preferred stock could be issued by the Board of Directors to render more difficult or to discourage an attempt to obtain control of us by means of a merger, tender offer, proxy contest or otherwise, it is anticipated that such uses will be unlikely given that Lake Shore, MHC must always own a majority of our common stock.

Restrictions in Lake Shore Savings' Charter and Bylaws

Although the Board of Directors of Lake Shore Savings is not aware of any effort that might be made to obtain control of Lake Shore Savings after the offering, the Board of Directors believed it appropriate to adopt provisions permitted by federal law to protect the interests of the institution and its stockholders from any hostile takeover. These provisions may, indirectly, inhibit a change in control of us, as Lake Shore Savings' sole stockholder.

Lake Shore Savings' stockholders will not be permitted to cumulate their votes in the election of directors. Furthermore, Lake Shore Savings' bylaws provide for the election of three classes of directors to staggered terms. In addition, Lake Shore Savings' charter provides that, for a period of five years from the date of the reorganization, no person except Lake Shore Bancorp and Lake Shore, MHC or a tax-qualified employee stock benefit plan of Lake Shore Bancorp or Lake Shore Savings, may directly or indirectly acquire the beneficial ownership of more than 10% of any class of Lake Shore Savings' equity securities. Additionally, special meetings of stockholders related to changes in control of Lake Shore Savings or amendments to its charter may only be called upon direction of the Board of Directors. Lake Shore Savings' charter and bylaws also contain other provisions to protect the interests of the institution including a requirement that vacancies on the Board of Directors be filled by a majority vote of the Board of Directors, eligibility requirements for directors, and establishes advance notice procedures for stockholders to nominate directors or bring other business before the stockholders.

In addition, the charter provides for the issuance of shares of preferred stock on terms, including conversion and voting rights, as may be determined by Lake Shore Savings' Board of Directors without stockholder approval. Although Lake Shore Savings has no arrangements, understandings or plans at the present time for the issuance or use of the shares of undesignated preferred stock authorized, the Board of Directors believes that the availability of such shares will provide Lake Shore Savings with increased flexibility in structuring possible future financings and acquisitions and in meeting other corporate needs that may arise. If a proposed merger, tender offer or other attempt to gain control of Lake Shore Savings occurs of which management does not approve, the Board of Directors can authorize the issuance of one or more series of preferred stock with rights and preferences which could impede the completion of such a transaction. An effect of the possible issuance of such preferred stock, therefore, may be to deter a future takeover attempt. The Board of Directors does not intend to issue any preferred stock except on terms which the Board of Directors deems to be in the best interest of Lake Shore Savings and its then existing stockholders.

Regulatory Restrictions

Office of Thrift Supervision Regulations. Office of Thrift Supervision regulations provide that for a period of three years following the date of the completion of the reorganization, no person, acting singly or together with associates in a group of persons acting in concert, will directly or indirectly offer to acquire or acquire the beneficial ownership of more than 10% of our class of our equity securities without the prior written approval of the Office of Thrift Supervision. Where any person, directly or indirectly, acquires beneficial ownership of more than 10% of our class of any equity securities without the prior written approval of the Office of Thrift Supervision, the securities beneficially owned by such person in excess of 10% will not be voted by any person or counted as voting shares in connection with any matter submitted to the stockholders for a vote, and will not be counted as outstanding for purposes of determining the affirmative vote necessary to approve any matter submitted to the stockholders for a vote.

Remutualization Transactions . Current Office of Thrift Supervision regulations permit a mutual holding company to be acquired by a mutual institution in a remutualization transaction. However, the Office of Thrift Supervision has issued a policy statement indicating that it views remutualization transactions as raising significant issues concerning disparate treatment of minority stockholders and

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mutual members of the target entity and as raising issues concerning the effect on the mutual members of the acquiring entity. Under certain circumstances, the Office of Thrift Supervision intends to give these issues special scrutiny and reject applications for the remutualization of a mutual holding company unless the applicant can clearly demonstrate that the Office of Thrift Supervision's concerns are not warranted in the particular case.

Change in Bank Control Act. The acquisition of 10% or more of our outstanding common stock may trigger the provisions of the Change in Bank Control Act. The Office of Thrift Supervision has also adopted a regulation under the Change in Bank Control Act which generally requires persons who at any time intend to acquire control of a federally chartered savings association or its holding company, to provide 60 days prior written notice and certain financial and other information to the Office of Thrift Supervision.

The 60-day notice period does not commence until the information is deemed to be substantially complete. Control for these purposes exists in situations in which the acquiring party has voting control of at least 25% of any class of our voting stock or the power to direct our management or policies. However, under Office of Thrift Supervision regulations, control is presumed to exist where the acquiring party has voting control of at least 10% of any class of our voting securities if specified "control factors" are present. The statute and underlying regulations authorize the Office of Thrift Supervision to disapprove a proposed acquisition on certain specified grounds.

DESCRIPTION OF LAKE SHORE BANCORP CAPITAL STOCK

General

We are authorized to issue 25,000,000 shares of our common stock having a par value of \$.01 per share and 1,000,000 shares of preferred stock having a par value of \$.01 per share. Each share of our common stock will have the same relative rights as, and will be identical in all respects with, each other share of common stock. Upon payment of the purchase price for the common stock, as required by the plan of reorganization, all stock will be duly authorized, fully paid and nonassessable. We will not issue any shares of preferred stock in the reorganization.

Common Stock

Dividends . We can pay dividends if, as and when declared by our Board of Directors. The payment of dividends is limited by law and applicable regulation. See "*Our Dividend Policy.*" The holders of our common stock will be entitled to receive and share equally in dividends as may be declared by the Board of Directors out of funds legally available for dividends. If we issue preferred stock, the holders of the preferred stock may have a priority over the holders of the common stock with respect to dividends.

Voting Rights . After the reorganization, the holders of our common stock will possess exclusive voting rights in us. They will elect our Board of Directors and act on other matters as are required to be presented to them under federal law or as are otherwise presented to them by the Board of Directors. Except as discussed in "*Restrictions on Acquisition of Lake Shore Bancorp and Lake Shore Savings and Loan,*" each holder of common stock will be entitled to one vote per share and will not have any right to cumulate votes in the election of directors. If we issue preferred stock, holders of our preferred stock may also possess voting rights.

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Liquidation . If there is any liquidation, dissolution or winding up of Lake Shore Savings, as the holder of Lake Shore Savings' capital stock, we would be entitled to receive all of Lake Shore Savings' assets available for distribution after payment or provision for payment of all debts and liabilities of Lake Shore Savings, including all deposit accounts and accrued interest. Upon our liquidation, dissolution or winding up, the holders of our common stock would be entitled to receive all of our assets available for distribution after payment or provision for payment of all its debts and liabilities. If we issue preferred stock, the preferred stockholders may have a priority over the holders of the common stock upon liquidation or dissolution.

Preemptive Rights; Redemption . Holders of our common stock will not be entitled to preemptive rights with respect to any shares that may be issued. The common stock cannot be redeemed.

Preferred Stock

We will not issue any preferred stock in the reorganization and we have no current plans to issue any preferred stock after the reorganization. Preferred stock may be issued with designations, powers, preferences and rights as the Board of Directors may from time to time determine. The Board of Directors can, without stockholder approval, issue preferred stock with voting, dividend, liquidation and conversion rights that could dilute the voting strength of the holders of the common stock and may assist management in impeding an unfriendly takeover or attempted change in control.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for our common stock will be Registrar and Transfer Company.

REGISTRATION REQUIREMENTS

We have registered our common stock with the Securities and Exchange Commission under Section 12(g) of the Securities Exchange Act of 1934, as amended, and will not deregister our common stock for a period of at least three years following the offering. As a result of registration, the proxy and tender offer rules, insider trading reporting and restrictions, annual and periodic reporting and other requirements of that statute will apply.

LEGAL AND TAX MATTERS

The legality of our common stock has been passed upon for us by Thacher Proffitt & Wood LLP, Washington, D.C. Thacher Proffitt & Wood LLP, has consented to the references to their opinion in this prospectus. Certain legal matters will be passed upon for Ryan Beck & Co., Inc. by Luse Gorman Pomerenk & Schick, P.C., Washington, D.C.

EXPERTS

The financial statements as of December 31, 2004 and for the year then ended included in this Registration Statement on Form S-1, Form MHC-1 and Form MHC-2 have been so included in reliance on the report of Beard Miller Company LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

The financial statements as of December 31, 2003 and for each of the two years in the period ended December 31, 2003 included in this Registration Statement on Form S-1 have been so included in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

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RP Financial has consented to the summary in this prospectus of its report to us setting forth its opinion as to our estimated pro forma market value, as converted, and to the use of its name and statements with respect to it appearing in this prospectus.

CHANGE IN ACCOUNTANTS

On January 28, 2004, the Board of Directors of Lake Shore Savings and Loan Association dismissed PricewaterhouseCoopers LLP (“PwC”) as its independent registered public accounting firm. There were no disagreements with PwC during the year ended December 31, 2003 and through July 21, 2004 on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to PwC’s satisfaction, would have caused PwC to make reference thereto in their report on the Lake Shore Savings and Loan Association financial statements for such years. During the year ended December 31, 2003 and through July 21, 2004, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K. The reports of PwC on the financial statements of Lake Shore Savings and Loan Association as of and for the year ended December 31, 2003 did not contain an adverse opinion or a disclaimer opinion, or any qualification or modification as to uncertainty, audit scope or accounting principle.

PwC has furnished a letter addressed to the Securities and Exchange Commission and filed as Exhibit 16.1 to our registration statement on Form S-1 agreeing with the statements made herein.

On January 28, 2004, our Board of Directors retained Fagliarone Group CPAs, PC as our independent auditors for the fiscal year ended December 31, 2004. Fagliarone Group CPAs, PC elected not to register with the Public Company Accounting Oversight Board. Therefore in order to file a registration statement for an offering of our common stock pursuant to the Securities Act of 1933, as amended, and to register our common stock with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended, we dismissed Fagliarone Group CPAs, PC and retained Beard Miller Company LLP as our independent registered public company accounting firm on August 24, 2005.

Effective August 24, 2005, our Board of Directors dismissed the Fagliarone Group CPAs, PC as our independent auditors. There were no disagreements with the former independent auditors during the year ended December 31, 2004 or during the subsequent interim period preceding their dismissal on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the former accountant’s satisfaction, would have caused them to make reference to the subject matter of the disagreement in connection with their report. Nor did Fagliarone Group CPAs, PC’s audit report on our financial statements for 2004 contain an adverse opinion or a disclaimer of an opinion, or any qualification or modifications as to uncertainty, audit scope, or accounting principles.

Fagliarone Group CPAs, PC has furnished a letter addressed to the Securities and Exchange Commission and filed as Exhibit 16.2 to our registration statement on Form S-1 agreeing with the statements made herein.

WHERE YOU CAN FIND MORE INFORMATION

We have filed a registration statement with the Securities and Exchange Commission under the Securities Act of 1933 with respect to the common stock offered through this prospectus. As permitted by the rules and regulations of the Securities and Exchange Commission, this prospectus does not contain all the information set forth in the registration statement. You may examine this information without charge at the public reference facilities of the Securities and Exchange Commission located at 100 F Street, N.E., Washington, D.C. 20549. You may obtain copies of the material from the Securities and Exchange Commission at prescribed rates. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the Securities and Exchange Commission's public reference rooms. The registration statement also is available through the Securities and Exchange Commission's world wide web site on the internet at <http://www.sec.gov>.

This document contains a description of the material features of certain contracts and other documents filed as exhibits to the registration statement. The statements as to the contents of such exhibits are of necessity brief descriptions and are not necessarily complete. Each such statement is qualified by reference to the contract or document.

Lake Shore Savings and Loan Association has filed applications for approval of the plan of reorganization and minority stock issuance with the Office of Thrift Supervision. This prospectus omits certain information contained in the applications. The applications may be inspected, without charge, at the offices of the Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552 and at the offices of the Regional Director of the Office of Thrift Supervision at the Northeast Regional Office of the Office of Thrift Supervision, Harborside Financial Center, Plaza 5, Suite 1600, Jersey City, New Jersey 07311.

A copy of the plan of reorganization and minority stock issuance and our charter and bylaws are available without charge from us.

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Note: All schedules required by the Office of Thrift Supervision (OTS) are omitted as the required information is either not applicable or is included in the financial statements or related notes.

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R E P O R T O F I N D E P E N D E N T R E G I S T E R E D P U B L I C A C C O U N T I N G F I R M

To the Board of Directors
Lake Shore Savings and Loan Association
Dunkirk, New York

We have audited the accompanying statement of financial condition of Lake Shore Savings and Loan Association as of December 31, 2004, and the related statements of income, equity, and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Lake Shore Savings and Loan Association as of and for the years ended December 31, 2003 and 2002 were audited by other auditors whose report, dated July 21, 2004, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2004 financial statements referred to above present fairly, in all material respects, the financial position of Lake Shore Savings and Loan Association as of December 31, 2004, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Beard Miller Company LLP

Pittsburgh, Pennsylvania
October 7, 2005

Report of Independent Registered Public Accounting Firm

To the Board of Directors of
Lake Shore Savings and Loan Association and shareholders

In our opinion, the accompanying statement of financial condition and the related statements of income, equity and cash flows present fairly, in all material respects, the financial position of Lake Shore Savings and Loan Association (the "Association") at December 31, 2003, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
Buffalo, New York
July 21, 2004

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

STATEMENTS OF FINANCIAL CONDITION

	September 30, 2005	December 31,	
		2004	2003
	(Unaudited)		
	(Dollars In Thousands)		
A SSETS			
Cash and due from banks	\$ 8,176	\$ 7,203	\$ 7,982
Interest bearing deposits	2,632	1,617	71
Federal funds sold	4,675	2,757	8,700
Cash and Cash Equivalents	15,483	11,577	16,753
Securities available for sale	96,420	99,170	83,027
Securities held to maturity, fair value 2005 \$2,512 (unaudited); 2004 \$2,503; 2003 \$389	2,299	2,359	371
Federal Home Loan Bank stock, at cost	2,504	2,709	2,167
Loans receivable, net of allowance for loan losses 2005 \$1,267 (unaudited); 2004 \$1,288; 2003 \$1,293	202,417	199,525	187,138
Premises and equipment, net	6,679	6,645	6,469
Accrued interest receivable	1,200	1,195	1,042
Bank owned life insurance	5,674	5,520	5,317
Other assets	1,398	1,141	1,227
Total Assets	\$ 334,074	\$329,841	\$303,511
L IABILITIES AND E QUITTY			
L IABILITIES			
Deposits:			
Interest bearing	\$ 234,685	\$232,346	\$219,502
Non-interest bearing	16,891	11,208	10,993
Total Deposits	251,576	243,554	230,495
Short-term borrowings	9,425	11,725	11,800
Long-term debt	40,660	42,260	31,535
Advances from borrowers for taxes and insurance	1,240	2,098	1,924
Other liabilities	3,441	3,289	2,810
Total Liabilities	306,342	302,926	278,564
C OMMITMENTS AND C ONTINGENCIES			
E QUITTY			
Retained earnings	27,846	26,272	24,093
Accumulated other comprehensive income (loss)	(114)	643	854
Total Equity	27,732	26,915	24,947
Total Liabilities and Equity	\$ 334,074	\$329,841	\$303,511

See notes to financial statements.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

STATEMENTS OF INCOME

	Nine Months Ended September 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)		(In Thousands)		
INTEREST INCOME					
Loans, including fees	\$ 8,745	\$ 8,237	\$11,102	\$10,072	\$10,486
Investment securities, taxable	2,981	2,552	3,541	2,586	2,513
Other	120	86	101	122	183
Total Interest Income	11,846	10,875	14,744	12,780	13,182
INTEREST EXPENSE					
Deposits	3,247	2,707	3,674	3,887	4,504
Short-term borrowings	232	135	197	68	7
Long-term debt	1,119	1,012	1,396	679	396
Other	53	49	65	60	39
Total Interest Expense	4,651	3,903	5,332	4,694	4,946
Net Interest Income	7,195	6,972	9,412	8,086	8,236
PROVISION FOR LOAN LOSSES	20	207	267	345	360
Net Interest Income after Provision for Loan Losses	7,175	6,765	9,145	7,741	7,876
NON-INTEREST INCOME					
Service charges and fees	1,106	1,079	1,470	1,122	1,142
Net gains (losses) on sales of securities available for sale	—	33	33	(9)	176
Net gains on sales of loans	2	2	2	129	2
Earnings on bank owned life insurance	154	152	203	223	253
Other	139	112	167	263	73
Total Non-Interest Income	1,401	1,378	1,875	1,728	1,646
NON-INTEREST EXPENSES					
Salaries and employee benefits	3,290	3,205	4,468	3,854	3,247
Occupancy and equipment	1,020	967	1,310	1,107	879
Data processing	309	275	374	436	464
Advertising	221	138	193	338	147
Postage and supplies	200	223	274	351	278
Professional services	373	348	410	280	278
Other	716	713	910	852	908
Total Non-Interest Expenses	6,129	5,869	7,939	7,218	6,201
Income before Income Taxes	2,447	2,274	3,081	2,251	3,321
INCOME TAXES	873	683	902	744	1,085
Net Income	\$ 1,574	\$ 1,591	\$ 2,179	\$ 1,507	\$ 2,236

See notes to financial statements.

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S TATEMENTS OF E QUITY

Nine Months Ended September 30, 2005 (Unaudited) and
Years Ended December 31, 2004, 2003 and 2002

	Retained Earnings	Accumulated Other Comprehensive Income (Loss) (In Thousands)	Total
B ALANCE - J ANUARY 1, 2002	\$20,350	\$ 1,355	\$21,705
Comprehensive income:			
Net income	2,236	—	2,236
Change in unrealized net gains on securities available for sale, net of tax and reclassification adjustment	—	1	1
Total Comprehensive Income			2,237
B ALANCE - D ECEMBER 31, 2002	22,586	1,356	23,942
Comprehensive income:			
Net income	1,507	—	1,507
Change in unrealized net gains on securities available for sale, net of tax and reclassification adjustment	—	(502)	(502)
Total Comprehensive Income			1,005
B ALANCE - D ECEMBER 31, 2003	24,093	854	24,947
Comprehensive income:			
Net income	2,179	—	2,179
Change in unrealized net gains on securities available for sale, net of tax and reclassification adjustment	—	(211)	(211)
Total Comprehensive Income			1,968
B ALANCE - D ECEMBER 31, 2004	26,272	643	26,915
Comprehensive income:			
Net income	1,574	—	1,574
Change in unrealized net gains (losses) on securities available for sale, net of tax and reclassification adjustment	—	(757)	(757)
Total Comprehensive Income			817
B ALANCE - S EPTEMBER 30, 2005	\$27,846	\$ (114)	\$27,732

See notes to financial statements.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)		(In Thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income	\$ 1,574	\$ 1,591	\$ 2,179	\$ 1,507	\$ 2,236
Adjustments to reconcile net income to net cash provided by operating activities:					
Net (gains) losses on sales of available for sale securities	—	(33)	(33)	9	(176)
Net gains on sales of loans	(2)	(2)	(2)	(129)	(2)
Net amortization (accretion) of investment securities	52	62	81	(145)	(284)
Provision for loan losses	20	207	267	345	360
Depreciation and amortization	454	456	607	445	365
Deferred income tax expense (benefit)	(51)	(148)	(57)	81	(110)
Earnings on bank owned life insurance	(154)	(152)	(203)	(223)	(253)
(Increase) decrease in accrued interest receivable	(20)	(130)	(153)	(107)	147
(Increase) decrease in other assets	(160)	314	517	(522)	272
Increase (decrease) in other liabilities	702	679	622	891	(50)
Net Cash Provided by Operating Activities	2,415	2,844	3,825	2,152	2,505
CASH FLOWS FROM INVESTING ACTIVITIES					
Activity in available for sale securities:					
Sales	—	1,033	1,033	2,024	3,176
Maturities, prepayments and calls	18,323	18,401	24,408	25,215	26,274
Purchases	(16,819)	(35,913)	(41,979)	(58,408)	(39,283)
Activity in held to maturity securities:					
Maturities, prepayments and calls	53	60	80	396	356
Purchases	—	(2,073)	(2,075)	—	—
Net (increase) decrease in investment in Federal Home Loan Bank stock	205	(587)	(542)	(747)	(258)
Proceeds from sales of loans	396	510	592	4,649	403
Loan origination and principal collections, net	(3,400)	(14,370)	(13,618)	(35,200)	(12,901)
Additions to premises and equipment	(531)	(422)	(783)	(3,115)	(430)
Net Cash Used in Investing Activities	(1,773)	(33,361)	(32,884)	(65,186)	(22,663)
CASH FLOWS FROM FINANCING ACTIVITIES					
Net increase in deposits	8,022	16,922	13,059	35,396	13,026
Net increase (decrease) in advances from borrowers for taxes and insurance	(858)	(900)	174	287	(18)
Net increase (decrease) in short-term borrowings	(2,300)	(375)	(75)	9,670	2,890
Proceeds from issuance of long-term debt	—	12,600	12,600	20,000	10,000
Repayment of long-term debt	(1,600)	(675)	(1,875)	(1,875)	(4,005)
Net Cash Provided by Financing Activities	3,264	27,572	23,883	63,478	21,893
Net Increase (Decrease) in Cash and Cash Equivalents	3,906	(2,945)	(5,176)	444	1,735
CASH AND CASH EQUIVALENTS - BEGINNING	11,577	16,753	16,753	16,309	14,574
CASH AND CASH EQUIVALENTS - ENDING	\$ 15,483	\$ 13,808	\$ 11,577	\$ 16,753	\$ 16,309
SUPPLEMENTARY CASH FLOWS INFORMATION					
Interest paid	\$ 4,609	\$ 3,821	\$ 5,299	\$ 4,711	\$ 4,953
Income taxes paid	\$ 610	\$ 560	\$ 960	\$ 710	\$ 1,468

See notes to financial statements.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND NATURE OF OPERATIONS

Lake Shore Savings and Loan Association (the "Association") is a mutually owned thrift, which is engaged primarily in the business of retail banking in Erie and Chautaugua Counties of New York State (see Note 15). Its primary deposit products are savings and term certificate accounts and its primary lending products are residential mortgages. The accounting and reporting policies of the Association, a state chartered FDIC insured association, conform to generally accepted accounting principles and to general practices within the thrift industry.

The interim financial statements included herein as of September 30, 2005 and for the nine months ended September 30, 2005 and 2004 have been prepared by the Association, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. 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 herein as of and for the year ended December 31, 2004. The results of operations for the nine months ended September 30, 2005 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2005.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

To prepare these financial statements in conformity with generally accepted accounting principles, management of the Association 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.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, interest bearing deposits and federal funds which are generally sold for one to three-day periods.

Investment Securities

Investment securities are classified as either available for sale or held to maturity. Securities held to maturity are those debt securities that the Association has the positive intent and ability to hold to maturity. All other securities are classified as available for sale.

Securities available for sale are carried at fair value with unrealized gains and losses, net of the related deferred income tax effect, excluded from earnings and reported as a separate component of accumulated other comprehensive income until realized. Realized gains and losses are determined using the specific identification method.

Securities held to maturity are recorded at cost with discounts accreted and premiums amortized to maturity using the level-yield method. If other than temporary impairment of a security exists, the carrying value of that security is written down to fair value with a charge to earnings.

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Association to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans Receivable

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans in western New York State. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans receivable that management has the intent and ability to hold until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees and costs are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Association is generally amortizing these amounts over the contractual life of the loan.

The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income is reversed in the current year. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level considered adequate by management to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

A loan is considered impaired when, based on current information and events, it is probable that the Association will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

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Allowance for Loan Losses (Continued)

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Association does not separately identify individual consumer and residential mortgage loans for impairment disclosures.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either 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.

Federal Home Loan Bank Stock

Federal law requires a member institution of the Federal Home Loan Bank system to hold restricted stock of its district Federal Home Loan Bank according to a predetermined formula. The restricted stock is carried at cost.

Premises and Equipment

Land is carried at cost. Buildings, improvements, furniture and equipment are carried at cost, net of accumulated depreciation. Depreciation is computed on the straight-line basis over the estimated useful lives of assets (generally forty years for buildings and three to ten years for furniture and equipment). Leasehold improvements are amortized on the straight-line method over the lesser of the life of the improvements or the lease term.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Association, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Association does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Foreclosed Real Estate

Foreclosed real estate consists of property acquired in settlement of loans which are carried at the lower of cost or fair value less disposal costs. Foreclosed real estate was \$193,000, \$140,000 and \$454,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively, and was included as a component of other assets.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Bank Owned Life Insurance

The Association invests in bank owned life insurance ("BOLI") as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Association on a chosen group of employees. The Association is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from the increase in cash surrender value of the policies is included in non-interest income in the statements of income (see Note 11).

Advertising Costs

The Association follows the policy of charging the costs of advertising to expense as incurred.

Income Taxes

Deferred taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Association has entered into commitments to extend credit. Such commitments are recorded in the statement of financial condition when they are funded.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the statement of financial condition, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects for the nine months ended September 30, 2005 and 2004 and the years ended December 31, 2004, 2003 and 2002 are as follows:

	Nine Months Ended September 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)				
	(In Thousands)				
Unrealized holding gains (losses) on securities available for sale	\$ (1,202)	\$ (196)	\$ (325)	\$ (782)	\$ 179
Reclassification adjustment for (gains) losses realized in income	—	(33)	(33)	9	(176)
Net Unrealized Gains (Losses)	(1,202)	(229)	(358)	(773)	3
Income tax effect	445	85	147	271	(2)
Net of Tax Amount	\$ (757)	\$ (144)	\$ (211)	\$ (502)	\$ 1

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Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123 (revised 2004), "Shared-Based Payment." Statement No. 123(R) addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Statement No. 123(R) requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised Statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates the intrinsic value method of accounting in APB Opinion No. 25, "Accounting for Stock Issued to Employees," which was permitted under Statement No. 123, as originally issued. The revised Statement also requires entities to disclose information about the nature of the share-based payment transactions and the effects of those transactions on the financial statements. At present, the Association has not issued any stock options or other equity-based compensation.

In March 2004, the SEC released Staff Accounting Bulletin (SAB) No. 105, "Application of Accounting Principles to Loan Commitments." SAB 105 provides guidance about the measurements of loan commitments recognized at fair value under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SAB 105 also requires companies to disclose their accounting policy for those loan commitments including methods and assumptions used to estimate fair value and associated hedging strategies. SAB 105 is effective for all loan commitments accounted for as derivatives that are entered into after March 31, 2004. The adoption of SAB 105 did not have any effect on the Association's financial statements.

Restrictions on Cash and Due from Banks

The Association is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve at September 30, 2005 (unaudited), December 31, 2004 and 2003 was \$1,093,000, \$1,348,000 and \$1,035,000, respectively.

Reclassifications

Certain amounts in the 2004, 2003, and 2002 financial statements have been reclassified to conform with the 2005 presentation format. These reclassifications had no effect on net income.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - INVESTMENT SECURITIES

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

	September 30, 2005 (Unaudited)			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
	(In Thousands)			
SECURITIES AVAILABLE FOR SALE :				
U.S. Treasury bonds	\$ 2,115	\$ 126	\$ —	\$ 2,241
Municipal bonds	2,006	1	(15)	1,992
Mortgage-backed securities:				
Collateralized mortgage obligations	49,932	36	(855)	49,113
Federal National Mortgage Association	7,467	4	(94)	7,377
Federal Home Loan Mortgage Corporation	16,670	3	(424)	16,249
Asset-backed securities	18,390	5	(209)	18,186
Equity securities	22	1,241	—	1,262
	<u>\$ 96,602</u>	<u>\$ 1,416</u>	<u>\$ (1,597)</u>	<u>\$96,420</u>
SECURITIES HELD TO MATURITY :				
U.S. Treasury bonds	\$ 2,059	\$ 205	\$ —	\$ 2,264
Mortgage-backed securities:				
Government National Mortgage Association	73	6	—	79
Federal National Mortgage Association	113	1	—	114
Federal Home Loan Mortgage Corporation	54	2	(1)	55
	<u>\$ 2,299</u>	<u>\$ 214</u>	<u>\$ (1)</u>	<u>\$ 2,512</u>

Approximately 95% of the collateralized mortgage obligations at September 30, 2005 are backed by federal agencies, Freddie Mac, Fannie Mae, and Ginnie Mae. The remaining 5% are issued by private owners.

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	December 31, 2004			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
	(In Thousands)			
S ECURITIES A VAILABLE FOR S ALE :				
U.S. Treasury bonds	\$ 2,118	\$ 44	\$ —	\$ 2,162
Mortgage-backed securities:				
Collateralized mortgage obligations	47,306	70	(443)	46,933
Federal National Mortgage Association	9,158	53	(36)	9,175
Federal Home Loan Mortgage Corporation	19,151	12	(240)	18,923
Asset-backed securities	20,395	48	(115)	20,328
Equity securities	22	1,627	—	1,649
	<u>\$ 98,150</u>	<u>\$ 1,854</u>	<u>\$ (834)</u>	<u>\$ 99,170</u>
S ECURITIES H ELD TO M ATURITY :				
U.S. Treasury bonds	\$ 2,067	\$ 129	\$ —	\$ 2,196
Mortgage-backed securities:				
Government National Mortgage Association	80	8	—	88
Federal National Mortgage Association	136	3	—	139
Federal Home Loan Mortgage Corporation	76	4	—	80
	<u>\$ 2,359</u>	<u>\$ 144</u>	<u>\$ —</u>	<u>\$ 2,503</u>

Approximately 93% of the collateralized mortgage obligations at December 31, 2004 are backed by federal agencies, Freddie Mac, Fannie Mae, and Ginnie Mae. The remaining 7% are issued by private owners.

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LAKE SHORE SAVINGS AND LOAN ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

	December 31, 2003			
	Amortized	Gross Unrealized	Gross Unrealized	Fair Value
	Cost	Gains	Losses	
	(In Thousands)			
SECURITIES AVAILABLE FOR SALE :				
U.S. Government agencies	\$ 1,000	\$ 63	\$ —	\$ 1,063
U.S. Treasury bonds	2,123	—	(39)	2,084
Mortgage-backed securities:				
Collateralized mortgage obligations	34,160	59	(340)	33,879
Federal National Mortgage Association	6,322	79	(3)	6,398
Federal Home Loan Mortgage Corporation	14,193	77	(69)	14,201
Asset-backed securities	23,828	293	(24)	24,097
Equity securities	22	1,283	—	1,305
	\$ 81,648	\$ 1,854	\$ (475)	\$83,027
SECURITIES HELD TO MATURITY :				
Mortgage-backed securities:				
Government National Mortgage Association	\$ 86	\$ 9	\$ —	\$ 95
Federal National Mortgage Association	176	6	—	182
Federal Home Loan Mortgage Corporation	109	3	—	112
	\$ 371	\$ 18	\$ —	\$ 389

Approximately 93% of the collateralized mortgage obligations at December 31, 2003 are backed by federal agencies, Freddie Mac, Fannie Mae, and Ginnie Mae. The remaining 7% are issued by private owners.

The following table sets forth the Association's investment in securities with gross unrealized losses of less than twelve months and gross unrealized losses of twelve months or more:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(In Thousands)						
September 30, 2005 (Unaudited):						
Municipal bonds	\$ 1,419	\$ (15)	\$ —	\$ —	\$ 1,419	\$ (15)
Mortgage-backed securities	31,139	(365)	37,056	(1,009)	68,195	(1,374)
Asset-backed securities	6,369	(82)	8,868	(127)	15,237	(209)
	<u>\$38,927</u>	<u>\$ (462)</u>	<u>\$45,924</u>	<u>\$ (1,136)</u>	<u>\$84,851</u>	<u>\$ (1,598)</u>

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	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(In Thousands)						
December 31, 2004:						
Mortgage-backed securities	\$51,485	\$ (523)	\$7,549	\$ (196)	\$59,034	\$ (719)
Asset-backed securities	14,200	(109)	744	(6)	14,944	(115)
	<u>\$65,685</u>	<u>\$ (632)</u>	<u>\$8,293</u>	<u>\$ (202)</u>	<u>\$73,978</u>	<u>\$ (834)</u>

The unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. At September 30, 2005 (unaudited), there were 36 securities in the less than twelve months category and 40 securities in the twelve months or more category. At December 31, 2004, there were 52 securities in the less than twelve months category and 8 securities in the twelve months or more category. These unrealized losses relate principally to mortgage-backed securities of FNMA and FHLMC. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies and whether downgrades by bond rating agencies have occurred. As the unrealized losses are interest rate related and management has the intent and ability to hold debt securities until maturity or market price recovery, no declines are deemed to be other than temporary.

Scheduled contractual maturities of investment securities are as follows:

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In Thousands)				
September 30, 2005 (Unaudited):				
Within one year	\$ —	\$ —	\$ —	\$ —
After one year through five years	—	—	—	—
After five years through ten years	1,604	1,589	—	—
After ten years	2,517	2,644	2,059	2,264
Mortgage-backed securities	74,069	72,739	240	248
Asset-backed securities	18,390	18,186	—	—
Equity securities	22	1,262	—	—
	<u>\$ 96,602</u>	<u>\$96,420</u>	<u>\$ 2,299</u>	<u>\$2,512</u>

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	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In Thousands)				
December 31, 2004:				
Within one year	\$ —	\$ —	\$ —	\$ —
After one year through five years	—	—	—	—
After five years through ten years	—	—	—	—
After ten years	2,118	2,162	2,067	2,196
Mortgage-backed securities	75,615	75,031	292	307
Asset-backed securities	20,395	20,328	—	—
Equity securities	22	1,649	—	—
	<u>\$ 98,150</u>	<u>\$ 99,170</u>	<u>\$ 2,359</u>	<u>\$ 2,503</u>

During the nine months ended September 30, 2005 and 2004 (unaudited), the Association sold securities available for sale for total proceeds of \$-0- and \$1,033,000, respectively, resulting in gross realized gains of \$-0- and \$33,000, respectively. During 2004, the Association sold securities available for sale for total proceeds of \$1,033,000 resulting in gross realized gains of \$33,000. During 2003, the Association sold securities available for sale for total proceeds of \$2,024,000 resulting in gross realized losses of \$9,000. During 2002, the Association sold securities available for sale for total proceeds of \$3,176,000, resulting in gross realized gains of \$176,000.

At September 30, 2005, December 31, 2004 and 2003, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation common stock.

At September 30, 2005 (unaudited), two asset-backed securities and one government security with a cost of \$1,944,000 and fair value of \$2,069,000 were pledged under a collateral agreement with the Federal Reserve for liquidity borrowing. Two mortgage-backed securities with a cost of \$3,399,000 and fair value of \$3,305,000 were pledged under a collateral agreement with the City of Dunkirk Housing Authority. At December 31, 2004, two asset-backed securities and one government security with a total cost of \$2,205,000 and fair value of \$2,317,000 were pledged under a collateral agreement with the Federal Reserve for liquidity borrowing. A mortgage-backed security with a cost of \$32,000 and fair value of \$33,000 was pledged under a collateral agreement with the City of Dunkirk Housing Authority.

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N OTES TO F INANCIAL S TATEMENTS

N OTE 4 - L OANS R ECEIVABLE

Loans receivable, net consist of the following:

	September 30,	December 31,	
	2005	2004	2003
	(Unaudited)	(In Thousands)	
Real estate loans:			
Residential, 1 - 4 family	\$ 145,653	\$142,222	\$135,293
Home equity	29,222	28,442	25,876
Commercial	14,916	15,310	14,628
Construction	2,002	2,463	2,531
	191,793	188,437	178,328
Commercial loans	8,081	8,615	5,957
Consumer loans	2,733	2,870	3,310
	202,607	199,922	187,595
Allowance for loan losses	(1,267)	(1,288)	(1,293)
Net deferred loan costs	1,077	891	836
	\$ 202,417	\$199,525	\$187,138

An analysis of changes in the allowance for loan losses is as follows:

	Nine Months Ended September 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)	(In Thousands)			
Balance, beginning	\$ 1,288	\$ 1,293	\$1,293	\$1,217	\$ 924
Provision for loan losses	20	207	267	345	360
Charge-offs	(55)	(96)	(304)	(275)	(79)
Recoveries	14	26	32	6	12
Balance, ending	\$ 1,267	\$ 1,430	\$1,288	\$1,293	\$1,217

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N OTES TO F INANCIAL S TATEMENTS

N OTE 4 - L OANS R ECEIVABLE (C ONTINUED)

The following is a summary of information pertaining to impaired and nonaccrual loans:

	September 30,	December 31,		
	2005	2004	2003	2002
	(Unaudited)	(In Thousands)		
Impaired loans with no valuation allowance	\$ —	\$ —	\$ —	\$ —
Impaired loans with a valuation allowance	—	—	320	83
Total Impaired Loans	\$ —	\$ —	\$ 320	\$ 83
Valuation allowance allocated to impaired loans	\$ —	\$ —	\$ 187	\$ 15
Average investment in impaired loans	\$ —	\$ —	\$ 328	\$ 84
Interest income recognized on impaired loans on a cash basis	\$ —	\$ —	\$ —	\$ —
Nonaccrual loans	\$ 384	\$ 142	\$ 584	\$ 903
Loans past due 90 days or more and still accruing interest	617	650	468	505
Total Nonperforming Loans	\$ 1,001	\$ 792	\$ 1,052	\$ 1,408

The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance.

Residential real estate loans serviced for others by the Association totaled \$15,876,000, \$18,017,000 and \$20,901,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively.

At September 30, 2005 (unaudited), December 31, 2004 and 2003, loans to directors and executive officers and their affiliated entities totaled \$2,830,000, \$2,871,000, and \$3,030,000, respectively. During the nine months ended September 30, 2005 (unaudited) and the year ended December 31, 2004, total principal additions were \$107,000 and \$100,000 and total principal payments were \$148,000 and \$181,000, respectively. Furthermore, director retirements in 2004 resulted in the decline of total principal of \$78,000.

At September 30, 2005, there were approximately \$90,595,000 of one to four family residential real estate loans pledged as collateral for advances from the Federal Home Loan Bank.

Substantially all of the Association's loans are in western New York State and, accordingly, the ultimate collectibility of a substantial portion of the loans are susceptible to changes in market conditions in this primary market area.

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NOTES TO FINANCIAL STATEMENTS

NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment consist of the following:

	September 30, 2005	December 31,	
		2004	2003
	(Unaudited)	(In Thousands)	
Land	\$ 658	\$ 658	\$ 658
Buildings and improvements	6,175	6,019	5,442
Furniture and equipment	3,429	3,385	3,393
	10,262	10,062	9,493
Accumulated depreciation	(3,583)	(3,417)	(3,024)
	\$ 6,679	\$ 6,645	\$ 6,469

Depreciation and amortization of premises and equipment amounted to \$454,000 and \$456,000 for the nine months ended September 30, 2005 and 2004 (unaudited), respectively. Depreciation and amortization of premises and equipment amounted to \$607,000, \$445,000 and \$365,000 in 2004, 2003 and 2002, respectively, and is included in occupancy and equipment expense in the accompanying statements of income.

NOTE 6 - OTHER ASSETS

Included within other assets is an investment in a limited liability company. Effective November 1, 2002, the Association and Young Title Agency established Lake Shore Title & Abstract, LLC, a New York Limited Liability Company with the purpose of engaging in the business of all core title services in connection with real estate transactions. The Association made an investment of \$1,000 in 2002 for its 50% ownership interest. The Association recorded income of \$-0-, \$22,000, \$22,000, \$62,000 and \$-0- in the nine months ended September 30, 2005 and 2004 (unaudited) and in the years ended December 31, 2004, 2003 and 2002, respectively. The investment and related income are accounted for under the equity method.

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NOTES TO FINANCIAL STATEMENTS

NOTE 7 - DEPOSITS

Deposits consist of the following (dollars in thousands):

	September 30, 2005		December 31,			
			2004		2003	
	Weighted		Weighted		Weighted	
	Amount	Average Rate	Amount	Average Rate	Amount	Average Rate
	(Unaudited)					
Demand deposits:						
Non-interest bearing	\$ 16,891	— %	\$ 11,208	— %	\$ 10,993	— %
Interest bearing	37,957	0.44	39,488	0.33	37,076	0.23
Money market accounts	27,099	0.88	30,765	0.93	26,219	0.84
Savings accounts	29,942	0.52	30,007	0.50	31,483	0.50
Time deposits	139,687	3.16	132,086	2.57	124,724	2.60
	\$251,576	2.12%	\$243,554	1.71%	\$230,495	1.62%

Scheduled maturities of time deposits are as follows:

	September 30, 2005	December 31, 2004
	(Unaudited)	
	(In Thousands)	
2005	\$ 24,577	\$ 76,569
2006	76,609	35,717
2007	27,174	16,806
2008	9,772	2,622
2009	1,071	155
Thereafter	484	217
	\$ 139,687	\$ 132,086

Time deposits in amounts of \$100,000 or more amounted to \$31,640,000, \$29,312,000 and \$22,241,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. Deposit account balances in excess of \$100,000 are not federally insured.

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NOTES TO FINANCIAL STATEMENTS

NOTE 7 - DEPOSITS (CONTINUED)

Interest expense on deposits was as follows:

	Nine Months Ended September 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)		(In Thousands)		
Interest bearing checking accounts	\$ 106	\$ 79	\$ 110	\$ 176	\$ 297
Money market accounts	203	202	275	276	364
Savings accounts	115	120	159	287	417
Time deposits	2,823	2,306	3,130	3,148	3,426
	\$ 3,247	\$ 2,707	\$3,674	\$3,887	\$4,504

NOTE 8 - BORROWINGS

At September 30, 2005 (unaudited), December 31, 2004, 2003 and 2002, the Association had short-term borrowings from the Federal Home Loan Bank of New York of \$9,425,000, \$11,725,000, \$11,800,000 and \$3,000,000, respectively. The short-term borrowings at September 30, 2005 (unaudited) had fixed rates of interest ranging from 3.46% and 3.94% and mature within one year. The weighted average interest rate was 3.74%, 2.30%, 1.35% and 1.50% as of September 30, 2005 (unaudited), December 31, 2004, 2003 and 2002, respectively.

At September 30, 2005 (unaudited) and December 31, 2004, the Association had an unsecured line of credit with the Federal Home Loan Bank of \$23,449,000 and \$15,699,000, respectively, which bears interest at an adjustable rate and provides a secondary funding source for real estate lending, liquidity, and asset/liability management. This renewable facility expires on July 31, 2006. The Association also has a \$23,449,000 unsecured stand-by line of credit with the Federal Home Loan Bank. The Association had no outstanding borrowings on either line at September 30, 2005 (unaudited), December 31, 2004 and 2003.

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NOTE 8 - BORROWINGS (CONTINUED)

Long-term debt from the Federal Home Loan Bank of New York consisted of the following:

Maturity	Interest Rate	September 30, 2005	December 31,	
			2004	2003
		(Unaudited)	(Dollars In Thousands)	
November 8, 2004	2.23%	\$ —	\$ —	\$ 1,000
August 8, 2005	2.06%	—	1,000	1,000
October 31, 2005	2.24%	1,000	1,000	1,000
November 8, 2005	2.74%	1,000	1,000	1,000
November 21, 2005	2.29%	1,000	1,000	1,000
January 23, 2006	2.01%	1,000	1,000	—
April 12, 2006	2.30%	600	600	—
April 17, 2006	2.48%	500	500	—
April 19, 2006	2.41%	500	500	—
August 7, 2006	3.15%	1,000	1,000	—
August 8, 2006	2.64%	1,000	1,000	1,000
October 30, 2006	2.86%	1,000	1,000	1,000
November 8, 2006	3.15%	1,000	1,000	1,000
November 20, 2006	2.88%	1,000	1,000	1,000
January 23, 2007	2.59%	1,000	1,000	—
August 6, 2007	3.62%	1,000	1,000	—
August 8, 2007	3.22%	2,000	2,000	2,000
October 29, 2007	3.34%	1,000	1,000	1,000
November 8, 2007	3.48%	1,000	1,000	1,000
November 19, 2007	3.36%	1,000	1,000	1,000
January 23, 2008	3.08%	2,000	2,000	—
August 5, 2008	4.01%	1,000	1,000	—
August 8, 2008	3.63%	2,000	2,000	2,000
September 17, 2008	3.66%	1,000	1,000	—
October 29, 2008	3.77%	2,000	2,000	2,000
November 10, 2008	3.85%	1,000	1,000	1,000
November 19, 2008	3.74%	1,000	1,000	1,000
January 23, 2009	3.45%	1,000	1,000	—
September 17, 2009	3.92%	2,000	2,000	—
October 29, 2009	4.15%	2,000	2,000	2,000
November 9, 2009	4.18%	1,000	1,000	1,000
November 19, 2009	4.08%	1,000	1,000	1,000
November 8, 2010	4.42%	500	500	500
November 19, 2010	4.39%	1,000	1,000	1,000
November 8, 2011	4.60%	500	500	500
November 21, 2011	4.57%	1,000	1,000	1,000
Strip borrowings:				
Matures on a quarterly basis through May 14, 2012		Rates vary from 6.26%		
		through 6.32%	1,700	2,000
Matures on a quarterly basis through August 1, 2011		Rates vary from 5.47%		
		to 6.55%	1,360	2,135
		\$ 40,660	\$42,260	\$31,535

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NOTES TO FINANCIAL STATEMENTS

NOTE 8 - BORROWINGS (CONTINUED)

Contractual maturities of long-term debt at September 30, 2005 (unaudited) and December 31, 2004 are as follows:

	September 30, 2005	December 31, 2004
	(Unaudited)	
	(In Thousands)	
2005	\$ 3,180	\$ 4,780
2006	8,230	8,230
2007	7,510	7,510
2008	10,480	10,480
2009	7,460	7,460
Thereafter	3,800	3,800
	<u>\$ 40,660</u>	<u>\$ 42,260</u>

NOTE 9 - LEASE OBLIGATIONS

The Association is committed under several long-term operating leases which provide for minimum lease payments. Certain leases contain options for renewal. Total rental expense under these operating leases amounted to \$61,000 and \$58,000 for the nine months ended September 30, 2005 and 2004 (unaudited) and \$78,000 for 2004 and 2003 and \$79,000 for 2002.

The Association is also committed under a long-term capital lease with an outstanding balance of \$361,000, \$373,000 and \$387,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively, (included in other liabilities) having a remaining term of 13 years at December 31, 2004. Assets related to the capital lease are included in premises and equipment and consist of the fair value of \$400,000 less accumulated amortization of approximately \$73,000, \$53,000 and \$27,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. The Association has signed an agreement to commit to a second long-term capital lease, effective December 31, 2005. The lease agreement is for a term of 23 years and the future lease payments are included in the table shown below.

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N OTE 9 - L EASE O BLIGATIONS (C ONTINUED)

Minimum future lease payments for the operating and capital leases are as follows:

	September 30, 2005		December 31, 2004	
	Operating	Capital	Operating	Capital
	Leases	Leases	Leases	Lease
	(Unaudited)	(In Thousands)		
2005	\$ 22	\$ 18	\$ 80	\$ 39
2006	87	141	87	39
2007	86	141	86	39
2008	80	145	80	43
2009	79	152	79	43
Thereafter	516	2,693	516	368
Total Minimum Lease Payments	\$ 870	\$3,290	\$ 928	\$ 571

N OTE 10 - I NCOME T AXES

The provision for income taxes consists of the following:

		Nine Months Ended September 30,		Years Ended December 31,		
		2005	2004	2004	2003	2002
		(Unaudited)				
		(In Thousands)				
Current:						
Federal		\$ 849	\$ 781	\$959	\$663	\$1,176
State		75	50	—	—	19
		924	831	959	663	1,195
Deferred:						
Federal		(55)	(136)	(57)	24	(171)
State		4	(12)	—	57	61
		(51)	(148)	(57)	81	(110)
		\$ 873	\$ 683	\$902	\$744	\$1,085

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NOTES TO FINANCIAL STATEMENTS

NOTE 10 - INCOME TAXES (CONTINUED)

A reconciliation of the statutory federal income tax at a rate of 34% to the income tax expense included in the statements of income is as follows:

	Nine Months Ended September 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)				
Federal income tax at statutory rate	34.0%	34.0%	34.0%	34.0%	34.0%
State tax, net of federal benefit	2.1	1.1	0.0	1.7	1.6
Life insurance income	(2.1)	(2.3)	(2.2)	(3.4)	(2.6)
Other	1.7	(2.4)	(2.5)	0.8	(0.3)
	35.7%	30.4%	29.3%	33.1%	32.7%

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities are as follows:

	September 30,	December 31,	
	2005	2004	2003
	(Unaudited)		
	(In Thousands)		
Deferred tax assets:			
Deferred compensation	\$ 996	\$ 892	\$ 714
Allowance for loan losses	279	273	275
Capital loss carryforward	56	56	56
Other	—	7	61
Unrealized losses on securities available for sale	67	—	—
Total Deferred Tax Assets	1,398	1,228	1,106
Deferred tax liabilities:			
Unrealized gains on securities available for sale	—	(378)	(525)
Depreciation	(410)	(412)	(382)
Deferred loan origination costs	(398)	(329)	(309)
Unrealized gains on deferred compensation investment	(24)	(55)	(40)
Other	(16)	—	—
Total Deferred Tax Liabilities	(848)	(1,174)	(1,256)
	\$ 550	\$ 54	\$ (150)

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NOTES TO FINANCIAL STATEMENTS

NOTE 10 - INCOME TAXES (CONTINUED)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based on estimates of the scheduled reversal of deferred tax liabilities and projections for future taxable income, management expects to fully realize the benefits of those deductible differences.

For the tax years prior to 1996, under the Internal Revenue Code, a special bad debt deduction for additions to the Association's tax bad debt reserves was allowed. However, federal legislation enacted in 1996 eliminated this reserve method. For tax years beginning after January 1, 1996, the Association is only permitted to take deductions for bad debts for federal tax purposes determined based upon the experience method. This legislation also required that the Association recapture into taxable income the portion of existing tax bad debt reserves created in the years beginning after December 31, 1987 over a six-year period which ended in 2003.

Under prior federal law, tax bad debt reserves created prior to January 1, 1998 were subject to recapture into taxable income should the Association fail to meet certain qualifying asset and definition tests. The 1996 federal legislation eliminated these thrift related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should the Association make certain non-dividend distributions or cease to maintain a thrift or bank charter. Management has no intention of taking any such actions. At September 30, 2005 (unaudited) and December 31, 2004, the Association's total pre-1988 tax bad debt reserve was \$2,240,000. This reserve reflects the cumulative effect of federal tax deductions by the Association for which no federal income tax provision has been made.

Provided the Association continues to satisfy certain definitional tests and other conditions for New York State income tax purposes, the Association is permitted to continue to take special reserve method bad debt deductions. The deductible annual addition to the state reserve may be computed using a specific formula based on the Association's loss history ("Experience Method") or a statutory percentage equal to 32% of the Association's New York State taxable income. The Association used the percentage method in 2005, 2004, 2003 and 2002.

NOTE 11 - EMPLOYEE AND DIRECTOR BENEFIT PLANS

The Association maintains a 401(k) savings plan covering employees who have completed nine months of service and attained age 21. Participants may make contributions to the Plan in the form of salary deferrals of up to 75% of their total compensation subject to certain IRS limitations. The Association contributes a matching contribution equal to 40% of the participant salary deferral up to 6% of compensation. The Association may also make a discretionary profit sharing contribution which is allocated among all eligible employees. The Association's expense for the 401(k) plan for the nine months ended September 30, 2005 and 2004 (unaudited) and the years ended December 31, 2004, 2003 and 2002 was \$229,000, \$215,000, \$297,000, \$255,000 and \$220,000, respectively.

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N OTE 11 - E MPLOYEE AND D IRECTOR B ENEFIT P LANS (C ONTINUED)

Effective October 1, 1999, the Association initiated a non-qualified Executive Supplemental Benefit Plan and a non-qualified Directors Supplemental Benefit Plan. Both plans are unfunded and provide a predefined annual benefit to be paid to executives and directors for fifteen years upon their retirement. Although the plans are unfunded, the Association has set aside bank owned life insurance for the purpose of funding the liability. The cash surrender value of bank owned life insurance amounted to \$5,674,000, \$5,520,000 and \$5,317,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. Annual benefits increase at a predetermined amount until the executive or director reaches a predetermined retirement age. Predefined benefits are 100% vested at all times and in the event of death, are guaranteed to continue at the full amount to their designated beneficiaries. The Association had a liability under such plans of \$1,350,000, \$1,211,000 and \$962,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. This liability was calculated using an assumed discount rate of 7% in 2005, 2004 and 2003.

Effective October 1, 2001, the Association initiated an additional non-qualified Executive Supplemental Benefit Plan and a non-qualified Director's Supplemental Benefit Plan. Both plans are unfunded and provide a predefined annual benefit to be paid to executives and directors for fifteen years upon their retirement. Under the Plan Agreement, the Association can set aside assets to fund the liability which will be subject to claims of the Association's creditors upon liquidation of the Association. At September 30, 2005 (unaudited) and December 31, 2004, the Association has set aside U.S. Treasury bonds with an amortized cost of \$2,059,000 and \$2,067,000, which are included in held to maturity investment securities in the accompanying statements of financial condition. Annual benefits increase at a predetermined amount until the executive or director reaches a predetermined retirement age. Vesting requirements are based on length of service and upon reaching the vesting requirements, the predefined benefits are guaranteed to continue at the full amounts to the designated beneficiaries in the event of death. The Association had a liability under such plans of \$637,000, \$533,000 and \$371,000 at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. This liability was calculated using an assumed discount rate of 5.75% in 2005, 2004 and 2003.

The Association's expense for the non-qualified Executive Supplemental Benefit Plans and non-qualified Directors Supplemental Benefit Plans for the nine months ended September 30, 2005 and 2004 (unaudited) and the years ended December 31, 2004, 2003 and 2002 was \$289,000, \$325,000, \$427,000, \$433,000, and \$401,000, respectively.

The Association also provides a deferred compensation plan for its directors that allows the directors to elect to defer all or a portion of their compensation and allocate such awards to achieve a rate of return based on several investment options. Participants also elect the timing of distributions from the plan. Such distributions are payable in cash. The Association had a liability under this plan of \$665,000 and \$597,000 at December 31, 2004 and 2003, respectively. The Association has chosen to separately invest in the investment options specified by the Directors. The Association had \$707,000, \$665,000 and \$597,000 invested in such investment options and recorded as other assets at September 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. The Association's net expense for the deferred compensation plan for the nine months ended September 30, 2005 and 2004 (unaudited) and the years ended December 31, 2004, 2003 and 2002 was \$57,000, \$31,000, \$77,000, \$148,000 and \$(41,000), respectively. The expense includes the amount of unrealized gain or loss recognized on the market value of the investment options for the period indicated. If an unrealized loss was recognized during the period, the expense may be reduced by the amount of the loss. During the year ended December 31, 2002, the unrealized losses exceeded the recorded expense.

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NOTES TO FINANCIAL STATEMENTS

NOTE 12 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and estimated fair value of the Association's financial instruments are as follows:

	September 30, 2005		December 31,			
			2004		2003	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Unaudited)		(In Thousands)			
Financial assets:						
Cash and cash equivalents	\$ 15,483	\$ 15,483	\$ 11,577	\$ 11,577	\$ 16,753	\$ 16,753
Securities available for sale	96,420	96,420	99,170	99,170	83,027	83,027
Securities held to maturity	2,299	2,512	2,359	2,503	371	389
Federal Home Loan Bank stock	2,504	2,504	2,709	2,709	2,167	2,167
Loans receivable	202,417	202,996	199,525	202,712	187,138	192,418
Accrued interest receivable	1,200	1,200	1,195	1,195	1,042	1,042
Financial liabilities:						
Deposits	251,576	250,355	243,554	243,183	230,495	231,955
Short-term borrowings	9,425	9,425	11,725	11,725	11,800	11,800
Long-term debt	40,660	39,894	42,260	42,103	31,535	31,817
Accrued interest payable	202	202	160	160	127	127
Off-balance-sheet financial instruments	—	—	—	—	—	—

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In addition, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in these estimates. Fair value methods and assumptions are set forth below for each type of financial instrument.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument, including judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Cash and Cash Equivalents

The carrying amount approximates the fair value because the instruments mature in 90 days or less.

Securities

The fair values are based on quoted market prices supplied by the Association's custody agent and investment broker.

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NOTES TO FINANCIAL STATEMENTS

NOTE 12 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Federal Home Loan Bank Stock

The carrying amount of Federal Home Loan Bank stock approximates fair value.

Accrued Interest Receivable and Payable

The carrying amount of accrued interest receivable and payable approximates fair value.

Loans Receivable

The fair value of performing variable rate loans that reprice frequently approximates carrying value. The fair value of fixed-rate performing loans is calculated by discounting scheduled cash flows through the estimated maturity using the Association's current origination rates. The estimate of maturity is based on the Association's contractual cash flows adjusted for prepayment estimates based on current economic and lending conditions. Fair value for significant nonperforming loans is based on carrying value which does not exceed recent external appraisals of any underlying collateral.

Deposits

The fair value of deposits with no stated maturity, such as savings, money market and checking, is the amount payable on demand at the reporting date. The fair value of certificates of deposit is based on the discounted value of contractual cash flows at current rates of interest for similar borrowings using rates currently offered for deposits of similar remaining maturities.

Borrowings

The fair value of advances from the Federal Home Loan Bank was calculated by discounting scheduled cash flows at current rates of interest for similar borrowings through maturity of such instruments.

Off-Balance Sheet Financial Instruments

Fair values for the Association's off-balance sheet financial instruments (lending commitments) are based on fees currently charged to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

NOTE 13 - REGULATORY CAPITAL REQUIREMENTS

The Association is subject to various regulatory capital requirements administered by the Federal banking agencies. 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 Association's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Association must meet specific capital guidelines that involve quantitative measures of the Association's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Association's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

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N OTE 13 - R EGULATORY C APITAL R EQUIREMENTS (C ONTINUED)

Quantitative measures established by regulation to ensure capital adequacy require the Association 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, 2005 (unaudited) and December 31, 2004, that the Association meets all capital adequacy requirements to which it is subject.

The most recent notification from the Federal banking agencies categorized the Association as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Association must maintain minimum ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Association's category.

The Association'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, 2005 (Unaudited):						
Total capital (to risk-weighted assets)	\$29,667	16.74%	\$≥ 14,178	≥ 8.0%	\$ ≥ 17,723	≥ 10.0%
Tier 1 capital (to adjusted total assets)	27,846	8.32	≥ 13,393	≥ 4.0	≥ 16,742	≥ 5.0
Tangible equity (to tangible assets)	27,846	8.32	≥ 5,022	≥ 1.5	N/A	N/A
Tier 1 capital (to risk-weighted assets)	27,846	15.71	N/A	N/A	≥ 10,634	≥ 6.0
As of December 31, 2004:						
Total capital (to risk-weighted assets)	\$28,288	16.34%	\$≥ 13,847	≥ 8.0%	\$ ≥ 17,309	≥ 10.0%
Tier 1 capital (to adjusted total assets)	26,272	7.99	≥ 13,156	≥ 4.0	≥ 16,445	≥ 5.0
Tangible equity (to tangible assets)	26,272	7.99	≥ 4,933	≥ 1.5	N/A	N/A
Tier 1 capital (to risk-weighted assets)	26,272	15.18	N/A	N/A	≥ 10,385	≥ 6.0
As of December 31, 2003:						
Total capital (to risk-weighted assets)	\$25,958	16.37%	\$≥ 12,686	≥ 8.0%	\$ ≥ 15,858	≥ 10.0%
Tier 1 capital (to adjusted total assets)	24,093	7.97	≥ 12,088	≥ 4.0	≥ 15,110	≥ 5.0
Tangible equity (to tangible assets)	24,093	7.97	≥ 4,533	≥ 1.5	N/A	N/A
Tier 1 capital (to risk-weighted assets)	24,093	15.19	N/A	N/A	≥ 9,515	≥ 6.0

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N OTE 13 - R EGULATORY C APITAL R EQUIREMENTS (C ONTINUED)

Following is a reconciliation of the Association's GAAP capital to regulatory Tier 1 capital at September 30, 2005 (unaudited) and December 31, 2004 and 2003:

	September 30,	December 31,	
	2005	2004	2003
	(Unaudited)	(In Thousands)	
GAAP (Equity) Capital	\$ 27,732	\$26,915	\$24,947
Plus: Unrealized (gains) losses on securities available for sale, net of tax	114	(643)	(854)
Tier 1 Capital	27,846	26,272	24,093
Plus: Allowance for loan losses	1,267	1,288	1,293
Allowed unrealized gain on securities available for sale	559	732	576
Less: Other investments required to be deducted	5	4	4
Total Capital	\$ 29,667	\$28,288	\$25,958

N OTE 14 - C OMMITMENTS TO E XTEND C REDIT

The Association 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 statements of financial condition.

The Association's exposure to credit loss is represented by the contractual amount of these commitments. The Association 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,	December 31,	
	2005	2004	2003
	(Unaudited)	(In Thousands)	
Commitments to grant loans	\$ 7,863	\$ 3,969	\$ 3,656
Unfunded commitments under lines of credit	20,564	19,224	17,708

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N OTE 14 - C OMMITMENTS TO E XTEND C REDIT (C ONTINUED)

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 Association, is based on management's credit evaluation of the customer. At September 30, 2005 (unaudited) and December 31, 2004, the Association's fixed rate loan commitments totaled \$3,378,000 and \$1,166,000, respectively. The range of interest rates on these fixed rate commitments was 5.25% to 6.375% at September 30, 2005 and 5.125% to 6.125% at December 31, 2004.

N OTE 15 - P LAN OF C ONVERSION AND R EORGANIZATION

On August 9, 2005, the Board of Directors of Lake Shore Savings Bank approved a plan of conversion whereby Lake Shore Bancorp, Inc. is offering common stock for sale in connection with the reorganization of Lake Shore Savings and Loan Association into the mutual holding company form of organization. The shares to be offered for sale represent 45% of the to-be outstanding common stock of Lake Shore Bancorp. In connection with the reorganization, Lake Shore Savings and Loan Association will convert its New York State mutual savings and loan charter to a Federal stock savings bank charter and change its name to Lake Shore Savings Bank. In addition, Lake Shore Savings Bank will form Lake Shore Bancorp to own 100% of Lake Shore Savings as part of the reorganization. Lake Shore, MHC, the federally-chartered mutual holding company to be formed by Lake Shore Savings, will own 53% of the outstanding common stock of Lake Shore Bancorp. The remaining 2% of the shares will be contributed to a charitable foundation that Lake Shore Savings intends to form.

Conversion costs will be deferred and reduce the proceeds from the shares sold in the conversion. If the conversion is not completed, all costs will be expensed. As of September 30, 2005, \$109,000 of conversion costs have been deferred.

As part of the Conversion, the Bank intends to enter into change of control agreements with certain executive officers. In addition, as part of the Conversion, the Bank intends to implement a severance plan, employee stock ownership plan, stock option plan and other benefit and salary continuation plans for directors, officers and employees.

Effective as of the re-organization date, Lake Shore Bancorp and Lake Shore Savings Bank will each enter into parallel employment agreements with Mr. David C. Mancuso to secure his services as President and Chief Executive Officer. The employment agreements have a fixed term of three years and may be renewed annually after a review of the executive's performance. These agreements provide for a minimum annual salary of \$213,550, discretionary cash bonuses, and participation on generally applicable terms and conditions in other compensation and fringe benefit plans. The agreements also guarantee customary corporate indemnification and error and omissions insurance coverage throughout the employment term and for six years after termination.

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N OTES TO F INANCIAL S TATEMENTS

N OTE 16 - S UBSEQUENT E VENTS (U NAUDITED)

On October 11, 2005, based on the recommendation of the Board's Compensation Committee, the Board of Directors approved the termination of the Bank's deferred compensation plan (refer to Note 11 - Employee and Director Benefit Plans for more information about this plan). This will result in all accrued benefits under this plan to be distributed to the participants. As a result of terminating this plan, the participants will lose the tax benefit of deferring compensation. The plan was terminated on November 16, 2005. The total amount accrued by the plan as of September 30, 2005 was \$707,000 and was recorded in other liabilities section of the financial statements. As indicated in Note 11, the Bank had chosen to separately invest the deferred compensation in the investment options specified by the participants. These investments were fully liquidated on November 16, 2005, as part of the plan termination. As of September 30, 2005, the Bank had recorded \$707,000 in its investments for this plan within other assets of the financial statements. The Association realized a gain of approximately \$43,000 as a result of terminating the plan.

On or about October 27, 2005, the Association was made aware of a check kiting matter involving one of its customers. As of December 19, 2005, the potential loss to the Association is estimated to be approximately \$190,000.

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You should rely only on the information contained in this document or that to which we have referred you. We have not authorized anyone to provide you with information that is different. This document does not constitute an offer to sell, or the solicitation of an offer to buy, any of the securities offered hereby to any person in any jurisdiction in which such offer or solicitation would be unlawful. Our affairs and the affairs of Lake Shore Savings, Lake Shore, MHC or Lake Shore Bancorp may change after the date of this prospectus. Delivery of this document and the sales of shares made hereunder does not mean otherwise.

Up to 2,587,500 Shares of Common Stock

Lake Shore Bancorp, Inc.

(Proposed Holding Company
for Lake Shore Savings Bank)

PROSPECTUS

Ryan Beck & Co.

_____, __2006

Until the later of _____ or 25 days after commencement of the stock offering, all dealers effecting transactions in these securities, whether or not participating in this stock offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution.*

OTS Application for Conversion and H-(e)1 fee	\$ 14,400
SEC registration fee(1)	3,700
Nasdaq National Market Listing and Annual Fee(1)	129,000
NASD Filing Fee(1)	3,600
Printing, postage and mailing	95,000
Legal fees (including Blue Sky) and expenses	600,000
Accounting fees and expenses	100,000
Appraiser's fees and expenses	60,000
Business plan fee	25,000
Marketing fees, selling commissions, and underwriter's expenses (including counsel fees)(2)	378,700
Conversion agent fees and expenses	27,500
Certificate printing	5,000
Miscellaneous	12,000
TOTAL	\$1,453,900

* Fees are estimated, except where indicated.

(1) Based on 3,107,875 shares of common stock at \$10.00 per share.

(2) Includes legal fees of \$100,000 for Luse Gorman Pomerenk & Schick, P.C.

Item 14. Indemnification of Directors and Officers.

In accordance with federal law, Lake Shore Bancorp, as a Subsidiary Holding Company, shall indemnify all officers, directors and employees of the Subsidiary Holding Company, and their heirs, executors and administrators, to the fullest extent permitted under federal law against all expenses and liabilities reasonably incurred by them in connection with or arising out of any action, suit or proceeding in which they may be involved by reason of their having been a director or officer at the time of incurring such expenses or liabilities, such expenses and liabilities to include, but not be limited to, judgment, court costs and attorneys' fees and the cost of reasonable settlements.

Item 15. Recent Sales of Unregistered Securities.

Not Applicable.

Item 16. Exhibits and Financial Statement Schedules.

The exhibits and financial statement schedules filed as a part of this Registration Statement are as follows:

(a) List of Exhibits. (Filed herewith unless otherwise noted)

- 1.1 Engagement Letter dated June 2, 2005, between Lake Shore Savings and Loan Association and Ryan Beck & Co., Inc.*
- 1.2 Form of Agency Agreement between Lake Shore Bancorp, Inc., Lake Shore Savings and Loan and Ryan Beck & Co., Inc.
- 2.1 Amended and Restated Plan of Reorganization and Minority Stock Issuance*
- 3.1 Charter Lake Shore Bancorp, Inc.*

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3.2	Bylaws of Lake Shore Bancorp, Inc.*
4.1	Form of Stock Certificate of Lake Shore Bancorp, Inc.**
5.1	Form of Opinion of Thacher Proffitt & Wood LLP regarding legality of securities to be registered*
8.1	Form of Opinion of Thacher Proffitt & Wood LLP regarding federal tax matters*
8.2	Opinion regarding state and local tax matters
10.1	Form of Executive Employment Agreement by and between David C. Mancuso and Lake Shore Bancorp, Inc.*
10.2	Form of Executive Employment Agreement by and between David C. Mancuso and Lake Shore Savings Bank*
10.3	Form of Change in Control Agreement*
10.4	Severance Pay Plan of Lake Shore Savings Bank*
10.5	1999 Executives Supplemental Benefit Plan*
10.6	2001 Executives Supplemental Benefit Plan*
10.7	1999 Directors Supplemental Benefit Plan*
10.8	2001 Directors Supplemental Benefit Plan*
10.9	Form of Employee Stock Ownership Plan of Lake Shore Bancorp, Inc.
16.1	Letter from PricewaterhouseCoopers LLP to the Securities and Exchange Commission*
16.2	Letter from Fagliarone Group CPAs, PC to the Securities and Exchange Commission*
23.1	Consent of Thacher Proffitt & Wood LLP (included in Exhibits 5.1 and 8.1 to this Registration Statement)
23.2	Consent of Beard Miller & Company LLP (also included in Exhibit 8.2 to this Registration Statement)
23.3	Consent of PricewaterhouseCoopers LLP
23.4	Consent of RP Financial, LC
24.1	Powers of Attorney (included in Signature Page of the initial Registration Statement)
99.1	Appraisal Report of RP Financial LC (portions filed in paper format only)
99.2	Form of marketing materials to be used in connection with the offering**

* Previously filed

** To be filed by amendment.

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(b) Financial Statement Schedules.

All schedules have been omitted as not applicable or not required under the rules of Regulation S-X.

Item 17. Undertakings.

The undersigned Registrant hereby undertakes:

- (1) To file, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement:
 - (i) To include any Prospectus required by Section 10(a)(3) of the Securities Act of 1933;
 - (ii) To reflect in the Prospectus any facts or events arising after the effective date of the Registration Statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the Registration Statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective Registration Statement;
 - (iii) To include any material information with respect to the plan of distribution not previously disclosed in the Registration Statement or any material change to such information in the Registration Statement;
- (2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.
- (3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the Offering.

Insofar as indemnification by the Registrant for liabilities arising under the Securities Act of 1933, as amended, may be permitted to directors, officers and controlling persons of the Registrant

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pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes that:

- (1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.
- (2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

Pursuant to the requirements of Securities Act of 1933, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Dunkirk, State of New York, on January 13, 2006.

Lake Shore Bancorp, Inc.

/ s / D AVID C. M ANCUSO
By: David C. Mancuso
President and Chief Executive Officer
(Duly Authorized Representative)

Pursuant to the requirements of the Securities Act of 1933, as amended, and any rules and regulations promulgated thereunder, this Registration Statement, has been signed by the following persons in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
/ s / D AVID C. M ANCUSO David C. Mancuso	President, Chief Executive Officer and Director (Principal Executive Officer)	January 13, 2006
/ s / R OBERT L. S MITH Robert L. Smith	Chief Financial Officer (Principal Financial and Accounting Officer)	January 13, 2006

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<u>Name</u>	<u>Title</u>	<u>Date</u>
<hr/> *	Director	January 13, 2006
Sharon E. Brautigam		
<hr/> *	Director	January 13, 2006
Michael E. Brunecz		
<hr/> *	Director	January 13, 2006
James P. Foley DDS		
<hr/> *	Director	January 13, 2006
Thomas E. Reed		
<hr/> *	Director	January 13, 2006
Daniel P. Reininga		
<hr/> *	Director	January 13, 2006
Gary W. Winger		
<hr/> *	Director	January 13, 2006
Nancy L. Yocum		

* By David C. Mancuso, attorney-in-fact. See Powers of attorney filed as Exhibit 24.1.

LAKE SHORE BANCORP, INC.
(a Federal Corporation in Formation)
Up to 2,587,500 Shares
(Subject to Increase Up to 2,975,625 Shares)

COMMON STOCK (\$0.01 Par Value)
Subscription Price \$10.00 Per Share

FORM OF AGENCY AGREEMENT

_____, 2006

Ryan Beck & Co., Inc.
18 Columbia Turnpike
Florham Park, New Jersey 07932

Ladies and Gentlemen:

Lake Shore Bancorp, Inc., a federal corporation in formation (the “Holding Company”), Lake Shore, MHC, a federal mutual holding company in formation (the “MHC”) and Lake Shore Savings and Loan Association, a New York chartered mutual savings and loan association (the “Bank”) (references to the “Bank” include the Bank as a New York chartered savings and loan association and as a federally chartered savings bank and in the mutual or stock form, as indicated by the context) (collectively, the “Primary Parties”) hereby confirm, jointly and severally, their agreement with Ryan Beck & Co., Inc. (the “Agent”), as follows:

1. The Offering. On August 9, 2005, the Boards of Directors of the Bank adopted a Plan of Reorganization and Minority Stock Issuance (the “Plan”), which provides for the charter conversion of the Bank from a New York chartered savings and loan association to a federally chartered mutual savings bank (“Charter Conversion”) and then the reorganization of the Bank into a two-tier mutual holding company structure, the issuance of all of the Bank’s outstanding common stock to the Holding Company, and the issuance of a majority of the outstanding common stock of the Holding Company to the MHC (together with the Charter Conversion and the Offering or Conversion Offerings, as defined below, the “Reorganization”). Upon completion of the Reorganization, the Bank will be a wholly owned subsidiary of the Holding Company and the Holding Company will be a majority owned subsidiary of the MHC. The Reorganization will be accomplished pursuant to federal law and the rules and regulations of the Office of Thrift Supervision (the “OTS”). The Holding Company is offering up to 2,587,500 shares (the “Shares” or “Conversion Shares”) of common stock, par value \$0.01 per share (the “Common Stock”) (subject to an increase up to 2,975,625 shares), in (i) a subscription offering (the “Subscription Offering”), and, if necessary, (ii) a direct community offering (the “Direct Community Offering”) and (iii) a syndicated community offering (the “Syndicated Community Offering”), in connection with the Reorganization. The Plan also provides that the Holding Company shall contribute 2% of its outstanding shares of Common Stock (the “Charitable Shares”) to a charitable foundation to be established by the Bank (“Charitable Foundation”).

Upon the completion of the Subscription Offering, Community Offering, and Syndicated Community Offering (collectively, the “Conversion Offerings” or “Offering”), the purchasers of Shares in the Conversion Offerings will own 45% of the outstanding Common Stock of the Holding Company, the Charitable Foundation will own 2% of the outstanding Common Stock of the Holding Company and the MHC will own 53% of the outstanding Common Stock of the Holding Company. The Holding Company will issue the Shares at a purchase price of \$10.00 per share (the “Purchase Price”). If the number of Conversion Shares is increased or decreased in accordance with the Plan, the term “Shares” or “Conversion Shares” shall mean such greater or lesser number, where applicable.

In the Subscription Offering, non-transferable rights to subscribe for between 1,912,500 and 2,587,500 shares (subject to an increase up to 2,975,625 shares) of the Common Stock (“Subscription Rights”) will be granted, in the following order of priority: (1) the Bank’s depositors with account balances of at least \$50.00 as of the close of business on June 30, 2004 (“Eligible Account Holders”); (2) the Bank’s tax-qualified employee benefit plans; (3) the Bank’s depositors with account balances of at least \$50.00 as of the close of business on December 31, 2005 (“Supplemental Eligible Account Holders”); and (4) the Bank’s depositors (other than Eligible Account Holders and Supplemental Eligible Account Holders) as of _____, 2006 (“Other Member Record Date”) (the “Other Members”), subject to the priorities and purchase limitations set forth in the Plan. The Holding Company may offer shares of Common Stock for which subscriptions have not been received in the Subscription Offering in the Community Offering to members of the general public, with preference given to natural persons residing in Chautauqua, Erie and Cattaraugus Counties, New York. Shares may also be reserved in the Community Offering for institutional investors. In the event a Community Offering is held, it may be held at any time during or immediately after the Subscription Offering. Depending on market conditions, shares not subscribed for in the Subscription Offering or purchased in the Community Offering may be offered in the Syndicated Community Offering to selected members of the general public through a syndicate of registered broker-dealers managed by the Agent (“Assisting Brokers”) which are members of the National Association of Securities Dealers, Inc. (“NASD”).

It is acknowledged that the number of Shares to be sold in the Offering may be increased or decreased as described in the Prospectus (as hereinafter defined); that the purchase of Shares in the Offering is subject to maximum and minimum purchase limitations as described in the Prospectus; and that the Holding Company may reject, in whole or in part, any subscription received in the Community Offering and Syndicated Community Offering.

The Holding Company has filed with the U.S. Securities and Exchange Commission (the “Commission”) a Registration Statement on Form S-1 (File No. 333-129439) in order to register the Shares and the Charitable Shares under the Securities Act of 1933, as amended (the “1933 Act”), and has filed such amendments thereto as have been required to the date hereof (the “Registration Statement”). The prospectus, as amended, included in the Registration Statement at the time it initially became effective is hereinafter called the “Prospectus,” except that if any prospectus is filed by the Holding Company pursuant to Rule 424(b) or (c) of the regulations of the Commission under the 1933 Act differing from the prospectus included in the Registration Statement at the time it initially becomes effective, the term “Prospectus” shall refer to the prospectus filed pursuant to Rule 424(b) or (c) from and after the time said prospectus is filed with the Commission and shall include

any supplements and amendments thereto from and after their dates of effectiveness or use, respectively.

In accordance with 12 C.F.R. Sections 543.8 through 543.14 (the “Charter Conversion Regulations”), the Bank has filed with the OTS an application for Charter Conversion (the “Charter Conversion Application”). In connection with the Reorganization, the Bank has also filed with the OTS, pursuant to Title 12, Parts 575 and 563b of the Code of Federal Regulations (the “Conversion Regulations”), a Form MHC-1 Notice of Mutual Holding Company Reorganization and an Application for Approval of a Minority Stock Issuance by a Stock Holding Company Subsidiary of a Mutual Holding Company on Form MHC-2, including exhibits and the Prospectus, and has filed amendments thereto as required by the OTS (as so amended, the “MHC-1/MHC-2”). The Holding Company filed with the OTS its application on Form H-(e)1 (the “Holding Company Application”) to acquire the Bank under the Home Owners Loan Act and the resolutions promulgated thereunder (“HOLA”). The Bank’s application with the OTS for approval of the formation of an interim stock savings bank and the merger of the interim stock savings bank with and into the Bank (the “Merger Application”) was filed as an Exhibit to the MHC-1/MHC-2. The MHC-1/MHC-2, the Holding Company Application, the Merger Application and the Charter Conversion Application shall collectively be hereinafter referred to as the “OTS Applications.”

Concurrently with the execution of this Agreement, the Holding Company is delivering to the Agent copies of the Prospectus dated _____, 2006 of the Holding Company to be used in the Subscription Offering and Community Offering (if any), and, if necessary, will deliver copies of the Prospectus and any prospectus supplement for use in a Syndicated Community Offering and/or Public Offering, as defined in the Prospectus (as hereinafter defined).

2. Appointment of Agent. Subject to the terms and conditions of this Agreement, the Primary Parties hereby appoint Agent as their financial advisor and marketing agent to utilize its best efforts to solicit subscriptions for the Conversion Shares and to advise and assist the Primary Parties with respect to the sale of the Conversion Shares in the Conversion Offerings.

On the basis of the representations and warranties of the Primary Parties contained in, and subject to the terms and conditions of, this Agreement the Agent accepts such appointment and agrees to consult with and advise the MHC, the Holding Company and the Bank as to the matters set forth in the letter agreement (“Letter Agreement”), dated June 14, 2005, between the Bank and Agent (a copy of which is attached hereto as Exhibit A). It is acknowledged by the Primary Parties that the Agent shall not be obligated to purchase any Shares and shall not be obligated to take any action which is inconsistent with any applicable law, regulation, decision or order. Subscriptions for Conversion Shares will be offered by means of order forms as described in the Prospectus. Except as provided in the last paragraph of this Section 2, the appointment of the Agent hereunder shall terminate upon consummation of the Offering.

If selected broker-dealers are used to assist in the sale of Conversion Shares in the Syndicated Community Offering, the Primary Parties hereby, subject to the terms and conditions of this Agreement, appoint the Agent to manage such broker-dealers in the Syndicated Community Offering. On the basis of the representations and warranties of the Primary Parties contained in, and subject to

the terms and conditions of, this Agreement, the Agent accepts such appointment and agrees to manage the selling group of broker-dealers in the Syndicated Community Offering.

The Agent agrees to make available to the Holding Company for a period of one year following the consummation of the Offering its Strategic Advisory Services ("STARS") program. If the Bank elects to participate in the STARS program, the Agent will meet with the Bank at its request and will render general advice on the financial matters listed in Section 9 of the Letter Agreement (but not including (i) any in-depth merger and acquisition analyses or studies which are available under the Agent's normal fee schedule, or (ii) advice with respect to a specific acquisition transaction by, or sale of, the Bank or the Holding Company). If the Holding Company elects to participate in the STARS program, the Agent will waive the regular retainer fee and hourly charges for the first one-year period. The Holding Company would be required, however, to reimburse the Agent for its reasonable out-of-pocket expenses incurred in conjunction with the performance of these services. Such out-of-pocket expenses include travel, legal and other miscellaneous expenses. The Agent would not be permitted to incur any single expense in excess of \$1,000 pursuant to this paragraph without the prior approval of the Holding Company. If negotiations for a transaction conducted during the one-year period result in the execution of a definitive agreement and/or consummation of a transaction for which the Agent customarily would be entitled to a fee for its advisory or other investment banking services, the Agent shall receive a contingent advisory fee in accordance with the terms of a separate engagement letter to be entered into with respect to such transaction. Nothing in this Agreement shall require the Holding Company to obtain such financial advisory services from the Agent. After the completion of such one-year period, if the parties wish to continue the relationship, a fee will be negotiated and an agreement with respect to specific advisory services will be entered into at that time.

3. Refund of Purchase Price. In the event that the Offering is not consummated for any reason, including but not limited to the inability to sell the Conversion Shares during the Offering (including any permitted extension thereof), this Agreement shall terminate and any persons who have subscribed for any of the Conversion Shares shall have refunded to them the full amount which has been received from such person, together with interest at the Bank's current passbook savings rate, from the date payment is received to the date said refund is made as provided in the Prospectus. Upon termination of this Agreement, neither the Agent nor the Primary Parties shall have any obligation to the other except that (i) the Primary Parties shall remain liable for any amounts due pursuant to Sections 4, 8, 10 and 11 hereof, unless the transaction is not consummated due to the breach by the Agent of a warranty, representation or covenant; and (ii) the Agent shall remain liable for any amount due pursuant to Sections 10 and 11 hereof, unless the transaction is not consummated due to the breach by the Primary Parties of a warranty, representation or covenant.

4. Fees. In addition to the expenses specified in Section 8 hereof, as compensation for the Agent's services under this Agreement, the Agent has received or will receive the following fees from the Primary Parties:

- a. An advisory and administrative services fee in the amount of \$50,000, of which \$40,000 has been paid prior to the date hereof and the remaining \$10,000 shall be payable at the Closing Date.

- b. A sales fee equal to 1.00% of the aggregate Purchase Price of the Conversion Shares sold in the Offering, other than those Shares sold pursuant to subparagraph C. below. No fee shall be payable pursuant to this subsection in connection with the sale of Shares to officers, directors, employees or immediate family members (which term includes spouses, parents, siblings and children who live in the same house as the officer, director or employee) of such persons and qualified and non-qualified employee benefit plans of the Holding Company and the Bank and the Charitable Shares to be issued to the Charitable Foundation.
- c. A fee equal to 1.00% of the aggregate Purchase Price of the Conversion Shares sold by the Agent in any Syndicated Community Offering which fee along with the fee payable directly by the Holding Company to assisting brokers (including Ryan Beck) will not exceed 6.00% in the aggregate. Assisting Brokers will not be utilized without the prior approval of the Primary Parties, and it is agreed that Agent will manage the Assisting Brokers in the Syndicated Offering.

In the event that the Holding Company is required to resolicit subscribers for Shares in the Subscription and Community Offering and the Agent is required to provide significant additional services in connection with such a resolicitation, the Primary Parties and the Agent shall mutually agree to the dollar amount of additional fees due to the Agent, if any. Until any agreement called for by this paragraph is reached, the Agent shall not accrue expenses relating to any resolicitation in an amount that would cause the total expenses incurred by the Agent to be greater than as set forth in Section 8 hereof without the prior written consent of the Holding Company or the Bank, which consent shall not be unreasonably withheld.

If this Agreement is terminated in accordance with the provisions of Sections 3, 9, or 13, the Agent shall not be entitled to receive the fee set forth in Sections 4(a)-(c), but the Agent will retain the advisory and administrative services fee already earned of \$40,000 and the Primary Parties will reimburse the Agent for its reasonable expenses pursuant to Section 8, including without limitation communication (telephone and document delivery charges), legal and travel expenses, subject to the limitations set forth in Section 8 hereof.

5. Closing. If the minimum number of Conversion Shares required to be sold in the Offering on the basis of the most recently updated Appraisal (as defined in Section 6(g)) are subscribed for at or before the termination of the Offering, and the other conditions to the completion of the Offering are satisfied, the Holding Company agrees to issue the Shares on the Closing Date (as hereinafter defined) against payment therefore by the means authorized by the Plan and to deliver certificates evidencing ownership of the Conversion Shares in such authorized denominations and registered in such names as may be indicated on the subscription order forms directly to the purchasers thereof as promptly as practicable after the Closing Date. The Closing shall be held at the offices of special counsel to the Primary Parties, or at such other place as shall be agreed upon among the Primary Parties and the Agent, at 10:00 a.m., Eastern Standard Time, on the business day selected by the Holding Company which business day shall be no less than two business days following the giving of prior notice by the Holding Company to the Agent or at such other time as shall be agreed upon by the Primary Parties and the Agent. At the Closing, the Primary Parties shall deliver to the Agent by wire transfer in same-day funds the commissions, fees and expenses owing as set forth in

Sections 4 and 8 hereof and the opinions required hereby and other documents deemed reasonably necessary by the Agent shall be executed and delivered to effect the sale of the Shares as contemplated hereby and pursuant to the terms of the Prospectus. The Holding Company shall notify the Agent when funds shall have been received for the minimum number of shares of the Common Stock. The hour and date upon which the Holding Company shall release the Conversion Shares for delivery in accordance with the terms hereof is referred to herein as the "Closing Date."

The Agent shall have no liability to any party for the records or other information provided by the Holding Company and the Bank (or their agents) to the Agent for use in allocating the Shares. Subject to the limitations of Section 10 hereof, the Holding Company and the Bank shall indemnify and hold harmless the Agent for any liability arising out of the allocation of the Shares in accordance with (i) the Plan generally, and (ii) the records or other information provided to the Agent by the Holding Company and the Bank (or their agents).

6. Representations and Warranties of the Primary Parties. The Primary Parties jointly and severally represent and warrant to the Agent that, except as disclosed in the Prospectus:

(a) The Bank has and, as of the Closing Date, the MHC and the Holding Company will have all such power, authority, authorizations, approvals and orders as may be required to enter into this Agreement, to carry out the provisions and conditions hereof and to issue and sell the Shares as provided herein and as described in the Prospectus, subject to the various limitations and required approvals described therein. Subject to the receipt of depositor and regulatory approval, the consummation of the Reorganization, the execution, delivery and performance of this Agreement and the consummation of the transactions herein contemplated have been duly and validly authorized by all necessary corporate action on the part of the Bank and, as of the Closing Date, will have been duly and validly authorized by all necessary corporate action on the part of the MHC and the Holding Company. This Agreement has been validly executed and delivered by the Holding Company (in formation), the MHC (in formation) and the Bank, and is a valid, legal and binding obligation of the Holding Company, the Bank and the MHC, enforceable in accordance with its terms, except to the extent, if any, that the provisions of Sections 10 and 11 hereof may be unenforceable as against public policy, and except to the extent that such enforceability may be limited by bankruptcy laws, insolvency laws, or other laws affecting the enforcement of creditors' rights generally, or the rights of creditors of savings institutions insured by the FDIC (including the laws relating to the rights of the contracting parties to equitable remedies).

(b) The Plan has been approved by the OTS.

(c) The Registration Statement was declared effective by the Commission on _____, 2006; and no stop order has been issued with respect thereto and no proceedings therefore have been initiated or, to the best knowledge of the Primary Parties, threatened by the Commission. At the time the Registration Statement, including the Prospectus contained therein (including any amendment or supplement thereto), became effective, the Registration Statement complied as to form in all material respects with the 1933 Act and the regulations promulgated thereunder and the Registration Statement, including the Prospectus contained therein (including any amendment or supplement thereto), any Blue Sky Application or any Sales Information (as such terms are defined in Section 10 hereof) authorized by the Primary Parties for use in connection with the

Offering did not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, and at the time any Rule 424(b) or (c) Prospectus was filed with the Commission and at the Closing Date referred to in Section 5, the Registration Statement, including the Prospectus contained therein (including any amendment or supplement thereto), and any Blue Sky Application or any Sales Information authorized by the Primary Parties for use in connection with the Offering will not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading; provided, however, that the representations and warranties in this Section 6(c) shall not apply to statements or omissions made in reliance upon and in conformity with written information furnished to the Primary Parties by the Agent expressly regarding the Agent for use under the captions “Market for the Common Stock” and “The Reorganization and Offering—Marketing Arrangements” or written statements or omissions from any sales information or information filed pursuant to state securities or blue sky laws or regulations regarding the Agent.

(d) At the time of filing the Registration Statement relating to the offering of the Shares and at the date hereof, the Holding Company was not, and is not, an ineligible issuer, as defined in Rule 405. At the time of the filing of the Registration Statement and at the time of the use of any issuer free writing prospectus, as defined in Rule 433(h), the Holding Company met the conditions required by Rules 164 and 433 for the use of a free writing prospectus. If required to be filed, the Holding Company has filed any issuer free writing prospectus related to the offered Shares at the time it is required to be filed under Rule 433 and, if not required to be filed, will retain such free writing prospectus in the Holding Company’s records pursuant to Rule 433(g) and if any issuer free writing prospectus is used after the date hereof in connection with the offering of the Shares the Holding Company will file or retain such free writing prospectus as required by Rule 433.

(e) As of the Applicable Time, neither (i) the Issuer-Represented General Free Writing Prospectus(es) issued at or prior to the Applicable Time and the Statutory Prospectus, all considered together (collectively, the “General Disclosure Package”), nor (ii) any individual Issuer-Represented Limited-Use Free Writing Prospectus, when considered together with the General Disclosure Package, included any untrue statement of a material fact or omitted to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. The preceding sentence does not apply to statements in or omissions from any Prospectus included in the Registration Statement relating to the offered Shares or any Issuer-Represented Free Writing Prospectus based upon and in conformity with written information furnished to the Holding Company by the Agent specifically for use therein. As used in this paragraph and elsewhere in this Agreement:

- i. “Applicable Time” means each and every date when a potential purchaser submitted a subscription or otherwise committed to purchase Shares.
- ii. “Statutory Prospectus”, as of any time, means the Prospectus relating to the offered Shares that is included in the Registration Statement relating to the offered Shares immediately prior to that time, including any document incorporated by reference therein.

- iii. "Issuer-Represented Free Writing Prospectus" means any "issuer free writing prospectus," as defined in Rule 433(h), relating to the offered Shares that is required to be filed with the Commission by the Holding Company or required to be filed with the Commission. The term does not include any writing exempted from the definition of prospectus pursuant to clause (g) of Section 2(a)(10) of the 1933 Act, without regard to Rule 172 or Rule 173.
- iv. "Issuer-Represented General Free Writing Prospectus" means any Issuer-Represented Free Writing Prospectus that is intended for general distribution to prospective investors, as evidenced by its being specified in Schedule ____ to this Agreement.
- v. "Issuer-Represented Limited-Use Free Writing Prospectus" means any Issuer-Represented Free Writing Prospectus that is not an Issuer-Represented General Free Writing Prospectus. The term Issuer-Represented Limited-Use Free Writing Prospectus also includes any " *bona fide* electronic road show," as defined in Rule 433, that is made available without restriction pursuant to Rule 433(d)(8)(ii) or otherwise, even though not required to be filed with the Commission.

(f) Each Issuer-Represented Free Writing Prospectus, as of its date of first use and at all subsequent times through the completion of the Offering and sale of the offered Shares or until any earlier date that the Holding Company notified or notifies the Agent (as described in the next sentence), did not, does not and will not include any information that conflicted, conflicts or will conflict with the information contained in the Registration Statement relating to the offered Shares, including any document incorporated by reference therein that has not been superseded or modified. If at any time following the date of first use of an Issuer-Represented Free Writing Prospectus there occurred or occurs an event or development as a result of which such Issuer-Represented Free Writing Prospectus conflicted or would conflict with the information contained in the Registration Statement relating to the offered Shares or included or would include an untrue statement of a material fact or omitted or would omit to state a material fact necessary in order to make the statements therein, in the light of the circumstances prevailing at that subsequent time, not misleading, the Holding Company has notified or will notify promptly the Agent so that any use of such Issuer-Represented Free-Writing Prospectus may cease until it is amended or supplemented and the Holding Company has promptly amended or will promptly amend or supplement such Issuer-Represented Free Writing Prospectus to eliminate or correct such conflict, untrue statement or omission. The foregoing two sentences do not apply to statements in or omissions from any Issuer-Represented Free Writing Prospectus based upon and in conformity with written information furnished to the Holding Company by the Agent specifically for use therein.

(g) The OTS Applications, including the Prospectus were authorized for use by the OTS on _____, 2006; the proxy statement of the Bank relating to the special meeting of the depositors of the Bank at which the Plan shall be considered for approval by the Bank's eligible voting depositors (the "Proxy Statement") was authorized for use by the OTS and at all times subsequent thereto until the Closing Date, the OTS Applications, including the Prospectus, did and will comply as to form in all material respects with the Charter Conversion Regulations, the Conversion Regulations and any other applicable rules and regulations of the OTS (except as modified or waived by the OTS). On the Closing Date, the Charter Conversion will have been

completed. At the time of the approval and at all times subsequent thereto until the Closing Date, the OTS Applications, including the Prospectus and Proxy Statement (including any amendment or supplement thereto), did not and does not include any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; provided, however, that representations or warranties in this subsection (g) shall not apply to statements or omissions made in reliance upon and in conformity with written information furnished to the Primary Parties by the Agent expressly regarding the Agent for use in Prospectus contained in the MHC-1/MHC-2 under the captions “Market for the Common Stock” and “The Reorganization and Offering —Marketing Arrangements” or written statements or omissions from any sales information or information filed pursuant to state securities or blue sky laws or regulations regarding the Agent.

(h) No order has been issued by the OTS, the Commission, or any state regulatory authority, preventing or suspending the use of the Prospectus and no action by or before any such government entity to revoke any approval, authorization or order of effectiveness related to the Reorganization is pending or, to the best knowledge of the Primary Parties, threatened.

(i) The Plan has been duly adopted by the Board of Directors of the Bank. To the best knowledge of the Primary Parties, no person has, or at the Closing Date will have, sought to obtain review of the final action of the OTS in approving the Plan, the Reorganization, or the OTS Applications, pursuant to the HOLA or any other statute or regulation.

(j) The Holding Company has filed with the OTS the Holding Company Application (including the Merger Application) and as of the Closing Date, the OTS will have approved the Holding Company’s acquisition of the Bank.

(k) RP Financial, LC., which prepared the appraisal of the aggregate pro forma market value of the Holding Company and the Bank on which the Offering was based (the “Appraisal”), has advised the Primary Parties in writing that it is independent with respect to each of the Primary Parties within the meaning of the Conversion Regulations.

(l) Beard Miller Company LLP, which certified the financial statements filed as part of the Registration Statement and the MHC-1/MHC-2, has advised the Primary Parties that it is, with respect to each of the Primary Parties, an independent certified public accountant within the meaning of 12 C.F.R. Sections 563c.3 and 571.2(c)(3) and under the 1933 Act and the Regulations promulgated thereunder.

(m) The financial statements and the notes thereto which are included in the Registration Statement and which are a part of the Prospectus present fairly the financial condition and retained earnings of the Bank as of the dates indicated and the results of operations and cash flows for the periods specified. The financial statements comply in all material respects with the applicable accounting requirements of Title 12 of the Code of Federal Regulations, Regulation S-X of the Commission and accounting principles generally accepted in the United States of America (“GAAP”) applied on a consistent basis during the periods presented except as otherwise noted therein, and present fairly in all material respects the information required to be stated therein. The other financial, statistical and pro forma information and related notes included in the Prospectus

present fairly the information shown therein on a basis consistent with the audited and unaudited financial statements included in the Prospectus, and as to the pro forma adjustments, the adjustments made therein have been properly applied on the basis described therein.

(n) Since the respective dates as of which information is given in the Registration Statement, including the Prospectus, other than as disclosed therein: (i) there has not been any material adverse change in the financial condition or in the earnings, capital, properties or business affairs of any of the Primary Parties or of the Primary Parties considered as one enterprise, whether or not arising in the ordinary course of business; (ii) there has not been any change in total assets of the Bank in an amount greater than _____%, any material increase in the aggregate amount of loans past due ninety (90) days or more, or any real estate acquired by foreclosure or loans characterized as “in substance foreclosure”; nor has the Bank or the Holding Company issued any securities or incurred any liability or obligation for borrowings other than in the ordinary course of business; and (iii) there have not been any material transactions entered into by any of the Primary Parties, other than those in the ordinary course of business. The capitalization, liabilities, assets, properties and business of the Primary Parties conform in all material respects to the descriptions thereof contained in the Prospectus and none of the Primary Parties has any material liabilities of any kind, contingent or otherwise, except as disclosed in Registration Statement or the Prospectus.

(o) As of the Closing Date, the Holding Company will be a corporation duly organized and validly existing under the federal laws of the United States, with corporate power and authority to own its properties and to conduct its business as described in the Prospectus, and will be qualified to transact business and in good standing in each jurisdiction in which the conduct of business requires such qualification unless the failure to qualify in one or more of such jurisdictions would not have a material adverse effect on the financial condition, earnings, capital, properties or business affairs of the Primary Parties. As of the Closing Date, the Holding Company will have obtained all licenses, permits and other governmental authorizations required for the conduct of its business, except those that individually or in the aggregate would not materially adversely affect the financial condition, earnings, capital, assets, properties or business of the Primary Parties taken as a whole; and all such licenses, permits and governmental authorizations are in full force and effect, and the Holding Company will be in compliance therewith in all material respects.

(p) As of the Closing Date, the MHC will be duly organized and will be validly existing as a federally chartered mutual holding company under the laws of the United States, duly authorized to conduct its business and own its property as described in the Registration Statement and the Prospectus; as of the Closing Date, the MHC will have obtained all licenses, permits and other governmental authorizations required for the conduct of its business except those that individually or in the aggregate would not materially adversely affect the financial condition, earnings, capital, assets or properties of the Primary Parties taken as a whole; as of the Closing Date, all such licenses, permits and governmental authorizations will be in full force and effect and the MHC will be in compliance therewith in all material respects; as of the Closing Date, the MHC will be duly qualified as a foreign corporation to transact business in each jurisdiction in which the failure to be so qualified in one or more of such jurisdictions would have a material adverse effect on the financial condition, earnings, capital, assets, properties or business of the Primary Parties.

(q) The MHC does not, and as of the Closing Date, will not own any equity securities or any equity interest in any business enterprise except as described in the Prospectus.

(r) The MHC is not authorized to issue any shares of capital stock.

(s) The Bank is a duly organized and validly existing New York chartered savings and loan association in mutual form and upon the Reorganization will become a duly organized and validly existing federally-chartered savings bank in mutual and then stock form and in both instances, duly authorized to conduct its business as described in the Prospectus; the activities of the Bank are permitted by the rules, regulations and practices of the OTS; the Bank has obtained all licenses, permits and other governmental authorizations currently required for the conduct of its business except those that individually or in the aggregate would not materially adversely affect the financial condition of the Primary Parties taken as a whole; all such licenses, permits and other governmental authorizations are in full force and effect and the Bank is in good standing under the laws of the State of New York and as of the Closing Date, the laws of the United States; as of the Closing Date, all of the issued and outstanding capital stock of the Bank will be duly and validly issued and fully paid and nonassessable; and as of the Closing Date, the Holding Company will directly own all of such capital stock free and clear of any mortgage, pledge, lien, encumbrance, claim or restriction. The Bank does not own equity securities or any equity interest in any other business enterprise except as otherwise described in the Prospectus.

(t) The Bank is a member of the Federal Home Loan Bank of New York ("FHLB of New York"); the deposit accounts of the Bank are insured by the FDIC up to applicable limits. Upon consummation of the Reorganization, the rights of the depositors of the Bank in its mutual form shall be transferred to the MHC in accordance with the Plan and the requirements of the Conversion Regulations.

(u) The Bank is not authorized to issue any shares of Capital Stock.

(v) The Charitable Foundation has been duly authorized and incorporated and is validly existing as a non-stock corporation in good standing under the laws of the State of Delaware with corporate power and authority to own, lease and operate its properties and to conduct its business as described in the Prospectus; no approvals are required to establish the Charitable Foundation and to contribute the shares of Common Stock thereto as described in the Prospectus other than those imposed by the OTS. The issuance of the Charitable Shares to the Charitable Foundation pursuant to the Plan has been registered pursuant to the Registration Statement.

(w) Upon consummation of the Reorganization, the authorized, issued and outstanding equity capital of the Holding Company will be within the range set forth in the Prospectus under the caption "Capitalization," no shares of Common Stock have been or will be issued and outstanding prior to the Closing Date; and the shares of Common Stock to be subscribed for in the Offering and the Charitable Shares issued to the Charitable Foundation have been duly and validly authorized for issuance and, when issued and delivered by the Holding Company pursuant to the Plan against payment of the consideration (or contributed to the Charitable Foundation as it relates to the Charitable Shares) calculated as set forth in the Plan and the Prospectus, will be duly and validly issued and fully paid and nonassessable; the issuance of the Shares and the Charitable Shares are not

subject to preemptive rights, except for the Subscription Rights granted to the Shares pursuant to the Plan; and the terms and provisions of the shares of Common Stock will conform in all material respects to the description thereof contained in the Prospectus. Upon issuance of the Shares and the Charitable Shares, good title to the Shares and the Charitable Shares will be transferred from the Holding Company to the purchasers of Shares and the Charitable Foundation against payment therefor (or contributed to the Charitable Foundation as it relates to the Charitable Shares) in the Offering as set forth in the Plan and the Prospectus.

(x) The Bank is not and as of the Closing Date, neither the Holding Company nor the MHC will be in violation of their respective charter or their respective bylaws, or in material default in the performance or observance of any obligation, agreement, covenant, or condition contained in any contract, lease, loan agreement, indenture or other instrument to which they are a party or by which they, or any of their respective property, may be bound which would result in a material adverse change in the condition (financial or otherwise), earnings, capital, properties or assets. The consummation of the transactions herein contemplated will not (i) conflict with or constitute a breach of, or default under, the charter or bylaws of the Bank and, as of the Closing Date, the Holding Company or the MHC, or materially conflict with or constitute a material breach of, or default under, any material contract, lease or other instrument to which any of the Primary Parties has a beneficial interest, or any applicable law, rule, regulation or order that is material to the financial condition of the Bank; (ii) violate any authorization, approval, judgment, decree, order, statute, rule or regulation applicable to the Primary Parties except for such violations which would not have a material adverse effect on the financial condition and results of operations of the Bank; or (iii) result in the creation of any material lien, charge or encumbrance upon any property of the Primary Parties.

(y) No material default exists, and no event has occurred which with notice or lapse of time, or both, would constitute a material default on the part of any of the Primary Parties, in the due performance and observance of any term, covenant or condition of any indenture, mortgage, deed of trust, note, bank loan or credit agreement or any other material instrument or agreement to which any of the Primary Parties is a party or by which any of them or any of their property is bound or affected in any respect which, in any such case, is material to the Primary Parties individually or considered as one enterprise, and such agreements are in full force and effect; and no other party to any such agreements has instituted or, to the best knowledge of the Primary Parties, threatened any action or proceeding wherein any of the Primary Parties is alleged to be in default thereunder under circumstances where such action or proceeding, if determined adversely to any of the Primary Parties, would have a material adverse effect upon the Primary Parties individually or considered as one enterprise.

(z) The Primary Parties have good and marketable title to all assets which are material to the businesses of the Primary Parties and to those assets described in the Prospectus as owned by them, free and clear of all material liens, charges, encumbrances, restrictions or other claims, except such as are described in the Prospectus or which do not have a material adverse effect on the businesses of the Primary Parties taken as a whole; and all of the leases and subleases which are material to the businesses of the Primary Parties, as described in the Registration Statement or Prospectus, are in full force and effect.

(aa) The Primary Parties are not in material violation of any directive from the OTS, the FDIC, the Commission or any other agency to make any material change in the method of conducting their respective businesses; the Primary Parties have conducted and are conducting their respective businesses so as to comply in all respects with all applicable statutes and regulations (including, without limitation, regulations, decisions, directives and orders of the OTS, the Commission and the FDIC), except where the failure to so comply would not reasonably be expected to result in any material adverse change in the financial condition, results of operations, capital, properties or business affairs of the Primary Parties considered as one enterprise and there is no charge, investigation, action, suit or proceeding before or by any court, regulatory authority or governmental agency or body pending or, to the best knowledge of any of the Primary Parties, threatened, which would reasonably be expected to materially and adversely affect the Reorganization and the Offering, the performance of this Agreement, or the consummation of the transactions contemplated in the Plan as described in the Registration Statement, or which would reasonably be expected to result in any material adverse change in the financial condition results of operations, capital, properties or business affairs of the Primary Parties considered as one enterprise.

(bb) The Primary Parties have received an opinion of their special counsel, Thatcher, Proffitt & Wood LLP, with respect to the federal income tax consequences and _____ regarding the State of New York income tax consequences of the Reorganization, as described in the Registration Statement and the Prospectus; and the facts and representations upon which such opinions are based are truthful, accurate and complete, and none of the Primary Parties will take any action inconsistent therewith.

(cc) The Bank has timely filed or extended all required federal and state tax returns, has paid all taxes that have become due and payable in respect of such returns, except where permitted to be extended, has made adequate reserves for similar future tax liabilities, and no deficiency has been asserted with respect thereto by any taxing authority.

(dd) No approval, authorization, consent or other order of any regulatory or supervisory or other public authority is required for the execution and delivery by the Primary Parties of this Agreement, or the issuance of the Shares or the Charitable Shares, except for the approval of the OTS and the Commission (which have been received) and any necessary qualification, notification, or registration or exemption under the securities or blue sky laws of the various states in which the Shares are to be offered.

(ee) None of the Primary Parties has: (i) issued any securities within the last 18 months (except for (a) notes to evidence bank loans or other liabilities in the ordinary course of business or as described in the Prospectus, and (b) shares of Common Stock issued in connection with the Holding Company's initial capitalization); (ii) had any dealings with respect to sales of securities within the 12 months prior to the date hereof with any member of the NASD, or any person related to or associated with such member, other than discussions and meetings relating to the Offering and purchases and sales of U.S. government and agency and other securities in the ordinary course of business; (iii) entered into a financial or management consulting agreement except for the Letter Agreement and as contemplated hereunder; or (iv) engaged any intermediary between the Agent and the Primary Parties in connection with the Offering, and no person is being compensated in any manner for such services.

(ff) Neither the Primary Parties nor, to the best knowledge of the Primary Parties, any employee of the Primary Parties, has made any payment of funds of the Primary Parties as a loan to any person for the purchase of Conversion Shares, except for the Holding Company's loan to the ESOP the proceeds of which will be used to purchase Conversion Shares, or has made any other payment of funds prohibited by law, and no funds have been set aside to be used for any payment prohibited by law.

(gg) The Bank complies in all material respects with the applicable financial record keeping and reporting requirements of the Currency and Foreign Transactions Reporting Act of 1970, as amended, and the regulations and rules thereunder.

(hh) The Primary Parties have not relied upon Agent or its counsel for any legal, tax or accounting advice in connection with the Reorganization.

(ii) The records of Eligible Account Holders, Supplemental Eligible Account Holders and Other Members are accurate and complete in all material respects.

(jj) The Primary Parties comply in all material respects with all laws, rules and regulations relating to environmental protection, and none of them has been notified or is otherwise aware that any of them is potentially liable, or is considered potentially liable, under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, or any other Federal, state or local environmental laws and regulations; no action, suit, regulatory investigation or other proceeding is pending, or to the knowledge of the Primary Parties, threatened against the Primary Parties relating to environmental protection, nor do the Primary Parties have any reason to believe any such proceedings may be brought against any of them; and no disposal, release or discharge of hazardous or toxic substances, pollutants or contaminants, including petroleum and gas products, as any of such terms may be defined under federal, state or local law, has occurred on, in, at or about any facilities or properties owned or leased by any of the Primary Parties or, to the knowledge of the Bank, in which the Bank has a security interest.

(kk) All of the loans represented as assets on the most recent financial statements or selected financial information of the Bank included in the Prospectus meet or are exempt from all requirements of federal, state and local law pertaining to lending, including, without limitation, truth in lending (including the requirements of Regulations Z and 12 C.F.R. Part 226), real estate settlement procedures, consumer credit protection, equal credit opportunity and all disclosure laws applicable to such loans, except for violations which, if asserted, would not result in a material adverse effect on the financial condition, results of operations or business of the Primary Parties taken as a whole.

(ll) None of the Primary Parties are required to be registered as an investment company under the Investment Company Act of 1940.

(mm) As of the date hereof, the charters of the Holding Company and the MHC have been filed with the OTS, but neither charter is effective or otherwise in force.

Any certificates signed by an officer of any of the Primary Parties and delivered to the Agent or its counsel that refer to this Agreement shall be deemed to be a representation and warranty by the Primary Parties to the Agent as to the matters covered thereby with the same effect as if such representation and warranty were set forth herein.

Section 6.B. Representations and Warranties of the Agent. Agent represents and warrants to the Primary Parties that:

(a) Agent is a corporation and is validly existing in good standing under the laws of the State of New Jersey with full power and authority to provide the services to be furnished to the Primary Parties hereunder.

(b) The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby have been duly and validly authorized by all necessary action on the part of Agent, and this Agreement is the legal, valid and binding agreement of Agent, enforceable in accordance with its terms except as the legality, validity, binding nature and enforceability thereof may be limited by (i) bankruptcy, insolvency, moratorium, conservatorship, receivership or other similar laws relating to or affecting the enforcement of creditors' rights generally, (ii) general equity principles regardless of whether such enforceability is considered in a proceeding in equity or at law, and (iii) the extent, if any, that the provisions of Sections 10 or 11 hereof may be unenforceable as against public policy.

(c) Each of Agent and its employees, agents and representatives who shall perform any of the services hereunder shall have, and until the Reorganization is completed or terminated shall maintain all licenses, approvals and permits necessary to perform such services.

(d) No action, suit, charge or proceeding before the Commission, the NASD, any state securities commission or any court is pending, or to the knowledge of Agent threatened, against Agent which, if determined adversely to Agent, would have a material adverse effect upon the ability of Agent to perform its obligations under this Agreement.

(e) Agent is registered as a broker/dealer pursuant to Section 15(b) of the 1934 Act and is a member of the National Association of Securities Dealers, Inc.

(f) Any funds received in the Offering by the Agent will be handled by the Agent in accordance with Rule 15c2-4 under the Securities Exchange Act of 1934, as amended (the "1934 Act") to the extent applicable.

7. Covenants of the Primary Parties. The Primary Parties hereby jointly and severally covenant with the Agent as follows:

(a) The Holding Company will not, at any time after the date the Registration Statement is declared effective, file any amendment or supplement to the Registration Statement without providing the Agent and its counsel an opportunity to review such amendment or file any amendment or supplement to which amendment the Agent or its counsel shall reasonably object.

(b) The Holding Company represents and agrees that, unless it obtains the prior consent of the Agent and the Agent represents and agrees that, unless it obtains the prior consent of the Holding Company, it has not made and will not make any offer relating to the offered Shares that would constitute an “issuer free writing prospectus,” as defined in Rule 433, or that would constitute a “free writing prospectus,” as defined in Rule 405, required to be filed with the Commission. Any such free writing prospectus consented to by the Holding Company and the Agent is hereinafter referred to as a “Permitted Free Writing Prospectus.” The Holding Company represents that it has treated or agrees that it will treat each Permitted Free Writing Prospectus as an “issuer free writing prospectus,” as defined in Rule 433, and has complied and will comply with the requirements of Rule 433 applicable to any Permitted Free Writing Prospectus, including timely Commission filing where required, legending and record keeping. The Company need not treat any communication as a free writing prospectus if it is exempt from the definition of prospectus pursuant to Clause (a) of Section 2(a)(10) of the 1933 Act without regard to Rule 172 or 173.

(c) The Primary Parties will not, at any time after the date the OTS Applications are approved, file any amendment or supplement to such OTS Applications without providing the Agent and its counsel an opportunity to review such amendment or supplement or file any amendment or supplement to which amendment or supplement the Agent or its counsel shall reasonably object.

(d) The Primary Parties will use their best efforts to cause the OTS to approve the Holding Company’s acquisition of the Bank and will use their best efforts to cause any post-effective amendment to the Registration Statement to be declared effective by the Commission and any post-effective amendment to the OTS Applications to be approved by the OTS, and will immediately upon receipt of any information concerning the events listed below notify the Agent (i) when the Registration Statement, as amended, has become effective; (ii) when each of the Charter Conversion Application, the MHC-1/MHC-2, the Holding Company Application and the Merger Application, all as amended, have been approved by the OTS; (iii) of the receipt of any comments from the Commission, the OTS, or any other governmental entity with respect to the Reorganization or the transactions contemplated by this Agreement; (iv) of any request by the Commission, the OTS, any other governmental entity for any amendment or supplement to the Registration Statement or the OTS Applications or for additional information; (v) of the issuance by the Commission, the OTS, or any other governmental agency of any order or other action suspending the Charter Conversion, the Reorganization or the Offering or the use of the Registration Statement or the Prospectus or any other filing of the Primary Parties under the Charter Conversion Regulations or the Conversion Regulations or other applicable law, or the threat of any such action; or (vi) of the issuance by the Commission, the OTS, the FDIC or any state authority of any stop order suspending the effectiveness of the Registration Statement or of the initiation or threat of initiation or threat of any proceedings for that purpose. The Primary Parties will make every reasonable effort to prevent the issuance by the Commission, the OTS, the FDIC or any state authority of any order referred to in (v) and (vi) above and, if any such order shall at any time be issued, to obtain the lifting thereof at the earliest possible time.

(e) The Primary Parties will deliver to the Agent and to its counsel conformed copies of each of the following documents, with all exhibits: each of the Charter Conversion Application, the MHC-1/MHC-2, the Holding Company Application and the Merger Application as originally filed and of each amendment or supplement thereto, and the Registration Statement, as

originally filed and each amendment thereto. Further, the Primary Parties will deliver such additional copies of the foregoing documents to counsel to the Agent as may be required for any NASD filings. In addition, the Primary Parties will also deliver to the Agent such number of copies of the Prospectus, as amended or supplemented, as the Agent may reasonably request.

(f) The Primary Parties will comply in all material respects with any and all terms, conditions, requirements and provisions with respect to the Reorganization and the transactions contemplated thereby imposed by the Commission, by applicable state law and regulations, and by the 1933 Act, the 1934 Act, and the rules and regulations of the Commission promulgated under such statutes, to be complied with prior to or subsequent to the Closing Date; and when the Prospectus is required to be delivered, the Primary Parties will comply in all material respects, at their own expense, with all material requirements imposed upon them by the OTS, the Charter Conversion Regulations, the Conversion Regulations (except as modified or waived in writing by the OTS), the Commission, by applicable state law and regulations and by the 1933 Act, the 1934 Act and the rules and regulations of the Commission promulgated under such statutes, in each case as from time to time in force, so far as necessary to permit the continuance of sales or dealing in shares of Common Stock during such period in accordance with the provisions hereof and the Prospectus.

(g) The Primary Parties will also comply with any conditions imposed by the OTS in connection with the establishment and operation of the Charitable Foundation and use their best efforts to ensure that the Charitable Foundation submits within the time frames required by applicable law a request to the Internal Revenue Service to be recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code; the Primary Parties will take no action which will result in the possible loss of the Charitable Foundation's tax exempt status; and none of the Primary Parties will contribute any additional assets to the Charitable Foundation until such time that such additional contributions will be deductible for federal and state income tax purposes.

(h) Each of the Primary Parties will inform the Agent of any event or circumstances of which it is or becomes aware as a result of which the Registration Statement and/or Prospectus, as then supplemented or amended, would include an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein not misleading. If it is necessary, in the reasonable opinion of counsel for the Primary Parties, to amend or supplement the Registration Statement or the Prospectus in order to correct such untrue statement of a material fact or to make the statements therein not misleading in light of the circumstances existing at the time of their use, the Primary Parties will, at their expense, prepare, file with the Commission and the OTS, and furnish to the Agent, a reasonable number of copies of an amendment or amendments of, or a supplement or supplements to, the Registration Statement and the Prospectus (in form and substance reasonably satisfactory to counsel for the Agent after a reasonable time for review) which will amend or supplement the Registration Statement and/or the Prospectus so that as amended or supplemented it will not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein, in light of the circumstances existing at the time, not misleading. For the purpose of this subsection, each of the Primary Parties will furnish such information with respect to itself as the Agent may from time to time reasonably request.

(i) Pursuant to the terms of the Plan, the Holding Company will endeavor in good faith, in cooperation with the Agent, to register or to qualify the Shares for offer and sale or to

exempt such Shares from registration and to exempt the Holding Company and its officers, directors and employees from registration as broker-dealers, under the applicable securities laws of the jurisdictions in which the Offering will be conducted; provided, however, that the Holding Company shall not be obligated to file any general consent to service of process or to qualify as a foreign corporation to do business in any jurisdiction in which it is not so qualified. In each jurisdiction where any of the Shares shall have been registered or qualified as above provided, the Holding Company will make and file such statements and reports in each year as are or may be required by the laws of such jurisdictions.

(j) The Holding Company will not sell or issue, contract to sell or otherwise dispose of, for a period of 90 days after the date hereof, without the Agent's prior written consent, which consent shall not be unreasonably withheld, any shares of Common Stock other than in connection with any plan or arrangement described in the Prospectus.

(k) For the period of three years from the date of this Agreement, the Holding Company will furnish to the Agent upon request (i) a copy of each report of the Holding Company furnished to or filed with the Commission under the 1934 Act or any national securities exchange or system on which any class of securities of the Holding Company is listed or quoted, (ii) a copy of each report of the Holding Company mailed to holders of Common Stock or non-confidential report filed with the Commission or the OTS or any other supervisory or regulatory authority or any national securities exchange or system on which any class of the securities of the Holding Company is listed or quoted, (iii) each press release and material news item and article released by the Holding Company and/or Bank, and (iv) from time-to-time, such other publicly available information concerning the Primary Parties as the Agent may reasonably request.

(l) The Primary Parties will use the net proceeds from the sale of the Common Stock in the manner set forth in the Prospectus under the caption "How We Intend To Use The Proceeds From The Offering."

(m) The Holding Company will distribute the Prospectus or other offering materials in connection with the offering and sale of the Common Stock only in accordance with the Conversion Regulations, the 1933 Act and the 1934 Act and the rules and regulations promulgated under such statutes, and the laws of any state in which the shares are qualified for sale.

(n) Prior to the Closing Date, the Holding Company shall register its Common Stock under Section 12(g) of the 1934 Act, as amended, and will request that such registration statement be effective upon completion of the Reorganization. The Holding Company shall maintain the effectiveness of such registration for not less than three years or such shorter period as permitted by the OTS.

(o) For so long as the Common Stock is registered under the 1934 Act, the Holding Company will furnish to its stockholders after the end of each fiscal year, in the time periods prescribed by applicable law and regulations, such reports and other information as are required to be furnished to its stockholders under the 1934 Act (including consolidated financial statements of the Holding Company and its subsidiaries, certified by independent public accountants).

(p) The Holding Company will report the use of proceeds of the Offering in accordance with Rule 463 under the 1933 Act.

(q) The Primary Parties will maintain appropriate arrangements for depositing all funds received from persons mailing subscriptions for or orders to purchase Conversion Shares on an interest bearing basis at the rate described in the Prospectus until the Closing Date and satisfaction of all conditions precedent to the release of the Holding Company's obligation to refund payments received from persons subscribing for or ordering Conversion Shares in the Conversion Offerings, in accordance with the Plan as described in the Prospectus, or until refunds of such funds have been made to the persons entitled thereto or withdrawal authorizations canceled in accordance with the Plan and as described in the Prospectus. The Primary Parties will maintain, together with the Agent, such records of all funds received to permit the funds of each subscriber to be separately insured by the FDIC (to the maximum extent allowable) and to enable the Primary Parties to make the appropriate refunds of such funds in the event that such refunds are required to be made in accordance with the Plan and as described in the Prospectus.

(r) Within 90 days following the Closing Date, the MHC and the Holding Company will each register as a savings and loan holding company under the HOLA.

(s) The Primary Parties will take such actions and furnish such information as are reasonably requested by the Agent in order for the Agent to ensure compliance with Rule 2790 of the National Association of Securities Dealers, Inc. ("NASD").

(t) The Primary Parties will conduct their businesses in compliance in all material respects with all applicable federal and state laws, rules, regulations, decisions, directives and orders including, all decisions, directives and orders of the Commission, the OTS and the FDIC.

(u) The Holding Company and the Bank shall comply with any and all terms, conditions, requirements and provisions with respect to the Reorganization and the establishment and operation of the Charitable Foundation and the transactions contemplated thereby imposed by the OTS, the HOLA, the Commission, the 1933 Act, the Charter Conversion Regulations, the Conversion Regulations, the Exchange Act and the regulations promulgated by the Commission pursuant to the Exchange Act to be complied with subsequent to the Closing Date. The Company will comply with all provisions of all undertakings contained in the Registration Statement.

(v) The Primary Parties will not amend the Plan without notifying the Agent prior thereto.

(w) The Holding Company shall provide the Agent with any information necessary to carry out the allocation of the Conversion Shares in the event of an oversubscription, and such information shall be accurate and reliable in all material respects.

(x) The Holding Company will not deliver the Shares until the Primary Parties have satisfied or caused to be satisfied each condition set forth in Section 9 hereof, unless such condition is waived in writing by the Agent.

(y) Immediately upon completion of the sale by the Holding Company of the Shares contemplated by the Plan and the Prospectus, (i) the MHC shall have been formed pursuant to the Plan and shall own at all times more than 50% of the issued and outstanding shares of Common Stock, (ii) all of the issued and outstanding shares of capital stock of the Bank shall be owned by the Holding Company, (iii) the Holding Company shall have no direct subsidiaries other than the Bank, and (iv) the Reorganization shall have been effected in accordance with all applicable statutes, regulations, decisions and orders; and all terms, conditions, requirements and provisions with respect to the Reorganization (except those that are conditions subsequent) imposed by the Commission, the OTS or any other governmental agency, if any, shall have been complied with by the Primary Parties in all material respects or appropriate waivers shall have been obtained and all notice and waiting periods shall have been satisfied, waived or elapsed.

(z) Prior to the Closing Date, the Plan shall have been approved by the eligible voting depositors of the Bank in accordance with the Conversion Regulations and the provisions of the Bank's Charter and bylaws.

(aa) As of the Closing Date, the Primary Parties shall have completed all conditions precedent to the Reorganization (including the Charter Conversion) in accordance with the Plan and shall have complied, in all material respects with the Charter Conversion Regulations, the Conversion Regulations and with any other applicable laws, regulations (except as modified or waived in writing by the OTS), decisions and orders, including all terms, conditions, requirements and provisions precedent to the Reorganization imposed upon any of the Primary Parties by the OTS or any other regulatory authority as set forth in correspondence received from the OTS or any other regulatory authority.

(bb) On or before the Closing Date, the Primary Parties will have completed all conditions precedent to the Offering specified in the Plan and the offer and sale of the Shares will have been conducted in all material respects in accordance with the Plan, the Conversion Regulations (except as modified or waived in writing by the OTS) and with all other applicable laws, regulations, decisions and orders, including all terms, conditions, requirements and provisions precedent to the Offering imposed upon any of the Primary Parties by the OTS, the Commission or any other regulatory authority and in the manner described in the Prospectus.

8. Payment of Expenses. Whether or not the Reorganization is completed or is consummated, the Primary Parties will pay for all expenses incident to the performance of this Agreement, including without limitation: (a) the preparation and filing of the OTS Applications; (b) the preparation, printing, filing, delivery and shipment of the Registration Statement, including the Prospectus, and all amendments and supplements thereto; (c) all filing fees and expenses in connection with the qualification or registration of the Shares for offer and sale by the Holding Company under the securities or "blue sky" laws, including without limitation filing fees, reasonable legal fees and disbursements of counsel in connection therewith, and in connection with the preparation of a blue sky law survey; (d) the filing fees of the NASD; (e) fees and expenses related to the preparation of the independent appraisal; and (f) the reasonable expenses of the Agent. Notwithstanding the foregoing, the Primary Parties shall not be required to reimburse Agent for more than \$100,000 in legal fees (other than such fees as shall be related to "blue sky" matters and other than legal out of pocket expenses), except with the prior approval of the Primary Parties. The Agent

will not incur reimbursable out of pocket expenses in excess of \$20,000 without the consent of the Primary Parties. The Primary Parties acknowledge, however, that such caps may be increased by the mutual consent of the Primary Parties and the Agent in the event of any material delay in the Offering that would require an update of the financial information contained in the Registration Statement, as amended or supplemented, to reflect a period later than that set forth in the financial statements included in the original Registration Statement. Not later than two days prior to the Closing Date, the Agent will provide the Bank with a detailed accounting of all reimbursable expenses to be paid at the Closing.

9. Conditions to the Agent's Obligations. The obligations of the Agent hereunder and the occurrence of the Closing and the Reorganization are subject to the condition that all representations and warranties and other statements of the Primary Parties herein contained are, at and as of the commencement of the Offering and at and as of the Closing Date, true and correct, the condition that the Primary Parties shall have performed all of their obligations hereunder to be performed on or before such dates and to the following further conditions:

(a) The Charter Conversion has been approved by the OTS. The Registration Statement shall have been declared effective by the Commission and the Prospectus and Proxy Statement contained in the MHC-1/MHC-2 shall have been approved by the OTS for mailing prior to the commencement of the Offering, the Holding Company Application (including the Merger Application) shall have been approved and no stop order or other action suspending the effectiveness of the Registration Statement shall have been issued under the 1933 Act or proceedings therefore initiated or, to any of the Primary Parties' best knowledge, threatened by the Commission or any state authority and no order or other action suspending the authorization for use of the Prospectus or the consummation of the Reorganization shall have been issued or proceedings therefore initiated or, to any of the Primary Parties' best knowledge, threatened by the OTS, the Commission, or any other governmental body.

(b) At the Closing Date, the Agent shall have received:

(1) The favorable opinion, dated as of the Closing Date, of Thatcher Proffitt & Wood LLP, and/or local counsel acceptable to the Agent in form and substance satisfactory to counsel for the Agent to the effect that:

(i) Upon consummation of the Reorganization, the Holding Company will be a corporation duly organized and validly existing under the federal laws of the United States of America, with corporate power and authority to own its properties and to conduct its business as described in the Prospectus, and will be duly qualified to transact business and will be in good standing in each jurisdiction in which the conduct of its business requires such qualification and in which the failure to qualify would have a material adverse effect on the financial condition, earnings, capital, properties or business affairs of the Primary Parties.

(ii) The Bank is a duly organized and validly existing New York chartered mutual savings and loan association and following the Charter Conversion will be a duly organized and validly existing federally chartered mutual savings bank and immediately following completion of the Reorganization will be a validly existing federally chartered savings bank in stock

form with full power and authority to own its properties and to conduct its business as described in the Prospectus and to enter into this Agreement and perform its obligations hereunder; the activities of the Bank as described in the Prospectus are permitted by the rules, regulations and practices of the OTS; the issuance and sale of the Capital Stock of the Bank to the Holding Company in the Reorganization has been duly and validly authorized by all necessary corporate action on the part of the Holding Company and the Bank and, upon payment therefor in accordance with the terms of the Plan, will be validly issued, fully paid and nonassessable, and will be owned of record and beneficially by the Holding Company, free and clear of any mortgage, pledge, lien, encumbrance, claim or restriction.

(iii) The activities of the Bank described in the Prospectus are permitted under federal law to a federally chartered savings bank. To the best of such counsel's knowledge, each of the Holding Company and the Bank has obtained all licenses, permits, and other governmental authorizations that are material for the conduct of its business, all such licenses, permits and other governmental authorization are in full force and effect, and the Holding Company and the Bank are complying therewith in all material respects.

(iv) The Bank is a member of the FHLB of New York and the Bank is an insured depository institution under the provisions of the Federal Deposit Insurance Act, as amended, and to such counsel's knowledge no proceedings for the termination or revocation of such insurance are pending or threatened.

(v) Upon consummation of the Reorganization, the MHC will be duly organized and validly existing as a federally chartered mutual holding company, duly authorized to conduct its business and own its properties as described in the Registration Statement and Prospectus.

(vi) The Charitable Foundation has been duly authorized and incorporated and is validly existing as a non-stock corporation in good standing under the laws of the State of Delaware with corporate power and authority to own, lease and operate its properties and to conduct its business as described in the Prospectus; no approvals are required to establish the Charitable Foundation and to contribute the shares of Common Stock thereto as described in the Prospectus other than those imposed by the OTS.

(vii) Upon consummation of the Reorganization, (a) the authorized, issued and outstanding capital stock of the Holding Company will be within the range set forth in the Prospectus under the caption "Capitalization," and no shares of Common Stock have been or will be issued and outstanding prior to the Closing Date (except for the shares issued upon the incorporation of the Holding Company); (b) the shares of Common Stock of the Holding Company issued to the MHC will have been duly and validly authorized for issuance and will be fully paid and nonassessable; (c) the shares of Common Stock of the Holding Company to be subscribed for in the Offering and the Charitable Shares issued to the Charitable Foundation will have been duly and validly authorized for issuance, and when issued and delivered by the Holding Company pursuant to the Plan against payment of the consideration (or contributed to the Charitable Foundation as it relates to the Charitable Shares) calculated as set forth in the Plan, will be fully paid and nonassessable; and (d) the issuance of the shares of Common Stock and the Charitable Shares are not subject to preemptive

rights under the charter or bylaws of any of the Primary Parties, or arising or outstanding by operation of law or, to the best knowledge of such counsel, under any contract, indenture, agreement, instrument or other document, except for the subscription rights under the Plan.

(viii) The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of the Primary Parties; and this Agreement constitutes a valid, legal and binding obligation of each of the Primary Parties, enforceable in accordance with its terms, except to the extent that the provisions of Sections 10 and 11 hereof may be unenforceable as against public policy, and except to the extent that such enforceability may be limited by bankruptcy laws, insolvency laws, or other laws affecting the enforcement of creditors' rights generally, or the rights of creditors of savings institutions insured by the FDIC (including the laws relating to the rights of the contracting parties to equitable remedies).

(ix) The Plan has been duly adopted by the board of directors of the Bank and by the depositors of the Bank in the manner required by the Conversion Regulations and the Bank's charter and bylaws.

(x) The Reorganization, including the Charter Conversion and the Offering was effected in accordance with the Plan and all applicable laws, including statutes, regulations, decisions and orders; and all terms, conditions, requirements and provisions with respect to the Reorganization imposed by the Commission, the OTS or any other governmental agency, if any, were complied with by the Bank in all material respects or appropriate waivers were obtained and all notice and waiting periods were satisfied, waived or elapsed.

(xi) The OTS Applications have been approved by the OTS and the Prospectus and Proxy Statement have been authorized for use by the OTS, and subject to the satisfaction of any conditions set forth in such OTS approvals and clearance under applicable securities laws, no further approval, registration, authorization, consent or other order of any federal or state regulatory agency, public board or body is required in connection with the execution and delivery of this Agreement, the offer, sale and issuance of the Shares and the consummation of the Reorganization.

(xii) The Purchase by the Holding Company of all of the issued and outstanding Capital Stock of the Bank has been authorized by the OTS and no action has been taken, or to such counsel's knowledge, is pending or threatened, to revoke any such authorization or approval.

(xiii) The Registration Statement has become effective under the 1933 Act, no stop order suspending the effectiveness of the Registration Statement has been issued, and, to such counsel's knowledge, no proceedings for that purpose have been instituted or threatened.

(xiv) The material tax consequences of the Reorganization are set forth in the Prospectus under the caption "Summary - Tax Consequences of the Offering" and "Taxation." The information in the Prospectus under the caption "Summary - Tax Consequences of

the Offering” and “Taxation” has been reviewed by such counsel and fairly describes such opinion rendered by such counsel to the Primary Parties with respect to such matters.

(xv) The terms and provisions of the shares of Common Stock conform to the description thereof contained in the Registration Statement and the Prospectus, and the forms of certificates proposed to be used to evidence the shares of Common Stock are in due and proper form.

(xvi) At the time the OTS Applications were approved, the OTS Applications (as amended or supplemented) including the Prospectus and Proxy Statement contained therein, complied as to form in all material respects with the requirements of the Conversion Regulations and Charter Conversion Regulations and all applicable laws, rules and regulations and decisions and orders of the OTS, except as modified or waived by the OTS (other than the financial statements, notes to financial statements, financial tables and other financial and statistical data included therein and the appraisal valuation as to which counsel need express no opinion). To such counsel’s knowledge, no person has sought to obtain regulatory or judicial review of the final action of the OTS approving the OTS Applications.

(xvii) At the time that the Registration Statement became effective the Registration Statement, including the Prospectus contained therein (as amended or supplemented) (other than the financial statements, notes to financial statements, financial tables or other financial and statistical data included therein and the appraisal valuation as to which counsel need express no opinion), complied as to form in all material respects with the requirements of the 1933 Act and the rules and regulations promulgated thereunder.

(xviii) To such counsel’s knowledge, there are no legal or governmental proceedings pending, or threatened (i) asserting the invalidity of this Agreement or (ii) seeking to prevent the Reorganization or the offer, sale or issuance of the Shares.

(xix) The information in the Prospectus under the captions “Regulation,” “Taxation,” “Restrictions on Acquisition of Lake Shore Bancorp and Lake Shore Savings,” “Description of Lake Shore Bancorp Capital Stock” and “The Reorganization and Offering,” to the extent that it constitutes matters of law, summaries of legal matters, documents or proceedings, or legal conclusions, has been reviewed by such counsel and is accurate in all material respects (except as to the financial statements and other financial data included therein as to which such counsel need express no opinion).

(xx) None of the Primary Parties are required to be registered as an investment company under the Investment Company Act of 1940.

(xxi) The Bank has duly adopted a federal stock charter and bylaws effective upon consummation of the Reorganization and none of the Primary Parties is in violation of its charter or its bylaws or, to such counsel’s knowledge, any material obligation, agreement, covenant or condition contained in any material contract, indenture, mortgage, loan agreement, note, lease or other instrument filed as an exhibit to, or incorporated by reference in, the Registration Statement, which violation would have a material adverse effect on the financial condition of the

Primary Parties considered as one enterprise, or on the earnings, capital, properties or business affairs of the Primary Parties considered as one enterprise. In addition, the execution and delivery of and performance under this Agreement by the Primary Parties, the incurrence of the obligations set forth herein and the consummation of the transactions contemplated herein will not result in any material violation of the provisions of the charter or the bylaws of any of the Primary Parties or any material violation of any applicable law, act, regulation, or to such counsel's knowledge, order or court order, writ, injunction or decree.

The opinion may be limited to matters governed by the laws of the United States and the States of New Jersey and New York. In rendering such opinion regarding New York and New Jersey law, such counsel may rely on local counsel reasonably acceptable to the Agent and its counsel. In addition, in rendering such opinion, such counsel may rely (A) as to matters involving the application of laws of any jurisdiction other than the United States, to the extent such counsel deems proper and specified in such opinion, upon the opinion of other counsel of good standing, as long as such other opinion indicates that the Agent may rely on the opinion, and (B) as to matters of fact, to the extent such counsel deems proper, on certificates of responsible officers of the Primary Parties and public officials, provided copies of any such opinion(s) or certificates of public officials are delivered to Agent together with the opinion to be rendered hereunder by special counsel to the Primary Parties. The opinion of such counsel for the Primary Parties shall state that it has no reason to believe that the Agent is not justified in relying thereon.

(2) The letter of Thatcher Proffitt & Wood LLP in form and substance to the effect that during the preparation of the Registration Statement and the Prospectus, Thatcher Proffitt & Wood LLP participated in conferences with certain officers of and other representatives of the Primary Parties, counsel to the Agent, representatives of the independent public accounting firm for the Primary Parties and representatives of the Agent at which the contents of the Registration Statement and the Prospectus and related matters were discussed and has considered the matters required to be stated therein and the statements contained therein and, although (without limiting the opinions provided pursuant to Section 9(b)(1)) Thatcher Proffitt & Wood LLP has not independently verified the accuracy, completeness or fairness of the statements contained in the Registration Statement and Prospectus, on the basis of the foregoing, nothing has come to the attention of Thatcher Proffitt & Wood LLP that caused Thatcher Proffitt & Wood LLP to believe that the Registration Statement at the time it was declared effective by the Commission and as of the date of such letter or that the General Disclosure Package as of the Applicable Time, contained or contains any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading (it being understood that counsel need express no comment or opinion with respect to the financial statements, schedules and other financial and statistical data included, or statistical or appraisal methodology employed, in the Registration Statement, Prospectus or General Disclosure Package).

(3) The favorable opinion, dated as of the Closing Date, of Luse Gorman Pomerenk & Schick, P.C., counsel for the Agent, with respect to such matters as the Agent may reasonably require; such opinion may rely, as to matters of fact, upon certificates of officers and directors of the Primary Parties delivered pursuant hereto or as such counsel may reasonably request and upon the opinion of Thatcher Proffitt & Wood LLP.

(c) Concurrently with the execution of this Agreement, the Agent shall receive a letter from (i) Beard Miller Company LLP, dated the date hereof and addressed to the Agent, such letter confirming that Beard Miller Company LLP is a firm of independent public accountants within the meaning of the Code of Professional Ethics of the American Institute of Certified Public Accountants, the 1933 Act and the regulations promulgated thereunder and 12 C.F.R. Section 571.2(c)(3), and no information concerning its relationship with or interests in the Primary Parties is required by the OTS Applications or Item 13 of the Registration Statement, and stating in effect that in Beard Miller Company LLP's opinion the financial statements of the Bank included in the Prospectus comply as to form in all material respects with the applicable accounting requirements of the 1933 Act, the 1934 Act and the related published rules and regulations of the Commission thereunder and the Conversion Regulations and generally accepted accounting principles consistently applied; (ii) stating in effect that, on the basis of certain agreed upon procedures (but not an audit examination in accordance with generally accepted auditing standards) consisting of a reading of the minutes of the meetings of the Board of Directors of the Primary Parties, the Audit Committee of the Bank, a review of the unaudited interim financial information as of and for the interim period ending September 30, 2005 and _____, 2006, which with respect to the period ending September 30, 2005, shall be in accordance with Statement on Auditing Standards No. 100, and consultations with officers of the Holding Company responsible for financial and accounting matters, nothing came to their attention which caused them to believe that: (A) such unaudited financial statements and financial information included in the section titled "Recent Developments" are not in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited financial statements included in the Prospectus; or (B) during the period from the date of the Recent Developments information included in the Prospectus to a date not more than three business days prior to the date of the Prospectus there was any increase in non-performing loans, special mention loans, borrowings (defined as advances from the FHLB of New York, securities sold under agreements to repurchase and any other form of debt other than deposits) of the Bank or decrease in assets, deposits, loan losses allowances or retained earnings of the Bank or there was any decrease in net income, non-interest income, tax expense or net interest income of the Bank or any increase in non-interest expense for the number of full months commencing immediately after the Recent Developments period and ended on the last month-end prior to the date of the Prospectus as compared to the corresponding period in the preceding year, which was material to the financial position or results of operations of the Primary Parties; and (iii) stating that, in addition to the audit examination referred to in its opinion included in the Prospectus and the performance of the procedures referred to in clause (ii) of this subsection (c), they have compared with the general accounting records of the Bank, which are subject to the internal controls of the accounting system of the Bank and other data prepared by the Primary Parties directly from such accounting records, to the extent specified in such letter, such amounts and/or percentages set forth in the Prospectus as the Agent may reasonably request, and they have found such amounts and percentages to be in agreement therewith (subject to rounding).

(d) At the Closing Date, the Agent shall receive a letter from Beard Miller Company LLP dated the Closing Date, addressed to the Agent, confirming the statements made by its letter delivered by it pursuant to subsection (c) of this Section 9, the "specified date" referred to in clause (ii)(B) thereof to be a date specified in such letter, which shall not be more than three business days prior to the Closing Date.

(e) At the Closing Date, counsel to the Agent shall have been furnished with such documents and opinions as counsel for the Agent may require for the purpose of enabling them to advise the Agent with respect to the issuance and sale of the Common Stock as herein contemplated and related proceedings, or in order to evidence the accuracy of any of the representations and warranties, or the fulfillment of any of the conditions herein contained.

(f) At the Closing Date, the Agent shall receive a certificate of the Chief Executive Officer and Chief Financial Officer of each of the Primary Parties, dated the Closing Date, without personal liability to the effect that: (i) they have examined the Prospectus and at the time the Prospectus became authorized for final use, the Prospectus did not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading; (ii) there has not been, since the respective dates as of which information is given in the Prospectus, any material adverse change in the financial condition or in the earnings, capital, properties, business prospects or business affairs of the Primary Parties, considered as one enterprise, whether or not arising in the ordinary course of business; (iii) the representations and warranties contained in Section 6 of this Agreement are true and correct with the same force and effect as though made at and as of the Closing Date; (iv) each of the Primary Parties has complied in all material respects with all material agreements and satisfied all conditions on its part to be performed or satisfied at or prior to the Closing Date including the conditions contained in this Section 9; (v) no stop order has been issued or, to the best of their knowledge, is threatened, by the Commission or any other governmental body; (vi) no order suspending the Reorganization, including the Charter Conversion and the Offering, the acquisition of all of the shares of the Bank by the Holding Company, the acquisition by the MHC of shares of the Common Stock or the effectiveness of the Registration Statement has been issued and to the best of their knowledge, no proceedings for any such purpose have been initiated or threatened by the OTS, the Commission, or any other federal or state authority; (vii) to the best of their knowledge, no person has sought to obtain regulatory or judicial review of the action of the OTS in approving the Plan or to enjoin the Reorganization.

(g) At the Closing Date, the Agent shall receive a letter from RP Financial, LC., dated as of the Closing Date, (i) confirming that said firm is independent of the Primary Parties and is experienced and expert in the area of corporate appraisals within the meaning of the Conversion Regulations, (ii) stating in effect that the Appraisal complies in all material respects with the applicable requirements of the Conversion Regulations, and (iii) further stating that its opinion of the aggregate pro forma market value of the Primary Parties, as converted, expressed in the Appraisal as most recently updated, remains in effect.

(h) None of the Primary Parties shall have sustained, since the date of the latest audited financial statements included in the Registration Statement and Prospectus, any material loss or interference with its business from fire, explosion, flood or other calamity, whether or not covered by insurance, or from any labor dispute or court or governmental action, order or decree, otherwise than as set forth in the Registration Statement and the Prospectus, and since the respective dates as of which information is given in the Registration Statement and the Prospectus, there shall not have been any material change, or any development involving a prospective material change in, or affecting the general affairs of, management, financial position, retained earnings, long-term debt, stockholders' equity or results of operations of any of the Primary Parties, otherwise than as set forth or

contemplated in the Registration Statement and the Prospectus, the effect of which, in any such case described above, is in the Agent's reasonable judgment sufficiently material and adverse as to make it impracticable or inadvisable to proceed with the Offering or the delivery of the Shares on the terms and in the manner contemplated in the Prospectus.

(i) Prior to and at the Closing Date: (i) in the reasonable opinion of the Agent there shall have been no material adverse change in the financial condition or in the earnings, capital, properties of the Primary Parties considered as one enterprise, from and as of the latest dates as of which such condition is set forth in the Prospectus, except as referred to therein; (ii) there shall have been no material transaction entered into by the Primary Parties, independently or considered as one enterprise, from the latest date as of which the financial condition of the Primary Parties is set forth in the Prospectus, other than transactions referred to or contemplated therein; (iii) none of the Primary Parties shall have received from the OTS or the FDIC any direction (oral or written, other than directions applicable to all federally chartered savings banks) to make any material change in the method of conducting their business with which it has not complied in all material respects (which direction, if any, shall have been disclosed to the Agent) and which would reasonably be expected to have a material and adverse effect on the condition (financial or otherwise) or on the earnings, capital or properties of the Primary Parties considered as one enterprise; (iv) none of the Primary Parties shall have been in default (nor shall an event have occurred which, with notice or lapse of time or both, would constitute a default) under any provision of any agreement or instrument relating to any material outstanding indebtedness; (v) no action, suit or proceeding, at law or in equity or before or by any federal or state commission, board or other administrative agency, shall be pending or, to the knowledge of the Primary Parties, threatened against any of the Primary Parties or affecting any of their properties wherein an unfavorable decision, ruling or finding would reasonably be expected to have a material and adverse effect on the financial condition or on the earnings, capital, properties or business affairs of the Primary Parties, considered as one enterprise; and (vi) the Shares shall have been qualified or registered for offering and sale under the securities or "blue sky" laws of the jurisdictions requested by the Agent.

(j) At or prior to the Closing Date, the Agent shall receive (i) a copy of the letter from the OTS authorizing the use of the Prospectus and the Proxy Statement and approving the Charter Conversion Application, the MHC-1/MHC-2 and the Holding Company Application, (ii) a copy of the order from the Commission declaring the Registration Statement effective, (iii) copies of certificates of existence for each of the Primary Parties, or other writing from the OTS in form and substance reasonably satisfactory to the Agent evidencing the valid existence of the Holding Company, the MHC and the Bank as of the Closing Date (iv) a certificate from the FDIC evidencing the Bank's insurance of accounts, (v) a certificate of the FHLB of New York evidencing the Bank's membership therein, and (vi) any other documents that Agent shall reasonably request.

(k) Subsequent to the date hereof, there shall not have occurred any of the following: (i) a suspension or limitation in trading in securities generally on the New York Stock Exchange or American Stock Exchange or in the over-the-counter market, or quotations halted generally on the Nasdaq Stock Market, or minimum or maximum prices for trading have been fixed, or maximum ranges for prices for securities have been required by either of such exchanges or the NASD or by order of the Commission or any other governmental authority other than temporary trading halts (A) imposed as a result of intraday changes in the Dow Jones Industrial Average, (B)

lasting no longer than until the regularly scheduled commencement of trading on the next succeeding business-day, and (C) which, when combined with all other such halts occurring during the previous five business days, total less than three; (ii) a general moratorium on the operations of commercial banks or other federally-insured financial institutions or general moratorium on the withdrawal of deposits from commercial banks or other federally-insured financial institutions declared by either federal or state authorities; (iii) the engagement by the United States in hostilities which have resulted in the declaration, on or after the date hereof, of a national emergency or war; or (iv) a material decline in the price of equity or debt securities in the United States financial markets or elsewhere if the effect of any of (i) through (iv) herein, in the Agent's reasonable judgment, makes it impracticable or inadvisable to proceed with the offering or the delivery of the Shares on the terms and in the manner contemplated in the Registration Statement and the Prospectus.

(l) All such opinions, certificates, letters and documents will be in compliance with the provisions hereof only if they are reasonably satisfactory in form and substance to the Agent and of counsel for the Agent. Any certificate signed by an officer of the Holding Company or the Bank and delivered to the Agent or to counsel for the Agent shall be deemed a representation and warranty by the Holding Company or the Bank, as the case may be, to the Agent as to the statements made therein. If any condition to the Agent's obligations hereunder to be fulfilled prior to or at the Closing Date is not fulfilled, the Agent may terminate this Agreement (provided that if this Agreement is so terminated but the sale of Shares is nevertheless consummated, the Agent shall be entitled to the compensation provided for in Section 4 hereof) or, if the Agent so elects, may waive any such conditions which have not been fulfilled or may extend the time of their fulfillment.

10. Indemnification .

(a) The Primary Parties jointly and severally agree to indemnify and hold harmless the Agent, its officers, directors, agents, attorneys, servants and employees and each person, if any, who controls the Agent within the meaning of Section 15 of the 1933 Act or Section 20(a) of the 1934 Act, against any and all loss, liability, claim, damage or expense whatsoever (including but not limited to settlement expenses, subject to the limitation set forth in the last sentence of paragraph (c) below), joint or several, that the Agent or any of such officers, directors, agents, attorneys, servants, employees and controlling Persons (collectively, the "Related Persons") may suffer or to which the Agent or the Related Persons may become subject under all applicable federal and state laws or otherwise, and to promptly reimburse the Agent and any Related Persons upon written demand for any reasonable expenses (including reasonable fees and disbursements of counsel) incurred by the Agent or any Related Persons in connection with investigating, preparing or defending any actions, proceedings or claims (whether commenced or threatened) to the extent such losses, claims, damages, liabilities or actions: (i) arise out of or are based upon any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement (or any amendment or supplement thereto), preliminary or final Prospectus (or any amendment or supplement thereto), any Issuer-Represented Free Writing Prospectus, the OTS Applications, or any blue sky application or other instrument or document of the Primary Parties or based upon written information supplied by any of the Primary Parties filed in any state or jurisdiction to register or qualify any or all of the Shares under the securities laws thereof (collectively, the "Blue Sky Applications"), or any application or other document, advertisement, or communication ("Sales Information") prepared, made or executed by or on behalf of any of the Primary Parties with its consent or based upon written information furnished

by or on behalf of any of the Primary Parties, whether or not filed in any jurisdiction in order to qualify or register the Shares under the securities laws thereof, (ii) arise out of or are based upon the omission or alleged omission to state in any of the foregoing documents or information, a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; (iii) arise from any theory of liability whatsoever relating to or arising from or based upon the Registration Statement (or any amendment or supplement thereto), preliminary or final Prospectus (or any amendment or supplement thereto), any Issuer-Represented Free Writing Prospectus, the OTS Applications, any Blue Sky Applications or Sales Information or other documentation distributed in connection with the Offering; or (iv) result from any claims made with respect to the accuracy, reliability and completeness of the records of Eligible Account Holders, Supplemental Eligible Account Holders and Other Members or for any denial or reduction of a subscription or order to purchase Common Stock, whether as a result of a properly calculated allocation pursuant to the Plan or otherwise, based upon such records; provided, however, that no indemnification is required under this paragraph (a) to the extent such losses, claims, damages, liabilities or actions arise out of or are based upon any untrue material statements or alleged untrue material statements in, or material omission or alleged material omission from, the Registration Statement (or any amendment or supplement thereto) or the preliminary or final Prospectus (or any amendment or supplement thereto), any Issuer-Represented Free Writing Prospectus, the OTS Applications the Blue Sky Applications or Sales Information or other documentation distributed in connection with the Reorganization made in reliance upon and in conformity with written information furnished to the Primary Parties by the Agent or its representatives (including counsel) with respect to the Agent expressly for use in the Registration Statement (or any amendment or supplement thereto) or Prospectus (or any amendment or supplement thereto) under the captions "Market for the Common Stock" and "The Reorganization and Offering –Marketing Arrangements," except for information derived from the Prospectus. Provided further, that the Primary Parties will not be responsible for any loss, liability, claim, damage or expense to the extent they result primarily from material oral misstatements by the Agent to a purchaser of Shares which are not based upon information in the Registration Statement or Prospectus, or from actions taken or omitted to be taken by the Agent in bad faith or from the Agent's gross negligence or willful misconduct, and the Agent agrees to repay to the Primary Parties any amounts advanced to it by the Primary Parties in connection with matters as to which it is found not to be entitled to indemnification hereunder.

(b) The Agent agrees to indemnify and hold harmless the Primary Parties, their directors and officers, agents, servants and employees and each person, if any, who controls any of the Primary Parties within the meaning of Section 15 of the 1933 Act or Section 20(a) of the 1934 Act against any and all loss, liability, claim, damage or expense whatsoever (including but not limited to settlement expenses, subject to the limitation set forth in the last sentence of paragraph (c) below), joint or several which they, or any of them, may suffer or to which they, or any of them, may become subject under all applicable federal and state laws or otherwise, and to promptly reimburse the Primary Parties and any such persons upon written demand for any reasonable expenses (including fees and disbursements of counsel) incurred by them in connection with investigating, preparing or defending any actions, proceedings or claims (whether commenced or threatened) to the extent such losses, claims, damages, liabilities or actions arise out of or are based upon any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement (or any amendment or supplement thereto), any Issuer-Represented Free Writing Prospectus, the OTS Applications or

any Blue Sky Applications or Sales Information or are based upon the omission or alleged omission to state in any of the foregoing documents a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; provided, however, that the Agent's obligations under this Section 10(b) shall exist only if and only to the extent that such untrue statement or alleged untrue statement was made in, or such material fact or alleged material fact was omitted from, the Registration Statement (or any amendment or supplement thereto) or the Prospectus (or any amendment or supplement thereto) in reliance upon and in conformity with written information furnished to the Primary Parties by the Agent or its representatives (including counsel) expressly for use under the captions "Market for the Common Stock" and "The Reorganization and Offering —Marketing Arrangements."

(c) Each indemnified party shall give prompt written notice to each indemnifying party of any action, proceeding, claim (whether commenced or threatened), or suit instituted against it in respect of which indemnity may be sought hereunder, but failure to so notify an indemnifying party shall not relieve it from any liability which it may have on account of this Section 10, Section 11 or otherwise. An indemnifying party may participate at its own expense in the defense of such action. In addition, if it so elects within a reasonable time after receipt of such notice, an indemnifying party, jointly with any other indemnifying parties receiving such notice, may assume defense of such action with counsel chosen by it and approved by the indemnified parties that are defendants in such action, unless such indemnified parties reasonably object to such assumption on the ground that there may be legal defenses available to them that are different from or in addition to those available to such indemnifying party. If an indemnifying party assumes the defense of such action, the indemnifying parties shall not be liable for any fees and expenses of counsel for the indemnified parties incurred thereafter in connection with such action, proceeding or claim, other than reasonable costs of investigation. In no event shall the indemnifying parties be liable for the fees and expenses of more than one separate firm of attorneys (unless an indemnified party or parties shall have reasonably concluded that there may be defenses available to it or them which are different from or in addition to those of other indemnified parties) for all indemnified parties in connection with any one action, proceeding or claim or separate but similar or related actions, proceedings or claims in the same jurisdiction arising out of the same general allegations or circumstances. The Holding Company shall be liable for any settlement of any claim against the Agent (or its directors, officers, employees, affiliates or controlling persons), made with the Holding Company's consent, which consent shall not be unreasonably withheld. The Holding Company shall not, without the written consent of the Agent, settle or compromise any claim against it based upon circumstances giving rise to an indemnification claim against the Holding Company hereunder unless such settlement or compromise provides that the Agent and the other indemnified parties shall be unconditionally and irrevocably released from all liability in respect of such claim.

(d) The agreements contained in this Section 10 and in Section 11 hereof and the representations and warranties of the Primary Parties set forth in this Agreement shall remain operative and in full force and effect regardless of (i) any investigation made by or on behalf of the Agent or its officers, directors, controlling persons, agents or employees or by or on behalf of any of the Primary Parties or any officers, directors, controlling persons, agents or employees of any of the Primary Parties; (ii) delivery of and payment hereunder for the Shares; or (iii) any termination of this Agreement.

11. Contribution .

(a) In order to provide for just and equitable contribution in circumstances in which the indemnification provided for in Section 10 is due in accordance with its terms but is found in a final judgment by a court to be unavailable from the Primary Parties or the Agent, the Primary Parties and the Agent shall contribute to the aggregate losses, claims, damages and liabilities of the nature contemplated by such indemnification in such proportion so that (i) the Agent is responsible for that portion represented by the percentage that the fees paid to the Agent pursuant to Section 4 of this Agreement (not including expenses) ("Agent's Fees"), less any portion of Agent's Fees paid by Agent to Assisting Brokers, bear to the total proceeds received by the Primary Parties from the sale of the Conversion Shares in the Conversion Offerings, net of all expenses of the Offerings except Agent's Fees, and (ii) the Primary Parties shall be responsible for the balance. If, however, the allocation provided above is not permitted by applicable law or if the indemnified party failed to give the notice required under Section 10 above, then each indemnifying party shall contribute to such amount paid or payable by such indemnified party in such proportion as is appropriate to reflect not only such relative fault of the Primary Parties on the one hand and the Agent on the other in connection with the statements or omissions which resulted in such losses, claims, damages or liabilities (or actions, proceedings or claims in respect thereof), but also the relative benefits received by the Primary Parties on the one hand and the Agent on the other from the Offering, as well as any other relevant equitable considerations. The relative benefits received by the Primary Parties on the one hand and the Agent on the other hand shall be deemed to be in the same proportion as the total proceeds from the Conversion Offerings, net of all expenses of the Conversion Offerings except Agent's Fees, received by the Primary Parties bear, with respect to the Agent, to the total fees (not including expenses) received by the Agent less the portion of such fees paid by the Agent to Assisting Brokers. The relative fault shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Primary Parties on the one hand or the Agent on the other and the parties relative intent, good faith, knowledge, access to information and opportunity to correct or prevent such statement or omission. The Primary Parties and the Agent agree that it would not be just and equitable if contribution pursuant to this Section 11 were determined by pro-rata allocation or by any other method of allocation which does not take account of the equitable considerations referred to above in this Section 11. The amount paid or payable by an indemnified party as a result of the losses, claims, damages or liabilities (or action, proceedings or claims in respect thereof) referred to above in this Section 11 shall be deemed to include any legal or other expenses reasonably incurred by such indemnified party in connection with investigating or defending any such action, proceeding or claim. It is expressly agreed that the Agent shall not be liable for any loss, liability, claim, damage or expense or be required to contribute any amount which in the aggregate exceeds the amount paid (excluding reimbursable expenses) to the Agent under this Agreement less the portion of such fees paid by the Agent to Assisting Brokers. It is understood and agreed that the above-stated limitation on the Agent's liability is essential to the Agent and that the Agent would not have entered into this Agreement if such limitation had not been agreed to by the parties to this Agreement. No person found guilty of any fraudulent misrepresentation (within the meaning of Section 11(f) of the 1933 Act) shall be entitled to contribution from any person who was not found guilty of such fraudulent misrepresentation. The duties, obligations and liabilities of the Primary Parties and the Agent under this Section 11 and under Section 10 shall be in addition to any

duties, obligations and liabilities which the Primary Parties and the Agent may otherwise have. For purposes of this Section 11, each of the Agent's and the Primary Parties' officers and directors and each person, if any, who controls the Agent or any of the Primary Parties within the meaning of the 1933 Act and the 1934 Act shall have the same rights to contribution as the Primary Parties and the Agent. Any party entitled to contribution, promptly after receipt of notice of commencement of any action, suit, claim or proceeding against such party in respect of which a claim for contribution may be made against another party under this Section 11, will notify such party from whom contribution may be sought, but the omission to so notify such party shall not relieve the party from whom contribution may be sought from any other obligation it may have hereunder or otherwise than under this Section 11.

12. Representations, Warranties and Indemnities to Survive Delivery . All representations, warranties and indemnities and other statements contained in this Agreement, or contained in certificates of officers of the Primary Parties or the Agent submitted pursuant hereto, shall remain operative and in full force and effect, regardless of any termination or cancellation of this Agreement or any investigation made by or on behalf of the Agent or its controlling persons, or by or on behalf of the Primary Parties and shall survive the issuance of the Shares, and any legal representative, successor or assign of the Agent, any of the Primary Parties, and any indemnified person shall be entitled to the benefit of the respective agreements, indemnities, warranties and representations.

13. Termination . Agent may terminate this Agreement by giving the notice indicated below in this Section at any time after this Agreement becomes effective as follows:

(a) In the event the Holding Company fails to consummate the sale of the minimum number of the Conversion Shares by September 30, 2006 in accordance with the provisions of the Plan or as required by the Conversion Regulations and applicable law, this Agreement shall terminate upon refund by the Primary Parties to each person who has subscribed for or ordered any of the Conversion Shares the full amount which it may have received from such person, together with interest in accordance with Section 3, and no party to this Agreement shall have any obligation to the other hereunder, except as set forth in Sections 3, 4, 8, 10 and 11 hereof.

(b) If any of the conditions specified in Section 9 shall not have been fulfilled when and as required by this Agreement, or by the Closing Date, or waived in writing by the Agent, this Agreement and all of the Agent's obligations hereunder may be canceled by the Agent by notifying the Bank of such cancellation in writing at any time at or prior to the Closing Date, and any such cancellation shall be without liability of any party to any other party except as otherwise provided in Sections 3, 4, 8, 10 and 11 hereof.

(c) If Agent elects to terminate this Agreement as provided in this Section, the Bank shall be notified by the Agent as provided in Section 14 hereof.

(d) If this Agreement is terminated in accordance with the provisions of Sections 3, 9, or 13, the Primary Parties shall pay the Agent the fees earned pursuant to Section 4 and will reimburse the Agent for its reasonable expenses pursuant to Section 8, including without limitation communication (telephone and document delivery charges), legal and travel expenses.

14. Notices . All notices and other communications hereunder shall be in writing and shall be deemed to have been duly given if mailed or transmitted by any standard form of telecommunication. Notices to Agent shall be directed to Ryan Beck & Co. Inc., 18 Columbia Turnpike, Florham Park, New Jersey 07932, Attention: Robin Suskind (with a copy to John J. Gorman, Esq., Luse Gorman Pomerenk & Schick, P.C., 5335 Wisconsin Avenue, N.W., Suite 400, Washington, D.C. 20015); notices to the Primary Parties shall be directed to Lake Shore Savings and Loan Association, 125 East Fourth Street, Dunkirk New York 14048 Attention: David C. Mancuso, President and Chief Executive Officer (with a copy to V. Gerard Comizio, Thatcher Proffitt & Wood LLP, 1700 Pennsylvania Avenue, N.W., Suite 800, Washington, D.C. 20006).

15. Parties . This Agreement shall inure to the benefit of and be binding upon the Agent and the Primary Parties, and their respective successors. Nothing expressed or mentioned in this Agreement is intended or shall be construed to give any person, firm or corporation, other than the parties hereto and their respective successors and the controlling persons and officers and directors referred to in Sections 10 and 11 and their heirs and legal representatives, any legal or equitable right, remedy or claim under or in respect of this Agreement or any provisions herein contained. It is understood and agreed that this Agreement is the exclusive agreement among the parties, supersedes any prior Agreement among the parties and may not be varied except by a writing signed by all parties.

16. Partial Invalidity . In the event that any term, provision or covenant herein or the application thereof to any circumstances or situation shall be invalid or unenforceable, in whole or in part, the remainder hereof and the application of said term, provision or covenant to any other circumstance or situation shall not be affected thereby, and each term, provision or covenant herein shall be valid and enforceable to the full extent permitted by law.

17. Construction . This Agreement shall be construed in accordance with the laws of the State of New Jersey.

If the foregoing is in accordance with your understanding of our agreement, please sign and return to us a counterpart hereof, whereupon this instrument along with all counterparts will become a binding agreement between you and us in accordance with its terms.

Very truly yours,

LAKE SHORE SAVINGS AND LOAN ASSOCIATION

By: _____
David C. Mancuso
President and Chief Executive Officer

**LAKE SHORE BANCORP, INC.
(IN FORMATION)**

By: _____
David C. Mancuso
President and Chief Executive Officer

**LAKE SHORE, MHC
(IN FORMATION)**

By: _____
David C. Mancuso
President and Chief Executive Officer

The foregoing Agency Agreement is hereby confirmed and accepted as of the date first set and above written.

RYAN BECK & CO., INC.

By: _____
Managing Director

Master Selected Dealer Agreement

_____, 2006

Ryan Beck & Co., Inc.
18 Columbia Turnpike
Florham Park, NJ 07932

Gentlemen:

(1) *General.* We understand that Ryan Beck & Co., Inc. ("Ryan Beck") is entering into this Agreement with us and other firms who may be offered the right to purchase as principal a portion of securities being distributed to the public. The terms and conditions of this Agreement shall be applicable to any public offering of securities ("Securities") pursuant to a registration statement filed under the Securities Act of 1933 (the "Securities Act") or exempt from registration thereunder (other than a public offering of Securities effected wholly outside the United States of America), wherein Ryan Beck (acting for its own account or for the account of any underwriting or similar group or syndicate) is responsible for managing or otherwise implementing the sale of the Securities to selected dealers ("Selected Dealers") and has informed us that such terms and conditions shall be applicable. Any such offering of Securities to us as a Selected Dealer is hereinafter called an "Offering." In the case of any Offering in which you are acting for the account of any underwriting or similar group or syndicate ("Underwriters"), the terms and conditions of this Agreement shall be for the benefit of, and binding upon, such Underwriters, including, in the case of any Offering in which you are acting with others as representatives of Underwriters, such other representatives. The term "preliminary prospectus" means any preliminary prospectus relating to an Offering of Securities or any preliminary prospectus supplement together with a prospectus relating to an Offering of Securities; the term "Prospectus" means the prospectus, together with the final prospectus supplement, if any, relating to an Offering of Securities, filed pursuant to Rule 424(b) or Rule 424(c) under the Securities Act or any successor or similar rules.

This Agreement constitutes the entire agreement of the parties with regard to the subject matter hereof and supersedes any prior oral or written agreements or understanding between the parties hereto or their predecessors with respect to the subject matter hereof.

(2) *Conditions of Offering, Acceptance and Purchase.* Any Offering will be subject to delivery of the Securities and their acceptance by you and any other Underwriters, may be subject to the approval of all legal matters by counsel and the satisfaction of other conditions, and may be made on the basis of reservation of Securities or an allotment against subscription. You will advise us by telegram, telex, facsimile, e-mail, or other form of written communication ("Written Communication") of the particular method and supplementary terms and conditions (including, without limitation, the information as to prices and offering date referred to in Section 3(c)) of any Offering in which we are invited to participate. To the extent such supplementary terms and conditions are inconsistent with

any provision herein, such terms and conditions shall supersede any such provision. Unless otherwise indicated in any such Written Communication, acceptances and other communications by us with respect to any Offering should be sent to Ryan Beck. You may close the subscription books at any time in your sole discretion without notice, and you reserve the right to reject any acceptance in whole or in part. Payment for Securities purchased by us is to be made at such office as you may designate, at the public offering price, or, if you shall so advise us, at such price less the concession to dealers or at the price set forth or indicated in a Written Communication, on such date as you shall determine, on one day's prior notice to us, by wire transfer to a Ryan Beck account, against delivery of certificates or other forms evidencing such Securities. If payment is made for Securities purchased by us at the public offering price, the concession to which we shall be entitled will be paid to us upon termination of the provisions of Section 3(c) with respect to such Securities.

Unless we promptly give you written instructions otherwise, if transactions in the Securities may be settled through the facilities of The Depository Trust Company, delivery of Securities purchased by us will be made through such facilities if we are a member, or if we are not a member, settlement may be made through our ordinary correspondent who is a member.

(3) Representations, Warranties, and Agreements.

(a) *Registered Offerings.* In the case of any Offering of Securities that are registered under the Securities Act ("Registered Offering"), you shall provide us with such number of copies of each preliminary prospectus, the Prospectus and any supplement thereto relating to each Registered Offering as we may reasonably request for the purposes contemplated by the Securities Act and the Securities Exchange Act of 1934 (the "Exchange Act") and the applicable Rules and regulations of the Securities and Exchange Commission thereunder. We represent that we are familiar with Rule 15c2-8 under the Exchange Act relating to the distribution of preliminary and final prospectuses and agree that we will comply therewith. We agree to keep an accurate record of our distribution (including dates, number of copies, and persons to whom sent) of copies of the Prospectus or any preliminary prospectus (or any amendment or supplement to any thereof), and promptly upon request by you, to bring all subsequent changes to the attention of anyone to whom such material shall have been furnished. We agree to furnish to persons who receive a confirmation of sale a copy of the Prospectus filed pursuant to Rule 424(b) or Rule 424(c) under the Securities Act. We agree that in purchasing Securities in a Registered Offering we will rely upon no statements whatsoever, written or oral, other than the statements in the Prospectus delivered to us by you. We will not be authorized by the issuer or other seller of Securities offered pursuant to a Prospectus or by any Underwriter to give any information or to make any representation not contained in the Prospectus in connection with the sale of such Securities. We will not use any free writing prospectus, unless consented to by you or authorized expressly in writing to you by the issuer in the Registered Offering.

(b) *Offerings Pursuant to Offering Circular.* In the case of any Offering of Securities, other than a Registered Offering, which is made pursuant to an offering circular or other document comparable to a prospectus in a Registered Offering, including, without limitation, an Offering of "exempted securities" as defined in Section 3(a)(2) of the Securities Act (an "Exempted Securities Offering"), you shall provide us with such number of copies of each preliminary offering circular, the final offering circular and any supplement thereto relating to each Offering as we may

reasonably request. We agree that we will comply with the applicable federal and state laws, and the applicable rules and regulations of any regulatory body promulgated thereunder, governing the use and distribution of offering circulars by brokers or dealers. We agree that in purchasing Securities pursuant to an offering circular we will rely upon no statements whatsoever, written or oral, other than the statements in the final offering circular delivered to us by you. We will not be authorized by the issuer or other seller of Securities offered pursuant to an offering circular or by any Underwriter to give any information or to make any representation not contained in the offering circular in connection with the sale of such Securities.

(c) *Offer and Sale to the Public.* With respect to any Offering of Securities, you will inform us by a Written Communication of the public offering price, the selling concession, the reallowance (if any) to dealers, and the time when we may commence selling Securities to the public. After such public offering has commenced, you may change the public offering price, the selling concession, and the reallowance to dealers. With respect to each Offering of Securities, until the provisions of this Section 3(c) shall be terminated pursuant to Section 5, we agree to offer Securities to the public only at the public offering price, except that if a reallowance is in effect, a reallowance from the public offering price not in excess of such reallowance may be allowed as consideration for services rendered in distribution to dealers who are actually engaged in the investment banking or securities business, who execute the written agreement prescribed by Rule 2740 of the Rules of Conduct of the National Association of Securities Dealers, Inc. (the "NASD") and who are either members in good standing of the NASD or foreign brokers or dealers not eligible for membership in the NASD who represent to us that they will promptly reoffer such Securities at the public offering price and will abide by the conditions with respect to foreign brokers and dealers set forth in Section 3(f) hereof.

(d) *Stabilization and Overallotment.* You may, with respect to any Offering, be authorized to over-allot in arranging sales to Selected Dealers, to purchase and sell Securities, any other securities of the issuer of the Securities of the same class and series and any other securities of such issuer that you may designate for long or short account, and to stabilize or maintain the market price of the Securities. We agree not to purchase and sell Securities for which an order from a client has not been received without your consent in each instance. We agree to advise you from time to time upon request, prior to the termination of the provisions of Section 3(c) with respect to any Offering, of the amount of Securities purchased by us hereunder remaining unsold and we will, upon your request, sell to you, for the accounts of the Underwriters, such amount of Securities as you may designate, at the public offering price thereof less an amount to be determined by you not in excess of the concession to dealers. In the event that prior to the later of (i) the termination of the provisions of Section 3(c) with respect to any Offering, or (ii) the covering by you of any short position created by you in connection with such Offering for your account or the account of one or more Underwriters, you purchase or contract to purchase for the account of any of the Underwriters, in the open market or otherwise, any Securities theretofore delivered to us, you reserve the right to withhold the above-mentioned concession to dealers on such Securities if sold to us at the public offering price, or if such concession has been allowed to us through our purchase at a net price, we agree to repay such concession upon your demand, plus in each case any taxes on redelivery, commissions, accrued interest, and dividends paid in connection with such purchase or contract to purchase.

(e) *Open Market Transactions.* We agree to abide by Regulation M under the Exchange Act and we agree not to bid for, purchase, attempt to purchase, or sell, directly or indirectly, any Securities, any other Reference Securities (as defined in Regulation M) of the issuer, or any other securities of such issuer as you may designate, except as brokers pursuant to unsolicited orders and as otherwise provided in this Agreement. If the Securities are common stock or securities convertible into common stock, we agree not to effect, or attempt to induce others to effect, directly or indirectly, any transactions in or relating to any stock of such issuer, except to the extent permitted by Rule 101 of Regulation M under the Exchange Act.

(f) *NASD.* We represent that we are actually engaged in the investment banking or securities business and we are either (i) a member in good standing of the NASD, (ii) if not such a member, a foreign dealer not eligible for membership, or (iii) solely in connection with an Exempted Securities Offering, a bank, as defined in Section 3(a)(6) of the Exchange Act, that does not otherwise fall within provision (i) or (ii) of this sentence (a “Bank”). If we are a member as described in (i), we agree that in making sales of the Securities we will comply with all applicable interpretative materials and Conduct Rules of the NASD, including, without limitation, Conduct Rules 2740 (relating to Selling Concessions, Discounts and Other Allowances) and 2790 (relating to New Issues). If we are a foreign dealer as described in (ii), we agree not to offer or sell any Securities in the United States of America, its territories or its possessions or to persons who are citizens thereof or residents therein (other than through you), and in making sales of Securities outside the United States of America we agree to comply as though we were a member with Conduct Rules 2730 (relating to Securities Taken in Trade), 2740 (relating to Selling Concessions), 2750 (relating to Transactions with Related Persons) and 2790 (relating to New Issues) as though we were such a member and to comply with Conduct Rule 2420 (relating to Dealing with Non-Members) as it applies to a nonmember broker or dealer in a foreign country. In connection with an Exempted Securities Offering, if we are a Bank, we agree to also comply, as though we were an NASD member, with the provision of Rules 2730, 2740 and 2750 of the Conduct Rules. We further represent, by our participating in an Offering, that we have provided to you all documents and other information required to be filed with respect to us, any related person or any person associated with us or any such related person pursuant to the supplementary requirements of the NASD’s interpretation with respect to review of corporate financing as such requirements relate to such Offering.

We further agree that, in connection with any purchase of Securities from you that is not otherwise covered by the terms of this Agreement (whether you are acting as manager, as member of an underwriting syndicate or a selling group or otherwise), if a selling concession, discount or other allowance is granted to us, the preceding paragraph will be applicable.

(g) *Relationship among Underwriters and Selected Dealers.* You may buy Securities from or sell Securities to any Underwriter or Selected Dealer and, with your consent, the Underwriters (if any) and the Selected Dealers may purchase Securities from and sell Securities to each other at the public offering price less all or any part of the concession. We are not authorized to act as agent for you or any Underwriter or the issuer or other seller of any Securities in offering Securities to the public or otherwise. Nothing contained herein or in any Written Communication from you shall constitute the Selected Dealers partners with you or any Underwriter or with one another. If the Selected Dealers, among themselves or with the Underwriters, should be deemed to constitute a partnership for federal income tax purposes, then we elect to be excluded from the

application of Subchapter K, Chapter 1, Subtitle A of the Internal Revenue Code of 1986 and agree not to take any position inconsistent with that election. We authorize you, in your discretion, to execute and file on our behalf such evidence of that election as may be required by the Internal Revenue Service. Neither you nor any Underwriter shall be under any obligation to us except for obligations assumed hereby or in any Written Communication from you in connection with any Offering. In connection with any Offering, we agree to pay our proportionate share of any tax, claim, demand, or liability asserted against us, and the other Selected Dealers or any of them, or against you or the Underwriters, if any, based on any claim that such Selected Dealers or any of them constitute an association, unincorporated business, or other separate entity, including in each case our proportionate share of any expense incurred in defending against any such tax, claim, demand, or liability.

(h) *Blue Sky Laws*. Upon application to you, you will inform us as to the jurisdictions in which you believe the Securities have been qualified for sale or are exempt under the respective securities or “blue sky” laws of such jurisdictions. We understand and agree that compliance with the securities or “blue sky” laws in each jurisdiction in which we shall offer or sell any of the Securities shall be our sole responsibility and that you assume no responsibility or obligations as to the eligibility of the Securities for sale or our right to sell the Securities in any jurisdiction.

(i) *Compliance with Law*. We agree that in selling Securities pursuant to any Offering (which agreement shall also be for the benefit of the issuer or other seller of such Securities), we will comply with the applicable provisions of the Securities Act and the Exchange Act, the applicable Rules and regulations of the Securities and Exchange Commission thereunder, the applicable Rules and regulations of the NASD, the applicable Rules and regulations of any securities exchange having jurisdiction over the Offering, and the applicable laws, rules and regulations specified in Section 3(c) hereof. Without limiting the foregoing, (a) we agree that, at all times since we were invited to participate in an Offering of Securities, we have complied with the provisions of Regulation M applicable to such Offering, in each case after giving effect to any applicable exemptions and (b) we represent that our incurrence of obligations hereunder in connection with any Offering of Securities will not result in the violation by us of Rule 15c3-1 under the Exchange Act, if such requirements are applicable to us. You shall have full authority to take such action as you may deem advisable in respect of all matters pertaining to any Offering. Neither you nor any Underwriter shall be under any liability to us, except for lack of good faith and for obligations expressly assumed by you in this Agreement; *provided, however*, that nothing in this sentence shall be deemed to relieve you from any liability imposed by the Securities Act.

(j) *Best Efforts Offerings*. If you communicate to us that a particular offering is being made on a best efforts basis, then the terms in this Section 3(j) apply and other inconsistent terms in this Agreement do not apply.

(i) The offering will be a best efforts offering. The offering also will be contingent and involve a closing only after receipt of necessary documentation from the issuer and satisfaction of other conditions, if any, specified in the prospectus or offering circular and the agency or engagement agreement with you and the issuer. The offering is designed to comply with applicable

SEC rules, including Rules 15c2-4, 10b-9, and 15c6-1. See NASD Notice to Members 98-4, 87-61 and 84-7.

(ii) We represent and agree that we shall take necessary steps to comply with SEC Rules 15c2-4, 10b-9 and 15c6-1, including, but not limited to, depositing funds in a complying special account if funds are received before all closing conditions have been met. We also represent that we are aware that those who purchase in this best efforts offering are subject to the investor purchase limitations described in the prospectus or offering circular.

(4) *Indemnification.* We agree to indemnify and hold harmless Ryan Beck, the issuer of the Securities, each person, if any, who controls (within the meaning of either Section 15 of the Securities Act or Section 20 of the Exchange Act) Ryan Beck or the issuer of the Securities, and their respective directors, officers and employees from and against any and all losses, liabilities, costs or claims (or actions in respect thereof) (collectively, "Losses") to which any of them may become subject (including all reasonable costs of investigating, disputing or defending any such claim or action), insofar as such Losses arise out of or are in connection with the breach of any representation, warranty or agreement made by us herein.

If any claim, demand, action or proceeding (including any governmental investigation) shall be brought or alleged against an indemnified party in respect of which indemnity is to be sought against an indemnifying party, the indemnified party shall promptly notify the indemnifying party in writing, and the indemnifying party, upon request of the indemnified party, shall retain counsel reasonably satisfactory to the indemnified party to represent the indemnified party and any others the indemnified party may designate in such proceeding and shall pay the reasonable fees and expenses of such counsel related to such proceeding. In any such proceeding, any indemnified party shall have the right to retain its own counsel, but the reasonable fees and expenses of such counsel shall be at the expense of such indemnified party unless (i) the indemnifying party and the indemnified party shall have mutually agreed to the retention of such counsel, (ii) the indemnifying party has failed within a reasonable time to retain counsel reasonably satisfactory to such indemnified party or (iii) the named parties to any such proceeding (including any impleaded parties) include both the indemnifying party and the indemnified party and representation of both parties by the same counsel would be inappropriate due to actual or potential differing interests between them. It is agreed that the indemnifying party shall not, in connection with any proceeding or related proceedings in the same jurisdiction, be liable for the reasonable fees and expenses of more than one separate law firm (in addition to local counsel where necessary) for all such indemnified parties. Such firm shall be designated in writing by the indemnified party. The indemnifying party shall not be liable for any settlement of any proceeding effected without its written consent, but if settled with such consent or if there be a final judgment for the plaintiff, the indemnifying party agrees to indemnify the indemnified party from and against any loss or liability by reason of such settlement or judgment. No indemnifying party shall, without the prior written consent of the indemnified party, effect any settlement of any pending or threatened proceeding in respect of which any indemnified party is or could have been a party and indemnity could have been sought hereunder by such indemnified party, unless such settlement includes an unconditional release of such indemnified party from all liability on claims that are the subject matter of such proceeding.

The indemnity agreements contained in this Section and the representations and warranties by us in this Agreement shall remain operative and in full force and effect regardless of: (i) any termination of this Agreement, (ii) any investigation made by an indemnified party or on such party's behalf or any person controlling an indemnified party or by or on behalf of the indemnifying party, its directors or officers or any person controlling the indemnifying party, and (iii) acceptance of and payment for any Securities.

(5) *Termination; Supplements and Amendments.* This Agreement may be terminated by either party hereto upon five business days' written notice to the other party; provided that with respect to any Offering for which a Written Communication was sent and accepted prior to such notice, this Agreement as it applies to such Offering shall remain in full force and effect and shall terminate with respect to such Offering in accordance with the last sentence of this Section. This Agreement may be supplemented or amended by you by written notice thereof to us, and any such supplement or amendment to this Agreement shall be effective with respect to any Offering to which this Agreement applies after the date of such supplement or amendment. Each reference to "this Agreement" herein shall, as appropriate, be to this Agreement as so amended and supplemented. The terms and conditions set forth in Sections 3(c) and (e) with regard to any offering will terminate at the close of business on the thirtieth day after the date of the initial public offering of the Securities to which such Offering relates, but such terms and conditions, upon notice to us, may be terminated by you at any time.

(6) *Successors and Assigns.* This Agreement shall be binding on, and inure to the benefit of, the parties hereto and other persons specified or indicated in Section 1, and the respective successors and assigns of each of them.

(7) *Governing Law.* This Agreement and the terms and conditions set forth herein with respect to any Offering together with such supplementary terms and conditions with respect to such Offering as may be contained in any Written Communication from you to us in connection therewith shall be governed by, and construed in accordance with, the laws of the State of New York without regard to conflicts of laws principles.

By signing this Agreement we confirm that our subscription to, or our acceptance of any reservation of, any Securities pursuant to an Offering shall constitute (i) acceptance of and agreement to the terms and conditions of this Agreement (as supplemented and amended pursuant to Section 5) together with and subject to any supplementary terms and conditions contained in any Written Communication from you in connection with such Offering, all of which shall constitute a binding agreement between us and you, individually, or as representative of any Underwriters, (ii) in confirmation that our representations and warranties set forth in Section 3 are true and correct at that time and (iii) confirmation that our agreements set forth in Sections 2 and 3 have been and will be fully performed by us to the extent and at the times required thereby.

Very truly yours,

(Name of Firm)

Confirmed, as of the date
first above written.

RYAN, BECK & CO., INC.

By: _____

By: _____

Execution Date: _____

[BMC LOGO APPEARS HERE]

January 12, 2006

Lake Shore Savings & Loan Association
128 East Fourth Street
P.O. Box 512
Dunkirk, NY 14048-2291

**Re: New York State Tax Consequences of Lake Shore Savings & Loan Association's
intent to Reorganize into a Mutual Holding Company Structure**

Ladies and Gentlemen:

PRELIMINARY STATEMENT

You have requested our opinion relating to the New York state tax consequences of the Amended and Restated Plan of Reorganization (the "Plan") of Lake Shore Savings & Loan Association (the "Bank"), a New York chartered mutual savings and loan association. Pursuant to the Plan, the Bank will convert from a New York chartered mutual savings and loan association into a federal stock savings bank and become the wholly-owned subsidiary of Lake Shore Bancorp, Inc., a newly formed federal capital stock corporation (the "Company"), and the Company will become a majority-owned subsidiary of Lake Shore, MHC, a federal mutual holding company that will be chartered as of the closing date of the transaction (the "MHC").

Our New York state tax opinion is in addition to and relies upon the Federal income tax opinion ("federal tax opinion") of Thacher Proffitt & Wood LLP, special tax counsel to the Bank, the Company and the MHC. We have reviewed that opinion. The federal tax opinion outlines the proposed transactions and the facts, assumptions and representations of the Plan, and are also used herein. All capitalized terms used but not defined in this letter shall have the meanings assigned to them in the Plan.

FACTS

On August 9, 2005, the Board of Directors of the Bank adopted the Plan. The component and related transactions described in the Plan and in the Prospectus (collectively described as the "Reorganization") has been filed with the Securities and Exchange Commission. We are rendering this opinion pursuant to Section 22 of the Plan. All capitalized terms used but not defined in this letter shall have the meanings assigned to them in the Plan or Prospectus. For purposes of this letter, the term "membership interests", with respect to either the Bank or the MHC, shall mean the liquidation rights in, respectively, the Bank or the MHC.

The Reorganization will be effected, pursuant to the Plan, as follows:

1. The Bank will exchange its New York mutual savings and loan association charter for a federal mutual savings bank charter (the “Charter Conversion”).
2. The Bank will organize the MHC, which will initially be organized in stock form and initially exist as the Bank’s wholly-owned subsidiary.
3. The MHC will organize two wholly-owned subsidiaries, one of which will be the Company, and the other of which will be an interim stock savings bank (“Interim”).
4. The following events will occur simultaneously pursuant to the Plan: (i) the Bank will exchange its federal mutual savings bank charter for a federal stock savings bank charter and thereby become Stock Bank (the “Conversion”); (ii) the MHC will cancel its stock and exchange its charter for a federal mutual holding company charter and thereby become a mutual holding company; (iii) Interim will merge with and into Stock Bank with Stock Bank surviving, and the former holders of membership interests in the Bank (“Bank Members”) will exchange the stock of Stock Bank constructively received in the Conversion for membership interests in the MHC (the “Exchange”). As a mutual entity, the MHC will not have any authorized capital stock. As a result of the merger and charter exchanges, Stock Bank will become a wholly-owned subsidiary of the MHC, and the Bank Members will hold membership interests in the MHC comparable to the membership interests they previously held in the Bank.
5. The MHC will then contribute all of the stock of Stock Bank to the Company.

As a result of these transactions, Stock Bank will be a wholly-owned subsidiary of the Company and the Company will be a wholly-owned subsidiary of the MHC. In substance, upon the Charter Conversion and pursuant to the other transactions described above, the Bank Members will constructively receive the stock of Stock Bank and will then exchange such stock for membership interests in the MHC.

Simultaneously with the Charter Conversion, the Conversion and the Exchange, the Company will offer to sell additional shares of its common stock pursuant to the Plan, with priority subscription rights granted in descending order of priority to Eligible Account Holders, certain employee stock benefit plans of the Bank, Supplemental Eligible Account Holders, Other Depositors and certain members of the general public.

Upon the consummation of the Reorganization, the legal existence of the Bank will not terminate, but the MHC will be a continuation of the Bank. All assets, rights, obligations and liabilities of whatever nature of the Bank that are not expressly retained by the MHC shall be transferred to the Stock Bank as part of the Reorganization. All property of the Bank (not expressly retained by the MHC), including its right, title and interest in all property of whatsoever kind and nature, interest and asset of every conceivable value or benefit then existing or pertaining to the Bank, or which would inure to the Bank immediately by operation of law and without the necessity of any conveyance or transfer and without any further act or deed, will vest in the MHC and will then be transferred to the Stock Bank. The Stock Bank will have, hold and enjoy the same in its right and fully and to the same extent as the same was possessed, held and enjoyed by the Bank. The Stock Bank will continue to have, succeed to and be responsible for all the rights, liabilities and obligations the Bank had when it was in mutual form and will maintain its headquarters and operations at the Bank’s present locations.

Upon consummation of the Reorganization, substantially all of the assets and liabilities (including the savings accounts, demand accounts, tax and loan accounts, United States Treasury general accounts, or United States Treasury Time Deposit Open Accounts, as defined in the OTS regulations) of the Bank shall become the assets and liabilities of the Stock Bank, which will thereupon become a savings association subsidiary of the Company and of the MHC. All assets, rights, obligations and liabilities of whatever nature of the Bank that are not expressly retained by the MHC shall be transferred to the Stock Bank. The Bank will apply to the OTS to have the Company receive or retain (as the case may be) up to 50% of the net proceeds of the Stock Offering, or such other amount as may be determined by the Board of Directors. The Stock Bank may distribute additional capital to the MHC following the Reorganization, subject to the OTS regulations governing capital distributions.

The Bank has annually been filing a New York Banking Corporation Franchise Tax Return and paying tax under Article 32 of the New York State Banking Law.

The deemed transfer of tangible personal property by the Bank to the Stock Bank in connection with the Reorganization will not be in the ordinary course of the Bank's business.

LAW AND ANALYSIS

The federal tax opinion of Thacher Proffitt & Wood LLP provides that the Reorganization will be "tax-free" under the Internal Revenue Code of 1986, as amended. The Reorganization is exempt from taxation under a number of Internal Revenue Code ("IRC") sections including but not limited to Sections 368(a)(1)(F), 381(b) and 351.

New York Tax Law §1451 annually imposes a franchise tax on every banking corporation for the privilege of exercising its franchise or doing business in New York State in a corporate or organized capacity.

Section 1451(a) of the New York Tax Law imposes a basic tax on the taxpayer's entire net income, or portion thereof allocated to New York State, for any taxable year or part thereof.

Entire net income is defined in New York Tax Law §1453(a) as "total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income) ... which the taxpayer is required to report to the United States Treasury Department . subject to the modifications and adjustments hereinafter provided."

Section 1453(b) through (k-1) of the New York Tax Law and §§18-2.3, 18-2.4 and 18-2.5 of the Franchise Tax on Banking Corporations Regulations, promulgated thereunder, provide for the modifications and adjustments required by §1453(a). However, there are no modifications or adjustments applicable to a transaction where, for federal income tax purposes, steps to a conversion are treated as exchanges pursuant to Sections 368(a)(1)(F), 381(b) and 351 of the Code and will result in no recognition of gain or loss for federal income tax purposes. Therefore, for purposes of §1453 of the New York Tax Law, such steps or exchanges would be treated the same as they are treated for federal income tax purposes.

In general terms, a corporate reorganization is a tax-free transaction under federal law if the consideration for the acquisition consists primarily of stock or securities of the acquiring corporation or its parent. In most cases, the gain or loss recognized on a reorganization for New York state tax purposes will be the same as the gain or loss recognized for federal tax purposes because New York uses federal taxable income as the starting point for the computation of its tax base and there is no provision of New York law that modifies the federal recognition or nonrecognition rules applicable to reorganizations.

Accordingly, if the steps to the Conversion described herein are treated as tax-free exchanges under Sections 368(a)(1)(F), 381(b) and 351 of the Code, such exchanges would be tax-free for purposes of computing entire net income under §1453 of the New York Tax Law.

New York Tax Law §1101(b)(4)(iv)(A) provides that the term “retail sale” does not include “the transfer of tangible personal property to a corporation, solely in consideration for the issuance of its stock, pursuant to a merger or consolidation effected under the law of New York or any other jurisdiction.” Regulation §526.6 of the Sales and Compensating Use Tax provides examples of the types of transactions that are exempt from sales tax. A merger or consolidation effected under IRC Section 368(a)(1)(a) is specifically exempted. However, the Regulation imposes sales tax upon transactions in which the stock of a corporation is issued to purchase the assets of another corporation. This has not occurred in this transaction. The intent of the statute and the regulation is to exclude transactions wherein one company is merged into another company or when two companies are consolidated into one. Any such transfers of tangible personal property to a corporation are not subject to New York sales tax; therefore, the transactions necessary to effectuate the reorganization into the mutual holding company structure more likely than not will not be subject to New York sales tax.

Section 1402 of the New York Tax Law imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars. The term “conveyance” is defined in §1401(e) of the New York Tax Law. Included in the definition of conveyance is the transfer or transfers of any interest in real property by any method, including the transfer or acquisition of a controlling interest in any entity with an interest in real property.

Section 1401(b) of the New York Tax Law defines the term “controlling interest.” This section provides, in the case of a corporation, that controlling interest means either fifty percent or more of the total combined voting power of all classes of stock or fifty percent or more of the capital, profits or beneficial interest in such voting stock.

However, §1405(b)(6) of the New York Tax Law sets forth that conveyances are exempt from the real estate transfer tax to the extent that they “effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership.”

Pursuant to the Reorganization, the original holders of membership interests in the Bank will ultimately become the holders of membership interests in the MHC. Because the original holders of membership interests in the Bank will receive a proportionately equal membership interests in the MHC as a result of the Reorganization, the any deemed real estate conveyance, will more likely than not, be exempt from New York Realty Transfer Tax based upon the mere change of identity or form of ownership or organization exemption provided in §1405(b)(6) of the New York Tax Law. See also New York Regulations, Rule §§ 23-03 and 23-05(b)(8).

Section 270 of the New York Tax Law provides in part: “There is hereby imposed . a tax . on all sales, or agreements to sell, or memoranda of sales and all deliveries or transfers of shares or certificates of stock, or certificates of rights to stock, or certificates of interest in property or accumulations. in any domestic or foreign association, company or corporation . whether made upon or shown by the books of the association, company, corporation, or trustee, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of sale or transfer, whether intermediate or final, and whether investing the holder with the beneficial interest in or legal title to said stock, or other certificates taxable hereunder, or merely with the possession or use thereof for any purpose.”

Subdivision (h) of §440.1 of the Stock Transfer Tax Regulations provides as follows: The tax imposed by article 12 of the Tax Law does not apply to the original issuance of stock.

Subdivision (j) of section 440.1 of the Stock Transfer Tax regulations provides in part: The following are examples of transactions not subject to tax:

(2) The surrender of a single certificate for reissuance to the same stockholder of several certificates representing, in the aggregate, the same number of shares.

(3) The surrender of a number of certificates of reissuance, to the same stockholder, of a single certificate for the same number of shares.

Pursuant to the Reorganization, the original holders of membership interests in the Bank will ultimately become the holders of membership interests in the MHC. Because the original holders of membership interests in the Bank will receive a proportionately equal membership interests in the MHC as a result of the Reorganization, , there will not be any change in the underlying ownership interest. Thus, it is more likely than not that no stock transfer tax liability should exist. See also Regulation §§. 440.1(h) and 440.1(j).

OPINION

Based upon our review of the Plan, agreements and documents mentioned above, and the federal income tax opinion of Thacher Proffitt & Wood LLP, it is our opinion that:

- 1) To the extent the Reorganization, as more fully described in the Plan of Reorganization, qualifies as “tax-free” under the Internal Revenue Code of 1986, then the Reorganization will not result in any income tax liabilities under New York Tax Law §1451.
The Federal income tax opinion of Thacher Proffitt & Wood LLP, item (a)(2) specifically states that the Bank’s members will recognize no gain or loss as a result of the conversion. For New York income tax purposes, the Bank’s members will follow the Federal non-recognition treatment.
- 2) More likely than not, the deemed transfer of the Bank’s tangible personal property pursuant to the Plan of Reorganization will not result in New York Sales and Use tax liability.
- 3) More likely than not, the New York Realty Transfer Tax will not be imposed on the deemed conveyance of real estate pursuant to the Plan of Reorganization because there is no change in beneficial ownership and such a deemed conveyance merely effectuates a change of identity or form of ownership or organization.
- 4) More likely than not, the New York Stock Transfer Tax will not be imposed on the issuance and/or transfer of membership interests pursuant to the Plan of Reorganization because there will not be any change in the underlying ownership interests.

Since this letter is provided in advance of the closing of the Reorganization and Offerings, we have assumed that such transactions will be consummated. Any change to the Plan of Reorganization could cause us to modify the opinions expressed herein.

In providing our opinion, we have considered the provisions of New York state tax law and the interplay of the Internal Revenue Code of 1986, as amended, New York tax regulations, judicial decisions and New York rulings, to date. A change in the authorities upon which our opinion is based could affect our conclusions. Moreover, there can be no assurances that our opinion expressed herein, if challenged, will be accepted by the State of New York. We have assumed the authenticity of original documents, the accuracy of copies and the genuineness of signatures. We have further assumed the absence of adverse facts not apparent from the face of the instruments and documents we examined.

In issuing our opinion, we have assumed that the Plan has been duly and validly authorized and has been approved and adopted by the Board of Directors of the Bank at a meeting duly called and held; that the Bank will comply with the terms and conditions of the Plan, and that the various representations and warranties which are provided to us are accurate, complete, true and correct. Accordingly, we express no opinion concerning the effect, if any, of variations from the foregoing. We specifically express no opinion concerning tax matters relating to the Plan under the Federal income tax laws.

We have not been asked to, and we do not, render any opinion with respect to any matters other than those expressly set forth above. This opinion is rendered for your use only, and may not be delivered to or relied upon by any other person or entity without our express written consent.

We consent to the filing of this opinion as an exhibit to the Form S-1 filed with the Securities and Exchange Commission and to the references to us in the Prospectus under “The Reorganization and Offering – Accounting Consequences” and the Form MHC-2 filed with the Office of Thrift Supervision.

Very truly yours,

/s/ BEARD MILLER COMPANY LLP

E M P L O Y E E S T O C K O W N E R S H I P P L A N
O F
L A K E S H O R E B A N C O R P , I N C .
Effective as of [January 1, 2006]

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EMPLOYEE STOCK OWNERSHIP PLAN

OF

LAKE SHORE BANCORP, INC.

Article I

Definitions

The following definitions shall apply for the purposes of the Plan, unless a different meaning is clearly indicated by the context:

Section 1.1 Account means an account established for each Participant to which is allocated such Participant's share, if any, of all Financed Shares and other property that are released from the Loan Repayment Account in accordance with section 6.4, together with his share, if any, of any Discretionary Contributions that may be made by a Participating Employer.

Section 1.2 Affiliated Employer means the Company; any corporation which is a member of a controlled group of corporations (as defined in section 414(b) of the Code) that includes the Company; any trade or business (whether or not incorporated) that is under common control (as defined in section 414(c) of the Code) with the Company; any organization (whether or not incorporated) that is a member of an affiliated service group (as defined in section 414(m) of the Code) that includes the Company; any leasing organization (as defined in section 414(n) of the Code) to the extent that any of its employees are required pursuant to section 414(n) of the Code to be treated as employees of the Company; and any other entity that is required to be aggregated with the Company pursuant to regulations under section 414(o) of the Code.

Section 1.3 Allocation Compensation during any period means the compensation taken into account in determining the allocation of benefits and contributions among Participants and consists of the aggregate compensation received by an Employee from the Employer or any Affiliated Employer with respect to such period that constitute wages within the meaning of section 3401 of the Code plus the amount by which such Employee's compensation with respect to such period has been reduced pursuant to a compensation reduction agreement under the terms of any of the following plans which may be maintained by the Employer:

- (a) a qualified cash or deferred arrangement described in section 401(k) of the Code;
- (b) a salary reduction simplified employee pension plan described in section 408(k) of the Code;
- (c) a tax deferred annuity plan described in section 403(b) of the Code; or

(d) a cafeteria plan described in section 125 of the Code and a transportation plan described in Section 132(f) of the Code; but excluding any income related to any award or exercise of a stock option or the award, vesting or payment of dividends with respect to restricted stock.

In no event, however, shall an Employee's Allocation Compensation for any calendar year include any compensation in excess of \$220,000, or any such other amount as may be prescribed in accordance with regulations prescribed under section 401(a)(17) of the Code. If there are less than twelve (12) months in the Plan Year, the \$220,000 limitation (as adjusted) shall be prorated by multiplying such limitation by a fraction, the numerator of which is the number of months in the Plan Year and the denominator of which is twelve (12).

*Section 1.4 **Bank*** means Lake Shore Savings Bank and any successor thereto.

*Section 1.5 **Board*** means the Board of Directors of Lake Shore Bancorp, Inc.

*Section 1.6 **Beneficiary*** means the person or persons designated by a Participant or Former Participant or other person entitled to a benefit under the Plan, or otherwise determined to be entitled to a benefit under the Plan. If more than one person is designated, each shall have an equal share unless the person making the designation directed otherwise. The word "person" includes an individual, a trust, an estate or any other person that is permitted to be named as a Beneficiary.

*Section 1.7 **Change in Control*** means an event described in section 14.1.

*Section 1.8 **Code*** means the Internal Revenue Code of 1986 (including the corresponding provisions of any succeeding law).

*Section 1.9 **Committee*** means the Compensation Committee described in section 15.3.

*Section 1.10 **Company*** means Lake Shore Bancorp, Inc., a federally-chartered corporation, and any successor thereto.

*Section 1.11 **Designated Beneficiary*** means a natural person designated by a Participant or Former Participant as a Beneficiary under Section 13.2 and shall not include any Beneficiary designated by a person other than a Participant or Former Participant or any Beneficiary other than a natural person. If a natural person is the beneficiary of a trust which a Participant or Former Participant has named as his Beneficiary, such natural person shall be treated as a Designated Beneficiary if: (a) the trust is a valid trust under applicable state law (or would be a valid trust except for the fact that it does not have a corpus); (b) the trust is irrevocable or will, by its terms, become irrevocable upon the death of the Participant or Former Participant; (c) the beneficiaries of the trust who are beneficiaries with respect to the trust's interest as a Beneficiary are identifiable from the terms of the trust instrument; and (d) the following information is furnished to the Committee:

(i) by the Participant or Former Participant, if any distributions are required to be made pursuant to section 13.5 prior to the death of the Participant or Former Participant and the Participant's or Former Participant's spouse is his sole primary Beneficiary, either: (A) a copy of the trust instrument, together with a written undertaking by the Participant or Former Participant to furnish to the Committee a copy of any subsequent amendment within a reasonable time after such amendment is made; or (B)(I) a list of all of the beneficiaries of the trust (including contingent and remainderman beneficiaries with a description of the conditions on their entitlement); (II) a certification of the Participant or Former Participant to the effect that, to the best of his knowledge, such list is correct and complete and that the conditions of section 1.11(a), (b) and (c) are satisfied; (III) a written undertaking to provide a new certification to the extent that an amendment changes any information previously certified; and (IV) a written undertaking to furnish a copy of the trust instrument to the Committee on demand; and

(ii) by the trustee of the trust by October 31st of the first calendar year that begins after the death of the Participant or Former Participant, if any distributions are required to be made pursuant to section 13.5 after the death of the Participant or Former Participant, either: (A) a copy of the actual trust instrument for the trust; or (B)(I) a final list of all of the beneficiaries of the trust (including contingent and remainderman beneficiaries with a description of the conditions on their entitlement) as of September 30th of the first calendar year that begins after the date of death; (II) a certification of the trustee to the effect that, to the best of his knowledge, such list is correct and complete and that the conditions of section 1.11(a), (b) and (c) are satisfied; and (III) a written undertaking to furnish a copy of the trust instrument to the Committee on demand.

Section 1.12 Disability means a condition of total incapacity, mental or physical, for further performance of duty with all Participating Employers, which the Committee shall have determined, on the basis of competent medical evidence, is likely to be permanent.

Section 1.13 Discretionary Contribution means Shares or amounts of money contributed to the Plan by the Participating Employers in accordance with section 5.3.

Section 1.14 Domestic Relations Order means a judgment, decree or order (including the approval of a property settlement) that is made pursuant to a state domestic relations or community property law and relates to the provision of child support, alimony payments, or marital property rights to a spouse, child or other dependent of a Participant or Former Participant.

Section 1.15 Eligibility Computation Period means, with respect to any person, (a) the 12-consecutive month period beginning on such person's Employment Commencement Date and (b) each 12-consecutive month period thereafter which is the Plan Year beginning with the Plan Year in which the anniversary of the date on which the Employee first performed an Hour of Service.

*Section 1.16 **Effective Date*** means [January 1, 2006].

*Section 1.17 **Eligible Employee*** means an Employee who is eligible for membership in the Plan in accordance with Article II.

*Section 1.18 **Eligible Participant*** means, for any Plan Year, an Employee who is a Participant during all or any part of such Plan Year and either remains a Participant on the last day of such Plan Year or terminated participation during such Plan Year on account of termination of employment, death, Disability or Retirement; *provided, however*, that no Employee shall be an Eligible Participant for the Plan Year that includes the effective date of the transaction pursuant to which the Bank becomes a wholly owned subsidiary of Lake Shore Bancorp, Inc. if he terminates employment for any reason with all Participating Employers prior to such effective date.

*Section 1.19 **Employee*** means any person, including an officer, who is employed by any Affiliated Employer.

*Section 1.20 **Employment Commencement Date*** means the date on which a person first performs an Hour of Service, except that if an Employee separates from service with the Employer, incurs a One-Year Break in Service and subsequently returns to service with the Employer, his Employment Commencement Date shall be the date on which he first performs an Hour of Service following the One-Year Break in Service.

*Section 1.21 **ERISA*** means the Employee Retirement Income Security Act of 1974, as amended from time to time (including the corresponding provisions of any succeeding law).

*Section 1.22 **Exchange Act*** means the Securities Exchange Act of 1934, as amended from time to time (including the corresponding provisions of any succeeding law).

*Section 1.23 **Fair Market Value*** on any date means:

(e) with respect to a Share:

(i) the final quoted sale price on the date in question (or, if there is no reported sale on such date, on the last preceding date on which any reported sale occurred) of a Share as reported in the principal consolidated reporting system with respect to securities listed or admitted to trading on the principal United States securities exchange on which like Shares are listed or admitted to trading; or

(ii) if like Shares are not listed or admitted to trading on any such exchange, the closing bid quotation with respect to a Share on such date on the National Association of Securities Dealers Automated Quotation System, or, if no such quotation is provided, on another similar system, selected by the Committee, then in use; or

(iii) if sections 1.23(a)(i) and (ii) are not applicable, the fair market value of a Share as determined by an appraiser independent of the Employer and experienced and expert in the field of corporate appraisal.

(f) with respect to property other than Shares, the fair market value determined in the manner selected by the Trustee.

*Section 1.24 **Financed Share*** means: (a) a Share that has been purchased with the proceeds of a Share Acquisition Loan, that has been allocated to the Loan Repayment Account in accordance with section 6.3 and that has not been released in accordance with section 6.4; or (b) a Share that constitutes a dividend paid with respect to a Share described in section 1.24(a), that has been allocated to the Loan Repayment Account in accordance with section 6.3 and that has not been released in accordance with section 6.4.

*Section 1.25 **Five Percent Owner*** means, for any Plan Year, a person who, during such Plan Year, owned (or was considered as owning for purposes of section 318 of the Code): (a) more than 5% of the value of all classes of outstanding stock of any Affiliated Employer; or (b) stock possessing more than 5% of the combined voting power of all classes of outstanding stock of any Affiliated Employer.

*Section 1.26 **Forfeitures*** means the amounts forfeited by Participants and Former Participants on termination of employment prior to full vesting, pursuant to section 9.3, less amounts credited because of re-employment, pursuant to section 9.4.

*Section 1.27 **Former Participant*** means a Participant whose participation in the Plan has terminated pursuant to section 2.3.

*Section 1.28 **General Investment Account*** means an Investment Account established and maintained in accordance with Article XI.

*Section 1.29 **Highly Compensated Employee*** means, for any Plan Year, an Employee who:

(i) was a Five Percent Owner at any time during such Plan Year or any prior Plan Year; or

(ii) received Total Compensation during the immediately preceding Plan Year (A) in excess of \$95,000 (or such other amount as may be prescribed by the Secretary of the Treasury pursuant to section 401(a)(17) of the Code); and (B) if elected by the Plan Administrator in such form and manner as the Secretary of the Treasury may prescribe, in excess of the Total Compensation received for such preceding Plan Year by at least 80% of the Employees.

The determination of who is a Highly Compensated Employee will be made in accordance with section 414(q) of the Code and the regulations thereunder. The Company has not elected to use the top 20% election mentioned in subparagraph (ii)(B) of this section.

Section 1.30 Hour of Service means each hour for which a person is paid, or entitled to payment, for the performance of duties for any Affiliated Employer, plus:

(g) each hour for which such person is paid, or entitled to payments by an Affiliated Employer on account of a period during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty, or leave of absence. Hours under this section 1.30(a) shall be calculated and credited pursuant to section 2530.200b-2 of the Department of Labor's regulations (or any successor regulation), which are incorporated herein by reference; and

(h) each hour for which back pay, irrespective of mitigation of damages, is either awarded or agreed to by any Affiliated Employer; provided, however, that such hours have not previously been credited under other provisions of this section 1.30; and provided, further, that not more than 501 Hours of Service shall be credited under section 1.30(a) to such person on account of a single continuous period during which such person performs no duties for an Affiliated Employer whether or not such period occurs in a single Plan Year. Hours under this section 1.30(b) shall be credited to the person for the Eligibility or Vesting Computation Period or Eligibility or Vesting Computation Periods to which the award or agreement pertains, rather than the Eligibility or Vesting Computation Period in which the award, agreement or payment is made.

Anything in this section 1.30 to the contrary notwithstanding, no Hours of Service shall be credited for a payment made or due under a plan maintained solely for the purpose of complying with applicable workmen's compensation or disability insurance laws, or a payment which solely reimburses any person for medical or medically-related expenses incurred by such person.

Section 1.31 Investment Account means either a General Investment Account or a Share Investment Account.

Section 1.32 Investment Fund means any one of the three or more funds as may be established from time to time by the Committee which, together with any and all Shares and other investments held under the Plan, constitute the Trust Fund.

Section 1.33 Loan Repayment Account means an account established and maintained in accordance with section 6.3.

Section 1.34 Loan Repayment Contribution means amounts of money contributed to the Plan by the Participating Employers in accordance with section 5.2.

Section 1.35 Maternity or Paternity Leave means a person's absence from work for all Affiliated Employers: (a) by reason of the pregnancy of such person; (b) by reason of the birth of a child of such person; (c) by reason of the placement of a child with the person in connection with the adoption of such child by such person; or (d) for purposes of caring for a child of such person immediately following the birth of the child or the placement of the child with such person.

Section 1.36 Military Service means service in the armed forces of the United States, including but not limited to Qualified Military Service. It may also include, if and to the extent that the Board so provides and if all Participants and Former Participants in like circumstances are similarly treated, special service for the government of the United States and other public service.

Section 1.37 Named Fiduciary means any person, committee, corporation or organization described in section 15.1.

Section 1.38 Officer means an Employee who is an administrative executive in regular and continued service with any Affiliated Employer; provided, however, that at no time shall more than the lesser of (a) 50 Employees or (b) the greater of (i) 3 Employees or (ii) 10% of all Employees be treated as Officers. The determination of whether an Employee is to be considered an Officer shall be made in accordance with section 416(i) of the Code.

Section 1.39 One-Year Break in Service means an Eligibility or Vesting Computation Period during which an Employee fails to complete more than 500 Hours of Service.

Section 1.40 Participant means any person who has satisfied the eligibility requirements set forth in section 2.1, who has become a Participant in accordance with section 2.2, and whose membership has not terminated under section 2.3.

Section 1.41 Participating Employer means the Bank, and any successor thereto and any other Affiliated Employer which, with the prior written approval of the Board of Directors of Lake Shore Bancorp, Inc. and subject to such terms and conditions as may be imposed by the Board of Directors of Lake Shore Bancorp, Inc., shall adopt this Plan.

Section 1.42 Plan means the Employee Stock Ownership Plan of Lake Shore Bancorp, Inc., as amended from time to time.

Section 1.43 Plan Administrator means the Committee or any person, committee, corporation or organization designated in section 15.2, or appointed pursuant to section 15.2, to perform the responsibilities of that office.

Section 1.44 Plan Year means the period commencing on the [January 1, 2006] and ending on [December 31, 2006] and each calendar year ending on each December 31st thereafter.

Section 1.45 Qualified Domestic Relations Order means a Domestic Relations Order that: (a) clearly specifies (i) the name and last known mailing address of the Participant or Former Participant and of each person given rights under such Domestic Relations Order, (ii) the amount or percentages of the Participant's or Former Participant's benefits under this Plan to be paid to each person covered by such Domestic Relations Order, (iii) the number of payments or the period to which such Domestic Relations Order applies, and (iv) the name of this Plan; and (b) does not require the payment of a benefit in a form or amount that is (i) not otherwise provided for under the Plan, or (ii) inconsistent with a previous Qualified Domestic Relations Order.

*Section 1.46 **Qualified Military Service*** means with respect to any person on any date, any service in the uniformed services of the United States (as defined in chapter 43 of Title 38 of the United States Code) completed prior to such date, but only if, on such date, such person is entitled to re-employment rights with respect to an Affiliated Employer on account of such service.

*Section 1.47 **Qualified Participant*** means a Participant who has attained age 55 and who has been a Participant of the Plan for at least 10 years.

*Section 1.48 **Retirement*** means any termination of membership in the Plan at or after the later of (a) the attainment of age 65 and (b) the completion of five (5) Years of Vesting Service.

*Section 1.49 **Retroactive Contribution*** means a contribution made on a retroactive basis in respect of a period of Qualified Military Service in accordance with section 5.4.

*Section 1.50 **Share*** means a share of any class of stock issued by any Affiliated Employer; provided, however, that such share is a “qualifying employer security” within the meaning of section 409(l) of the Code and section 407(d)(5) of ERISA.

*Section 1.51 **Share Acquisition Loan*** means a loan obtained by the Trustee in accordance with Article VI.

*Section 1.52 **Share Investment Account*** means an Investment Account established and maintained in accordance with Article XI.

*Section 1.53 **Tender Offer*** means a tender offer made to holders of any one or more classes of Shares generally, or any other offer made to holders of any one or more classes of Shares generally to purchase, exchange, redeem or otherwise transfer Shares, whether for cash or other consideration whether or not such offer constitutes a “tender offer” or an “exchange offer” for purposes of the Exchange Act.

*Section 1.54 **Total Compensation*** during any period means an Employee’s aggregate total compensation paid by the Employer and any Affiliated Employer with respect to such period that constitutes wages within the meaning of section 3401 of the Code, plus any amounts by which the Employee’s compensation paid by the Employer or any Affiliated Employer has been reduced pursuant to a compensation reduction agreement under the terms of any qualified cash or deferred arrangement described in section 401(k) of the Code, any salary reduction simplified employee pension plan described in section 408(k) of the Code, any tax deferred annuity plan described in section 403(b) of the Code, any cafeteria plan described in section 125 of the Code, any transportation program described in Section 132(f) of the Code or any compensation reduction agreement under the terms of any plan described in section 457 of the Code. In no event, however, shall an Employee’s Total Compensation for any calendar year include any compensation in excess of \$220,000 (or such other amount as may be permitted under section 401(a)(17) of the Code).

*Section 1.55 **Trust*** means the legal relationship created by the Trust Agreement pursuant to which the Trustee holds the Trust Fund in trust.

*Section 1.56 **Trust Agreement*** means the agreement between the Bank and the Trustee therein named or its successors pursuant to which the Trust Fund shall be held in trust.

*Section 1.57 **Trust Fund*** means the corpus (consisting of contributions paid over to the Trustee and investments thereof), and all earnings, appreciation or additions thereof and thereto, held by the Trustee under the Trust Agreement in accordance with the Plan, less any depreciation thereof and any payments made therefrom pursuant to the Plan.

*Section 1.58 **Trustee*** means the Trustee of the Trust Fund from time to time in office. The Trustee shall serve as Trustee until it is removed or resigns from office and is replaced by a successor Trustee appointed in accordance with the terms of the Trust Agreement.

*Section 1.59 **Valuation Date*** means the last business day of each Plan Year and such other dates as the Plan Administrator may prescribe.

*Section 1.60 **Vesting Computation Period*** means, with respect to any person, the Plan Year including periods prior to the Effective Date of the Plan.

*Section 1.61 **Year of Eligibility Service*** means an Eligibility Computation Period during which the Employee completed at least 1,000 Hours of Service.

*Section 1.62 **Year of Vesting Service*** means a Vesting Computation Period during which the Employee completed at least 1,000 Hours of Service.

Article II

Participation

*Section 2.1 **Eligibility for Participation.***

(a) Only Eligible Employees may be or become Participant of the Plan. An Employee shall be an Eligible Employee if he (i) is employed by one or more Participating Employers; (ii) has attained age 21; (iii) has completed at least one Year of Eligibility Service; and (iv) is not excluded under section 2.1(b).

(b) An Employee is not an Eligible Employee if he:

(i) does not receive Allocation Compensation from at least one Participating Employer;

(ii) is an Employee who has waived any claim to participation in the Plan;

(iii) is an Employee or in a unit of Employees covered by a collective bargaining agreement with a Participating Employer where retirement benefits

were the subject of good faith bargaining, unless such agreement expressly provides that Employees such as he be covered under the Plan; or

(iv) is a "leased employee" as defined in section 18.8.

Section 2.2 Commencement of Participation.

Every Employee who is an Eligible Employee on the effective date of the transaction whereby the Bank becomes a wholly owned subsidiary of Lake Shore Bancorp, Inc. shall automatically become a Participant as of the Effective Date. An Employee who becomes an Eligible Employee after the Effective Date shall automatically become a Participant on the first day of the January, April, July or October coincident with or next following the Eligibility Computation Period in which he becomes an Eligible Employee.

Section 2.3 Termination of Participation.

Participation in the Plan shall cease, and a Participant shall become a Former Participant, upon termination of employment with all Participating Employers, death, Disability or Retirement, failure to return to work upon the expiration of a leave of absence granted pursuant to section 3.3, becoming an Employee who is excluded under section 2.1(b) or distribution of the entire vested interest in his Account.

Article III

Special Provisions

Section 3.1 Military Service.

In the case of a termination of employment of any Employee to enter directly into Military Service, the entire period of his absence shall be treated, for purposes of vesting and eligibility for participation (but not, except as required by law, for purposes of eligibility to share in allocations of contributions in accordance with Article VII), as if he had worked for the Employer during the period of his absence. In the event of the re-employment of such person by the Employer within a period of not more than six months:

- (a) after he becomes entitled to release or discharge, if he has entered into the armed forces; or
- (b) after such service terminates, if he has entered into other service defined as Military Service;

such period, also, shall be deemed to be Military Service.

Section 3.2 Maternity or Paternity Leave.

(a) Subject to section 3.2(c), in the event of an Employee's absence from work in the service of the Employer and all Affiliated Employers for a period:

- (i) that commences on or after October 1, 1985;

-
- (ii) for which the person is not paid or entitled to payment by the Employer or any Affiliated Employer; and
 - (iii) that constitutes Maternity or Paternity Leave;

then the rules of section 3.2(b) shall apply.

(b) In cases of absence described in section 3.2(a), solely for purposes of determining whether a One-Year Break in Service has occurred, the person shall be credited for the period of an absence described in section 3.2(a) with the number of Hours of Service equal to the lesser of:

(i) (A) the number of Hours of Service that would have been credited to the person if he had continued working for the Bank or an Affiliated Employer during the period of such absence, or (B) if the number of Hours of Service prescribed under section 3.2(b)(i)(A) cannot be determined, 8 Hours of Service for each working day during the period of absence; or

(ii) 501 Hours of Service.

Such credit shall be given during the Computation Period during which such absence began, if necessary to prevent a One-Year Break in Service from occurring during such Computation Period, and in all other cases, such credit shall be given during the immediately following Computation Period.

(c) Notwithstanding anything in the Plan to the contrary, this section 3.2 shall not apply unless the person furnishes to the Plan Administrator such information as the Plan Administrator may reasonably require in order to establish (i) that the person's absence is one described in section 3.2(a), and (ii) the number of working days during such absence.

Section 3.3 Adjustments to Years of Eligibility Service.

The Years of Eligibility Service of an Employee who returns to the employment of the Employer or any Affiliated Employer following a separation from service shall include his Years of Eligibility Service prior to such separation from service, and such an Employee shall be readmitted to participation immediately upon his return to service if he is then an Eligible Employee.

Section 3.4 Leave of Absence.

In the event of temporary absence from work in the service of the Employer and all Affiliated Employers for any period for which a Participant shall have been granted a leave of absence by the Employer, the entire period of his absence shall be treated for purposes of vesting and eligibility for participation (but not for purposes of eligibility to share in the allocation of contributions in accordance with Article VII), as if he had worked for the Employer during the period of his absence. Absence from work for a period greater than, or failure to return to work upon the expiration of, the period of leave of absence granted by the Employer shall terminate

participation in the Plan as of the date on which such period ended. In granting leaves of absence for purposes of the Plan, all Employees in like circumstances shall be similarly treated.

Section 3.5 Family and Medical Leave.

In the event of absence for a period recognized a family and medical leave under the federal Family and Medical Leave Act of 1992, the period of such absence shall be recognized for purposes of vesting and eligibility to participate to the full extent required by law.

Section 3.6 Service with Uniformed Forces.

Periods of service with the uniformed forces of the United States shall be treated in the manner required pursuant to section 414(u) of the Code.

Article IV

Contributions by Participants Not Permitted

Section 4.1 Contributions by Participants Not Permitted.

Participants shall not be required, nor shall they be permitted, to make contributions to the Plan.

Article V

Contributions by the Employer

Section 5.1 In General.

Subject to the limitations of Article VIII, for each Plan Year, the Participating Employers shall contribute to the Plan the amount, if any, determined by the Board of Directors of Lake Shore Bancorp, Inc., but in no event less than the amount described in section 5.2(a). The amount contributed for any Plan Year shall be treated as a Loan Repayment Contribution, a Discretionary Contribution, or a combination thereof, in accordance with the provisions of this Article V.

Section 5.2 Loan Repayment Contributions.

For each Plan Year, a portion of the Participating Employers' contributions, if any, to the Plan equal to the sum of:

- (i) the minimum amount required to be added to the Loan Repayment Account in order to provide adequate funds for the payment of the principal and interest then required to be repaid under the terms of any outstanding Share Acquisition Loan obtained by the Trustee; plus
- (j) the additional amount, if any, designated by the Committee to be applied to the prepayment of principal or interest under the terms of any outstanding Share Acquisition Loan obtained by the Trustee;

shall be treated as a Loan Repayment Contribution for such Plan Year. A Loan Repayment Contribution for a Plan Year shall be allocated to the Loan Repayment Account and shall be applied by the Trustee, in the manner directed by the Committee, to the payment of accrued interest and to the reduction of the principal balance of any Share Acquisition Loan obtained by the Trustee that is outstanding on the date on which the Loan Repayment Contribution is made. To the extent that a Loan Repayment Contribution for a Plan Year results in a release of Financed Shares in accordance with section 6.4, such Shares shall be allocated among the Accounts of Eligible Participants for such Plan Year in accordance with section 7.2.

Section 5.3 Discretionary Contributions.

In the event that the amount of the Participating Employers' contributions to the Plan for a Plan Year exceeds the amount of the Loan Repayment Contributions for such Plan Year, such excess shall be treated as a Discretionary Contribution and shall be allocated among the Accounts of the Eligible Participants for such Plan Year in accordance with section 7.3.

Section 5.4 Retroactive Contributions.

A Participating Employer shall make a Retroactive Contribution in respect of any individual previously employed by it who is re-employed by any Affiliated Employer after December 12, 1994 following the completion of a period of Qualified Military Service. Such Retroactive Contribution shall be made in the following manner for each Plan Year that includes any part of the period of Qualified Military Service:

(k) An allocation percentage shall be computed by dividing (i) the sum of the Fair Market Value of all Financed Shares allocated to Eligible Participants for such Plan Year plus the dollar amount of all Discretionary Contributions made in cash for such Plan Year plus the Fair Market Value of all Discretionary Contributions made in Shares for such Plan Year, divided by (ii) the aggregate amount of Allocation Compensation used in the allocation for such Plan Year. Fair Market Value for such purposes shall be determined as of the last day of the Plan Year.

(l) A notional allocation shall be determined by multiplying (A) the percentage determined under section 5.4(a) by (B) the Allocation Compensation which the individual would have had for such Plan Year if he had remained in the service of his Participating Employer in the same capacity and earning Allocation Compensation and Total Compensation at the annual rates in effect immediately prior to the commencement of the Qualified Military Leave (or, if such rates are not reasonably certain, at an annual rate equal to the actual Allocation Compensation and Total Compensation, respectively, paid to him for the 12-month period immediately preceding the Qualified Military Service).

(m) An actual Retroactive Contribution for the Plan Year shall be determined by computing the excess of (A) the notional allocation determined under section 5.4(b) over (B) the sum of the dollar amount of any Discretionary Contribution in cash, the Fair Market Value of any Discretionary Contribution in

Shares and the Fair Market Value of any Financed Shares actually allocated to such individual for such Plan Year.

Section 5.5 Time and Manner of Payment.

(a) Payment of contributions made pursuant to this Article V shall be made: (i) in cash, in the case of a Loan Repayment Contribution; and (ii) in cash, in Shares, or in a combination of cash and Shares, in the case of an Discretionary Contribution or a Retroactive Contribution.

(b) Contributions made pursuant to this Article V for a Plan Year shall be paid to the Trust Fund on or before the due date (including any extensions thereof) of the Employer's federal income tax return for its taxable year during which such Plan Year ends. All such contributions shall be allocated to the Accounts of the Eligible Participants in the case of a Discretionary Contribution, to the Account of the Participant for whom it is made in the case of a Retroactive Contribution, and to the Loan Repayment Account in the case of a Loan Repayment Contribution, as soon as is practicable following the payment thereof to the Trust Fund.

Article VI

Share Acquisition Loans

Section 6.1 In General.

The Committee may, with the prior approval of the Board of Directors of Lake Shore Bancorp, Inc., direct the Trustee to obtain a Share Acquisition Loan on behalf of the Plan, the proceeds of which shall be applied on the earliest practicable date:

(n) to purchase Shares; or

(o) to make payments of principal or interest, or a combination of principal and interest, with respect to such Share Acquisition Loan; or

(p) (c) to make payments of principal and interest, or a combination of principal and interest, with respect to a previously obtained Share Acquisition Loan that is then outstanding.

Any such Share Acquisition Loan shall be obtained on such terms and conditions as the Committee may approve; provided, however, that such terms and conditions shall provide for the payment of interest at no more than a reasonable rate and shall permit such Share Acquisition Loan to satisfy the requirements of section 4975(d)(3) of the Code and section 408(b)(3) of ERISA.

Section 6.2 Collateral; Liability for Repayment.

(a) The Committee may direct the Trustee to pledge, at the time a Share Acquisition Loan is obtained, the following assets of the Plan as collateral for such Share Acquisition Loan:

(i) any Shares purchased with the proceeds of such Share Acquisition Loan and any earnings attributable thereto;

(ii) any Financed Shares then pledged as collateral for a prior Share Acquisition Loan which is repaid with the proceeds of such Share Acquisition Loan and any earnings attributable thereto; and

(iii) pending the application thereof to purchase Shares or repay a prior Share Acquisition Loan, the proceeds of such Share Acquisition Loan and any earnings attributable thereto.

Except as specifically provided in this section 6.2(a), no assets of the Plan shall be pledged as collateral for the repayment of any Share Acquisition Loan.

(b) No person entitled to payment under a Share Acquisition Loan shall have any right to the assets of the Plan except for:

(i) Financed Shares that have been pledged as collateral for such Share Acquisition Loan pursuant to section 6.2(a);

(ii) Loan Repayment Contributions made pursuant to section 5.2; and

(iii) earnings attributable to Financed Shares described in section 6.2(b)(i) and to Loan Repayment Contributions described in section 6.2(b)(ii).

Except in the event of a default or a refinancing pursuant to which an existing Share Acquisition Loan is repaid or as provided in section 14.3, the aggregate amount of all payments of principal and interest made by the Trustee with respect to all Share Acquisition Loans obtained on behalf of the Plan shall at no time exceed the aggregate amount of all Loan Repayment Contributions theretofore made plus the aggregate amount of all earnings (other than dividends paid in the form of Shares) attributable to Financed Shares and to such Loan Repayment Contributions.

(c) Any Share Acquisition Loan shall be without recourse against the Plan and Trust.

Section 6.3 Loan Repayment Account.

In the event that one or more Share Acquisition Loans shall be obtained, a Loan Repayment Account shall be established under the Plan. The Loan Repayment Account shall be credited with all Shares acquired with the proceeds of a Share Acquisition Loan, all Loan Repayment Contributions and all earnings (including dividends paid in the form of Shares) or appreciation attributable to such Shares and Loan Repayment Contributions. The Loan Repayment Account shall be charged with all payments of principal and interest made by the Trustee with respect to any Share Acquisition Loan, all Shares released in accordance with section 6.4 and all losses, depreciation or expenses attributable to Shares or to other property credited thereto. The Financed Shares, as well as any earnings thereon, shall be allocated to such Loan Repayment Account and shall be accounted for separately from all other amounts or property contributed under the Plan.

Section 6.4 Release of Financed Shares.

As of the last day of each Plan Year during which a Share Acquisition Loan is outstanding, a portion of the Financed Shares purchased with the proceeds of such Share Acquisition Loan and allocated to the Loan Repayment Account shall be released. The number of Financed Shares released in any such Plan Year shall be equal to the amount determined according to one of the following methods:

(a) by computing the product of: (i) the number of Financed Shares purchased with the proceeds of such Share Acquisition Loan and allocated to the Loan Repayment Account immediately before the release is effected; multiplied by (ii) a fraction, the numerator of which is the aggregate amount of the principal and interest payments (other than payments made upon the refinancing of a Share Acquisition Loan as contemplated by section 6.1(c)) made with respect to such Share Acquisition Loan during such Plan Year, and the denominator of which is the aggregate amount of all principal and interest remaining to be paid with respect to such Share Acquisition Loan as of the first day of such Plan Year; or

(b) by computing the product of: (i) the number of Financed Shares purchased with the proceeds of such Share Acquisition Loan and allocated to the Loan Repayment Account immediately before the release is effected; multiplied by (ii) a fraction, the numerator of which is the aggregate amount of the principal payments (other than payments made upon the refinancing of a Share Acquisition Loan as contemplated by section 6.1(c)) made with respect to such Share Acquisition Loan during such Plan Year, and the denominator of which is the aggregate amount of all principal remaining to be paid with respect to such Share Acquisition Loan as of the first day of such Plan Year; provided, however, that the method described in this section 6.4(b) may be used only if the Share Acquisition Loan does not extend for a period in excess of 10 years after the date of origination and only to the extent that principal payments on such Share Acquisition Loan are made at least as rapidly as under a loan of like principal amount with a like interest rate and term requiring level amortization of principal and interest.

The method to be used shall be specified in the documents governing the Share Acquisition Loan or, if not specified therein, prescribed by the Committee, in its discretion. In the event that property other than, or in addition to, Financed Shares shall be held in the Loan Repayment Account and pledged as collateral for a Share Acquisition Loan, then the property to be released pursuant to this section 6.4 shall be property having a Fair Market Value determined by applying the method to be used to the Fair Market Value of all property pledged as collateral for such Share Acquisition Loan; provided, however, that no property other than Financed Shares shall be released pursuant to this section 6.4 unless all Financed Shares have previously been released.

Section 6.5 Restrictions on Financed Shares.

Except to the extent required under any applicable law, rule or regulation, no Shares purchased with the proceeds of a Share Acquisition Loan shall be subject to a put, call or

other option, or to any buy-sell or similar arrangement, while held by the Trustee or when distributed from the Plan. The provisions of this section 6.5 shall continue to apply in the event that this Plan shall cease to be an employee stock ownership plan, within the meaning of section 4975(e)(7) of the Code.

Article VII

Allocation of Contributions

Section 7.1 Allocation Among Eligible Participants.

Subject to the limitations of Article VIII, Discretionary Contributions for a Plan Year made in accordance with section 5.3 and Financed Shares and other property that are released from the Loan Repayment Account for a Plan Year in accordance with section 6.4 shall be allocated among the Eligible Participants for such Plan Year, in the manner provided in this Article VII.

Section 7.2 Allocation of Released Shares or Other Property.

Subject to the limitations of Article VIII, in the event that Financed Shares or other property are released from the Loan Repayment Account for a Plan Year in accordance with section 6.4, such released Shares or other property shall be allocated among the Accounts of the Eligible Participants for the Plan Year in the proportion that each such Eligible Participant's Allocation Compensation for the portion of such Plan Year during which he was a Participant bears to the aggregate of such Allocation Compensation of all Eligible Participants for such Plan Year.

Section 7.3 Allocation of Discretionary Contributions.

Subject to the limitations of Article VIII, in the event that the Participating Employers make Discretionary Contributions for a Plan Year, such Discretionary Contributions shall be allocated among the Accounts of the Eligible Participants for such Plan Year in the proportion that each such Eligible Participant's Allocation Compensation for the portion of such Plan Year during which he was a Participant bears to the aggregate of such Allocation Compensation of all Eligible Participants for such Plan Year.

Article VIII

Limitations on Allocations

Section 8.1 Optional Limitations on Allocations.

If, for any Plan Year, the application of sections 7.2 and 7.3 would result in more than one-third of the number of Shares or of the amount of money or property to be allocated thereunder being allocated to the Accounts of Eligible Participants for such Plan Year who are also Highly Compensated Employees for such Plan Year, then the Committee may, but shall not be required to, direct that this section 8.1 shall apply in lieu of sections 7.2 and 7.3. If the Committee gives such a direction, then the Committee shall impose a maximum dollar limitation

on the amount of Allocation Compensation that may be taken into account for each Eligible Participant. The dollar limitation which shall be imposed shall be the limitation which produces the result that the aggregate Allocation Compensation taken into account for Eligible Participant who are Highly Compensated Employees, constitutes exactly one-third of the aggregate Allocation Compensation taken into account for all Eligible Participants.

Section 8.2 General Limitations on Contributions.

(a) No amount shall be allocated to a Participant's Account under this Plan for any Limitation Year to the extent that such an allocation would result in an Annual Addition of an amount greater than the lesser of (i) \$44,000 (or such other amount as is permissible under section 415 (c)(1)(A) of the Code), or (ii) 100% of the Participant's Total Compensation for such Limitation Year.

(b) For purposes of this section 8.2, the following special definitions shall apply:

(i) **Annual Addition** means the sum of the following amounts allocated on behalf of a Participant for a Limitation Year:

(A) all contributions by the Employer (including contributions made under a salary reduction agreement pursuant to sections 401(k), 408(k) or 403(b) of the Code) under any qualified defined contribution plan or simplified employee pension (other than this Plan) maintained by the Employer, as well as the Participant's allocable share, if any, of any forfeitures under such plans as well as amounts allocated to an individual medical benefit account, as defined in section 415(l)(2) of the Code, which is part of a pension or annuity plan maintained by the Employer; plus

(B) the sum of all of the nondeductible voluntary contributions under any other qualified defined contribution plan (whether or not terminated) maintained by the Employer;

(C) all Discretionary Contributions under this Plan; plus

(D) except as hereinafter provided in this section 8.2(b)(i), a portion of the Employer's Loan Repayment Contributions to the Plan for such Limitation Year which bears the same proportion to the total amount of the Employer's Loan Repayment Contributions for the Limitation Year that the number of Shares (or the Fair Market Value of property other than Shares) allocated to the Participant's Account pursuant to section 7.2 or 8.1, whichever is applicable, bears to the aggregate number of Shares (or Fair Market Value of property other than Shares) so allocated to all Participants for such Limitation Year.

Notwithstanding section 8.2(b)(i)(D), if, for any Limitation Year, the aggregate amount of Discretionary Contributions allocated to the Accounts of the individuals who are Highly Compensated Employees for such Limitation Year, when added to such Highly Compensated Employees' allocable share of any Loan

Repayment Contributions for such Limitation Year, does not exceed one-third of the total of all Discretionary Contributions and Loan Repayment Contributions for such Limitation Year, then that portion, if any, of the Loan Repayment Contributions for such Limitation Year that is applied to the payment of interest on a Share Acquisition Loan shall not be included as an Annual Addition. In no event shall any Financed Shares, any dividends or other earnings thereon, any proceeds of the sale thereof or any portion of the value of the foregoing be included as an Annual Addition. No catch-up elective deferrals under section 414(v) of the Code shall be included as an Annual Addition.

(ii) **Employer** means Lake Shore Bancorp, Inc., and all members of a controlled group of corporations, as defined in section 414(b) of the Code, as modified by section 415(h) of the Code, all commonly controlled trades or businesses, as defined in section 414(c) of the Code, as modified by section 415(h) of the Code, all affiliated service groups, as defined in section 414(m) of the Code, of which Lake Shore Bancorp, Inc. is a member, as well as any leasing organization, as defined in section 18.8, that employs any person who is considered an employee under section 18.8 and any other entity that is required to be aggregated with the Employer pursuant to regulations under section 414(o) of the Code.

(iii) **Limitation Year** means the Plan Year.

(c) When an individual's Annual Addition to this Plan must be reduced to satisfy the limitations of section 8.2(a), such reduction shall be applied to Discretionary Contributions and to Shares allocated as a result of a Loan Repayment Contribution which are included as an Annual Addition in such order as shall result in the smallest reduction in the number of Shares allocable to the Individual's Account. The amount by which any Individual's Annual Addition to this Plan is reduced shall be allocated in accordance with Articles V and VII as a contribution by the Participating Employers in the next succeeding Limitation Year.

(d) Prior to determining an individual's actual Total Compensation for a Limitation Year, the Participating Employer may determine the limitations under this section 8.2 for an individual on the basis of a reasonable estimation of the individual's Total Compensation for the Limitation Year that is uniformly determined for all individuals who are similarly situated. As soon as it is administratively feasible after the end of the Limitation Year, the limitations of this section 8.2 shall be determined on the basis of the individual's actual Total Compensation for the Limitation Year.

Article IX

Vesting

Section 9.1 Vesting.

Subject to the provisions of sections 9.2 and 14.1(a), the balance credited to each Participant's Account shall become vested in accordance with the following schedule:

Years of Vesting Service	Vested Percentage
less than 2 years	0%
2 years	20%
3 years	40%
4 years	60%
5 years	80%
6 or more years	100%

Section 9.2 Vesting on Death, Disability, Retirement or Change in Control.

Any previously unvested portion of the remainder of the balance credited to the Account of a Participant or of a person who is a Former Participant solely because he is excluded from membership under section 2.1(b) shall become fully vested immediately upon his attainment of age 65 while employed by any Applicable Employer, or, if earlier, upon the termination of his employment with all Affiliated Employers by reason of death, Disability, Retirement or upon the occurrence of a Change in Control.

Section 9.3 Forfeitures on Termination of Employment.

Upon the termination of employment of a Participant or Former Participant for any reason other than death, Disability or Retirement, that portion of the balance credited to his Account which is not vested at the date of such termination shall be forfeited upon the earliest of (a) full distribution of the vest portion of the Account or (b) the fifth anniversary following the date of re-employment. The proceeds of such forfeited amounts, reduced by any amounts required to be credited because of re-employment pursuant to section 9.4, shall be treated as Forfeitures and shall be disposed of as provided in section 9.5. If no portion of the balance credited to an Account of a Participant or Former Participant is vested as of the date of his termination of employment, a distribution of \$0, representing full distribution of the Account, shall be deemed to have been made to the Participant or Former Participant on such date.

Section 9.4 Amounts Credited Upon Re-Employment.

If an Employee forfeited any amount of the balance credited to his Account upon his termination of employment, and is re-employed by any Affiliated Employer prior to the occurrence of five consecutive One-Year Breaks in Service, then:

- (i) an amount equal to the Fair Market Value of the Shares forfeited, determined as of the date of forfeiture; and
- (ii) the amount credited to his General Investment Account that was forfeited, determined as of the date of forfeiture;

shall be credited back to his Account; provided however, that the Employee repays the amount distributed to him from his Account as a result of such termination no later than the fifth anniversary of his re-employment or the end of the fifth Plan Year to begin after such distribution, whichever is earlier. Such amounts to be re-credited shall be obtained from the proceeds of the forfeited amounts redeemed pursuant to section 9.3 during the Plan Year in which the repayment is made, unless such proceeds are insufficient, in which case the Employee's Employer shall make an additional contribution in the amount of such deficiency. For purposes of this section 9.4, a Participant or Former participant who received a distribution of \$0, shall be deemed to have made repayment on the date of re-employment with an Employer.

Section 9.5 Allocation of Forfeitures.

Any Forfeitures that occur during a Plan Year shall be used to reduce the contributions required of the Employer under the Plan in the next Plan Year and shall be treated as Loan Repayment Contributions and Discretionary Contributions in the proportions designated by the Committee in accordance with Article V.

Article X

The Trust Fund

Section 10.1 The Trust Fund.

The Trust Fund shall be held and invested under the Trust Agreement with the Trustee. The provisions of the Trust Agreement shall vest such powers in the Trustee as to investment, control and disbursement of the Trust Fund, and such other provisions not inconsistent with the Plan, including provision for the appointment of one or more "investment managers" within the meaning of section 3(38) of ERISA to manage and control (including acquiring and disposing of) all or any of the assets of the Trust Fund, as the Board may from time to time authorize. Except as required by ERISA, no bond or other security shall be required of any Trustee at any time in office.

Section 10.2 Investments.

Except to the extent provided to the contrary in section 10.3, the Trust Fund shall be invested in:

- (i) Shares;

(ii) such Investment Funds as may be established from time to time by the Committee; and

(iii) such other investments as may be permitted under the Trust Agreement;

in such proportions as shall be determined by the Committee or, if so provided under the Trust Agreement, as directed by one or more investment managers or by the Trustee, in its discretion; provided, however, that the investments of the Trust Fund shall consist primarily of Shares.

Notwithstanding the immediately preceding sentence, the Trustee may temporarily invest the Trust Fund in short-term obligations of, or guaranteed by, the United States Government or an agency thereof, or may retain uninvested, or sell investments to provide, amounts of cash required for purposes of the Plan.

Section 10.3 Distributions for Diversification of Investments.

(a) Notwithstanding section 10.2, each Qualified Participant may:

(i) during the first 90 days of each of the first five Plan Years to begin after the Plan Year in which he first becomes a Qualified Participant, elect that such percentage of the balance credited to his Account as he may specify, but in no event more than 25% of the balance credited to his Account, be either distributed to him pursuant to this section 10.3(a)(i) or transferred to the 401(k) plan maintained by Lake Shore Savings Bank to the extent permitted by such plan, no later than 90 days after the last day that such election may be made; and

(ii) during the first 90 days of the sixth Plan Year to begin after the Plan Year in which he first becomes a Qualified Participant or of any Plan Year thereafter, elect that such percentage of the balance credited to his Account as he may specify, but in no event more than 50% of the balance credited to his Account, be either distributed to him pursuant to this section 10.3(a)(ii) or transferred to the 401(k) Plan maintained by Lake Shore Savings Bank to the extent permitted by such plan, no later than 90 days after the last day that such election may be made.

For purposes of an election under this section 10.3, the balance credited to a Participant's Account shall be the balance credited to his Account determined as of the last Valuation Date to occur in the Plan Year immediately preceding the Plan Year in which such election is made and the 25% and 50% limitations shall apply to such balance after the balance has been reduced by the amount of all amounts distributed or transferred to the 401(k) Plan maintained by Lake Shore Savings Bank under this section 10.3.

(b) An election made under section 10.3(a) shall be made in writing, in the form and manner prescribed by the Plan Administrator, and shall be filed with the Plan Administrator during the election period specified in section 10.3(a). As soon as is practicable, and in no case later than 90 days following the end of the election period during which such

election is made, the Plan Administrator shall take such actions as are necessary to cause the specified percentage of the balance credited to the Account of the Qualified Participant making the election to be distributed to such Qualified Participant.

(c) An election made under section 10.3(a) may be changed or revoked at any time during the election period described in section 10.3(a) during which it is initially made. In no event, however, shall any election under this section 10.3 result in more than 25% of the balance credited to the Participant's Account being distributed to the Participant or transferred to the 401(k) Plan maintained by Lake Shore Savings Bank, if such election is made during a Plan Year to which section 10.3(a)(i) applies, or result in more than 50% of the balance distributed to the Participant or transferred to the 401(k) Plan maintained by Lake Shore Savings Bank, if such election is made during the Plan Year to which section 10.3(a)(ii) applies or thereafter.

Section 10.4 Use of Commingled Trust Funds.

Subject to the provisions of the Trust Agreement, amounts held in the Trust Fund may be invested in:

(a) any commingled or group trust fund described in section 401(a) of the Code and exempt under section 501(a) of the Code; or

(b) any common trust fund exempt under section 584 of the Code maintained exclusively for the collective investment of the assets of trusts that are exempt under section 501(a) of the Code; provided that the trustee of such commingled, group or common trust fund is a bank or trust company.

Section 10.5 Management and Control of Assets.

All assets of the Plan shall be held by the Trustee in trust for the exclusive benefit of Participants, Former Participants and their Beneficiaries. No part of the corpus or income of the Trust Fund shall be used for, or diverted to, purposes other than for the exclusive benefit of Participants, Former Participants and their Beneficiaries, and for defraying reasonable administrative expenses of the Plan and Trust Fund. No person shall have any interest in or right to any part of the earnings of the Trust Fund, or any rights in, to or under the Trust Fund or any part of its assets, except to the extent expressly provided in the Plan.

Article XI

Valuation of Interests in the Trust Fund

Section 11.1 Establishment of Investment Accounts.

The Plan Administrator shall establish, or cause to be established, for each person for whom an Account is maintained a Share Investment Account and a General Investment Account. Such Share Investment Accounts and General Investment Accounts shall be maintained in accordance with this Article XI.

Section 11.2 Share Investment Accounts.

The Share Investment Account established for a person in accordance with section 11.1 shall be credited with: (a) all Shares allocated to such person's Account; (b) all Shares purchased with amounts of money or property allocated to such person's Account; (c) all dividends paid in the form of Shares with respect to Shares credited to his Account; and (d) all Shares purchased with amounts credited to such person's General Investment Account. Such Share Investment Account shall be charged with all Shares that are sold or exchanged to acquire other investments or to provide cash and with all Shares that are distributed in kind.

Section 11.3 General Investment Accounts.

The General Investment Account that is established for a person in accordance with section 11.1 shall be credited with: (a) all amounts, other than Shares, allocated to such person's Account; (b) all dividends paid in a form other than Shares with respect to Shares credited to such person's Share Investment Account; (c) the proceeds of any sale of Shares credited to such person's Share Investment Account; and (d) any earnings attributable to amounts credited to such person's General Investment Account. Such General Investment Account shall be charged with all amounts credited thereto that are applied to the purchase of Shares, any losses or depreciation attributable to amounts credited thereto, any expenses allocable thereto and any distributions of amounts credited thereto.

Section 11.4 Valuation of Investment Accounts.

(a) The Plan Administrator shall determine, or cause to be determined, the aggregate value of each person's Share Investment Account as of each Valuation Date by multiplying the number of Shares credited to such Share Investment Account on such Valuation Date by the Fair Market Value of a Share on such Valuation Date.

(b) As of each Valuation Date, the Accounts of each Participant shall be separately adjusted to reflect their proportionate share of any appreciation or depreciation in the fair market value of the Investment Funds, any income earned by the Investment Funds and any expenses incurred by the Investment Funds, as well as any contributions, withdrawals or distributions and investment transfers not posted as of the last Valuation Date.

Section 11.5 Annual Statements.

There shall be furnished, by mail or otherwise, at least once in each Plan Year to each person who would then be entitled to receive all or part of the balance credited to any Account if the Plan were then terminated, a statement of his interest in the Plan as of such date as shall be selected by the Plan Administrator, which statement shall be deemed to have been accepted as correct and be binding on such person unless the Plan Administrator receives written notice to the contrary within 30 days after the statement is mailed or furnished to such person.

Article XII

Shares

Section 12.1 Specific Allocation of Shares.

All Shares purchased under the Plan shall be specifically allocated to the Share Investment Accounts of Participants, Former Participants and their Beneficiaries in accordance with section 11.2, with the exception of Financed Shares, which shall be allocated to the Loan Repayment Account.

Section 12.2 Dividends.

(a) Dividends paid with respect to Shares held under the Plan shall be credited to the Loan Repayment Account, if paid with respect to Financed Shares. Such dividends shall be: (i) applied to the payment of principal and accrued interest with respect to any Share Acquisition Loan, if paid in cash; or (ii) held in the Loan Repayment Account as Financed Shares for release in accordance with section 6.4, if paid in the form of Shares.

(b) Dividends paid with respect to Shares allocated to a person's Share Investment Account shall be credited to such person's Share Investment Account. Cash dividends credited to a person's General Investment Account shall be, at the direction of the Committee, either: (i) held in such General Investment Account and invested in accordance with sections 10.2 and 11.3; (ii) distributed immediately to such person; (iii) distributed to such person within 90 days of the close of the Plan Year in which such dividends were paid; (iv) used to make payments of principal or interest on a Share Acquisition Loan; provided, however, that the Fair Market Value of Financed Shares released from the Loan Repayment Account as a result of such payment equals or exceeds the amount of the dividend; or (v) either held as provided in section 12.2(b)(i) or distributed as provided in section 12.2(b)(ii), as each person shall elect for his own Account.

Section 12.3 Voting Rights.

(a) Each person shall direct the manner in which all voting rights appurtenant to Shares allocated to his Share Investment Account will be exercised, provided that such Shares were allocated to his Share Investment Account as of the applicable record date. Such person shall, for such purpose, be deemed a "named fiduciary" within the meaning of section 402(a)(2) of ERISA. Such a direction shall be given by completing and filing with the inspector of elections, the Trustee or such other person who shall be independent of the Participating Employers as the Committee shall designate, at least 10 days prior to the date of the meeting of holders of Shares at which such voting rights will be exercised, a written direction in the form and manner prescribed by the Committee. The inspector of elections, the Trustee or such other person designated by the Committee shall tabulate the directions given on a strictly confidential basis, and shall provide the Committee with only the final results of the tabulation. The final results of the tabulation shall be followed by the Committee in directing the Trustee as to the manner in which such voting rights shall be exercised. The Plan Administrator shall make a reasonable effort to furnish, or cause to be furnished, to each person for whom a Share Investment Account is maintained all annual reports, proxy materials and other information

known by the Plan Administrator to have been furnished by the issuer of the Shares, or by any solicitor of proxies, to the holders of Shares.

(b) To the extent that any person shall fail to give instructions with respect to the exercise of voting rights appurtenant to Shares allocated to his Share Investment Account:

(i) the Trustee shall, with respect to each matter to be voted upon: (A) cast a number of affirmative votes equal to the product of (I) the number of allocated Shares for which no written instructions have been given, multiplied by (II) a fraction, the numerator of which is the number of allocated Shares for which affirmative votes will be cast in accordance with written instructions given as provided in section 12.3(a) and the denominator of which is the aggregate number of affirmative and negative votes which will be cast in accordance with written instructions given as aforesaid, and (B) cast a number of negative votes equal to the excess (if any) of (I) the number of allocated Shares for which no written instructions have been given over (II) the number of affirmative votes being cast with respect to such allocated Shares pursuant to section 12.3(b)(i)(A); or

(ii) if the Trustee shall determine that it may not, consistent with its fiduciary duties, vote the allocated Shares for which no written instructions have been given in the manner described in section 12.3(b)(i), it shall vote such Shares in such manner as it, in its discretion, may determine to be in the best interests of the persons to whose Share Investment Accounts such Shares have been allocated.

(c) (i) The voting rights appurtenant to Financed Shares shall be exercised as follows with respect to each matter as to which holders of Shares may vote:

(A) a number of votes equal to the product of (I) the total number of votes appurtenant to Financed Shares allocated to the Loan Repayment Account on the applicable record date; multiplied by (II) a fraction, the numerator of which is the total number of affirmative votes cast by Participants, Former Participants and the Beneficiaries of deceased Former Participants with respect to such matter pursuant to section 12.3(a) and the denominator of which is the total number of affirmative and negative votes cast by Participants, Former Participants and the Beneficiaries of deceased Former Participants, shall be cast in the affirmative; and

(B) a number of votes equal to the excess of (I) the total number of votes appurtenant to Financed Shares allocated to the Loan Repayment Account on the applicable record date, over (II) the number of affirmative votes cast pursuant to section 12.3(c)(i)(A) shall be cast in the negative.

To the extent that the Financed Shares consist of more than one class of Shares, this section 12.3(c)(i) shall be applied separately with respect to each class of Shares.

(ii) If voting rights are to be exercised with respect to Financed Shares as provided in section 12.3(c)(i)(A) and (B) at a time when there are no Shares allocated to the Share Investment Accounts of Participants, Former Participants and the Beneficiaries

of deceased Former Participants, then the voting rights appurtenant to Financed Shares shall be exercised as follows with respect to each matter as to which holders of Shares may vote:

(A) Each person who is a Participant on the applicable record date will be granted a number of votes equal to the quotient, rounded to the nearest integral number, of (I) such Participant's Allocation Compensation for the Plan Year ending on or immediately prior to such record date (or for the portion of such Plan Year during which he was a Participant); divided by (II) \$1,000.00; and

(B) a number of votes equal to the product of (I) the total number of Financed Shares allocated to the Loan Repayment Account on the applicable record date; multiplied by (II) a fraction, the numerator of which is the total number of votes that are cast in the affirmative with respect to such matter pursuant to section 12.3(c)(ii)(A) and the denominator of which is the total number of votes that are cast either in the affirmative or in the negative with respect to such matter pursuant to section 12.3(c)(ii)(A), shall be cast in the affirmative; and

(C) a number of votes equal to the excess of (I) the total number of Financed Shares allocated to the Loan Repayment Account on the applicable record date, over (II) the number of affirmative votes cast with respect to such matter pursuant to section 12.3(c)(ii) (B), shall be cast in the negative.

To the extent that the Financed Shares consist of more than one class of Shares, this section 12.3(c)(ii) shall be applied separately with respect to each class of Shares.

Section 12.4 Tender Offers.

(a) Each person shall direct whether Shares allocated to his Share Investment Account will be delivered in response to any Tender Offer. Such person shall, for such purpose, be deemed a "named fiduciary" within the meaning of section 402(a)(2) of ERISA. Such a direction shall be given by completing and filing with the Trustee or such other person who shall be independent of the Participating Employers as the Committee shall designate, at least 10 days prior to the latest date for exercising a right to deliver Shares pursuant to such Tender Offer, a written direction in the form and manner prescribed by the Committee. The Trustee or other person designated by the Committee shall tabulate the directions given on a strictly confidential basis, and shall provide the Committee with only the final results of the tabulation. The final results of the tabulation shall be followed by the Committee in directing the number of Shares to be delivered. The Plan Administrator shall make a reasonable effort to furnish, or cause to be furnished, to each person for whom a Share Investment Account is maintained, all information known by the Plan Administrator to have been furnished by the issuer or by or on behalf of any person making such Tender Offer, to the holders of Shares in connection with such Tender Offer.

(b) To the extent that any person shall fail to give instructions with respect to Shares allocated to his Share Investment Account:

(i) the Trustee shall (A) tender or otherwise offer for purchase, exchange or redemption a number of such Shares equal to the product of (I) the number of allocated Shares for which no written instructions have been given, multiplied by (II) a fraction, the numerator of which is the number of allocated Shares tendered or otherwise offered for purchase, exchange or redemption in accordance with written instructions given as provided in section 12.4(a) and the denominator of which is the aggregate number of allocated Shares for which written instructions have been given as aforesaid, and (B) withhold a number of Shares equal to the excess (if any) of (I) the number of allocated Shares for which no written instructions have been given over (II) the number of Shares being tendered or otherwise offered pursuant to section 12.4(b)(i)(A); or

(ii) if the Trustee shall determine that it may not, consistent with its fiduciary duties, exercise the tender or other rights appurtenant to allocated Shares for which no written instructions have been given in the manner described in section 12.4(b)(i), it shall tender, or otherwise offer, or withhold such Shares in such manner as it, in its discretion, may determine to be in the best interests of the persons to whose Share Investment Accounts such Shares have been allocated.

(c) In the case of any Tender Offer, any Financed Shares held in the Loan Repayment Account shall be dealt with as follows:

(i) If such Tender Offer occurs at a time when there are no Shares allocated to the Share Investment Accounts of Participants, Former Participants and the Beneficiaries of deceased Former Participants, then the disposition of the Financed Shares shall be determined as follows:

(A) each person who is a Participant on the applicable record date will be granted a number of tender rights equal to the quotient, rounded to the nearest integral number, of (I) such Participant's Allocation Compensation for the Plan Year ending on or immediately prior to such record date (or for the portion of such Plan Year during which he was a Participant), divided by (II) \$1,000.00; and

(B) on the last day for delivering Shares or otherwise responding to such Tender Offer, a number of Shares equal to the product of (I) the total number of Financed Shares allocated to the Loan Repayment Account on the last day of the effective period of such Tender Offer; multiplied by (II) a fraction, the numerator of which is the total number of tender rights exercised in favor of the delivery of Shares in response to the Tender Offer pursuant to section 12.4(c)(i)(A) and the denominator of which is the total number of tender rights that are exercisable in response to the Tender Offer pursuant to section 12.4(c)(i)(A), shall be delivered in response to the Tender Offer; and

(C) a number of Shares equal to the excess of (I) the total number of Financed Shares allocated to the Loan Repayment Account on the last day of the effective period of such Tender Offer; over (II) the number of Shares to be

delivered in response to the Tender Offer pursuant to section 12.4(c)(i)(B), shall be withheld from delivery.

(ii) If such Tender Offer occurs at a time when the voting rights appurtenant to such Financed Shares are to be exercised in accordance with section 12.3(c)(i), then:

(A) on the last day for delivering Shares or otherwise responding to such Tender Offer, a number of Financed Shares equal to the product of (I) the total number of Financed Shares allocated to the Loan Repayment Account on the last day of the effective period of such Tender Offer; multiplied by (II) a fraction, the numerator of which is the total number of Shares delivered from the Share Investment Accounts of Participants, Former Participants and the Beneficiaries of deceased Former Participants in response to such Tender Offer pursuant to section 12.4(a), and the denominator of which is the total number of Shares allocated to the Share Investment Accounts of Participants, Former Participants and Beneficiaries of deceased Former Participants immediately prior to the last day for delivering Shares or otherwise responding to such Tender Offer, shall be delivered; and

(B) a number of Financed Shares equal to the excess of (I) the total number of Financed Shares allocated to the Loan Repayment Account on the last day for delivering Shares or otherwise responding to such Tender Offer; over (II) the number of Financed Shares to be delivered pursuant to section 12.4(c)(ii)(A), shall be withheld from delivery.

To the extent that the Financed Shares consist of more than one class of Shares, this section 12.4(c) shall be applied separately with respect to each class of Shares.

Article XIII

Payment of Benefits

Section 13.1 In General.

The balance credited to a Participant's or Former Participant's Account under the Plan shall be paid only at the times, to the extent, in the manner and to the persons provided in this Article XIII.

Section 13.2 Designation of Beneficiaries.

(a) Subject to section 13.2(b), any person entitled to a benefit under the Plan may designate a Beneficiary to receive any amount to which he is entitled that remains undistributed on the date of his death. Such person shall designate his Beneficiary (and may change or revoke any such designation) in writing in the form and manner prescribed by the Plan Administrator. Such designation, and any change or revocation thereof, shall be effective only if

received by the Plan Administrator prior to such person's death and shall become irrevocable upon such person's death.

(b) A Participant or Former Participant who is married shall automatically be deemed to have designated his spouse as his Beneficiary, unless, prior to the time such designation would, under section 13.2(a), become irrevocable:

(i) the Participant or Former Participant designates an additional or a different Beneficiary in accordance with this section 13.2; and

(ii) (A) the spouse of such Participant or Former Participant consents to such designation in a writing that acknowledges the effect of such consent and is witnessed by a Plan representative or a notary public; or (B) the spouse of such Participant or Former Participant has previously consented to such designation by signing a written waiver of any right to consent to any designation made by the Participant or Former Participant, and such waiver acknowledged the effect of the waiver and was witnessed by a Plan representative or a notary public; or (C) it is established to the satisfaction of a Plan representative that the consent required under section 13.2(b)(ii)(A) may not be obtained because such spouse cannot be located or because of other circumstances permitted under regulations issued by the Secretary of the Treasury.

(c) In the event that a Beneficiary entitled to payments hereunder shall die after the death of the person who designated him but prior to receiving payment of his entire interest in the Account of the person who designated him, then such Beneficiary's interest in the Account of such person, or any unpaid balance thereof, shall be paid as provided in section 13.3 to the Beneficiary who has been designated by the deceased Beneficiary, or if there is none, to the executor or administrator of the estate of such deceased Beneficiary, or if no such executor or administrator is appointed within such time as the Plan Administrator, in his sole discretion, shall deem reasonable, to such one or more of the spouse and descendants and blood relatives of such deceased Beneficiary as the Plan Administrator may select. If a person entitled to a benefit under the Plan and any of the Beneficiaries designated by him shall die in such circumstances that there shall be substantial doubt as to which of them shall have been the first to die, for all purposes of the Plan, the person who made the Beneficiary designation shall be deemed to have survived such Beneficiary.

(d) If no Beneficiary survives the person entitled to the benefit under the Plan or if no Beneficiary has been designated by such person, such benefit shall be paid to the executor or administrator of the estate of such person, or if no such executor or administrator is appointed within such time as the Plan Administrator, in his sole discretion, shall deem reasonable, to such one or more of the spouse and descendants and blood relatives of such deceased person as the Plan Administrator may select.

Section 13.3 Distributions to Participants and Former Participants.

(a) Except as provided in section 13.5, the vested portion of the balance credited to a Former Participant's Account shall be distributed to him in a single distribution as

of the last Valuation Date to occur in the Plan Year in which he terminates employment with all Affiliated Employers or the Plan Year in which he attains age 65, whichever is later; provided, however, that if the Former Participant elects, at such time and in such manner as the Plan Administrator may prescribe, that distribution be made as of an earlier Valuation Date that coincides with or follows his termination of employment with all Affiliated Employers, distribution shall be made as of such earlier Valuation Date and if the entire vested balance credited to a Former Participant's Accounts is not more than \$1,000 then the full vested amount shall be paid as of the earliest practicable Valuation Date following his termination of employment. The actual distribution shall be made within sixty days after the applicable Valuation Date. If an Account of a Participant or Former Participant does not contain any vested amounts as of the date of his termination of employment with all Affiliated Employers, a distribution of \$0, representing a full distribution of the Account, shall be deemed to have been made to the Participant or Former Participant on such date.

(b) In the event of the death of a Participant or Former Participant before the date of actual distribution of the vested portion of the balance credited to his Account, such vested portion shall be distributed to his Beneficiary in a single distribution as of the first Valuation Date to occur following the latest of (i) the date on which the Plan Administrator is notified of the Participant's or Former Participant's death; and (ii) the date on which the Plan Administrator determines the identity and location of the Participant's or Former Participant's Beneficiary or Beneficiaries. The actual distribution shall be made within sixty days after the applicable Valuation Date.

Section 13.4 Manner of Payment.

Distributions made pursuant to section 13.3 or section 13.5 shall be made, in accordance with the written direction of the person requesting the payment, in whole Shares, in cash, or in a combination of cash and whole Shares. Such written direction shall be given in such form and manner as the Plan Administrator may prescribe. If no such direction is given, then payment shall be made in the maximum number of whole Shares that may be acquired with the amount of the payment, plus, if necessary, an amount of money equal to any remaining amount of the payment that is less than the Fair Market Value of a whole Share.

Section 13.5 Minimum Required Distributions.

(a) Required minimum distributions of a Participant's or Former Participant's Account shall commence no later than:

(i) if the Participant or Former Participant was not a Five Percent Owner at any time during the Plan Year ending in the calendar year in which he attained age 70 ¹/₂, during any of the four preceding Plan Years or during any subsequent years, the later of (A) the calendar year in which he attains or attained age 70 ¹/₂ or (B) the calendar year in which he terminates employment with all Affiliated Employers; or

(ii) if the Participant or Former Participant attains age 70 ¹/₂ after December 31, 1998 and is or was a Five Percent Owner at any time during the

Plan Year ending in the calendar year in which he attained age $70\frac{1}{2}$, during any of the four preceding Plan Years or during any subsequent years, the later of (A) the calendar year in which he attains age $70\frac{1}{2}$ or (B) the calendar year in which he first becomes a Five Percent Owner.

(b) The required minimum distributions contemplated by section 13.5(a) shall be made as follows:

(i) The minimum required distribution to be made for the calendar year for which the first minimum distribution is required shall be no later than April 1st of the immediately following calendar year and shall be equal to the quotient obtained by dividing (A) the vested balance credited to the Participant's or Former Participant's Account as of the last Valuation Date to occur in the calendar year immediately preceding the calendar year in which the first minimum distribution is required (adjusted to account for any additions thereto or subtractions therefrom after such Valuation Date but on or before December 31st of such calendar year); by (B) the Participant's or Former Participant's life expectancy (or, if his Beneficiary is a Designated Beneficiary, the joint life and last survivor expectancy of him and his Beneficiary); and

(ii) the minimum required distribution to be made for each calendar year following the calendar year for which the first minimum distribution is required shall be made no later than December 31st of the calendar year for which the distribution is required and shall be equal to the quotient obtained by dividing (A) the vested balance credited to the Participant's or Former Participant's Account as of the last Valuation Date to occur in the calendar year prior to the calendar year for which the distribution is required (adjusted to account for any additions thereto or subtractions therefrom after such Valuation Date but on or before December 31st of such calendar year and, in the case of the distribution for the calendar year immediately following the calendar year for which the first minimum distribution is required, reduced by any distribution for the prior calendar year that is made in the current calendar year); by (B) the Participant's or Former Participant's life expectancy (or, if his Beneficiary is a Designated Beneficiary, the joint life and last survivor expectancy of him and his Beneficiary).

(c) For purposes of section 13.5(b) during the Participant's or Former Participant's lifetime, life expectancy shall be equal to:

(i) the distribution period in the Uniform Lifetime Table set forth in section 1.401(a)(9)-9 of the Treasury regulations, using the Participant's age as of the Participant's birthday in such calendar year; or

(ii) if the Participant's spouse is the sole Designated Beneficiary and the spouse is more than ten years younger than the Participant, the number in the Joint and Last Survivor Table set forth in section 1.401(a)(9)-9 of the Treasury

regulations, using the Participant's and spouse's attained ages as of the Participant's and spouse's birthdays in such calendar year.

(d) Payment of the distributions required to be made to a Participant or Former Participant under this section 13.5 shall be made in accordance with section 13.4.

Section 13.6 Direct Rollover of Eligible Rollover Distributions.

(a) A Distributee may elect, at the time and in the manner prescribed by the Plan Administrator, to have any portion of an Eligible Rollover Distribution paid directly to an Eligible Retirement Plan specified by the Distributee in a Direct Rollover.

(b) The following rules shall apply with respect to Direct Rollovers made pursuant to this section 13.6:

(i) A Distributee may only elect to make a Direct Rollover of an Eligible Rollover Distribution if such Eligible Rollover Distribution (when combined with other Eligible Rollover Distributions made or to be made in the same calendar year) is reasonably expected to be at least \$200;

(ii) If a Distributee elects a Direct Rollover of a portion of an Eligible Rollover Distribution, that portion must be equal to at least \$500; and

(iii) A Distributee may not divide his or her Eligible Rollover Distribution into separate distributions to be transferred to two or more Eligible Retirement Plans.

(c) For purposes of this section 13.6 and any other applicable section of the Plan, the following definitions shall have the following meanings:

(i) ***Direct Rollover*** means a payment by the Plan to the Eligible Retirement Plan specified by the Distributee.

(ii) ***Distributee*** means an Employee or former Employee. In addition, the Employee's or former Employee's surviving spouse and the Employee's spouse or former spouse who is the alternate payee under a Qualified Domestic Relations Order are considered Distributees with regard to the interest of the spouse or former spouse.

(iii) ***Eligible Retirement Plan*** means an individual retirement account described in section 408(a) of the Code, an individual retirement annuity described in section 408(b) of the Code, an annuity plan described in section 403(a) of the Code, a qualified trust described in section 401(a) of the Code an annuity contract described in section 403(b) of the Code or an eligible deferred compensation plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or an agency or instrumentality of a state or political subdivision thereof and which agrees to separately account for amounts

transferred into such plan from this Plan, that accepts the Distributee's Eligible Rollover Distribution.

(iv) ***Eligible Rollover Distribution*** means any distribution of all or any portion of the balance to the credit of the Distributee, except that an Eligible Rollover Distribution does not include: any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the Distributee or the joint lives (or joint life expectancies) of the Distributee's designated Beneficiary, or for a specified period of ten (10) years or more; any distribution to the extent such distribution is required under section 401(a)(9) of the Code; and any distribution made on account of hardship. A portion of a distribution that is includible in the gross income of the Distributee that is treated as an Eligible Rollover Distribution may only be transferred in a direct rollover to an Eligible Retirement Plan that agrees to separately account for such portion of the distribution. This section 13.6 shall not apply to any Eligible Rollover Distributions during the year that are reasonably expected (as determined by the Committee) to total less than \$200. In no event shall any withdrawal during service that is made on account of hardship be considered an Eligible Rollover Distribution. This section 13.6 shall be interpreted to comply with the provisions of section 401(a)(31) of the Code.

Section 13.7 Valuation of Shares Upon Distribution.

Notwithstanding any contrary provision in this Article XIII, in the event that all or a portion of a payment of a distribution is to be made in cash, the recipient shall only be entitled to receive the proceeds of the Shares allocated to his Account that are sold in connection with such distribution and which are valued as of the date of such sale.

Section 13.8 Put Options.

(a) Subject to section 13.8(c) and except as provided otherwise in section 13.8(b), each Participant or Former Participant to whom Shares are distributed under the Plan, each Beneficiary of a deceased Participant or Former Participant, including the estate of a deceased Participant or Former Participant, to whom Shares are distributed under the Plan, and each person to whom such a Participant, Former Participant or Beneficiary gives Shares that have been distributed under the Plan shall have the right to require Lake Shore Bancorp, Inc. to purchase from him all or any portion of such Shares. A person shall exercise such right by delivering to Lake Shore Bancorp, Inc. a written notice, in such form and manner as Lake Shore Bancorp, Inc. may by written notice to such person prescribe, setting forth the number of Shares to be purchased by Lake Shore Bancorp, Inc., the number of the stock certificate evidencing such person's ownership of such Shares, and the effective date of the purchase. Such notice shall be given at least 30 days in advance of the effective date of purchase, and the effective date of purchase specified therein shall be, either within the 60 day period that begins on the date on which the Shares to be purchased by Lake Shore Bancorp, Inc. were distributed from the Plan or within the 60 day period that begins on the first day of the Plan Year immediately following the Plan Year in which the Shares to be purchased by Lake Shore Bancorp, Inc. are distributed from the Plan. As soon as practicable following its receipt of such a notice, Lake Shore Bancorp, Inc.

shall take such actions as are necessary to purchase the Shares specified in such notice at a price per Share equal to the Fair Market Value of a Share determined as of the Valuation Date coincident with or immediately preceding the effective date of the purchase.

(b) Lake Shore Bancorp, Inc. shall have no obligation to purchase any Share (i) pursuant to a notice that is not timely given, or on an effective date of purchase that is not within the periods prescribed in section 13.8(a), or (ii) during a period in which Shares are publicly traded on an established market.

Section 13.9 Right of First Refusal.

(a) For any period during which Shares are not publicly traded on an established market, no person who owns Shares that were distributed from the Plan, other than a person to whom such Shares were sold in compliance with this section 13.9, shall sell such Shares to any person other than Lake Shore Bancorp, Inc. without first offering to sell such Shares to Lake Shore Bancorp, Inc. in accordance with this section 13.9.

(b) In the event that a person to whom this section 13.9 applies shall receive and desire to accept from a person other than Lake Shore Bancorp, Inc. an offer to purchase Shares to which this section 13.9 applies, he shall furnish to Lake Shore Bancorp, Inc. a written notice which shall:

(i) include a copy of such offer to purchase;

(ii) offer to sell to Lake Shore Bancorp, Inc. the Shares subject to such offer to purchase at a price per Share that is equal to the greater of:

(A) the price per Share specified in such offer to purchase; or

(B) the Fair Market Value of a Share as of the Valuation Date coincident with or immediately preceding the date of such notice;

and otherwise upon the same terms and conditions as those specified in such offer to purchase; and

(iii) include an indication of his intention to accept such offer to purchase if Lake Shore Bancorp, Inc. does not accept his offer to sell.

Such person shall refrain from accepting such offer to purchase for a period of fourteen days following the date on which such notice is given.

(c) Lake Shore Bancorp, Inc. shall have the right to purchase the Shares covered by the offer to sell contained in a notice given pursuant to section 13.9(b), on the terms and conditions specified in such notice, by written notice given to the party making the offer to sell not later than the fourteenth day after the notice described in section 13.9(b) is given. If Lake Shore Bancorp, Inc. does not give such a notice during the prescribed fourteen day period, then the person owning such Shares may accept the offer to purchase described in the notice.

Article XIV

Change in Control

Section 14.1 Definition of Change in Control; Pending Change in Control.

(a) A Change in Control shall be deemed to have occurred upon the happening of any of the following events:

(i) the consummation of a reorganization, merger or consolidation of the Company with one or more other persons, other than a transaction following which:

(A) at least 51% of the equity ownership interests of the entity resulting from such transaction are beneficially owned (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act of 1934, as amended ("Exchange Act")) in substantially the same relative proportions by persons who, immediately prior to such transaction, beneficially owned (within the meaning of Rule 13d-3 promulgated under the Exchange Act) at least 51% of the outstanding equity ownership interests in the Company; and

(B) at least 51% of the securities entitled to vote generally in the election of directors of the entity resulting from such transaction are beneficially owned (within the meaning of Rule 13d-3 promulgated under the Exchange Act) in substantially the same relative proportions by persons who, immediately prior to such transaction, beneficially owned (within the meaning of Rule 13d-3 promulgated under the Exchange Act) at least 51% of the securities entitled to vote generally in the election of directors of the Company;

(ii) the acquisition of all or substantially all of the assets of the Company or beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 25% or more of the outstanding securities of the Company entitled to vote generally in the election of directors by any person or by any persons acting in concert;

(iii) a complete liquidation or dissolution of the Company;

(iv) the occurrence of any event if, immediately following such event, at least 50% of the members of the Board of Directors of the Company do not belong to any of the following groups:

(A) individuals who were members of the Board of Directors of the Company on the date of this Agreement; or

(B) individuals who first became members of the Board of Directors of the Company after the date of this Agreement either:

(1) upon election to serve as a member of the Board of Directors of the Company by affirmative vote of three-quarters of the members of such board, or of a nominating committee thereof, in office at the time of such first election; or

(2) upon election by the shareholders of the Board of Directors of the Company to serve as a member of such board, but only if nominated for election by affirmative vote of three-quarters of the members of the Board of Directors of the Company, or of a nominating committee thereof, in office at the time of such first nomination;

provided, however, that such individual's election or nomination did not result from an actual or threatened election contest or other actual or threatened solicitation of proxies or consents other than by or on behalf of the Board of Directors of the Company;

provided, however, that this section 15(a)(iv) shall only apply if the Company is not majority owned by Lake Shore, MHC; or

(v) any event which would be described in section 15(a)(i), (ii), (iii) or (iv) if the term "Bank" were substituted for the term "Company" therein.

In no event, however, shall a Change of Control be deemed to have occurred as a result of (i) any acquisition of securities or assets of the Company, the Bank, or a subsidiary of either of them, by the Company, the Bank, or any subsidiary of either of them, or by any employee benefit plan maintained by any of them or (ii) the conversion of Lake Shore, MHC to a stock form company and the issuance of additional shares of the Company in connection therewith. For purposes of this section 15(a), the term "person" shall have the meaning assigned to it under sections 13(d)(3) or 14(d)(2) of the Exchange Act.

(b) A Pending Change of Control shall be deemed to have occurred upon the happening of any of the following events:

(i) approval by the stockholders of Lake Shore Bancorp, Inc. of a transaction, or a plan for the consummation of a transaction, which, if consummated, would result in a Change in Control;

(ii) approval by the Board of Directors of Lake Shore Bancorp, Inc. of a transaction, or a plan for the consummation of a transaction, which, if consummated, would result in a Change in Control;

(iii) the commencement of a tender offer (within the meaning of section 14(d)(i) of the Exchange Act, as amended) for securities issued by Lake Shore Bancorp, Inc., which, if completed, would result in a Change in Control;

(iv) the furnishing or distribution of a proxy statement or other document, whether or not in opposition to management, soliciting proxies, consents or authorizations (within the meaning of section 14 of the Exchange Act) in respect of securities issued by Lake Shore Bancorp, Inc. in favor of any election, transaction or other action which, if effected, would result in a Change in Control; or

(v) any event which would be described in Sections 14.1(b)(i), (ii), (iii) or (iv) if “Lake Shore Savings Bank” were substituted for “Lake Shore Bancorp, Inc.” therein.

Section 14.2 Vesting on Change of Control.

Notwithstanding any other provision of the Plan, upon the effective date of a Change in Control, the Account of each person who would then, upon termination of the Plan, be entitled to a benefit, shall be fully vested and nonforfeitable.

Section 14.3 Repayment of Share Acquisition Loan.

Notwithstanding any other provision of the Plan, upon the occurrence of a Change in Control, the Committee shall direct the Trustee to sell a sufficient number of shares of Stock to repay any outstanding Share Acquisition Loan, all remaining Shares which had been unallocated (or the proceeds from the sale thereof, if applicable) shall be allocated among the accounts of all individuals with undistributed Account balances on the effective date of such Change in Control who are employed by the Company or Bank on the effective date of such Change of Control. Such allocation of Shares or proceeds shall be in proportion to the balance credited to their Accounts immediately prior to such allocation.

Section 14.4 Plan Termination After Change in Control.

Notwithstanding any other provision of the Plan, after repayment of the loan and allocation of Shares or proceeds as provided in Section 14.3, the Plan shall be terminated and all amounts shall be distributed as soon as practicable.

Section 14.5 Amendment of Section XIV.

Notwithstanding any other provision of the Plan, this Section 14 of the Plan may not be amended after the earliest date on which a Change in Control or Pending Change in Control occurs, except (i) to the extent any amendment is required by the Internal Revenue Service as a condition to the continued treatment of the Plan as a tax-qualified plan under section 401(a) of the Code or (ii) to the extent that the Company, in its sole discretion, determines that any such amendment is necessary in order to permit any transaction to which the Company, and/or its parent or affiliate, is or proposes to be a party to qualify for “pooling of interests” accounting treatment.

Article XV
Administration

Section 15.1 Named Fiduciaries.

The term “Named Fiduciary” shall mean (but only to the extent of the responsibilities of each of them) the Plan Administrator, the Committee, the Board and the Trustee. This Article XV is intended to allocate to each Named Fiduciary the responsibility for the prudent execution of the functions assigned to him or it, and none of such responsibilities or any other responsibility shall be shared by two or more of such Named Fiduciaries. Whenever one Named Fiduciary is required by the Plan or Trust Agreement to follow the directions of another Named Fiduciary, the two Named Fiduciaries shall not be deemed to have been assigned a shared responsibility, but the responsibility of the Named Fiduciary giving the directions shall be deemed his sole responsibility, and the responsibility of the Named Fiduciary receiving those directions shall be to follow them insofar as such instructions are on their face proper under applicable law.

Section 15.2 Plan Administrator.

There shall be a Plan Administrator, who shall be the [Director of Human Resources] of Lake Shore Savings Bank, or such Employee or officer as may be designated by the Committee, as hereinafter provided, and who shall, subject to the responsibilities of the Committee and the Board, have the responsibility for the day-to-day control, management, operation and administration of the Plan (except trust duties). The Plan Administrator shall have the following responsibilities:

- (a) To maintain records necessary or appropriate for the administration of the Plan;
- (b) To give and receive such instructions, notices, information, materials, reports and certifications to the Trustee as may be necessary or appropriate in the administration of the Plan;
- (c) To prescribe forms and make rules and regulations consistent with the terms of the Plan and with the interpretations and other actions of the Committee;
- (d) To require such proof of age or evidence of good health of an Employee, Participant or Former Participant or the spouse of either, or of a Beneficiary as may be necessary or appropriate in the administration of the Plan;
- (e) To prepare and file, distribute or furnish all reports, plan descriptions, and other information concerning the Plan, including, without limitation, filings with the Secretary of Labor and communications with Participants, Former Participants and other persons, as shall be required of the Plan Administrator under ERISA;

(f) To determine any question arising in connection with the Plan, and the Plan Administrator's decision or action in respect thereof shall be final and conclusive and binding upon the Employer, the Trustee, Participants, Former Participants, Beneficiaries and any other person having an interest under the Plan; provided, however, that any question relating to inconsistency or omission in the Plan, or interpretation of the provisions of the Plan, shall be referred to the Committee by the Plan Administrator and the decision of the Committee in respect thereof shall be final;

(g) Subject to the provisions of section 15.5, to review and dispose of claims under the Plan filed pursuant to section 15.4;

(h) If the Plan Administrator shall determine that by reason of illness, senility, insanity, or for any other reason, it is undesirable to make any payment to a Participant, Former Participant, Beneficiary or any other person entitled thereto, to direct the application of any amount so payable to the use or benefit of such person in any manner that he may deem advisable or to direct in his discretion the withholding of any payment under the Plan due to any person under legal disability until a representative competent to receive such payment in his behalf shall be appointed pursuant to law;

(i) To discharge such other responsibilities or follow such directions as may be assigned or given by the Committee or the Board; and

(j) To perform any duty or take any action which is allocated to the Plan Administrator under the Plan.

The Plan Administrator shall have the power and authority necessary or appropriate to carry out his responsibilities. The Plan Administrator may resign only by giving at least 30 days' prior written notice of resignation to the Committee, and such resignation shall be effective on the date specified in such notice.

Section 15.3 Committee Responsibilities.

The Committee shall, subject to the responsibilities of the Board, have the following responsibilities:

(a) To review the performance of the Plan Administrator;

(b) To hear and decide appeals, pursuant to the claims procedure contained in section 15.5 of the Plan, taken from the decisions of the Plan Administrator;

(c) To hear and decide questions, including interpretation of the Plan, as may be referred to the Committee by the Plan Administrator;

(d) To review the performance of the Trustee and such investment managers as may be appointed in or pursuant to the Trust Agreement in investing, managing and controlling the assets of the Plan;

(e) To the extent required by ERISA, to establish a funding policy and method consistent with the objectives of the Plan and the requirements of ERISA, and to review such policy and method at least annually;

(f) To report and make recommendations to the Board regarding changes in the Plan, including changes in the operation and management of the Plan and removal and replacement of the Trustee and such investment managers as may be appointed in or pursuant to the Trust Agreement;

(g) To designate an Alternate Plan Administrator to serve in the event that the Plan Administrator is absent or otherwise unable to discharge his responsibilities;

(h) To remove and replace the Plan Administrator or Alternate, or both of them, and to fill a vacancy in either office;

(i) To the extent provided under and subject to the provisions of the Trust Agreement, to appoint "investment managers" as defined in section 3(38) of ERISA to manage and control (including acquiring and disposing of) all or any of the assets of the Plan;

(j) With the prior approval of the Board, to direct the Trustee to obtain one or more Share Acquisition Loans;

(k) To develop and provide procedures and forms necessary to facilitate voting and tendering directions on a confidential basis;

(l) To discharge such other responsibilities or follow such directions as may be assigned or given by the Board; and

(m) To perform any duty or take any action which is allocated to the Committee under the Plan.

The Committee shall have the power and authority necessary or appropriate to carry out its responsibilities.

Section 15.4 Claims Procedure.

Any claim relating to benefits under the Plan shall be filed with the Plan Administrator on a form prescribed by him. If a claim is denied in whole or in part, the Plan Administrator shall give the claimant written notice of such denial, which notice shall specifically set forth:

(a) The reasons for the denial;

-
- (b) The pertinent Plan provisions on which the denial was based;
 - (c) Any additional material or information necessary for the claimant to perfect his claim and an explanation of why such material or information is needed; and
 - (d) An explanation of the Plan's procedure for review of the denial of the claim.

In the event that the claim is not granted and notice of denial of a claim is not furnished by the 30th day after such claim was filed, the claim shall be deemed to have been denied on that day for the purpose of permitting the claimant to request review of the claim.

Section 15.5 Claims Review Procedure.

Any person whose claim filed pursuant to section 15.4 has been denied in whole or in part by the Plan Administrator may request review of the claim by the Committee, upon a form prescribed by the Plan Administrator. The claimant shall file such form (including a statement of his position) with the Committee no later than 60 days after the mailing or delivery of the written notice of denial provided for in section 15.4, or, if such notice is not provided, within 60 days after such claim is deemed denied pursuant to section 15.4. The claimant shall be permitted to review pertinent documents. A decision shall be rendered by the Committee and communicated to the claimant not later than 30 days after receipt of the claimant's written request for review. However, if the Committee finds it necessary, due to special circumstances (for example, the need to hold a hearing), to extend this period and so notifies the claimant in writing, the decision shall be rendered as soon as practicable, but in no event later than 120 days after the claimant's request for review. The Committee's decision shall be in writing and shall specifically set forth:

- (a) The reasons for the decision; and
- (b) The pertinent Plan provisions on which the decision is based.

Any such decision of the Committee shall be binding upon the claimant and the Employer, and the Plan Administrator shall take appropriate action to carry out such decision.

Section 15.6 Allocation of Fiduciary Responsibilities and Employment of Advisors.

Any Named Fiduciary may:

- (a) Allocate any of his or its responsibilities (other than trustee responsibilities) under the Plan to such other person or persons as he or it may designate, provided that such allocation and designation shall be in writing and filed with the Plan Administrator;
- (b) Employ one or more persons to render advice to him or it with regard to any of his or its responsibilities under the Plan; and
- (c) Consult with counsel, who may be counsel to the Employer.

Section 15.7 Other Administrative Provisions.

(a) Any person whose claim has been denied in whole or in part must exhaust the administrative review procedures provided in section 15.5 prior to initiating any claim for judicial review.

(b) No bond or other security shall be required of a member of the Committee, the Plan Administrator, or any officer or Employee of the Employer to whom fiduciary responsibilities are allocated by a Named Fiduciary, except as may be required by ERISA.

(c) Subject to any limitation on the application of this section 15.7(c) pursuant to ERISA, neither the Plan Administrator, nor a member of the Committee, nor any officer or Employee of the Employer to whom fiduciary responsibilities are allocated by a Named Fiduciary, shall be liable for any act of omission or commission by himself or by another person, except for his own individual willful and intentional malfeasance.

(d) The Plan Administrator or the Committee may, except with respect to actions under section 15.5, shorten, extend or waive the time (but not beyond 60 days) required by the Plan for filing any notice or other form with the Plan Administrator or the Committee, or taking any other action under the Plan.

(e) The Plan Administrator or the Committee may direct that the costs of services provided pursuant to section 15.6, and such other reasonable expenses as may be incurred in the administration of the Plan, shall be paid out of the funds of the Plan unless the Employer shall pay them.

(f) Any person, group of persons, committee, corporation or organization may serve in more than one fiduciary capacity with respect to the Plan.

(g) Any action taken or omitted by any fiduciary with respect to the Plan, including any decision, interpretation, claim denial or review on appeal, shall be conclusive and binding on all interested parties and shall be subject to judicial modification or reversal only to the extent it is determined by a court of competent jurisdiction that such action or omission was arbitrary and capricious and contrary to the terms of the Plan.

Article XVI

Amendment, Termination and Tax Qualification

Section 16.1 Amendment and Termination by Lake Shore Bancorp, Inc.

The Participating Employers expect to continue the Plan indefinitely, but specifically reserve the right, in their sole discretion, at any time, by appropriate action of their respective boards of directors or other authorized officials, to amend, in whole or in part, any or all of the provisions of the Plan and to terminate the Plan at any time. Subject to the provisions of section 16.2, no such amendment or termination shall permit any part of the Trust Fund to be

used for or diverted to purposes other than for the exclusive benefit of Participants, Former Participants, Beneficiaries or other persons entitled to benefits, and no such amendment or termination shall reduce the accrued benefit of any Participant, Former Participant, Beneficiary or other person who may be entitled to benefits, without his consent. In the event of a termination or partial termination of the Plan, or in the event of a complete discontinuance of the Participating Employer's contributions to the Plan, the Accounts of each affected person shall forthwith become nonforfeitable and shall be payable in accordance with the provisions of Article XIII.

Section 16.2 Amendment or Termination Other Than by Lake Shore Bancorp, Inc.

In the event that a corporation or trade or business other than Lake Shore Bancorp, Inc. shall adopt this Plan, such corporation or trade or business shall, by adopting the Plan, empower Lake Shore Bancorp, Inc., to amend or terminate the Plan, insofar as it shall cover employees of such corporation or trade or business, upon the terms and conditions set forth in section 16.1; provided, however, that any such corporation or trade or business may, by action of its board of directors or other governing body, amend or terminate the Plan, insofar as it shall cover employees of such corporation or trade or business, at different times and in a different manner. In the event of any such amendment or termination by action of the board of directors or other governing body of such a corporation or trade or business, a separate plan shall be deemed to have been established for the employees of such corporation or trade or business, and the assets of such plan shall be segregated from the assets of this Plan at the earliest practicable date and shall be dealt with in accordance with the documents governing such separate plan.

Section 16.3 Conformity to Internal Revenue Code.

The Participating Employers have established the Plan with the intent that the Plan and Trust will at all times be qualified under section 401 (a) and exempt under section 501(a) of the Code and with the intent that contributions under the Plan will be allowed as deductions in computing the net income of the Participating Employers for federal income tax purposes, and the provisions of the Plan and Trust Agreement shall be construed to effectuate such intentions. Accordingly, notwithstanding anything to the contrary hereinbefore provided, the Plan and the Trust Agreement may be amended at any time without prior notice to Participants, Former Participants, Beneficiaries or any other persons entitled to benefits, if such amendment is deemed by the Board to be necessary or appropriate to effectuate such intent.

Section 16.4 Contingent Nature of Contributions.

(a) All Discretionary Contributions to the Plan are conditioned upon the issuance by the Internal Revenue Service of a determination that the Plan and Trust are qualified under section 401(a) of the Code and exempt under section 501(a) of the Code. If the Participating Employers apply to the Internal Revenue Service for such a determination within 90 days after the date on which it files its federal income tax return for its taxable year that includes the last day of the Plan Year in which the Plan is adopted, and if the Internal Revenue Service issues a determination that the Plan and Trust are not so qualified or exempt, all Discretionary Contributions made by the Participating Employers prior to the date of receipt of

such a determination may, at the election of the Participating Employers, be returned to the Participating Employers within one year after the date of such determination.

(b) All Discretionary Contributions and Loan Repayment Contributions to the Plan are made upon the condition that such Discretionary Contributions and Loan Repayment Contributions will be allowed as a deduction in computing the net income of the Employer for federal income tax purposes. To the extent that any such deduction is disallowed, the amount disallowed may, at the election of the Participating Employers, be returned to the Participating Employers within one year after the deduction is disallowed.

(c) Any contribution to the Plan made by the Participating Employers as a result of a mistake of fact may, at the election of the Participating Employers, be returned to the Participating Employers within one year after such contribution is made.

Article XVII

Special Rules for Top Heavy Plan Years

Section 17.1 In General.

As of the Determination Date for each Plan Year, the Plan Administrator shall determine whether the Plan is a Top Heavy Plan in accordance with the provisions of this Article XVII. If, as of such Determination Date, the Plan is a Top Heavy Plan, then the Plan Year immediately following such Determination Date shall be a Top Heavy Plan Year and the special provisions of this Article XVII shall be in effect; provided, however, that if, as of the Determination Date for the Plan Year in which the Effective Date occurs, the Plan is a Top Heavy Plan, such Plan Year shall be a Top Heavy Plan Year, and the provisions of this Article XVII shall be given retroactive effect for such Plan Year.

Section 17.2 Definition of Top Heavy Plan.

(a) Subject to section 17.2(c), the Plan is a Top Heavy Plan if, as of a Determination Date: (i) it is not a member of a Required Aggregation Group, and (ii)(A) the sum of the Cumulative Accrued Benefits of all Key Employees exceeds 60% of (B) the sum of the Cumulative Accrued Benefits of all Employees (excluding former Key Employees), former Employees (excluding former Key Employees and other former Employees who have not performed any services for the Employer or any Affiliated Employer during the immediately preceding Plan Year), and their Beneficiaries.

(b) Subject to section 17.2(c), the Plan is a Top Heavy Plan if, as of a Determination Date: (i) the Plan is a member of a Required Aggregation Group, and (ii)(A) the sum of the Cumulative Accrued Benefits of all Key Employees under all plans that are members of the Required Aggregation Group exceeds 60% of (B) the sum of the Cumulative Accrued Benefits of all Employees (excluding former Key Employees), former Employees (excluding former Key Employees and other former Employees who have not performed any services for the Employer or any Affiliated Employer during the immediately preceding Plan Year), and their Beneficiaries under all plans that are members of the Required Aggregation Group.

(c) Notwithstanding sections 17.2(a) and 17.2(b), the Plan is not a Top Heavy Plan if, as of a Determination Date: (i) the Plan is a member of a Permissible Aggregation Group, and (ii)(A) the sum of the Cumulative Accrued Benefits of all Key Employees under all plans that are members of the Permissible Aggregation Group does not exceed 60% of (B) the sum of the Cumulative Accrued Benefits of all Employees (excluding former Key Employees), former Employees (excluding former Key Employees and other former Employees who have not performed any services for the Employer or any Affiliated Employer during the immediately preceding Plan Year), and their Beneficiaries under all plans that are members of the Permissible Aggregation Group.

Section 17.3 Determination Date.

The Determination Date for the Plan Year in which the Effective Date occurs shall be the last day of such Plan Year, and the Determination Date for each Plan Year beginning after the Plan Year in which the Effective Date occurs shall be the last day of the preceding Plan Year. The Determination Date for any other qualified plan maintained by the Employer for a plan year shall be the last day of the preceding plan year of each such plan, except that in the case of the first plan year of such plan, it shall be the last day of such first plan year.

Section 17.4 Cumulative Accrued Benefits.

(a) An individual's Cumulative Accrued Benefits under this Plan as of a Determination Date are equal to the sum of:

(i) the balance credited to such individual's Account under this Plan as of the most recent Valuation Date preceding the Determination Date;

(ii) the amount of any Discretionary Contributions or Loan Repayment Contributions made after such Valuation Date but on or before the Determination Date; and

(iii) the amount of any distributions of such individual's Cumulative Accrued Benefits under the Plan (including distributions under terminated plans that would have been included in the Required Aggregation Group if not terminated) during the five-year period (for in-service distributions) or one-year period (for all distributions other than in-service distributions) ending on the Determination Date.

For purposes of this section 17.4(a), the computation of an individual's Cumulative Accrued Benefits, and the extent to which distributions, rollovers and transfers are taken into account, will be made in accordance with section 416 of the Code and the regulations thereunder.

(b) For purposes of this Plan, the term "Cumulative Accrued Benefits" with respect to any other qualified plan, shall mean the cumulative accrued benefits determined for purposes of section 416 of the Code under the provisions of such plans.

(c) For purposes of determining the top heavy status of a Required Aggregation Group or a Permissible Aggregation Group, the Cumulative Accrued Benefits under this Plan and the Cumulative Accrued Benefits under any other plan shall be determined as of the Determination Date that falls within the same calendar year as the Determination Dates for all other members of such Required Aggregation Group or Permissible Aggregation Group.

Section 17.5 Key Employees.

(a) For purposes of the Plan, the term Key Employee means any employee or former employee of the Employer or any Affiliated Employer who is at any time during the current Plan Year:

(i) a Five Percent Owner;

(ii) a person who would be described in section 1.25 if the number “1%” were substituted for the number “5%” in section 1.25 and who has an annual Total Compensation from the Employer and any Affiliated Employer of more than \$150,000; or

(iii) an Officer of the Employer or any Affiliated Employer who has an annual Total Compensation greater than \$135,000 (or any greater amount as specified in section 416(i)(1)(A)(i) of the Code) for the Plan Year.

(b) For purposes of section 17.5(a):

(i) for purposes of section 17.5(a)(iii), in the event the Employer or any Affiliated Employer has more officers than are considered Officers, the term Key Employee shall mean those officers, up to the maximum number, with the highest annual compensation in any one of the five consecutive Plan Years ending on the Determination Date; and

(ii) for purposes of section 17.5(a)(ii), if two or more persons have equal ownership interests in the Employer, each such person shall be considered as having a larger ownership interest than any such person with a lower annual compensation from the Employer or any Affiliated Employer.

(c) For purposes of section 17.5(a): (i) a person’s compensation from Affiliated Employers shall be aggregated, but his ownership interests in Affiliated Employers shall not be aggregated; (ii) an employee shall only be deemed to be an officer if he has the power and responsibility of a person who is an officer within the meaning of section 416 of the Code; and (iii) the term Key Employee shall also include the Beneficiary of a deceased Key Employee.

Section 17.6 Required Aggregation Group.

For purposes of this Article XVII, a Required Aggregation Group shall consist of (a) this Plan; (b) any other qualified plans currently maintained (or previously maintained and terminated within the five year period ending on the Determination Date) by the Employer and any Affiliated Employers that cover Key Employees; and (c) any other qualified plans currently

maintained (or previously maintained and terminated within the five year period ending on the Determination Date) by the Employer or any Affiliated Employers that cover Key Employees that are required to be aggregated for purposes of satisfying the requirements of sections 401(a)(4) or 410(b) of the Code.

Section 17.7 Permissible Aggregation Group.

For purposes of this Article XVII, a Permissible Aggregation Group shall consist of (a) the Required Aggregation Group and (b) any other qualified plans maintained by the Employer and any Affiliated Employers; provided, however, that the Permissible Aggregation Group must satisfy the requirements of sections 401(a)(4) and 410(b) of the Code.

Section 17.8 Special Requirements During Top Heavy Plan Years.

Notwithstanding any other provision of the Plan to the contrary, for each Top Heavy Plan Year, in the case of a Participant (other than a Key Employee) on the last day of such Top Heavy Plan Year who is not also a participant in another qualified plan which satisfies the minimum contribution and benefit requirements of section 416 of the Code with respect to such Participant, the sum of the Discretionary Contributions and Loan Repayment Contributions made with respect to such Participant, when expressed as a percentage of his Total Compensation for such Top Heavy Plan Year, shall not be less than 3% of such Participant's Total Compensation for such Top Heavy Plan Year or, if less, the highest combined rate, expressed as a percentage of Total Compensation at which Discretionary Contributions and Loan Repayment Contributions were made on behalf of a Key Employee for such Top Heavy Plan Year. The Employer shall make an additional contribution to the Account of each Participant to the extent necessary to satisfy the foregoing requirement.

Article XVIII

Miscellaneous Provisions

Section 18.1 Governing Law.

The Plan shall be construed, administered and enforced according to the laws of the State of New York without giving effect to the conflict of laws principles thereof, except to the extent that such laws are preempted by federal law.

Section 18.2 No Right to Continued Employment.

Neither the establishment of the Plan, nor any provisions of the Plan or of the Trust Agreement establishing the Trust Fund nor any action of the Plan Administrator, the Committee or the Trustee, shall be held or construed to confer upon any Employee any right to a continuation of employment by any Affiliated Employer. Each Affiliated Employer reserves the right to dismiss any Employee or otherwise deal with any Employee to the same extent as though the Plan had not been adopted.

Section 18.3 Construction of Language.

Wherever appropriate in the Plan, words used in the singular may be read in the plural, words used in the plural may be read in the singular, and words importing the masculine gender may be read as referring equally to the feminine and the neuter. Any reference to an Article or section number shall refer to an Article or section of the Plan, unless otherwise indicated.

Section 18.4 Headings.

The headings of Articles and sections are included solely for convenience of reference. If there is any conflict between such headings and the text of the Plan, the text shall control.

Section 18.5 Merger with Other Plans.

The Plan shall not be merged or consolidated with, nor transfer its assets or liabilities to, any other plan unless each Participant, Former Participant, Beneficiary and other person entitled to benefits, would (if that plan then terminated) receive a benefit immediately after the merger, consolidation or transfer which is equal to or greater than the benefit he would have been entitled to receive if the Plan had terminated immediately before the merger, consolidation or transfer.

Section 18.6 Non-alienation of Benefits.

(a) Except as provided in section 18.6(b) and (c), the right to receive a benefit under the Plan shall not be subject in any manner to anticipation, alienation or assignment, nor shall such right be liable for or subject to debts, contracts, liabilities or torts. Should any Participant, Former Participant or other person attempt to anticipate, alienate or assign his interest in or right to a benefit, or should any person claiming against him seek to subject such interest or right to legal or equitable process, all the interest or right of such Participant or Former Participant or other person entitled to benefits in the Plan shall cease, and in that event such interest or right shall be held or applied, at the direction of the Plan Administrator, for or to the benefit of such Participant or Former Participant, or other person or his spouse, children or other dependents in such manner and in such proportions as the Plan Administrator may deem proper.

(b) This section 18.6 shall not prohibit the Plan Administrator from recognizing a Domestic Relations Order that is determined to be a Qualified Domestic Relations Order in accordance with section 18.7.

(c) Notwithstanding anything in the Plan to the contrary, a Participant's, Former Participant's or Beneficiary's Accounts under the Plan may be offset by any amount such Participant, Former Participant or Beneficiary is required or ordered to pay to the Plan if:

(i) the order or requirement to pay arises: (A) under a judgment issued on or after August 5, 1997 of conviction for a crime involving the Plan; (B) under a civil judgment (including a consent order or decree) entered by a court on or

after August 5, 1997 in an action brought in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of ERISA; or (C) pursuant to a settlement agreement entered into on or after August 5, 1997 between the Participant, Former Participant or Beneficiary and one or both of the United States Department of Labor and the Pension Benefit Guaranty Corporation in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of ERISA by a fiduciary or any other person; and

(ii) the judgment, order, decree or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the Plan against the Participant's, Former Participant's or Beneficiary's benefits under the Plan.

Section 18.7 Procedures Involving Domestic Relations Orders.

Upon receiving a Domestic Relations Order, the Plan Administrator shall segregate in a separate account or in an escrow account or separately account for the amounts payable to any person pursuant to such Domestic Relations Order, pending a determination whether such Domestic Relations Order constitutes a Qualified Domestic Relations Order, and shall give notice of the receipt of the Domestic Relations Order to the Participant or Former Participant and each other person affected thereby. If, within 18 months after receipt of such Domestic Relations Order, the Plan Administrator, a court of competent jurisdiction or another appropriate authority determines that such Domestic Relations Order constitutes a Qualified Domestic Relations Order, the Plan Administrator shall direct the Trustee to pay the segregated amounts (plus any interest thereon) to the person or persons entitled thereto under the Qualified Domestic Relations Order. If it is determined that the Domestic Relations Order is not a Qualified Domestic Relations Order or if no determination is made within the prescribed 18-month period, the segregated amounts shall be distributed as though the Domestic Relations Order had not been received, and any later determination that such Domestic Relations Order constitutes a Qualified Domestic Relations Order shall be applied only with respect to benefits that remain undistributed on the date of such determination. The Plan Administrator shall be authorized to establish such reasonable administrative procedures as he deems necessary or appropriate to administer this section 18.7. This section 18.7 shall be construed and administered so as to comply with the requirements of section 401(a)(13) of the Code.

Section 18.8 Leased Employees.

(a) Subject to section 18.8(b), a leased employee shall be treated as an Employee for purposes of the Plan. For purposes of this section 18.8, the term "leased employee" means any person (i) who would not, but for the application of this section 18.8, be an Employee and (ii) who pursuant to an agreement between the Employer and any other person ("leasing organization") has performed for the Employer (or for the Employer and related persons determined in accordance with section 414(n)(6) of the Code), on a substantially full-time basis for a period of at least one year, services performed under the primary direction or control of the Employer.

(b) For purposes of the Plan:

(i) contributions or benefits provided to the leased employee by the leasing organization which are attributable to services performed for the Employer shall be treated as provided by the Employer; and

(ii) section 18.8(a) shall not apply to a leased employee if:

(a) the number of leased employees performing services for the Employer does not exceed 20% of the number of the Employer's Employees who are not Highly Compensated Employees; and

(b) such leased employee is covered by a money purchase pension plan providing (I) a nonintegrated contribution rate of at least 10% of the leased employee's compensation; (II) immediate participation; (III) full and immediate vesting; and (IV) coverage for all of the employees of the leasing organization (other than employees who perform substantially all of their services for the leasing organization).

Section 18.9 Status as an Employee Stock Ownership Plan.

It is intended that the Plan constitute an "employee stock ownership plan," as defined in section 4975(e)(7) of the Code and section 407(d)(6) of ERISA. The Plan shall be construed and administered to give effect to such intent.

I N W I T N E S S W H E R E O F , this Plan has been executed by the undersigned officer of Lake Shore Bancorp, Inc. pursuant to authority given by resolution of the Board of Directors.

L A K E S H O R E B A N C O R P , I N C .

By _____
Name:
Title:

Consent of Independent Registered Public Accounting Firm

We hereby consent to the use in the Prospectus of Lake Shore Savings & Loan Association, constituting a part of this Amendment No. 1 to the Registration Statement (Form S-1) and Forms MHC-1 and MHC-2, of our report dated October 7, 2005, relating to the financial statements of Lake Shore Savings & Loan Association which is included in that Prospectus.

We also consent to the reference to us under the caption “Experts” in the Prospectus.

/s/ Beard Miller Company LLP

Pittsburgh, Pennsylvania
January 11, 2006

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the use in this Amendment No. 1 to Registration Statement on Form S-1 of our report dated July 21, 2004 relating to the financial statements of Lake Shore Savings and Loan Association as of December 31, 2003 and for the two years then ended, which appears in such Amendment No. 1 to Registration Statement. We also consent to the reference to us under the heading “Experts” in such Amendment No. 1 to Registration Statement.

/s/ PricewaterhouseCoopers LLP
Buffalo, New York
January 13, 2006

January 13, 2006

Board of Directors
Lake Shore Savings and Loan Association
125 East Fourth Street
Dunkirk, New York 14048

Members of the Board of Directors:

We hereby consent to the use of our firm's name in the Form MHC-1, Form MHC-2, and any amendments thereto, and in the Registration Statement on Form S-1, and any amendments thereto. We also hereby consent to the inclusion of, summary of and references to our Appraisal in such filings including the prospectus of Lake Shore Bancorp, Inc.

Sincerely,

/s/ RP FINANCIAL, LC.
RP[®] FINANCIAL, LC.

***PRO FORMA VALUATION REPORT
MUTUAL HOLDING COMPANY
STOCK OFFERING***

***LAKE SHORE SAVINGS AND LOAN
ASSOCIATION
Dunkirk, New York***

***Dated As Of:
December 22, 2005***

Prepared By:

***RP[®] Financial, LC.
1700 North Moore Street
Suite 2210
Arlington, Virginia 22209***

December 22, 2005

Board of Directors
Lake Shore Savings and Loan Association
125 East Fourth Street
Dunkirk, New York 14048

Members of the Board of Directors:

At your request, we have completed and hereby provide an independent appraisal ("Appraisal") of the estimated pro forma market value of the common stock which is to be offered in connection with the mutual-to-stock conversion transaction described below.

This Appraisal is furnished pursuant to the conversion regulations promulgated by the Office of Thrift Supervision ("OTS"). Specifically, this Appraisal has been prepared in accordance with the "Guidelines for Appraisal Reports for the Valuation of Savings and Loan Associations Converting from Mutual to Stock Form of Organization" as set forth by the OTS, and applicable regulatory interpretations thereof.

Description of Plan of Reorganization

The Board of Directors of Lake Shore Savings and Loan Association ("Lake Shore Savings" or the "Association") adopted a plan of reorganization and related minority stock issuance on August 9, 2005, pursuant to which Lake Shore Savings will reorganize into a mutual holding company structure. As part of the plan of reorganization, Lake Shore Savings will convert from a New York-chartered mutual savings and loan association to a federally-chartered stock savings bank and will become a wholly-owned subsidiary of Lake Shore Bancorp, Inc. ("Lake Shore Bancorp" or the "Company"), a federally-chartered mid-tier holding corporation, and Lake Shore Bancorp will issue a majority of its common stock to Lake Shore, MHC (the "MHC"), a federally-chartered mutual holding company, and sell a minority of its common stock to the public. It is anticipated that the public shares will be offered in a subscription offering to the Association's Eligible Account Holders, Tax-Qualified Employee Benefit Plans including the employee stock ownership plan (the "ESOP"), Supplemental Eligible Account Holders and Other Members, as such terms are defined for purposes of applicable federal regulatory requirements governing mutual-to-stock conversions. To the extent that shares remain available for purchase after satisfaction of all subscriptions received in the subscription offering, the shares may be offered for sale in a community offering. In addition, as part of the reorganization, the Association will form The Lake Shore Charitable Foundation (the "Foundation") to further the Association's commitment to the local community. The Foundation will be funded with stock equal to 2.0% of the stock issued in the reorganization. The total shares offered for sale to the public and issued to the Foundation will constitute a minority of the Company's stock (49.0% or less).

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The aggregate amount of stock sold by the Company cannot exceed the appraised value of the Association. Immediately following the offering, the primary assets of the Company will be the capital stock of the Association and the net offering proceeds remaining after contributing proceeds to the Association in exchange for 100% of the capital stock of the Association. The Company will contribute at least 50% of the net offering proceeds in exchange for the Association's capital stock. The remaining net offering proceeds, retained at the Company, will be used to fund a loan to the ESOP and as general working capital.

RP ®Financial, LC.

RP ®Financial, LC. ("RP Financial") is a financial consulting firm serving the financial services industry nationwide that, among other things, specializes in financial valuations and analyses of business enterprises and securities, including the pro forma valuation for savings institutions converting from mutual-to-stock form. The background and experience of RP Financial is detailed in Exhibit V-1. We believe that, except for the fee we will receive for our appraisal, we are independent of the Association and the other parties engaged by Lake Shore Savings to assist in the corporate reorganization and minority stock issuance process.

Valuation Methodology

In preparing our appraisal, we have reviewed the Association's, the Company's and MHC's regulatory applications, including the prospectus as filed with the OTS and the Securities and Exchange Commission ("SEC"). We have conducted a financial analysis of the Association that has included due diligence related discussions with Lake Shore Savings' management; Beard Miller Company LLP, the Association's independent auditor; Thacher Proffitt & Wood LLP, Lake Shore Savings' conversion counsel; and Ryan Beck & Co., Inc., which has been retained as the financial and marketing advisor in connection with the Association's stock offering. All conclusions set forth in the Appraisal were reached independently from such discussions. In addition, where appropriate, we have considered information based on other available published sources that we believe are reliable. While we believe the information and data gathered from all these sources are reliable, we cannot guarantee the accuracy and completeness of such information.

We have investigated the competitive environment within which Lake Shore Savings operates and have assessed the Association's relative strengths and weaknesses. We have monitored all material regulatory and legislative actions affecting financial institutions generally and analyzed the potential impact of such developments on Lake Shore Savings and the industry as a whole to the extent we were aware of such matters. We have analyzed the potential effects of the stock conversion on the Association's operating characteristics and financial performance as they relate to the pro forma market value of Lake Shore Bancorp. We have reviewed the economy and demographic characteristics of the primary market area in which the Association currently operates. We have compared Lake Shore Savings' financial performance and condition with publicly-traded thrift institutions evaluated and selected in accordance with the

Valuation Guidelines, as well as all publicly-traded thrifts and thrift holding companies. We have reviewed conditions in the securities markets in general and the market for thrifts and thrift holding companies, and mutual holding company offerings.

The Appraisal is based on Lake Shore Savings' representation that the information contained in the regulatory applications and additional information furnished to us by the Association and its independent auditors, legal counsel, investment bankers and other authorized agents are truthful, accurate and complete. We did not independently verify the financial statements and other information provided by the Association, or its independent auditors, legal counsel, investment bankers and other authorized agents nor did we independently value the assets or liabilities of the Association. The valuation considers Lake Shore Savings only as a going concern and should not be considered as an indication of the Association's liquidation value.

Our appraised value is predicated on a continuation of the current operating environment for the Association, the MHC and the Company and for all thrifts and their holding companies. Changes in the local and national economy, the federal and state legislative and regulatory environments for financial institutions and mutual holding companies, the stock market, interest rates, and other external forces (such as natural disasters or significant world events) may occur from time to time, often with great unpredictability, and may materially impact the value of thrift stocks as a whole or the Association's value alone. It is our understanding that there are no current plans for pursuing a second-step conversion or for selling control of the Company or the Association following the offering. To the extent that such factors can be foreseen, they have been factored into our analysis.

The estimated pro forma market value is defined as the price at which the Company's stock, immediately upon completion of the offering, would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

Valuation Conclusion

It is our opinion that, as of December 22, 2005, the estimated aggregate pro forma market value of the shares to be issued immediately following the offering, both shares issued publicly as well as to the MHC, was \$50,000,000 at the midpoint, equal to 5,000,000 shares issued at a per share value of \$10.00. Pursuant to conversion guidelines, the 15% offering range indicates a minimum value of \$42,500,000 and a maximum value of \$57,500,000. Based on the \$10.00 per share offering price determined by the Board, this valuation range equates to total shares outstanding of 4,250,000 shares at the minimum of the valuation range and 5,750,000 total shares outstanding at the maximum of the valuation range. In the event that the appraised value is subject to an increase, the aggregate pro forma market value may be increased up to a supermaximum value of \$66,125,000 without a resolicitation. Based on the \$10.00 per share offering price, the supermaximum value would result in total shares outstanding of 6,612,500. The Board of Directors has established a public offering range such that the public ownership of

the Company will constitute a 45.0% ownership interest of the Company prior to the issuance of the shares to the Foundation. Accordingly, the offering range to the public of the minority stock will be \$19,125,000 at the minimum, \$22,500,000 at the midpoint, \$25,875,000 at the maximum and \$29,756,250 at the supermaximum. Based on the public offering range, and inclusive of the shares issued to the Foundation, the public ownership of the shares will represent 47.0% of the shares issued, with the MHC owning the majority of the shares.

Limiting Factors and Considerations

The valuation is not intended, and must not be construed, as a recommendation of any kind as to the advisability of purchasing shares of the common stock. Moreover, because such valuation is determined in accordance with applicable OTS regulatory guidelines and is necessarily based upon estimates and projections of a number of matters, all of which are subject to change from time to time, no assurance can be given that persons who purchase shares of common stock in the conversion will thereafter be able to buy or sell such shares at prices related to the foregoing valuation of the estimated pro forma market value thereof. The appraisal reflects only a valuation range as of this date for the pro forma market value of Lake Shore Bancorp immediately upon issuance of the stock and does not take into account any trading activity with respect to the purchase and sale of common stock in the secondary market on the date of issuance of such securities or at anytime thereafter following the completion of the public stock offering.

The valuation prepared by RP Financial in accordance with applicable OTS regulatory guidelines was based on the financial condition and operations of Lake Shore Savings as of September 30, 2005, the date of the financial data included in the prospectus.

RP Financial is not a seller of securities within the meaning of any federal and state securities laws and any report prepared by RP Financial shall not be used as an offer or solicitation with respect to the purchase or sale of any securities. RP Financial maintains a policy which prohibits RP Financial, its principals or employees from purchasing stock of its financial institution clients.

The valuation will be updated as provided for in the OTS conversion regulations and guidelines. These updates will consider, among other things, any developments or changes in the financial performance and condition of Lake Shore Savings, management policies, and current conditions in the equity markets for thrift stocks, both existing issues and new issues. These updates may also consider changes in other external factors which impact value including, but not limited to: various changes in the federal and state legislative and regulatory environments for financial institutions, the stock market and the market for thrift stocks, and interest rates. Should any such new developments or changes be material, in our opinion, to the valuation of the shares, appropriate adjustments to the estimated pro forma market value will be

made. The reasons for any such adjustments will be explained in the update at the date of the release of the update.

Respectfully submitted,
RP[®] FINANCIAL, LC.

William E. Pommerening
Chief Executive Officer and Managing Director

Gregory E. Dunn
Senior Vice President

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I. OVERVIEW AND FINANCIAL ANALYSIS

Introduction

Lake Shore Savings and Loan Association (“Lake Shore Savings” or the “Association”), chartered in 1891, is a New York-chartered savings and loan association headquartered in Dunkirk, New York. The Association serves upstate western New York through its administrative facilities and main office in Dunkirk and seven branch offices. The administrative facilities, main office and four branches are located in Chautauqua County, which is south of Buffalo, and three branches are located in the Buffalo metropolitan area in Erie County. The third Erie County branch was opened in early-December 2005. A map of the Association’s branch offices is provided in Exhibit I-1. Lake Shore Savings, is a member of the Federal Home Loan Bank (“FHLB”) system, and its deposits are insured up to the regulatory maximums by the Federal Deposit Insurance Corporation (“FDIC”). At September 30, 2005, Lake Shore Savings had \$334.1 million in assets, \$251.6 million in deposits and total equity of \$27.7 million equal to 8.3% of total assets. Lake Shore Savings’ audited financial statements are included by reference as Exhibit I-2.

Plan of Reorganization

On August 9, 2005, the Board of Directors of Lake Shore Savings adopted a plan to reorganize from the mutual form of organization to the mutual holding company form of organization. As part of the reorganization, Lake Shore Savings will convert from a New York-chartered mutual savings and loan association to a federal stock savings bank and change its name to Lake Shore Savings Bank. Pursuant to the reorganization, Lake Shore Savings will become a wholly-owned subsidiary of Lake Shore Bancorp, Inc. (“Lake Shore Bancorp” or the “Company”), a federally-chartered mid-tier holding corporation, and Lake Shore Bancorp will issue a majority of its common stock to Lake Shore, MHC (the “MHC”), a federally-chartered mutual holding company, and sell a minority of its common stock to the public. Concurrent with the reorganization, the Company will retain up to 50% of the net stock proceeds. Immediately after consummation of the reorganization, it is not anticipated that the MHC or the Company will

engage in any business activity other than ownership of their respective subsidiaries and investment of stock proceeds that are retained by the Company. The MHC will own a controlling interest in the Company of at least 51%, and the Company will be the sole subsidiary of the MHC. The Company will own 100% of the Association's outstanding stock. The Company's initial activities will be ownership of its subsidiary, Lake Shore Savings, investment of the net cash proceeds retained at the holding company level (initially in short-term investment securities) and extending a loan to the Association's newly-formed employee stock ownership plan ("ESOP"). Subsequent activities of the Company may include payment of regular or special dividends, acquisitions of other financial institutions, acquisitions of other financial service providers and/or stock repurchases.

The plan of reorganization provides for a stock contribution to be made to The Lake Shore Charitable Foundation (the "Foundation"), which will be a newly formed non-stock Delaware corporation. The Foundation will be funded with common stock contributed by the Company in an amount equal to 2.0% the gross proceeds of shares issued in the reorganization. The Foundation will be dedicated to assist the communities within Lake Shore Savings' market area beyond community development and lending and will enhance the Association's current activities under the Community Reinvestment Act.

Strategic Overview

Lake Shore Savings maintains a local community banking emphasis, with a primary strategic objective of meeting the borrowing and savings needs of its local customer base. Historically, Lake Shore Savings' operating strategy has been fairly reflective of a traditional thrift operating strategy in which 1-4 family residential mortgage loans and retail deposits have constituted the principal components of the Association's assets and liabilities, respectively. Beyond 1-4 family permanent mortgage loans, the Association's lending activities include diversification into commercial real estate, home equity, consumer, commercial business and construction loans. Pursuant to the Association's current strategic plan, Lake Shore Savings will continue to emphasize 1-4 family lending and will also continue to pursue lending diversification in which growth of commercial real estate loans will be emphasized.

Investments serve as a supplement to the Association's lending activities and the investment portfolio is considered to be indicative of a low risk investment philosophy. The investment portfolio is comprised primarily of mortgage-backed securities, with the balance of the portfolio consisting of asset-backed securities, municipal bonds, U.S. Government and agency securities, Freddie Mac common stock and FHLB stock.

Retail deposits have consistently served as the primary interest-bearing funding source for the Association. The deposit base is concentrated in time deposits and time deposits have been the primary source of the Association's deposit growth in recent years. Growth of transaction accounts and, in particular, growth of checking account deposits has been targeted as an area of emphasis in the Association's business plan. The Association utilizes borrowings as a supplemental funding source to facilitate management of funding costs and interest rate risk. Borrowings utilized by the Association have generally been limited to FHLB advances.

Lake Shore Savings' earnings base is largely dependent upon net interest income and operating expense levels. Overall, the Association's operating strategy has provided for a relatively strong net interest margin; although, Lake Shore Savings' net interest margin has declined from peak levels in recent periods, which can be largely attributable to interest rate spread compression resulting from the flattening yield curve. To facilitate and implement growth strategies higher operating expenses have been incurred by the Association, which includes the costs associated with expanding the branch network into Erie County as well as adding staff to support and manage contemplated growth of Lake Shore Savings' community banking franchise. The additional operating expenses have been more than offset by asset growth, as indicated by a decline in the Association's operating expense to average assets ratio since 2003.

Reflective of a traditional thrift operating strategy, non-interest operating income has not been a significant contributor to the Association's earnings. Growth of non-interest operating income is contemplated in the Association's business plan, through such strategies as developing more of a sales culture in the branches and through growing fee-based transaction accounts.

The post-offering business plan of the Association is expected to continue to focus on operating and growing a profitable institutions serving retail customers and small businesses in

local markets. Accordingly, Lake Shore Savings will continue to be an independent community-oriented financial institution with a commitment to local real estate financing with operations funded by retail deposits, borrowings, equity capital and internal cash flows. In addition, the Association will seek to implement strategies that will increase its residential and commercial real estate lending presence in Erie County, as well as emphasize expansion and diversification of other products and services particularly with respect to building the core deposit base.

The Association's Board of Directors has elected to complete a public stock offering to improve the competitive position of Lake Shore Savings. The capital realized from the minority stock offering will increase the operating flexibility and overall financial strength of Lake Shore Savings. The additional capital realized from stock proceeds will increase liquidity to support funding of future loan growth and other interest-earning assets. Lake Shore Savings' higher capital position resulting from the infusion of stock proceeds will also serve to reduce interest rate risk, particularly through enhancing the Association's interest-earning-assets-to-interest-bearing-liabilities ("IEA/IBL") ratio. The additional funds realized from the stock offering will provide an alternative funding source to deposits and borrowings in meeting the Association's future funding needs, which may facilitate a reduction in Lake Shore Savings' funding costs. Additionally, Lake Shore Savings' higher equity-to-assets ratio will also better position the Association to take advantage of expansion opportunities as they arise. Such expansion would most likely occur through the establishment or acquisition of additional banking offices or customer facilities that would provide for further penetration in the markets currently served by the Association or nearby surrounding markets. The Association will also be bettered position to pursue growth through acquisition of other financial service providers following the stock offering, given its strengthened capital position. At this time, the Association has no specific plans for expansion other than through establishing additional branches. The projected uses of proceeds are highlighted below.

- MHC. The Association intends to capitalize the MHC with \$100,000 of cash. The primary activity of the MHC will be ownership of the majority interest in the Company. The MHC funds will be held in low risk liquid instruments.
- Lake Shore Bancorp. The Company is expected to retain up to 50% of the net offering proceeds. At present, funds at the mid-tier holding company level, net of the loan to the ESOP, are expected to be primarily invested initially into short-term investment grade securities. Over time, the funds may be utilized for various

corporate purposes, possibly including acquisitions, infusing additional equity into the Association, repurchases of common stock, and the payment of regular and/or special cash dividends.

- Lake Shore Savings. Approximately 50% of the net stock proceeds will be infused into the Association in exchange for all of the Association's newly issued stock. Cash proceeds (i.e., net proceeds less deposits withdrawn to fund stock purchases) infused into the Association are anticipated to become part of general operating funds, and are expected to be primarily utilized to fund loan growth.

Overall, it is the Association's objective to pursue growth that will serve to increase returns, while, at the same time, growth will not be pursued that could potentially compromise the overall risk associated with Lake Shore Savings' operations.

Balance Sheet Trends

Table 1.1 shows the Association's historical balance sheet data for the past five and three-quarter years. From December 31, 2000 through September 30, 2005, Lake Shore Savings' assets increased at an 11.2% annual rate. Asset growth was mostly realized through growth of interest-earning assets, which consisted mostly of loan growth. Asset growth has been funded with a combination of deposits and borrowings, as well as retained earnings. A summary of Lake Shore Savings' key operating ratios for the past five and three-quarter years is presented in Exhibit I-3.

Lake Shore Savings' loans receivable portfolio increased at a 10.0% annual rate from year end 2000 through September 30, 2005, with the portfolio exhibiting positive growth throughout the period. The Association's lower loan growth rate compared to its asset growth rate served to reduce the loans-to-assets ratio from 63.9% at year end 2000 to 60.6% at September 30, 2005. Lake Shore Savings' historical emphasis on 1-4 family lending is reflected in its loan portfolio composition, as 71.9% of total loans receivable consisted of 1-4 family permanent mortgage loans at September 30, 2005. Trends in the Association's loan portfolio composition over the past five and three-quarter years show that 1-4 family permanent mortgage loans have been maintained at a fairly stable level of total loans, with such loans ranging from a low of 68.0% of total loans at year end 2002 to a high of 72.1% of total loans at year end 2003. Over the past five and three-quarter years, lending diversification by the Association has been mostly in the areas of home equity lines of credit, which equaled 14.4% of total loans at

{Table 1.1 is omitted. It has been filed as a paper filing.}

September 30, 2005, and commercial real estate loans, which equaled 7.4% of total loans at September 30, 2005. The relative concentrations of home equity lines of credit and commercial real estate loans comprising total loans have also been fairly consistent over the past five and three-quarter years. Construction loans have been a limited area of lending diversification for the Association, with such loans equaling 1.0% of total loans at September 30, 2005. Commercial business loans represent the primary area of non-mortgage lending by the Association, with such loans ranging from a low of 3.2% of total loans outstanding at year end 2003 to a high of 5.1% of total loans at year end 2001. Commercial business loans equaled 4.0% of the Association's total loan portfolio at September 30, 2005. Consumer lending, other than home equity lines of credit which are included in the mortgage portfolio, has not been an area of lending emphasis for the Association, with such loans ranging from a high of 3.0% of total loans at year end 2000 to a low of 1.4% of total loans at September 30, 2005.

The intent of the Association's investment policy is to provide adequate liquidity and to generate a favorable return within the context of supporting Lake Shore Savings' overall credit and interest rate risk objectives. It is anticipated that proceeds retained at the holding company level will primarily be invested into investments with short-term maturities. Over the past five and three-quarter years, the Association's level of cash and investment securities (inclusive of FHLB stock) ranged from a low of 27.3% of assets at fiscal year end 2001 to a high of 34.9% of assets at September 30, 2005. Mortgage-backed securities comprise the most significant component of the Association's investment portfolio, with the portfolio consisting of securities guaranteed or insured by a federal agency except for approximately \$2.6 million of private issue collateralized mortgage obligations ("CMOs"). Mortgage-backed securities are generally purchased as a means to deploy excess liquidity at more favorable yields than other investment alternatives that are consistent with Lake Shore Savings' investment philosophy. As of September 30, 2005, the mortgage-backed securities portfolio consisted of \$49.1 million of CMOs and \$23.9 million of pass-through securities. With the exception of \$240,000 of pass-through certificates, the entire mortgage-backed securities portfolio was classified as available for sale. As of September 30, 2005, the net unrealized loss on the available for sale mortgage-backed securities portfolio equaled \$1.3 million.

Beyond the Association's investment in mortgage-backed securities, investment securities held by the Association at September 30, 2005 consisted of asset-backed securities that are substantially secured by home equity loans (\$18.2 million), U.S. Government obligations securities (\$4.3 million), municipal bonds (\$2.0 million) and Freddie Mac common stock (\$1.3 million). The Association also held \$2.5 million of FHLB stock at September 30, 2005. Available for sale investments and held to maturity investments totaled \$23.7 million and \$2.1 million, respectively, at September 30, 2005. Investments maintained as held to maturity consisted of U.S. Government securities. As of September 30, 2005, the net unrealized gain on the available for sale investment portfolio equaled \$1.1 million. The Association also maintained cash and cash equivalents of \$15.5 million at September 30, 2005, which equaled 4.6% of assets. Exhibit I-4 provides historical detail of the Association's investment portfolio.

The Association also maintains an investment in bank-owned life insurance ("BOLI") policies, which cover the lives of some of the Association's senior officers and directors. The purpose of the investment is to provide funding for the benefit plans of the covered individuals. The life insurance policies earn tax-exempt income through cash value accumulation and death proceeds. As of September 30, 2005, the cash surrender value of the Association's BOLI equaled \$5.7 million.

Over the past five and three-quarter years, Lake Shore Savings' funding needs have been substantially met through retail deposits, internal cash flows, borrowings and retained earnings. From year end 2000 through September 30, 2005, the Association's deposits increased at an annual rate of 8.3%. Positive deposit growth was sustained throughout the period covered in Table 1.1, with the most significant growth occurring in 2003. The stronger deposit growth recorded in 2003 was supported by the opening of two branches in Erie County. Deposit growth did not keep pace with the Association's asset growth, as the ratio of deposits funding assets declined from 85.3% at year end 2000 to 75.3% at September 30, 2005. Transaction and savings accounts equaled 44.5% of the Association's total deposits at September 30, 2005, versus a comparable ratio of 48.5% at year end 2002. Time deposits have been the primary source of the Association's deposit growth over the past three and three-quarter years, increasing from \$100.5 million or 51.5% of total deposits at year end 2002 to \$139.7 million or 55.5% of total deposits at September 30, 2005.

Borrowings serve as an alternative funding source for the Association to address funding needs for growth and to support control of deposit costs. Borrowings have become a more prominent funding source for the Association in recent years, with total borrowings increasing from 3.5% of assets at year end 2000 to a peak ratio of 16.4% at year end 2004. The Association maintained total borrowings of \$50.1 million at September 30, 2005 or 15.0% of assets. Borrowings held by the Association consist of a mixture of short-term FHLB advances and fixed rate FHLB advances with laddered terms.

Since year end 2000, retention of earnings and the adjustment for accumulated other comprehensive income translated into an annual capital growth rate of 7.8% for the Association. Asset growth was stronger than the Association's equity growth rate, as Lake Shore Savings' equity-to-assets ratio declined from 9.6% at year end 2000 to 8.3% at September 30, 2005. All of the Association's capital is tangible capital, and the Association maintained capital surpluses relative to all of its regulatory capital requirements at September 30, 2005. The addition of stock proceeds will serve to strengthen the Association's capital position, as well as support growth opportunities. At the same time, as the result of the significant increase that will be realized in the Association's pro forma capital position, Lake Shore Savings' ROE can be expected to decline from current returns

Income and Expense Trends

Table 1.2 shows the Association's historical income statements for the past five years and for the twelve months ended September 30, 2005. The Association reported positive earnings over the past five and three-quarter years, ranging from a low of 0.58% of average assets during 2003 to a high of 1.00% of average assets during 2002. For the twelve months ended September 30, 2005, the Association's reported net income of \$2.2 million or 0.65% of average assets. The lower earnings reported in 2003 was mostly attributable to a decline in net interest income, as the result of interest rate spread compression. The increase in the Association's return on average assets ratio since 2003 has primarily been realized through leveraging of the operating expense ratio, which more than negated additional compression that was experienced in the Association's net interest margin during 2004 and for the twelve months ended September 30, 2005. Non-interest operating income has been a fairly stable, but somewhat limited contributor to the

{Table 1.2 is omitted. It has been filed as a paper filing.}

Association's earnings. Loan loss provisions have had a varied impact on the Association's earnings over the past five and three-quarter years, but typically have been fairly limited. Likewise, gains and losses realized from the sale of investments and loans have not been a significant factor in the Association's earnings over the past five and three-quarter years.

Over the past five and three-quarter years, the Association's net interest income to average assets ratio ranged from a high of 3.68% during 2002 to a low of 2.89% during the twelve months ended September 30, 2005. The decline in the net interest income ratio since 2002 reflects a narrowing of the Association's interest rate spread, which has resulted from a steeper decline in the overall yield earned on interest-earning assets relative to the overall rate paid on funding liabilities. Factors that have contributed to the Association's interest rate spread compression include the declining interest rate environment that facilitated accelerated repayments in the loan and MBS portfolios due to borrowers refinancing into lower rate loans and more recently the adverse impact of a flattening yield curve on a balance sheet that is liability sensitive in the short-term. Overall, the Association's interest rate spread declined from 3.68% during 2002 to 2.95% during the nine months ended September 30, 2005. The Association's historical net interest rate spreads and yields and costs are set forth in Exhibits I-3 and I-5.

Non-interest operating income has been maintained at a fairly stable level over the past five and three-quarter years, ranging from a high of 0.77% of average assets during 2001 to a low of 0.57% of average assets during 2004 and for the twelve months ended September 30, 2005. The decline in the non-interest operating income ratio since 2002 can in part be attributed to changes in the Association's balance sheet composition. In particular, trends in the Association's balance sheet composition reflect increasing concentrations of investments and borrowings, which, unlike loans and deposits, do not represent sources of fee income. Fees and service charges constitute that major component of the Association's non-interest operating income.

Operating expenses represent the other major component of the Association's earnings, ranging from a high of 2.80% of average assets during 2000 to a low of 2.46% of average assets during the twelve months ended September 30, 2005. Similar to the decline in the non-interest operating income ratio, the leveraging of the operating expense ratio was in part facilitated by

changes in the Association's balance sheet composition towards higher concentrations of investments and borrowings which are less costly to generate and service than loans and deposits. Upward pressure will be placed on the Association's operating expense ratio following the stock offering, due to expenses associated with operating as a publicly-traded company, including expenses related to the stock benefit plans. At the same, the increase in capital realized from the stock offering will increase the Association's capacity to leverage operating expenses through pursuing a more aggressive growth strategy.

Overall, the general trends in the Association's net interest margin and operating expense ratio since 2000 reflect a slight decline in core earnings, as indicated by the Association's expense coverage ratio (net interest income divided by operating expenses). Lake Shore Savings' expense coverage ratio equaled 1.28 times during 2000, versus a comparable ratio of 1.17 times during the twelve months ended September 30, 2005. The decline in the expense coverage ratio was the result of a decline in the net interest income ratio, which was partially negated by a decline in the operating expense ratio as well. Similarly, Lake Shore Savings' efficiency ratio (operating expenses, net of amortization of intangibles, as a percent of the sum of net interest income and other operating income) of 65.4% during 2000 was slightly more favorable than the 71.1% efficiency ratio maintained for the twelve months ended September 30, 2005.

Maintenance of generally favorable credit quality measures has served to limit the amount of loss provisions established by the Association over the past five and three-quarter years. Loan loss provisions established by the Association ranged from a high of 0.16% of average assets during 2001 and 2002 to a low of 0.02% of average assets during the twelve months ended September 30, 2005. As of September 30, 2005, the Association maintained valuation allowances of \$1.3 million, equal to 0.63% of net loans receivable and 126.6% of non-accruing loans and accruing loans past due 90 days or more. Exhibit I-6 sets forth the Association's loan loss allowance activity during the past five and three-quarter years.

Gains realized from the sale of loans and investments generally have been a minor factor in the Association's earnings, with the largest gains amounting to 0.10% of average assets during 2001. Loan sale gains reflect the sale of fixed rate loan originations to the secondary market for

purposes of interest rate risk management during certain interest rate environments, as well as the sale of student loans. The Association's current philosophy has been to generally retain all loan originations for investment. Student loans are generally sold when the loan goes into repayment. Gains and losses from the sale of investment securities were recorded by the Association throughout past five and three-quarter years, reflecting ongoing management of the investment portfolio for purposes of enhancing returns and managing interest rate risk. The gains and losses realized from the sale of investment securities are viewed as a non-recurring source of income, in light of the unpredictable and volatile characteristics of those gains.

For the twelve months ended September 30, 2005, the Association's effective tax rate equaled 33.6%, which was less than the Association's effective statutory rate. The Association maintains a lower effective tax rate than its marginal tax rate of 38.5%, primarily as the result of tax exempt income earned on some of the Association's investments.

Interest Rate Risk Management

The Association's balance sheet is liability-sensitive in the short-term (less than one year) and, thus, the net interest margin will typically be adversely affected during periods of rising and higher interest rates, as well as during periods when the yield curve becomes flatter due to short-term interest rates rising faster than long-term interest rates. As of September 30, 2005, the Net Portfolio Value ("NPV") analysis provided by the OTS indicated that a 2.0% instantaneous and sustained increase in interest rates would result in a 28% decline in the Association's NPV (see Exhibit I-7).

The Association pursues a number of strategies to manage interest rate risk, particularly with respect to seeking to limit the repricing mismatch between interest rate sensitive assets and liabilities. The Association manages interest rate risk from the asset side of the balance sheet through underwriting residential mortgages that will allow for their sale to the secondary market when such a strategy is appropriate, maintaining investments as available for sale, investing in securities with varied terms or repricing periods, and diversifying into other types of lending beyond 1-4 family permanent mortgage loans which consists primarily of shorter term and adjustable rate loans. As of December 31, 2004, of the Association's total loans due after

December 31, 2005, ARM loans comprised 21.8% of those loans (see Exhibit I-8). On the liability side of the balance sheet, management of interest rate risk has been pursued through utilizing fixed rate FHLB advances with laddered maturities to fund fixed rate residential mortgage loans and through emphasizing growth of lower cost and less interest rate sensitive transaction and savings accounts. Transaction and savings accounts comprised 44.5% of the Association's deposits at September 30, 2005.

The infusion of stock proceeds will serve to further limit the Association's interest rate risk exposure, as most of the net proceeds will be redeployed into interest-earning assets and the increase in the Association's capital will lessen the proportion of interest rate sensitive liabilities funding assets.

Lending Activities and Strategy

Lake Shore Savings' lending activities have traditionally emphasized 1-4 family permanent mortgage loans and such loans continue to comprise the largest component of the Association's loan portfolio. Beyond 1-4 family loans, lending diversification by the Association has emphasized home equity, commercial real estate and commercial business loans. To a lesser extent, the Association's lending activities include consumer loans and construction loans. Going forward, the Association's lending strategy is expected to remain fairly consistent with recent historical trends, with the origination of 1-4 family permanent mortgage loans remaining as the primary source of loan originations and areas of lending diversification continuing to emphasize originations of home equity and commercial real estate loans. Exhibit I-9 provides historical detail of Lake Shore Savings' loan portfolio composition over the past five and three-quarter years and Exhibit I-10 provides the contractual maturity of the Association's loan portfolio by loan type as of September 30, 2005.

Lake Shore Savings originates both fixed rate and adjustable rate 1-4 family permanent mortgage loans. The Association's current practice is to retain all 1-4 family originations for investment. In the past, the Association has sold loans to the State of New York Mortgage Agency and Freddie Mac and may do so again for purposes of interest rate risk management. The Association retains the servicing on loans that are sold. ARM loans offered by the

Association include loans with initial repricing terms of one, five or seven years, which convert to a one year ARM loan after the initial repricing period. ARM loans are indexed to the weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year as made available by the Federal Reserve Board. Fixed rate 1-4 family mortgage loans offered by the Association have terms of 15, 20 or 30 years. The Association also offers a two-step residential mortgage loan, which has a 30 year term and adjusts one time after an initial fixed rate period of seven years. The substantial portion of the Association's 1-4 family permanent mortgage loans are underwritten to secondary market standards specified by Freddie Mac. As of September 30, 2005, the Association's outstanding balance of 1-4 family permanent mortgage loans equaled \$145.7 million or 71.9% of total loans outstanding.

Home equity loans constitute the second largest component of the Association's loan portfolio, with such loans consisting of fixed-rate amortizing loans as well as variable rate home equity lines of credit ("HELOCs"). Home equity loans are offered up to a LTV ratio of 90.0%, inclusive of other liens on the property, when the Association also holds the first mortgage or up to a LTV ratio of 80% if the Association does not hold the first mortgage. Fixed rate amortizing home equity loans are offered for terms of 5 to 15 years, while HELOCs generally have 15 year terms. HELOCs are tied to the prime rate as reported in *The Wall Street Journal*. As of September 30, 2005, the Association's outstanding balance of home equity loans equaled \$29.2 million or 14.4% of total loans outstanding.

The other major area of lending diversification for the Association consists of commercial real estate loans, which are collateralized by properties in the Association's market area. Lake Shore Savings' originates commercial real estate loans up to a maximum LTV ratio of 80.0% and requires a minimum debt-coverage ratio of 1.2 times. Commercial real estate loans are generally offered for terms of 15 to 20 years, either as adjustable rate loans that reprice every five years or as fixed rate loans. Commercial real estate loans are generally priced off of the prime rate as reported in *The Wall Street Journal*. Properties securing the commercial real estate loan portfolio include retail properties, small office buildings and restaurants. Growth of the commercial real estate loan portfolio is currently an area of lending emphasis for the Association. As of September 30, 2005, the Association's outstanding balance of commercial real estate loans equaled \$14.9 million or 7.4% of the total loan portfolio.

Construction loans originated by the Association are loans to finance the construction of 1-4 family residences and commercial real estate properties. Construction loans extended for 1-4 family properties are for the construction of pre-sold homes. Construction loans are offered up to a LTV ratio of 80% and require payment of interest only during the construction period. Commercial real estate construction loans are originated as construction/permanent loans and are subject to the same underwriting criteria as required for permanent mortgage loans, as well as submission of completed plans, specifications and cost estimates related to the proposed construction. Loans for the construction of commercial real estate are extended up to a LTV ratio of 80.0% based on the lesser of the appraised value of the property or cost of construction. As of September 30, 2005, Lake Shore Savings' outstanding balance of construction loans equaled \$2.0 million or 1.0% of total loans outstanding.

Lake Shore Savings' diversification into non-mortgage loans consists primarily of commercial business loans and, to a lesser extent, consumer loans. The commercial business loan portfolio is generated through extending loans to small- and medium-sized companies operating in the local market area. Commercial business loans offered by the Association consist primarily of floating rate loans indexed to the prime rate as reported in *The Wall Street Journal*. Secured loans constitute the major portion of the commercial business loan portfolio, while the portfolio also includes a minor amount of unsecured loans. As of September 30, 2005, Lake Shore Savings' outstanding balance of commercial business loans equaled \$8.1 million or 4.0% of total loans outstanding.

Consumer lending has been a relatively minor area of lending diversification for the Association. The consumer loan portfolio includes loans secured by deposits, new and used automobile loans, recreational vehicle loans, guaranteed student loans, property improvement loans and unsecured personal loans. Consumer loans are generally extended as fixed rate loans with varied terms of up to 10 years depending on the collateral. Student loans are generally sold to Sallie Mae when the loan goes into repayment. As of September 30, 2005, the Association's outstanding balance of consumer loans equaled \$2.7 million or 1.4% of total loans outstanding.

Exhibit I-11 provides a summary of the Association's lending activities over the past five and three-quarter years. The Association's lending volume peaked in 2003, which was primarily supported by increased originations of residential mortgage loans. A large portion of the

Association's 1-4 family loan volume during 2003 were loans to refinance existing mortgages, as borrowers took advantage of historically low mortgage rates to refinance into lower rate loans. Loan originations in 2003 totaled \$91.7 million, versus \$39.7 million in 2000, \$51.6 million in 2001 and \$56.4 million in 2002. Loan originations declined to \$49.6 million in 2004 and to \$29.9 million for the first nine months of 2005 compared to \$41.0 million for the first nine months of 2004. The Association was also more active in selling loans during 2003, in which \$4.0 million of newly originated 1-4 family fixed rate loans were sold for purposes of interest rate risk management. Since 2003, loan sales by the Association have been substantially limited to relatively modest amounts of guaranteed student loans. The Association has sustained positive loan growth over the past four and three-quarter years, although relatively modest loan growth was recorded for the first nine months of 2005. The Association's most significant loan growth occurred during 2003. While the Association experienced a decline in lending volume during 2004 and the first nine months of 2005, the pace of loan repayments declined as well.

Asset Quality

The Association's 1-4 family lending emphasis has generally supported favorable credit quality measures. Over the past five and three-quarter years, Lake Shore Savings' ratio of non-performing assets, inclusive of accruing loans past due 90 days or more, ranged from a low of 0.28% of assets at year end 2004 to a high of 0.71% of assets at year end 2001. The Association held \$1.2 million of non-performing assets at September 30, 2005, equal to 0.36% of assets. As shown in Exhibit I-12, the Association's balance of non-performing assets at September 30, 2005 consisted of \$384,000 of non-accruing loans, \$617,000 of accruing loans past due 90 days or more and \$194,000 of real estate owned.

To track the Association's asset quality and the adequacy of valuation allowances, Lake Shore Savings has established detailed asset classification policies and procedures which are consistent with regulatory guidelines. Detailed asset classifications are reviewed quarterly by senior management and the Board. Pursuant to these procedures, when needed, the Association establishes additional valuation allowances to cover anticipated losses in classified or non-classified assets. As of September 30, 2005, the Association maintained valuation allowances of

\$1.3 million, equal to 0.63% of net loans receivable and 126.6% of the combined balance of non-accruing loans and accruing loans past due 90 days or more.

Funding Composition and Strategy

Deposits have consistently accounted for the major portion of the Association's interest-bearing funding composition and at September 30, 2005 deposits equaled 83.4% of Lake Shore Savings' interest-bearing funding composition. Exhibit I-13 sets forth the Association's deposit composition for the past three and three-quarter years and Exhibit I-14 provides the interest rate and maturity composition of the CD portfolio at September 30, 2005. CDs represent the largest component of the Association's deposit composition, with Lake Shore Savings' current CD composition reflecting a higher concentration of short-term CDs (maturities of one year or less). As of September 30, 2005, the CD portfolio totaled \$139.7 million or 55.5% of total deposits and 63.9% of the CDs were scheduled to mature in one year or less. As of September 30, 2005, jumbo CDs (CD accounts with balances of \$100,000 or more) amounted to \$31.6 million or 22.7% of total CDs. Lake Shore Savings maintained \$1.8 million of brokered CDs at September 30, 2005.

Lower cost savings and transaction accounts comprise the balance of the Association's deposit composition, with such deposits amounting to \$111.9 million or 44.5% of total deposits at September 30, 2005. Comparatively, at year end 2002, the ratio of transaction and savings accounts comprising total deposits equaled 48.5%. The lower ratio of transaction and savings accounts maintained at September 30, 2005 compared to year end 2002 was the result of transaction and savings account deposits increasing at a slower rate than time deposits.

Borrowings serve as an alternative funding source for the Association to facilitate management of funding costs and interest rate risk. The Association's utilization of borrowings has typically been limited to FHLB advances. Lake Shore Savings maintained \$50.1 million of FHLB advances at September 30, 2005, which were utilized to fund fixed rate residential loans. Borrowings held by the Association consist of a mixture of short-term FHLB advances and fixed rate FHLB advances with ladder terms. To the extent borrowings are added by the

Association, FHLB advances would likely continue to be the primary source of borrowings utilized.

Subsidiaries and Other Activities

Lake Shore Savings does not maintain any subsidiaries. In November 2002, the Association established and funded a 50% interest in the Lake Shore Title & Abstract LLC with a third party title agency for the purpose of offering abstracting and title services in connection with real estate transactions engaged in by Lake Shore Savings. There was no income or loss attributed to this venture in 2002. In subsequent periods, the income generated by and the expense attributable to this joint venture have been minimal.

Legal Proceedings

The Association is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business which, in the aggregate, are believed by management to be immaterial to the financial condition of the Association.

II. MARKET AREA

Introduction

Lake Shore Savings serves upstate western New York through its main office in Dunkirk and seven branch offices located in the towns of Fredonia, Westfield, Jamestown (two locations), East Amherst, Orchard Park and Hamburg. Dunkirk, Fredonia, Westfield and Jamestown are part of Chautauqua County, which is south of Buffalo. East Amherst, Orchard Park and Hamburg are located in the Buffalo metropolitan area in Erie County. The Hamburg office was opened in early-December 2005. Lake Shore Savings' activities are largely conducted within the markets served by the retail branches and surrounding contiguous markets. Exhibit II-1 provides information on the Association's office facilities.

The primary market area served by the Association is a mixture of urban, suburban and rural markets, with the Buffalo metropolitan area representing the most populous and largest source of economic activity in upstate western New York. The Association's competitive environment includes a large number of thrifts, commercial banks and other financial service providers, some of which have a regional or national presence. Due to its small size, the Association has more limited resources and a smaller market presence than many of its competitors. The primary market area economy is fairly diversified, with services, wholesale/retail trade, manufacturing and government constituting the basis of the primary market area economy.

Future business and growth opportunities will be partially influenced by economic and demographic characteristics of the markets served by the Association, particularly the future growth and stability of the regional economy, demographic growth trends, and the nature and intensity of the competitive environment for financial institutions. These factors have been examined to help determine the growth potential that exists for the Association and the relative economic health of the Association's market area.

Market Area Demographics

Key demographic and economic indicators in the Association's market area include population, number of households and household/per capita income levels. Demographic data for Chautauqua and Erie Counties, as well as comparative data for New York and the U.S., is provided in Table 2.1. The market area is characterized by two distinctly different types of markets. Erie County is a more densely populated urban and suburban market, while Chautauqua County has a smaller population base and is largely suburban and rural in nature. Notably, both primary market area counties have been experiencing declining populations and very modest growth in households. The declining population base has largely been the product of a weak regional economy, where overall job growth has been limited by the lack of new economic activity entering into the market area and a shrinking base of manufacturing jobs. Population and household growth for the primary market area counties are projected to remain well below the comparable projected growth rates for the U.S. and New York over the next five years.

Median household and per capita income were lower in Chautauqua County compared to Erie County, while the income measures for both counties were below the comparable measures for the U.S. and New York. The lower income measures indicated for Chautauqua County can be attributed to the more rural nature of that market area, while the comparatively higher household and per capita income measures indicated for Erie County reflect the influence of economic activity in the Buffalo metropolitan area. The cost of living in Erie County is higher than Chautauqua County and Erie County maintains a larger base of professional and white collar jobs compared to Chautauqua County. Over the next five years, the median household income growth rates for Chautauqua County and Erie County are projected to remain below the comparable growth rates projected for New York and the U.S. The less affluent nature of Chautauqua County is further implied by household income distribution measures, which show that, in comparison to Erie County, Chautauqua County maintains a higher percentage of households with incomes of less than \$25,000 and a lower percentage of households with incomes in the upper income brackets.

In summary, the demographic characteristics of the primary market area counties are not considered to be highly conducive for loan or deposit growth, and, thus, the Association's growth will continue to be somewhat contingent upon gaining market share or through

{Table 2.1 is omitted. It has been filed as a paper filing.}

geographic expansion into markets with more favorable demographic characteristics.

National Economic Factors

The future success of the Association's operations is partially dependent upon various national and local economic trends. In assessing national economic trends over the past year, economic data at the close of 2004 generally reflected signs of an improving economy. Positive economic signs in late-2004 included a jump in durable-goods orders in November, the largest increase in December retail sales in five years, December consumer confidence increasing to its best level since the summer and solid job growth reflected in the December employment data with the December national unemployment holding steady at 5.4%. Housing starts were also up strongly in December and the leading economic indicators rose in December for the second straight month. However, fourth quarter GDP growth was slower than expected, increasing at a 3.8% annual rate for the quarter.

Economic data for the beginning of the first quarter of 2005 was mixed. The manufacturing sector continued to expand in January 2005 and retail sales continued to be a healthy contributor to the economy in January. While the January 2005 unemployment rate declined to 5.2%, its lowest rate since 2001, its was mostly attributable to a decline in the number of people looking for jobs as job growth fell below expectations in January. After gaining 0.3% in December, the index of leading economic indicators slipped 0.3% in January. Retail sales were better-than-expected in February and job growth jumped in February, although the national unemployment rate rose in February to 5.4%. February economic data also showed a rise in durable-goods orders and a surge in new home sales, providing further indications that the economy's steady growth was continuing. However, despite a decline in the March U.S. unemployment rate to 5.2%, job growth was sluggish in March with the 110,000 jobs added in March marking the smallest gain since July 2004. While new home sales were unexpectedly strong in March, the economy showed signs of slowing down at the end of the first quarter as indicated by slowing job growth, a drop in consumer confidence and disappointing retail sales.

A sharp drop in initial jobless claims and a report showing a pick-up in manufacturing activity in the mid-Atlantic region suggested that the economy gained momentum at the start of

the second quarter of 2005. Job growth was stronger than expected in April, with the April national unemployment rate holding steady at 5.2%. Record new and existing home sales in April, as well as strong increases in April retail sales and durable goods orders, provided further evidence that the economy had recovered from the slowdown in March. Job growth slowed dramatically in May after surging in April, but the May unemployment rate dipped to 5.1%. Weak auto sales led to a drop in retail sales during May, while manufacturing activity rebounded in May. Sales of new and existing homes remained strong during May, as low interest rates continued to drive the housing market. Orders for durable goods were up strongly in May, as the result of a big jump in demand for commercial aircraft. However, excluding the transportation sector, orders for durable goods declined slightly in May. Economic data at the end of the second quarter showed signs that the expansion was on firm footing, as indicated by a pick-up in manufacturing activity in June, consumer confidence hitting a three year high in June and first quarter GDP growth was revised upward to a 3.8% annual rate compared to the original estimate of 3.5%. June employment data showed modest job growth, but the national unemployment rate dropped to 5.0%. Consumer spending rose sharply in June, which fueled a surge in retail sales and increased sales of durable goods orders.

Employment data for July 2005 indicated that the U.S. economy was continuing to strengthen, as the July unemployment rate held steady at 5.0% and 207,000 jobs were added in July. Other economic data generally reflected an upbeat picture of economic growth during July and August, although durable-goods orders unexpectedly dropped sharply in July. Sales of new homes remained strong in July and a mid-August reading of the index of leading indicators implied a continuation of moderate growth in the months ahead. Retail sales fell sharply in August due to a decline in demand for cars, while August industrial output was up nominally. The unemployment rate for August dropped to a four year low of 4.9%, as 169,000 jobs were added during the month. August data reflected a decline in new home construction as well as new home sales, although existing home sales increased during August.

The outlook for future economic growth became considerably less favorable following the devastation caused by Hurricane Katrina, with employment and output expected to take a sizable hit from the loss of economic activity in the Gulf region. As expected, initial jobless claims rose sharply in the aftermath of Katrina, while consumer confidence slid to a two year

low in September 2005 as energy prices soared and the September unemployment rate increased to 5.1%. However, despite Katrina and higher energy prices, manufacturing activity picked up in September. Comparatively, business activity in the service sector dropped sharply in September. Housing starts unexpectedly surged in September, while the index of leading indicators fell in September which was largely attributed to the hurricanes in the Gulf region. Overall, the economy expanded at a 4.1% annual rate in the third quarter, the fastest pace since early 2004 with brisk spending by consumers, businesses and the government helping to sustain the stronger growth.

The economy generally showed positive growth trends at the beginning of the fourth quarter of 2005, although the housing market showed signs of cooling off as mortgage rates moved higher. Retail sales, excluding autos and orders for durable goods, posted strong gains in October. Other measures showing that the economy was on solid footing included a decline in the October unemployment rate to 5.0% and a 0.9% rise in the October index of leading indicators. Falling gas prices helped to lift consumer confidence in October and November. Comparatively, higher mortgage rates served to slow home construction and existing home sales in October, but new home sales unexpectedly surged in October. November unemployment data showed job growth in line with expectations and no change in the national unemployment rate of 5.0%. Other economic data for November was also generally positive, as November retail sales were up solidly from a year ago, consumer spending picked up modestly in November and new home construction rose more than expected in November.

In terms of interest rate trends over the past year, long-term Treasury yields declined at the beginning of the fourth quarter of 2004 reflecting weaker than expected employment data for September 2004 and higher oil prices. In late-October, the yield on the 10-year Treasury note edged back below 4.0%. Treasury yields increased during early-November, on news of stronger than expected job growth for October and a decline in oil prices to a three week low. The Federal Reserve raised its target interest rate a quarter-point to 2.00% as expected at its November meeting, which combined with mixed economic data served to stabilize long-term Treasury yields in mid-November. Lower oil prices and concerns about the weak dollar pushed bonds prices lower in late-November. In early-December, bonds rallied on the weaker than expected employment data for November. The positive trend in Treasury prices continued

through mid-December, as the Federal Reserve raised its key interest rate target by a quarter-point to 2.25% and indicated that it would continue to raise interest rates at a measured pace based on expectations of moderate economic growth and well contained inflation. Treasury yields moved higher at the close of 2004 on news of a surge in consumer confidence during December.

Treasury yields increased sharply at the beginning of 2005 on signs that economic growth was picking up momentum and indications from the Federal Reserve that it was likely to keep raising rates because of wariness about inflation. Despite generally favorable economic data, Treasury yields eased lower during mid- and late-January as investors dumped stocks in favor of bonds. The Federal Reserve raised its target interest rate by another quarter-point in early-February and signaled no change in its plan for more increases. The as expected rate increase and January employment data showing lower than expected job growth sparked a rally in long-term Treasury bonds, with the yield on the 10-year Treasury falling below 4.0% in early-February. Bond yields moved higher in mid- and late-February on inflation concerns and indications of higher interest rates from the Federal Reserve. The generally strong economic data for February and signals from the Federal Reserve that it was becoming more concerned about inflation sustained the upward trend in interest rates through most of March. As expected, the Federal Reserve concluded its March meeting by raising its target rate to 2.75% from 2.5%. Treasury yields eased lower at the end of March and into early-April, as a key inflation gauge held steady in February and March job growth fell well short of expectations.

The downward trend in long-term Treasury yields generally prevailed through most of April 2005 on signs that the U.S. economy lost steam towards the end of the first quarter. A drop in consumer confidence in April and a weak first quarter GDP report fueled a decline in the 10-year Treasury yield below 4.20% at the end of April and, thus, further narrowed the gap between short- and long-term yields. The Federal Reserve raised the federal funds rate a quarter-point to 3.0% in early-May and indicated a plan of continued rate increases at a measured pace. The increase in short-term interest rates provided for further flattening of the yield curve, particularly as long-term interest rates declined in mid-May. The downward trend in long-term Treasury yields continued through early-June, reflecting increased expectations that the Federal Reserve would stop raising interest rates sooner than expected on news of weaker than expected job

growth in the May employment report. The yield on 10-year Treasury notes declined to a 14-month low of 3.89% at the beginning of June. Interest rates edged higher in mid-June, as the Federal Reserve indicated that the rate increases would continue. Higher oil prices, a decline in producer prices in May, as well as indications of slower economic growth suggested by a decline in the index of leading indicators for May, served to ease inflation concerns and pushed the yield on the 10-year Treasury note back below 4.0% in late-June. As expected the Federal Reserve raised its target for the federal funds rate by a quarter point to 3.25 % at its late-June meeting and indicated that it would continue with a policy of gradual interest rate hikes.

Economic data showing that the economy was gaining momentum pushed Treasury yields higher at the start of the third quarter of 2005. The decline in Treasury prices became more pronounced in late-July on news that China revalued its currency. Treasury yields continued to climb in early-August, following a strong employment report for July that suggested the economy was continuing to strengthen. As expected, the Federal Reserve concluded its August meeting by increasing its target rate by another quarter-point to 3.5% and indicated plans to continue to raise rates at a measured pace. The yield curve flattened during the second half of August and early-September, as long-term Treasury yields eased lower on expectations that rising oil prices would slow consumer spending. An upbeat assessment of the economy by the Federal Reserve and growing expectations that the Federal Reserve would continue to raise rates at its mid-September meeting reversed the downward trend in long-term Treasury yields in mid-September. The Federal Reserve concluded the September meeting by raising its target interest rate another quarter point to 3.75%, concluding that Katrina's impact on inflation was more worrisome than its effect on growth. The rate increase by the Federal Reserve combined with signs of inflation becoming more prominent pushed Treasury yields higher at the end of the third quarter.

Treasury yields generally trended higher at the beginning of the fourth quarter of 2005, as inflation worries become more prominent. The yield on the 10-year Treasury note moved above 4.5% in late-October, reflecting expectations of a continuation of rate increases by the Federal Reserve amid signs inflation could rise. Inflation fears, better than expected economic data and another rate hike by the Federal Reserve at the beginning of November pushed Treasury yields higher in early-November, as the yield on the 10-year Treasury note hit a 16-month high. At the

November meeting, the Federal Reserve indicated that it would continue to raise rates until the economy showed signs of slowing down. The yield on the 10-year Treasury note ebbed below 4.5% in mid- and late-November, as inflation concerns eased following reports that showed core producer prices fell in October and core consumer prices rose only slightly in October. Renewed inflation fears prompted by an upward revision in the third quarter growth rate for the U.S. economy pushed Treasury yields higher at the end of November and into early-December. Interest rates stabilized heading into mid-December, as a healthy increase in third quarter productivity helped to soothe inflation fears. Long-term Treasury yields declined slightly in mid-December following the Federal Reserve quarter point rate hike to a four and one-half year high of 4.25%, as the Federal Reserve signaled that the current cycle of rate increases may be nearing an end. Only a modest increase in the November core inflation data provided a boost to Treasury prices heading into late-December. As of December 22, 2005, one- and 10-year U.S. government bonds were yielding 4.35% and 4.44%, respectively, versus comparable year ago yields of 2.71% and 4.21%. Exhibit II-2 provides historical interest rate trends from 1995 through December 22, 2005.

Regional Economy

The Association's primary market area has a fairly diversified local economy, with employment in services, wholesale/retail trade, manufacturing and government serving as the basis of the regional economy. Service jobs represented the largest employment sector in both of the primary market area counties. Jobs in the wholesale/retail trade constituted the second largest employment sector in Erie County, while manufacturing jobs provided the second largest source of jobs in Chautauqua County. Once the backbone of the regional economy, the manufacturing sector has experienced job erosion since the 1970s. The loss of manufacturing jobs has been a major contributing factor to the decline that has been experienced in the regional population. Similar to national trends, service jobs have accounted for most of the recent job growth in the regional economy. However, in general, job growth in the primary market area counties has been limited by the lack of new economic activity entering the market and a declining population. Table 2.2 provides an overview of employment by sector, for both of the primary market area counties and the state of New York.

Table 2.2
Primary Market Area Employment Sectors
(Percent of Labor Force)(1)

Employment Sectors	New York	Chautauqua	Erie	Primary
				Market Average
Services	44.3%	36.6%	41.6%	39.1%
Government	14.4	14.4	14.4	14.4
Wholesale/Retail	13.5	14.8	15.4	15.1
Fin., Ins. & Real Estate	10.1	4.7	8.7	6.7
Manufacturing	6.2	16.9	10.5	13.7
Construction	4.3	3.9	3.9	3.9
Transport & Warehousing	3.0	2.3	2.8	2.6
Information	2.9	1.5	1.8	1.6
Other	1.3	4.9	0.9	2.9
	100.0%	100.0%	100.0%	100.0%

(1) As of 2003.

Source: Regional Economic Information System Bureau of Economic Analysis.

Comparative unemployment rates for the primary market area counties, as well as for the U.S. and New York, are shown in Table 2.3. October 2005 unemployment rates for Chautauqua County and Erie County equaled 3.9% and 4.5%, respectively, versus a comparable unemployment rate of 4.6% for both the U.S. and New York. Similar to the U.S. and New York, the October 2005 unemployment rates for the counties of Chautauqua and Erie were lower compared to a year ago.

Table 2.3
Unemployment Trends(1)

Region	October 2004 Unemployment	October 2005 Unemployment
United States	5.1%	4.6%
New York	5.1	4.6
Chautauqua County	4.4	3.9
Erie County	5.0	4.5

(1) Unemployment rates have not been seasonally adjusted.

Source: U.S. Bureau of Labor Statistics.

Market Area Deposit Characteristics and Trends

The Association's retail deposit base is closely tied to the economic fortunes of upstate western New York and, in particular, the markets that are nearby to one of Lake Shore Savings' office locations. Table 2.4 displays deposit market trends from June 30, 2002 through June 30, 2005 for the branches that were maintained by the Association during that period. Additional data is also presented for the state of New York. The data indicates that Erie County's larger population base translated into a higher balance of total bank and thrift deposits compared to Chautauqua County, as well as a stronger deposit growth rate during the three year period covered in Table 2.4. Consistent with the state of New York, commercial banks maintained a larger market share of deposits than savings institutions in both primary market area counties. For the three year period covered in Table 2.4, savings institutions experienced an increase in deposit market share in both of the Association's primary market area counties.

Lake Shore Savings maintains its largest balance and largest market share of deposits in Chautauqua County. The Association's \$202.9 million of deposits at the Chautauqua County branches represented a 15.7% market share of thrift and bank deposits at June 30, 2005. Comparatively, the two branches that were opened in Erie County during 2003 had total deposits of \$46.7 million at June 30, 2005, which represented only a 0.2% market share of the Erie County bank and thrift deposits. As part of the Buffalo metropolitan area, the Erie County market is a highly competitive banking market where the Association competes against significantly larger competitors as well as a number of locally-based institutions that operate primarily in the Buffalo MSA. During the three year period covered in Table 2.4, a 1.4% annual deposit growth rate in Chautauqua County translated into a reduction in the Association's deposit market share from 16.2% at June 30, 2002 to 15.7% at June 30, 2005.

Competition

The Association faces notable competition in both deposit gathering and lending activities, including direct competition with several financial institutions and credit unions that primarily have a local or regional presence. Securities firms and mutual funds also represent major sources of competition in raising deposits. In many cases, these competitors are also

{Table 2.4 is omitted. It has been filed as a paper filing.}

seeking to provide some or all of the community-oriented services as Lake Shore Savings. With regard to lending competition, the Association encounters the most significant competition from the same institutions providing deposit services. In addition, the Association competes with mortgage companies and independent mortgage brokers in originating mortgage loans. Table 2.5 lists the Association’s largest competitors in the two counties currently served by its branches, based on deposit market share as noted parenthetically. The Association’s market share and market rank are also provided in Table 2.5.

Table 2.5
Lake Shore Savings and Loan Association
Market Area Deposit Competitors

<u>Location</u>	<u>Name</u>
Chautauqua County	HSBC Bank USA (18.4%) Manufacturers & Traders Trust (16.6%) Community Bank NA (14.8%) Lake Shore Sav. (15.7%) - Rank of 3
Erie County	Manufacturers & Traders Trust (31.6%) HSBC Bank USA (30.6%) Bank of America NA (9.1%) Lake Shore Sav. (0.2%) - Rank of 16

Sources: SNL Financial and FDIC.

III. PEER GROUP ANALYSIS

This chapter presents an analysis of Lake Shore Savings' operations versus a group of comparable companies (the "Peer Group") selected from the universe of all publicly-traded savings institutions. The primary basis of the pro forma market valuation of Lake Shore Savings is provided by these public companies. Factors affecting the Association's pro forma market value such as financial condition, credit risk, interest rate risk, and recent operating results can be readily assessed in relation to the Peer Group. Current market pricing of the Peer Group, subject to appropriate adjustments to account for differences between Lake Shore Savings and the Peer Group, will then be used as a basis for the valuation of Lake Shore Savings' to-be-issued common stock.

Peer Group Selection

The mutual holding company form of ownership has been in existence in its present form since 1991. As of the date of this appraisal, there were approximately 34 publicly-traded institutions operating as subsidiaries of MHCs. We believe there are a number of characteristics of MHC shares that make them different from the shares of fully-converted companies. These factors include: (1) lower aftermarket liquidity in the MHC shares since less than 50% of the shares are available for trading; (2) guaranteed minority ownership interest, with no opportunity of exercising voting control of the institution in the MHC form of organization; (3) the potential impact of "second-step" conversions on the pricing of public MHC institutions; (4) the regulatory policies regarding the dividend waiver by MHC institutions; and (5) most MHCs have formed mid-tier holding companies, facilitating the ability for stock repurchases, thus improving the liquidity of the stock on an interim basis. We believe that each of these factors has an impact on the pricing of the shares of MHC institutions, and that such factors are not reflected in the pricing of fully-converted public companies.

Given the unique characteristics of the MHC form of ownership, RP Financial concluded that the appropriate Peer Group for Lake Shore Savings' valuation should be comprised of subsidiary institutions of mutual holding companies. The selection of publicly-traded mutual holding companies for the Association's Peer Group is consistent with the regulatory guidelines

and other recently completed MHC transactions. Further, the Peer Group should be comprised of only those MHC institutions whose common stock is either listed on a national exchange or is NASDAQ listed, since the market for companies trading in this fashion is regular and reported. We believe non-listed MHC institutions are inappropriate for the Peer Group, since the trading activity for thinly-traded stocks is typically highly irregular in terms of frequency and price and may not be a reliable indicator of market value. We have excluded from the Peer Group those public MHC institutions that are currently pursuing a “second-step” conversion and/or companies whose market prices appear to be distorted by speculative factors or unusual operating conditions. MHCs which have recently completed a minority stock offering have been excluded as well, due to the lack of a seasoned trading history and insufficient quarterly financial data that includes the impact of the offering proceeds. The universe of all publicly-traded institutions is included as Exhibit III-1.

Basis of Comparison

This appraisal includes two sets of financial data and ratios for the Peer Group institutions. The first set of financial data reflects the actual book value, earnings, assets and operating results reported by the Peer Group institutions in its public filings inclusive of the minority ownership interest outstanding to the public. The second set of financial data, discussed at length in the following chapter, places the Peer Group institutions on equal footing by restating their financial data and pricing ratios on a “fully-converted” basis through assuming the sale of the majority shares held by the MHCs in public offerings based on their current trading prices and standard assumptions for a thrift conversion offering. Throughout the appraisal, the adjusted figures will be specifically identified as being on a “fully-converted” basis. Unless so noted, the figures referred to in the appraisal will be actual financial data reported by the Peer Group institutions.

Both sets of financial data have their specific use and applicability to the appraisal. The actual financial data, as reported by the Peer Group companies and reflective of the minority interest outstanding, will be used in Chapter III to make financial comparisons between the Peer Group and the Association. The differences between the Peer Group’s reported financial data

and the financial data of Lake Shore Savings are not significant enough to distort the conclusions of the comparison (in fact, such differences are greater in a standard conversion appraisal). The adjusted financial data (fully-converted basis) will be more fully described and quantified in the pricing analysis discussed in Chapter IV. The fully-converted pricing ratios are considered critical to the valuation analysis in Chapter IV, because they place each Peer Group institution on a fully-converted basis (making their pricing ratios comparable to the pro forma valuation conclusion reached herein), eliminate distortion in pricing ratios between Peer Group institutions that have sold different percentage ownership interests to the public, and reflect the implied pricing ratios being placed on the Peer Group institutions in the market today to reflect the unique trading characteristics of publicly-traded MHC institutions.

Lake Shore Savings' Peer Group

Under ideal circumstances, the Peer Group would be comprised of ten publicly-traded New York-based MHC institutions with capital, earnings, credit quality and interest rate risk comparable to Lake Shore Savings. However, given the limited number of publicly-traded institutions in the MHC form of ownership, the selection criteria was necessarily broad-based and not confined to a particular geographic market area. In light of the relatively small asset size of the Association, the selection criteria used for the Peer Group was the ten smallest publicly-traded MHCs in terms of asset size. The asset sizes of the Peer Group companies ranged from \$118 million to \$447 million. The universe of all publicly-traded MHC institutions, exclusive of institutions that have announced second-step conversions, is included as Exhibit III-2 and Exhibit III-3 provides summary demographic and deposit market share data for the primary market areas served by each of the Peer Group companies.

Unlike the universe of fully-converted publicly-traded thrifts, which includes approximately 140 companies, the universe of public MHC institutions is small, thereby reducing the prospects of a highly comparable Peer Group. Nonetheless, because the trading characteristics of public MHC institution shares are significantly different from those of fully-converted companies, public MHC institutions were the most appropriate group to consider as Peer Group candidates for this valuation. Relying solely on full stock public companies for the

Peer Group would not capture the difference in current market pricing for public MHC institutions and thus could lead to distorted valuation conclusions. The federal regulatory agencies have previously concurred with this selection procedure of the Peer Group for MHC valuations. To account for differences between Lake Shore Savings and the MHC Peer Group in reaching a valuation conclusion, it will be necessary to make certain valuation adjustments. The following discussion addresses financial similarities and differences between Lake Shore Savings and the Peer Group.

Table 3.1 on the following page lists key general characteristics of the Peer Group companies. Although there are differences among several of the Peer Group members, by and large they are well-capitalized and profitable institutions and their decision to reorganize in MHC form suggests a commonality of operating philosophy. Importantly, the trading prices of the Peer Group companies reflect the unique operating and other characteristics of public MHC institutions. While the Peer Group is not exactly comparable to Lake Shore Savings, we believe such companies form a good basis for the valuation of Lake Shore Savings, subject to certain valuation adjustments.

In aggregate, the Peer Group companies maintain a higher level of capitalization relative to the universe of all public thrifts (14.68% of assets versus 11.19% for the all public average), generate comparable earnings on a return on average assets basis (0.68% ROAA versus 0.72% for the all public average), and generate a lower return on equity (4.59% ROE versus 7.46% for the all public average). The summary table below underscores the key differences, particularly in the average pricing ratios between full stock and MHC institutions (both as reported and on a fully-converted basis).

	<i>All Publicly-Traded</i>	<i>Peer Group Reported Basis</i>	<i>Fully Converted Basis (Pro Forma)</i>
Financial Characteristics (Averages)			
Assets (\$Mil)	2,660	291	324
Equity/Assets (%)	11.19%	14.68%	23.39
Return on Assets (%)	0.72	0.68	0.72
Return on Equity (%)	7.46	4.59	3.03

{Table 3.1 is omitted. It has been filed as a paper filing.}

	All Publicly-Traded	Peer Group Reported Basis	Fully Converted Basis (Pro Forma)
Pricing Ratios (Averages)(1)			
Price/Earnings (x)	19.70x	27.64x	28.41x
Price/Book (%)	150.97%	162.56%	87.62%
Price/Assets (%)	16.76	22.85	20.39

(1) Based on market prices as of December 22, 2005.

The following sections present a comparison of Lake Shore Savings' financial condition, income and expense trends, loan composition, interest rate risk and credit risk versus the figures reported by the Peer Group. The conclusions drawn from the comparative analysis are then factored into the valuation analysis discussed in the final chapter.

Financial Condition

Table 3.2 shows comparative balance sheet measures for Lake Shore Savings and the Peer Group. Lake Shore Savings' and the Peer Group's ratios reflect balances as of September 30, 2005, unless otherwise indicated for the Peer Group companies. Lake Shore Savings' net worth base of 8.3% was below the Peer Group's average net worth ratio of 14.7%. However, the Association's pro forma capital position will increase with the addition of stock proceeds and will be more comparable to the Peer Group's ratio following the stock offering. Tangible equity-to-assets ratios for the Association and the Peer Group equaled 8.3% and 14.1%, respectively, as goodwill and intangibles maintained by the Peer Group equaled 0.6% of assets. The increase in Lake Shore Savings' pro forma capital position will be favorable from a risk perspective and in terms of future earnings potential that could be realized through leverage and lower funding costs. At the same time, the Association's higher pro forma capitalization will also result in a relatively low return on equity. Both Lake Shore Savings' and the Peer Group's capital ratios reflected capital surpluses with respect to the regulatory capital requirements, with the Peer Group's ratios currently exceeding the Association's ratios. On a pro forma basis, the Association's regulatory surpluses will likely be comparable to the Peer Group's ratios.

{Table 3.2 is omitted. It has been filed as a paper filing.}

The interest-earning asset compositions for the Association and the Peer Group were somewhat similar, with loans constituting the bulk of interest-earning assets for both Lake Shore Savings and the Peer Group. The Association's loans-to-assets ratio of 60.6% was slightly lower than the comparable Peer Group ratio of 64.2%. Comparatively, the Association's cash and investments-to-assets ratio of 34.9% was slightly above the comparable ratio for the Peer Group of 30.6%. Overall, Lake Shore Savings' interest-earning assets amounted to 95.5% of assets, which approximated the comparable Peer Group ratio of 94.8%.

Lake Shore Savings' funding liabilities reflected a funding strategy that was somewhat similar to that of the Peer Group's funding composition. The Association's deposits equaled 75.3% of assets, which was similar to the comparable Peer Group ratio of 72.1%. Borrowings also accounted for a slightly higher portion of the Association's interest-bearing funding composition, as indicated by borrowings-to-assets ratios of 15.0% and 12.2% for Lake Shore Savings and the Peer Group, respectively. Total interest-bearing liabilities maintained by the Association and the Peer Group, as a percent of assets, equaled 90.3% and 84.3%, respectively. Following the increase in capital provided by the net proceeds of the stock offering, the Association's ratio of interest-bearing liabilities as a percent of assets will be more comparable to the Peer Group's ratio.

A key measure of balance sheet strength for a thrift institution is its IEA/IBL ratio. Presently, the Peer Group's IEA/IBL ratio of 112.5% is stronger than the Association's ratio of 105.8%. The additional capital realized from stock proceeds should serve to provide Lake Shore Savings with an IEA/IBL ratio that is fairly comparable to the Peer Group's ratio, as the increase in capital provided by the infusion of stock proceeds will serve to lower the level of interest-bearing liabilities funding assets and will be primarily deployed into interest-earning assets.

The growth rate section of Table 3.2 shows annual growth rates for key balance sheet items. Lake Shore Savings' growth rates are based on annualized growth for the nine-month period ended September 30, 2005, while the Peer Group's growth rates are based on annual growth for the twelve months ended September 30, 2005 or the most recent period available. Lake Shore Savings' assets increased at a 1.7% annualized rate, which was slightly below the

Peer Group's asset growth rate of 3.6%. Asset growth for the Association consisted of a mix of loans and cash and investments, with a slightly higher growth rate indicated for loans. Asset growth for the Peer Group was realized through loan growth, which was partially funded with cash and investments.

Deposit growth funded the Association's asset growth as well as the pay down of borrowings, while a combination of deposits and borrowings funded the Peer Group's asset growth. Deposit growth rates were comparable for the Association and the Peer Group, equaling 4.4% and 4.6%, respectively. Capital growth rates posted by the Association and the Peer Group equaled 4.1% and 1.0%, respectively. Factors contributing to the Association's higher capital growth rate included its lower level of capital, as well as retention of all of its earnings. Comparatively, while recording a similar return on assets as the Association, the Peer Group's capital growth rate was slowed by dividend payments as well as stock repurchases. The increase in the Association's capital position resulting from the infusion of net stock proceeds, as well as possible dividend payments and stock repurchases, will depress the Association's capital growth rate following the stock offering.

Income and Expense Components

Table 3.3 displays comparable statements of operations for the Association and the Peer Group, based on earnings for the twelve months ended September 30, 2005, unless otherwise indicated for the Peer Group companies. Lake Shore Savings and the Peer Group reported net income to average assets ratios of 0.65% and 0.68%, respectively. The Peer Group maintained comparative earnings advantages with respect to net interest income and non-interest operating income ratios, while a lower operating expense ratio and a slightly lower level of loan loss provisions represented comparative earnings advantages for the Association. Net gains were not a factor in the Association's earnings, while the Peer Group reported a net loss on the sale of assets.

The Peer Group's stronger net interest margin was realized primarily through maintenance of a higher interest income ratio and, to a lesser extent, a lower interest expense ratio. The Peer Group's higher interest income ratio was realized through earning a higher yield

{Table 3.3 is omitted. It has been filed as a paper filing.}

on interest-earning assets (5.28% versus 5.09% for the Association), which was supported by the Peer Group's interest-earning asset composition that reflected a higher concentration of loans and a slightly greater degree of diversification into higher yielding types of loans in comparison to the Association's interest-earning asset composition. The Peer Group's lower interest expense ratio was supported by maintenance of a lower level of interest-bearing liabilities, as the Association's and the Peer Group's cost of funds both equaled 2.11%. Overall, Lake Shore Savings and the Peer Group reported net interest income to average assets ratios of 2.89% and 3.26%, respectively.

In another key area of core earnings strength, the Association maintained a lower level of operating expenses than the Peer Group. For the period covered in Table 3.3, the Association and the Peer Group reported operating expense to average assets ratios of 2.46% and 2.86%, respectively. The Association's lower operating expense ratio was achieved despite maintaining a higher number of employees than the Peer Group relative to their respective asset sizes. Assets per full time equivalent employee equaled \$3.5 million for the Association, versus \$4.8 million for the Peer Group. On a post-offering basis, the Association's operating expenses can be expected to increase with the addition of stock benefit plans and certain expenses that result from being a publicly traded company, with such expenses already impacting the Peer Group's operating expenses. At the same time, Lake Shore Savings' capacity to leverage operating expenses will be comparable to the Peer Group's leverage capacity following the increase in capital realized from the infusion of net stock proceeds.

When viewed together, net interest income and operating expenses provide considerable insight into a thrift's earnings strength, since those sources of income and expenses are typically the most prominent components of earnings and are generally more predictable than losses and gains realized from the sale of assets or other non-recurring activities. In this regard, as measured by their expense coverage ratios (net interest income divided by operating expenses), the earning strength of the Association and the Peer Group were comparable. Expense coverage ratios posted by Lake Shore Savings and the Peer Group equaled 1.17x and 1.14x, respectively. An expense coverage ratio of greater than 1.0x indicates that an institution is able to sustain pre-tax profitability without having to rely on non-interest sources of income.

As noted above, sources of non-interest operating income provided a slightly larger contribution to the Peer Group's earnings. Non-interest operating income equaled 0.72% and 0.57% of the Peer Group's and Lake Shore Savings' average assets, respectively. Taking non-interest operating income into account in comparing the Association's and the Peer Group's earnings, Lake Shore Savings' efficiency ratio (operating expenses, net of amortization of intangibles, as a percent of the sum of non-interest operating income and net interest income) of 71.1% was comparable to the Peer Group's efficiency ratio of 71.6%.

Loan loss provisions had a slightly larger impact on the Peer Group's earnings, with loan loss provisions established by the Association and the Peer Group equaling 0.02% and 0.07% of average assets, respectively. The relatively minor impact of loan loss provisions on the Association's and the Peer Group's earnings were indicative of their generally favorable credit quality measures and low risk lending strategies.

Net gains and losses from the sale of assets were not a factor in the Association's earnings, while the Peer Group posted a net loss equal to 0.04% of average assets. Typically, gains and losses generated from the sale of assets are viewed as earnings with a relatively high degree of volatility and, thus, are substantially discounted in the evaluation of an institution's core earnings. The net loss indicated for the Peer Group included a one time expense recorded by PSB Holdings pursuant to funding a charitable foundation at the time of its minority stock offering.

Taxes had a larger impact on the Association's earnings, as Lake Shore Savings and the Peer Group posted effective tax rates of 33.56% and 27.19%, respectively. As indicated in the prospectus, the Association's effective marginal tax rate is equal to 38.5%.

Loan Composition

Table 3.4 presents data related to the Association's and the Peer Group's loan portfolio compositions and investment in mortgage-backed securities. The Association's composition of assets reflected a higher concentration of 1-4 family permanent mortgage loans and mortgage-backed securities than maintained by the Peer Group (65.5% of assets versus 54.2% for the Peer Group). The Association's higher ratio was attributable to maintaining a higher concentration of

{Table 3.4 is omitted. It has been filed as a paper filing.}

mortgage-backed securities relative to the Peer Group, as the Association and the Peer Group maintained comparable ratios of 1-4 family loans as a percent of assets. Loans serviced for others equaled 4.8% and 11.5% of the Association's and the Peer Group's assets, respectively, thereby indicating a slightly greater influence of mortgage banking activities on the Peer Group's operations. The Peer Group's balance of loans serviced for others translated into a modest balance of servicing intangibles, versus a zero balance for the Association.

Diversification into higher risk types of lending was slightly greater for the Peer Group companies on average. Commercial real estate/multi-family loans represented the most significant area of lending diversification for the Peer Group (10.0% of assets), while other areas of lending diversification for the Peer Group were fairly balanced between construction and land loans (2.5% of assets), commercial business loans (2.7% of assets) and consumer loans (3.1% of assets). Lending diversification for the Association's consisted mostly of consumer loans which included home equity loans (9.6% of assets), followed by commercial real estate/multi-family loans (4.5% of assets), commercial business loans (2.4% of assets) and construction and land loans (0.6% of assets). Overall, the Peer Group's higher ratio of loans-to-assets and slightly greater degree of lending diversification into higher risk types of lending translated into a slightly higher risk weighted assets-to-assets ratio of 56.2%, versus a comparable ratio of 53.0% for the Association.

Interest Rate Risk

Table 3.5 reflects various key ratios highlighting the relative interest rate risk exposure of the Association versus the Peer Group companies. In terms of balance sheet composition, Lake Shore Savings' interest rate risk characteristics were considered to be less favorable than the Peer Group's. Most notably, Lake Shore Savings' lower tangible capital position and lower IEA/IBL ratio indicate a greater dependence on the yield-cost spread to sustain the net interest margin. The level of non-interest earning assets maintained by the Association and the Peer Group were fairly comparable. On a pro forma basis, the infusion of stock proceeds should provide the Association with comparable balance sheet interest rate risk characteristics as currently

{Table 3.5 is omitted. It has been filed as a paper filing.}

maintained by the Peer Group, particularly with respect to the increases that will be realized in the Association's equity-to-assets and IEA/IBL ratios.

To analyze interest rate risk associated with the net interest margin, we reviewed quarterly changes in net interest income as a percent of average assets for Lake Shore Savings and the Peer Group. In general, the relative fluctuations in the Association's and the Peer Group's net interest income to average assets ratios were considered to be fairly comparable and, thus, based on the interest rate environment that prevailed during the period analyzed in Table 3.5, Lake Shore Savings and the Peer Group were viewed as maintaining a similar degree of interest rate risk exposure in their respective net interest margins. The stability of the Association's net interest margin should be enhanced by the infusion of stock proceeds, as the increase in capital will reduce the level of interest rate sensitive liabilities funding Lake Shore Savings' assets.

Credit Risk

Overall, the credit risk associated with Lake Shore Savings' balance sheet was considered to be comparable to the Peer Group's, as implied by their respective ratios for credit quality and reserves for loan losses. As shown in Table 3.6, Lake Shore Savings' ratio of non-performing assets and accruing loans that are more than 90 days past due as a percent of assets approximated the comparable Peer Group ratio (0.36% versus 0.37% for the Peer Group). Comparatively, Lake Shore Savings' non-performing loans-to-loans ratio, which does not include accruing loans that are more than 90 days past due, was slightly lower than the Peer Group's ratio (0.19% versus 0.35% for the Peer Group). The Association and the Peer Group maintained comparable levels of loss reserves as a percent of non-performing loans (330.0% versus 291.9% for the Peer Group), while loss reserves as a percent of non-performing assets and accruing loans that are more than 90 days past due were higher for the Peer Group (287.4% versus 106.0% for the Association). Loss reserves maintained as percent of loans were also higher for the Peer Group (0.83% versus 0.63% for the Association).

{Table 3.6 is omitted. It has been filed as a paper filing.}

Summary

Based on the above analysis, RP Financial concluded that the Peer Group forms a reasonable basis for determining the pro forma market value of Lake Shore Savings. Such general characteristics as asset size, capital position, interest-earning asset composition, funding composition, core earnings measures, loan composition, credit quality and exposure to interest rate risk all tend to support the reasonability of the Peer Group from a financial standpoint. Those areas where differences exist will be addressed in the form of valuation adjustments to the extent necessary.

IV. VALUATION ANALYSIS

Introduction

This chapter presents the valuation analysis and methodology used to determine Lake Shore Savings' estimated pro forma market value for purposes of pricing the minority stock. The valuation incorporates the appraisal methodology promulgated by the OTS and adopted in practice by the FDIC for standard conversions and mutual holding company offerings, particularly regarding selection of the Peer Group, fundamental analysis on both the Association and the Peer Group, and determination of the Association's pro forma market value utilizing the market value approach.

Appraisal Guidelines

The OTS written appraisal guidelines specify the market value methodology for estimating the pro forma market value of an institution. The FDIC, state banking agencies and other Federal agencies have endorsed the OTS appraisal guidelines as the appropriate guidelines involving mutual-to-stock conversions. As previously noted, the appraisal guidelines for MHC offerings are somewhat different, particularly in the Peer Group selection process. Specifically, the regulatory agencies have indicated that the Peer Group should be based on the pro forma fully-converted pricing characteristics of publicly-traded MHCs, rather than on already fully-converted publicly-traded stock thrifts, given the unique differences in stock pricing of MHCs and fully-converted stock thrifts. Pursuant to this methodology: (1) a peer group of comparable publicly-traded MHC institutions is selected; (2) a financial and operational comparison of the subject company to the peer group is conducted to discern key differences; and (3) the pro forma market value of the subject company is determined based on the market pricing of the peer group, subject to certain valuation adjustments based on key differences. In addition, the pricing characteristics of recent conversions and MHC offerings must be considered.

RP Financial Approach to the Valuation

The valuation analysis herein complies with such regulatory approval guidelines. Accordingly, the valuation incorporates a detailed analysis based on the Peer Group, discussed in Chapter III, which constitutes “fundamental analysis” techniques. Additionally, the valuation incorporates a “technical analysis” of recently completed conversions and stock offerings of comparable MHCs, including closing pricing and aftermarket trading of such offerings. It should be noted that these valuation analyses, based on either the Peer Group or the recent conversions and MHC transactions, cannot possibly fully account for all the market forces which impact trading activity and pricing characteristics of a stock on a given day.

The pro forma market value determined herein is a preliminary value for the Association’s to-be-issued stock. Throughout the MHC process, RP Financial will: (1) review changes in the Association’s operations and financial condition; (2) monitor the Association’s operations and financial condition relative to the Peer Group to identify any fundamental changes; (3) monitor the external factors affecting value including, but not limited to, local and national economic conditions, interest rates, and the stock market environment, including the market for thrift stocks; and (4) monitor pending MHC offerings, and to a lesser extent, standard conversion offerings, both regionally and nationally. If material changes should occur prior to the close of the offering, RP Financial will evaluate if updated valuation reports should be prepared reflecting such changes and their related impact on value, if any. RP Financial will also prepare a final valuation update at the closing of the offering to determine if the prepared valuation analysis and resulting range of value continues to be appropriate.

The appraised value determined herein is based on the current market and operating environment for the Association and for all thrifts. Subsequent changes in the local and national economy, the legislative and regulatory environment, the stock market, interest rates, and other external forces (such as natural disasters or major world events), which may occur from time to time (often with great unpredictability) may materially impact the market value of all thrift stocks, including Lake Shore Savings’ value, the market value of the stocks of public MHC institutions, or Lake Shore Savings’ value alone. To the extent a change in factors impacting the

Association's value can be reasonably anticipated and/or quantified, RP Financial has incorporated the estimated impact into its analysis.

Valuation Analysis

A fundamental analysis discussing similarities and differences relative to the Peer Group was presented in Chapter III. The following sections summarize the key differences between the Association and the Peer Group and how those differences affect the pro forma valuation. Emphasis is placed on the specific strengths and weaknesses of the Association relative to the Peer Group in such key areas as financial condition, profitability, growth and viability of earnings, asset growth, primary market area, dividends, liquidity of the shares, marketing of the issue, management, and the effect of government regulations and/or regulatory reform. We have also considered the market for thrift stocks, in particular new issues, to assess the impact on value of Lake Shore Savings coming to market at this time.

1. Financial Condition

The financial condition of an institution is an important determinant in pro forma market value because investors typically look to such factors as liquidity, capital, asset composition and quality, and funding sources in assessing investment attractiveness. The similarities and differences in the Association's and the Peer Group's financial strengths are noted as follows:

- Overall A/L Composition. Loans funded by retail deposits were the primary components of both Lake Shore Savings' and the Peer Group's balance sheets. The Peer Group's interest-earning asset composition exhibited a slightly higher concentration of loans and a slightly greater degree of diversification into higher risk and higher yielding types of loans. Overall, the Peer Group's asset composition provided for a higher yield earned on interest-earning assets and a slightly higher risk weighted assets-to-assets ratio than maintained by the Association. Lake Shore Savings' funding composition reflected slightly higher levels of deposits and borrowings in comparison to the Peer Group's ratios. Notwithstanding the Association's greater utilization of borrowings, Lake Shore Savings' overall cost of funds was the same as the Peer Group's. Overall, as a percent of assets, the Association maintained a comparable level of interest-earning assets and a higher level of interest-bearing liabilities compared to the Peer Group's ratios, which provided for a higher IEA/IBL ratio for the Peer Group. After factoring in the impact of the net stock proceeds, the Association's

IEA/IBL ratio will be more comparable to the Peer Group's ratio. On balance, RP Financial concluded that asset/liability composition was a neutral factor in our adjustment for financial condition.

- Credit Quality. The Association and the Peer Group maintained comparable non-performing assets ratios and comparable loss reserves as a percent of non-performing loans. Loss reserves as a percent loans were higher for the Peer Group and net loan charge-offs were slightly higher for the Association. As noted above, the Peer Group's risk weighted assets-to-assets ratio was slightly higher than the Association's. Overall, RP Financial concluded that credit quality was a neutral factor in our adjustment for financial condition.
- Balance Sheet Liquidity. The Association operated with a slightly higher level of cash and investment securities relative to the Peer Group (34.9% of assets versus 30.6% for the Peer Group). Following the infusion of stock proceeds, the Association's cash and investments ratio is expected to increase as the proceeds retained at the holding company level will be initially deployed into investments. The Association's future borrowing capacity was considered to be fairly comparable to the Peer Group's, as both the Association and the Peer Group were considered to have ample borrowing capacities based on their current ratios of borrowings-to-assets. Overall, RP Financial concluded that a slight upward adjustment was warranted for the Association's balance sheet liquidity.
- Funding Liabilities. The Association's interest-bearing funding composition reflected slightly higher levels of deposits and borrowings relative to the comparable Peer Group ratios. Notwithstanding, the Association's greater utilization of borrowings, Lake Shore Savings' overall cost of funds was comparable to the Peer Group's. The Association's similar cost of funds was supported by a deposit composition that consisted of a relatively high proportion of lower costing savings and transaction accounts. Total interest-bearing liabilities as a percent of assets were higher for the Association compared to the Peer Group ratio, which was attributable to Lake Shore Savings' lower capital position. Following the stock offering, the increase in the Association's capital position should provide Lake Shore Savings with a comparable level of interest-bearing liabilities as maintained by the Peer Group. Overall, RP Financial concluded that no adjustment was warranted for Lake Shore Savings' funding composition.
- Capital. The Peer Group operates with a higher equity-to-assets ratio than the Association. However, following the stock offering, Lake Shore Savings' pro forma capital position will be comparable to the Peer Group's equity-to-assets ratio. The increase in the Association's pro forma capital position will result in greater leverage potential and reduce the level of interest-bearing liabilities utilized to fund assets. At the same time, the Association's more significant capital surplus will likely result in a lower ROE. On balance, RP Financial concluded that capital strength was a neutral factor in our adjustment for financial condition.

On balance, the strength of Lake Shore Savings' and the Peer Group's balance sheets were considered to be comparable. Accordingly, no adjustment was warranted for this valuation factor.

2. Profitability, Growth and Viability of Earnings

Earnings are a key factor in determining pro forma market value, as the level and risk characteristics of an institution's earnings stream and the prospects and ability to generate future earnings heavily influence the multiple that the investment community will pay for earnings. The major factors considered in the valuation are described below.

- Reported Earnings. The Association's reported earnings were comparable to the Peer Group's on a ROAA basis (0.65% of average assets versus 0.68% for the Peer Group). The Association maintained a lower level of operating expenses than the Peer Group, which was offset by the Peer Group's higher net interest margin, higher level of non-interest operating income and lower effective tax rate. The Peer Group's earnings were also negatively impacted by non-operating losses, which were not a factor in the Association's earnings. Reinvestment of stock proceeds into interest-earning assets will serve to increase the Association's earnings, with the benefit of reinvesting proceeds expected to be somewhat offset by higher operating expenses associated with operating as a publicly-traded company and the implementation of stock benefit plans. Overall, the Association's and the Peer Group's reported earnings were considered to be fairly comparable and, thus, RP Financial concluded that this was a neutral factor in our adjustment for profitability, growth and viability of earnings.
- Core Earnings. Both the Association's and the Peer Group's earnings were derived largely from recurring sources, including net interest income, operating expenses, and non-interest operating income. In these measures, the Association operated with a lower net interest margin, a lower operating expense ratio and a lower level of non-interest operating income. The Association's lower ratios for net interest income and operating expenses translated into an expense coverage ratio that was comparable to the Peer Group's ratio (1.17x versus 1.14x for the Peer Group). Similarly, the Association's efficiency ratio of 71.1% approximated the Peer Group's efficiency ratio of 71.6%, as the Association's lower operating expense ratio offset the Peer Group's higher ratios for net interest income and non-interest operating income. Loss provisions had a slightly larger impact on the Peer Group's earnings, while the Association had a higher effective tax rate than indicated for the Peer Group. Overall, these measures, as well as the expected earnings benefits the Association should realize from the redeployment of stock proceeds into interest-earning assets, which will be somewhat negated by expenses associated with the stock benefit plans and operating as a publicly-traded

company, indicate that the Association's and the Peer Group's core earnings are fairly comparable. Therefore, RP Financial concluded that this was a neutral factor in our adjustment for profitability, growth and viability of earnings.

- Interest Rate Risk. Quarterly changes in the Association's and the Peer Group's net interest income to average assets ratios indicated the degree of volatility associated with the Association's and the Peer Group's net interest margins were comparable. Other measures of interest rate risk, such as capital and IEA/IBL ratios, were more favorable for the Peer Group, thereby indicating a lower dependence on the yield-cost spread to sustain net interest income. On a pro forma basis, the infusion of stock proceeds can be expected to provide the Association with equity-to-assets and IEA/ILB ratios that are comparable to the Peer Group ratios. Accordingly, on balance, this was a neutral factor in our adjustment for profitability, growth and viability of earnings.
- Credit Risk. Loan loss provisions were a slightly larger factor in the Peer Group's earnings. In terms of future exposure to credit quality related losses, lending diversification into higher risk types of loans was slightly greater for the Peer Group. Credit quality measures for non-performing assets and loss reserves as a percent of non-performing loans were comparable for the Association and the Peer Group, while the Peer Group's higher loss reserves as a percent of loans represented lower credit risk exposure for the Peer Group. Overall, RP Financial concluded that earnings credit risk was a neutral factor in our adjustment for profitability, growth and viability of earnings.
- Earnings Growth Potential. Several factors were considered in assessing earnings growth potential. First, the Association's historical growth was not as strong as the Group's, particularly in the area of higher yielding loan growth. Second, the infusion of stock proceeds will provide the Association with comparable growth potential through leverage as currently maintained by the Peer Group. Third, opportunities to increase earnings through loan and deposit growth are considered to be less favorable in the Association's primary market area, based on the demographic and economic limitations that are associated with the primary market area served by Lake Shore Savings (shrinking and older population base with relatively low per capita income). Lastly, the Peer Group's slightly higher level of non-interest operating income implies greater earnings growth potential and sustainability of earnings during periods when net interest margins come under pressure as the result of adverse changes in interest rates. Overall, a slight downward adjustment was warranted for the Association's earnings growth potential.
- Return on Equity. Currently, the Association's ROE is above the Peer Group's ROE, which was realized through earning a comparable return on assets with a lower level of capital than maintained by the Peer Group. As the result of the significant increase in capital that will be realized from the infusion of net stock proceeds into the Association's equity, the Association's pro forma return equity on a core earnings basis will be more comparable to the Peer Group's ROE.

Accordingly, this was a neutral factor in the adjustment for profitability, growth and viability of earnings.

On balance, the profitability, growth and viability of Lake Shore Savings' and the Peer Group's earnings were considered to be comparable. Accordingly, no adjustment was warranted for this valuation factor.

3. Asset Growth

While asset growth rates for the Association and the Peer Group were fairly comparable, the composition of the Peer Group's asset growth was viewed as more favorable in light of the larger contribution that higher yielding loan growth made to the Peer Group's asset growth (11.8% loan growth rate compared to a 1.9% loan growth rate for the Association). On a pro forma basis, the Association's tangible equity-to-assets ratio will be comparable to the Peer Group's tangible equity-to-assets ratio, indicating comparable leverage capacity for the Association. Accordingly, on balance, we believe a slight downward valuation adjustment was warranted for this factor.

4. Primary Market Area

The general condition of an institution's market area has an impact on value, as future success is in part dependent upon opportunities for profitable activities in the local market served. Operating in upstate western New York, the Association faces significant competition for loans and deposits from other financial institutions, many of which are larger, provide a broader array of services and have significantly larger branch networks than maintained by the Association. Lake Shore Savings' primary market area for deposits and loans is considered to be where the Association maintains a branch presence in the counties of Chautauqua and Erie, as well as nearby surrounding markets. As part of the Buffalo metropolitan area, Erie County is a suburban and urban market area with a relatively dense population base. Comparatively, Chautauqua County is a more rural market area, with a much small population base than Erie County. Notably, both of the primary market area counties experienced a decline in population during the first five years of this decade, with additional population shrinkage projected over the

next five years. Population shrinkage reflects the lack of economic growth in the area, especially with regard to job losses in the manufacturing sector. Per capita and household income measures for the primary market area counties were lower than the comparable measures for the U.S. and New York, with the more significant gap in income measures reflected for the more rural market area of Chautauqua County.

The majority of the Peer Group companies serve markets with more favorable demographic growth characteristics than the Association's primary market area. In general, the Peer Group companies operated in markets with faster growing populations and higher per capita income. While a few of the Peer Group companies operate in large urban markets, the majority of the Peer Group companies operate in suburban and rural markets similar to Chautauqua County in size. The average and median deposit market shares maintained by the Peer Group companies were slightly above and below the Association's market share of deposits in Chautauqua County. In general, the degree of competition faced by the Peer Group companies was viewed as greater than experienced in the Association's primary market area, while the growth potential in the markets served by the Peer Group companies was for the most part viewed as more favorable than implied for the Association's primary market area. Summary demographic and deposit market share data for the Association and the Peer Group companies is provided in Exhibit III-3. As shown in Table 4.1, October 2005 unemployment rates for the majority of the markets served by the Peer Group companies were generally comparable or slightly above the unemployment rate reflected for Chautauqua County. On balance, we concluded that a slight downward adjustment was appropriate for the Association's market area.

Table 4.1
Market Area Unemployment Rates
Lake Shore Savings and the Peer Group Companies(1)

	County	October 2005 Unemployment
Lake Shore Savings - NY	Chautauqua	3.9%
<u>The Peer Group</u>		
Alliance Bank MHC – PA	Delaware	4.1%
Cheviot Financial Corp. MHC – OH	Hamilton	5.4
First Federal Fin. Services MHC – IL	Madison	5.0
Gouverneur Bancorp MHC – NY	St. Lawrence	4.5
Greene Co. Bancorp MHC – NY	Greene	4.0
Jacksonville Bancorp MHC – IL	Morgan	4.5
Naug. Valley Finan. Corp. MHC – CT	New Haven	5.3
Oneida Financial MHC – NY	Madison	3.9
PSB Holdings, Inc. MHC – CT	Windham	5.5
Pathfinder Bancorp MHC – NY	Oswego	5.2

(1) Unemployment rates are not seasonally adjusted.

Source: U.S. Bureau of Labor Statistics.

5. Dividends

At this time the Association has not established a dividend policy. Future declarations of dividends by the Board of Directors will depend upon a number of factors, including investment opportunities, growth objectives, financial condition, profitability, tax considerations, minimum capital requirements, regulatory limitations, stock market characteristics and general economic conditions.

All ten of the Peer Group companies pay regular cash dividends, with implied dividend yields ranging from 1.44% to 3.87%. The average dividend yield on the stocks of the Peer Group institutions equaled 2.46% as of December 22, 2005. As of December 22, 2005, approximately 87% of all publicly-traded thrifts had adopted cash dividend policies (see Exhibit IV-1), exhibiting an average yield of 2.20%. The dividend paying thrifts generally maintain higher than average profitability ratios, facilitating their ability to pay cash dividends.

Our valuation adjustment for dividends for Lake Shore Savings also considered the regulatory policy with regard to waiver of dividends by the MHC. Under current policy, any waiver of dividends by an FDIC regulated MHC requires that the minority stockholders' ownership interest be reduced in a second-step conversion to reflect the cumulative waived dividend account. Comparatively, no adjustment for waived dividends is required for OTS regulated companies in a second-step conversion. As an MHC operating under OTS regulation, the Association will be subject to the same regulatory dividend policy as a large majority of the Peer Group companies (nine of the Peer Group companies operate under OTS regulation). Accordingly, we believe that to the extent Lake Shore Savings' pro forma market value would be influenced by the OTS' dividend policy regarding MHC institutions, it has been sufficiently captured in the pricing of the Peer Group companies.

While the Association has not established a definitive dividend policy prior to converting, the Association will have the capacity to pay a dividend comparable to the Peer Group's average dividend yield based on pro forma earnings and capitalization. On balance, we concluded that no adjustment was warranted for purposes of the Association's dividend policy.

6. Liquidity of the Shares

The Peer Group is by definition composed of companies that are traded in the public markets. Nine of the Peer Group members trade on the NASDAQ system and the remaining company trades on the AMEX. Typically, the number of shares outstanding and market capitalization provides an indication of how much liquidity there will be in a particular stock. The market capitalization of the Peer Group companies, based on the shares issued and outstanding to public shareholders (i.e., excluding the majority ownership interest owned by the respective MHCs) ranged from \$11.1 million to \$50.0 million as of December 22, 2005, with average and median market values of \$26.3 million and \$26.5 million, respectively. The shares issued and outstanding to the public shareholders of the Peer Group members ranged from 688,000 to 4.5 million, with average and median shares outstanding of 2.2 million and 1.8 million, respectively. The Association's minority stock offering is expected to have a pro forma market value and shares outstanding that will be in the middle of the comparable ranges indicated for the Peer Group. Like the majority of the Peer Group companies, the Association's

stock will be quoted on the NASDAQ National Market System following the stock offering. Overall, we anticipate that the Association's public stock will have a comparable trading market as the Peer Group companies on average and, therefore, concluded no adjustment was necessary for this factor.

7. Marketing of the Issue

Three separate markets exist for thrift stocks: (1) the after-market for public companies, both fully-converted stock companies and MHCs, in which trading activity is regular and investment decisions are made based upon financial condition, earnings, capital, ROE, dividends and future prospects; (2) the new issue market in which converting thrifts are evaluated on the basis of the same factors but on a pro forma basis without the benefit of prior operations as a publicly-held company and stock trading history; and (3) the thrift acquisition market. All three of these markets were considered in the valuation of the Association's to-be-issued stock.

A. The Public Market

The value of publicly-traded thrift stocks is easily measurable, and is tracked by most investment houses and related organizations. Exhibit IV-1 provides pricing and financial data on all publicly-traded thrifts. In general, thrift stock values react to market stimuli such as interest rates, inflation, perceived industry health, projected rates of economic growth, regulatory issues and stock market conditions in general. Exhibit IV-2 displays historical stock market trends for various indices and includes historical stock price index values for thrifts and commercial banks. Exhibit IV-3 displays historical stock price indices for thrifts only.

In terms of assessing general stock market conditions, the performance of the overall stock market has been mixed over the past year. Some favorable economic data, including a strong report on December consumer confidence and a five-month low in new unemployment claims, lifted stocks in the last month of 2004 as the Dow Jones Industrial Average ("DJIA") moved to a three and one-half year high. The broader stock market started 2005 in a downward trend, as investors reacted negatively to some disappointing economic data and indications by the Federal Reserve that it was likely to keep raising rates because of wariness

about inflation. Concerns about slowing profit growth, weaker than expected growth in the fourth quarter of 2004 and the elections in Iraq extended the downward trend through mid-January. After three straight weekly declines, the DJIA edged higher in the last week of January on some upbeat earnings reports and a better than expected consumer confidence index. The positive trend in the broader stock market continued during the first half of February, as the Federal Reserve's quarter-point rate increase contained no surprises, oil prices declined and January retail sale beat expectations. The broader stock market had an uneven performance during the second half of February, reflecting concerns about inflation, higher oil prices and a weak dollar.

Despite surging oil prices, the DJIA moved back into positive territory for the year in early-March 2005. Strong job growth reflected in the February employment data and better than expected retail sales for February were factors that contributed to the positive move in stocks during the first week of March. Higher oil prices and interest rates pressured stocks lower in mid-March, as rising commodity prices rekindled inflation fears. The downturn in stocks continued into the second half of March, as stocks were weighed down by news of a record U.S. trade deficit in 2004, General Motors' warning that earnings would be significantly below an earlier forecast and record high oil prices. Increased expectations of higher interest rates further depressed stocks in late-March, as the Federal Reserve surprised investors by signaling for the first time in more than four years that it was concerned with inflation. As expected, the Federal Reserve concluded its March meeting by raising its target for the federal funds rate to 2.75% from 2.5%. After dropping to a two-month low, a decline in oil prices helped lift the DJIA to its biggest one-day gain for the year at the end of March 2005. However, the first quarter of 2005 still showed a decline in the DJIA for the third year in a row.

Weaker-than-expected job growth reflected in the March 2005 employment data pushed stocks lower at the start of the second quarter. Following a brief rally in early-April, the broader stock market moved to a five-month low in mid-April. The sell-off was based on concerns of a slowing U.S. economy, higher inflation and rising oil prices. Comparatively, economic data which showed a decline in initial jobless claims, a pick-up in Mid-Atlantic manufacturing activity and strong new home sales combined with some favorable first quarter earnings reports fueled a sharp rise in the stock market heading into late-April. A stronger-than-expected

employment report for April, optimism about interest rates and a big planned purchase of General Motors shares helped to lift stocks in early-May. Gains in the broader stock market generally continued through the balance of May, as oil prices dropped and the economy showed signs of sustaining growth with low inflation following an upward revision in GDP growth for the first quarter while an accompanying inflation measure remained unrevised. The positive trend in the broader stock market was sustained through the first half of June, fueled by economic data which showed steady growth and mild inflation. After moving to a three-month high in mid-June, stocks declined at the end of the second quarter on continued worries over oil prices, slowing economic growth and the Federal Reserve's plans for raising interest rates further.

The broader stock market rebounded at the start of the third quarter of 2005, as investors reacted favorably to falling oil prices and job growth reflected in the June employment data. Favorable inflation data for June and some positive third quarter earnings reports sustained the rally into the latter part of July. Stocks posted further gains in early-August on optimism about the economy, corporate profits and interest rates. Concerns that rising oil prices would reduce consumer spending and hurt corporate earnings produced a downward trend in the stock market during the second half of August, with the DJIA posting a 1.5% loss for the month of August. The stock market showed resiliency in aftermath of Hurricane Katrina, as oil prices fell following the Energy Department's decision to release some of the Strategic Petroleum Reserve. Lower oil prices and an upbeat report from the Federal Reserve that showed the economy kept growing in July and August helped to extend the rebound in the stock market heading into mid-September. The rebound in the broader stock market paused in mid-September, as Hurricane Rita, higher oil prices and a quarter point rate increase by the Federal Reserve contributed to the DJIA posting its worst weekly loss in three months for the trading week ending September 23rd. Stocks rebounded mildly at the close of the third quarter, which helped the DJIA to a 2.9% gain for the third quarter.

Inflation fears pushed stocks lower at the start of the fourth quarter of 2005, as comments from the Federal Reserve suggested that the central bank was worried about inflation and was likely to keep raising rates. The DJIA dropped to a five-month low in mid-October, reflecting concerns that high oil prices would depress consume spending. Mixed results for third

quarter earnings and inflation worries translated into an uneven trading market through the end of October. Optimism that a strong economy would produce a year-end rally provided a lift to the broader stock market in early-November. Lower bond yields and oil prices helped to extend the rally through mid-November. The DJIA approached a four and one-half year high in late-November, as the Federal Reserve hinted that the cycle of rate increases could be approaching an end. Stocks fluctuated in first half of December, as strong economic news and higher oil prices renewed concerns about inflation and rising interest rates. Acquisitions in the technology and pharmaceutical industries along with some positive economic news showing a dip in unemployment claims and strong third quarter GDP growth provided a boost to the broader stock market heading into late-December. As an indication of the general trends in the nation's stock markets over the past year, as of December 22, 2005, the DJIA closed at 10889.44 an increase of 0.6% from one year ago and an increase of 1.0% year-to-date, and the NASDAQ closed at 2246.49 an increase of 4.0% from one year ago and an increase of 3.3% year-to-date. The Standard & Poors 500 Index closed at 1268.12 on December 22, 2005, an increase of 4.8% from one year ago and an increase of 4.6% year-to-date.

The market for thrift stocks has been mixed during the past twelve months, but, in general, thrift stocks have appreciated and declined in conjunction with the broader market. Thrift issues followed the broader market higher in early-December 2004 and then declined modestly into a narrow trading range through late-December. The year end rally in the broader stock market provided a slight boost to thrift prices as well. The market for thrift stocks was mixed at the start of 2005, but, in general, thrift stocks eased lower during January. Fourth quarter earnings for the thrift sector were generally in line with expectations, but concerns about higher interest rates and margin compression hindered thrift stocks throughout most of January. Thrift stocks followed the broader market higher in early-February, but then eased slightly in mid-February as long-term interest rates spiked-up following an unexpected surge in the January 2005 wholesale core inflation rate. Comparatively, tame inflation data reflected in the January consumer price index provided a boost to the thrift sector in late-February. Thrift stocks followed the broader market higher in early-March, as long-term interest rates declined slightly. Likewise, thrift stocks declined in conjunction with broader market during mid-March on the spike-up in long-term interest rates and signals from the Federal Reserve that it was becoming

more concerned about inflation. Thrift stocks participated in the broader market rally at the close of the first quarter, with the SNL Thrift Index posting a one-day gain of 1.3% compared to 1.1% gain for the DJIA.

Thrift issues started the second quarter of 2005 trading in a narrow range and then followed the broader market lower in mid-April reflecting concerns that first quarter earnings in the thrift sector would show the negative effects of net interest margin compression resulting from the flattening of the yield curve. Acquisition speculation involving some large thrifts and a strong report on new home sales in March provided a boost to thrift stocks in late-April. Thrift stocks continued to show strength at the beginning of May, as long-term Treasury yields headed higher on news that the U.S. Treasury Department was considering bringing back the 30-year Treasury bond. Surprisingly strong job growth cooled off the thrift rally at the end of the first week of May. Thrift stocks rebounded in mid-May on strength in the broader market and a smaller than expected increase in the April consumer price index, which served to ease inflation concerns. Tame inflation data in the revised first quarter GDP report provided a boost to thrift stocks in late-May.

A weak employment report for May 2005 and concerns of an inverted yield curve provided for a mild pull back in thrift issues in early-June. Thrift stocks strengthened in mid-June, supported by a decline in the May consumer price index which served to calm inflation fears. Stocks in general also moved higher in mid-June on news that consumer confidence was up in June, reflecting the impact of a decline in the national unemployment rate and lower gasoline prices. Thrift stocks traded in a narrow range at the end of the second quarter, outperforming the broader market as acquisition activity in the financial services sector largely offset factors that were negatively impacting stocks in general such as higher oil prices.

Strength in the broader stock market and some positive second quarter earnings reports in the thrift sector supported a positive trend in thrift stocks at the beginning of the third quarter of 2005. Thrift stocks settled into a narrow trading range in late-July and early-August, as higher short-term interest rates provided for further flattening of the Treasury yield curve. Weakness in the broader market combined with a flatter yield curve pressured thrift stocks lower in mid- and late-August. Similar to the broader market, the market for thrift issues showed

mixed results in early-September amid ongoing concerns about the long-term economic impact of Hurricane Katrina. Strength in the broader market and speculation of the Federal Reserve taking a pause in increasing rates supported a mild rally in thrift stocks going into mid-September. Likewise, thrift issues sold off in conjunction with the broader stock market going into late-September, as investors reacted negatively to the Federal Reserve hiking interest rates by another quarter point and the threat of Hurricane Rita hurting energy production. In contrast to the rebound in the broader stock market, thrift issues continued their slide at the end of the third quarter as a sharp decline in September consumer confidence weighed heavily on the thrift sector.

Thrift stocks retreated further at the beginning of the fourth quarter of 2005 on concerns about higher interest rates and inflation. Mixed earnings reports and shareholder activism at Sovereign Bancorp produced a choppy trading market for the thrift sector heading into late-October. Some positive macroeconomic news, which included a rise in consumer spending, helped to initiate a rally in thrift stocks at the end of October. Strength in the broader stock market and merger speculation helped to fuel gains for thrift stocks through much of November. Overall, the SNL Index for all publicly-traded thrifts registered a 3.6% increase during November. Thrift issues generally eased lower during early-December, reflecting concerns about higher interest rates and the strength of the housing market. Signals from the Federal Reserve that it could stop raising rates sometime in 2006 and easing inflation fears on lower than expected revised third quarter GDP growth lifted thrift stocks going into late-December. On December 22, 2005, the SNL Index for all publicly-traded thrifts closed at 1,646.3, an increase of 3.0% from one year ago and an increase of 2.5% year-to-date. The SNL MHC Index closed at 2,957.6 on December 22, 2005, an increase of 2.0% from one year ago and an increase of 1.0% year-to-date.

B. The New Issue Market

In addition to thrift stock market conditions in general, the new issue market for converting thrifts is also an important consideration in determining the Association's pro forma market value. The new issue market is separate and distinct from the market for seasoned thrift stocks in that the pricing ratios for converting issues are computed on a pro forma basis,

specifically: (1) the numerator and denominator are both impacted by the conversion offering amount, unlike existing stock issues in which price change affects only the numerator; and (2) the pro forma pricing ratio incorporates assumptions regarding source and use of proceeds, effective tax rates, stock plan purchases, etc. which impact pro forma financials, whereas pricing for existing issues are based on reported financials. The distinction between pricing of converting and existing issues is perhaps no clearer than in the case of the price/book ("P/B") ratio in that the P/B ratio of a converting thrift will typically result in a discount to book value whereas in the current market for existing thrifts the P/B ratio often reflects a premium to book value. Therefore, it is appropriate to also consider the market for new issues, both at the time of the conversion and in the aftermarket.

After experiencing a softer market in the first quarter of 2005, particularly with respect to mutual holding company offerings where a number of new issues traded below their IPO prices, speculative interest in converting thrifts lessened and the new issue market for converting issues has shown signs of stabilizing during the second half of 2005. As shown in Table 4.2, one standard conversion, one second-step conversion and three mutual holding company offerings were completed during the past three months. The mutual holding company offerings are considered to be more relevant for purposes of our analysis. All three of the MHC offerings were closed at the top of their super ranges. On a fully-converted basis, the average closing pro forma price/tangible book ratio of the recent MHC offerings equaled 81.6%. On average, the prices of the recent MHC offerings reflected price appreciation of 2.8% after the first week of trading and then reflected a 3.1% increase in price after one month of trading.

Shown in Table 4.3 are the current pricing ratios for the two companies that have completed fully-converted offerings during the past three months and are traded on NASDAQ or an Exchange. One of the offerings was a second-step conversion (American Bancorp of New Jersey), thereby placing an upward bias on the P/TB ratio compared to the P/TB ratio for a standard conversion. The current average P/TB ratio of the publicly-traded recent conversions equaled 104.4%. Notably, American Bancorp's closing stock price on December 22, 2005 was slightly below its IPO price.

{Table 4.2 is omitted. It has been filed as a paper filing.}

{Table 4.3 is omitted. It has been filed as a paper filing.}

C. The Acquisition Market

Also considered in the valuation was the potential impact on Lake Shore Savings’ stock price of recently completed and pending acquisitions of other savings institutions operating in New York. As shown in Exhibit IV-4, there were ten New York thrift acquisitions completed from the beginning of 2002 through year-to-date 2005, and there are currently three acquisitions pending for New York savings institutions. To the extent that speculation of a re-mutualization may impact the Association’s valuation, we have largely taken this into account in selecting companies which operate in the MHC form of ownership. Accordingly, the Peer Group companies are considered to be subject to the same type of acquisition speculation that may influence Lake Shore Savings’ trading price.

* * * * *

In determining our valuation adjustment for marketing of the issue, we considered trends in both the overall thrift market, the new issue market including the new issue market for MHC shares and the local acquisition market for thrift stocks. Taking these factors and trends into account, RP Financial concluded that no adjustment was appropriate in the valuation analysis for purposes of marketing of the issue.

8. Management

Lake Shore Savings’ management team appears to have experience and expertise in all of the key areas of the Association’s operations. Exhibit IV-5 provides summary resumes of Lake Shore Savings’ Board of Directors and senior management. The financial characteristics of the Association suggest that the Board and senior management have been effective in implementing an operating strategy that can be well managed by the Association’s present organizational structure. The Association currently does not have any senior management positions that are vacant.

Similarly, the returns, capital positions and other operating measures of the Peer Group companies are indicative of well-managed financial institutions, which have Boards and management teams that have been effective in implementing competitive operating strategies.

Therefore, on balance, we concluded no valuation adjustment relative to the Peer Group was appropriate for this factor.

9. Effect of Government Regulation and Regulatory Reform

In summary, as a federally-insured savings institution operating in the MHC form of ownership, Lake Shore Savings will operate in substantially the same regulatory environment as the Peer Group members — all of whom are adequately capitalized institutions and are operating with no apparent restrictions. Exhibit IV-6 reflects the Association’s pro forma regulatory capital ratios. The one difference noted between Lake Shore Savings and one of the Peer Group companies that operates as an FDIC regulated institution was in the area of regulatory policy regarding dividend waivers (see the discussion above for “Dividends”). Since this factor was already accounted for in the “Dividends” section of this appraisal, no further adjustment has been applied for the effect of government regulation and regulatory reform.

Summary of Adjustments

Overall, based on the factors discussed above, we concluded that the Association’s pro forma market value should reflect the following valuation adjustments relative to the Peer Group:

<u>Key Valuation Parameters:</u>	<u>Valuation Adjustment</u>
Financial Condition	No Adjustment
Profitability, Growth and Viability of Earnings	No Adjustment
Asset Growth	Slight Downward
Primary Market Area	Slight Downward
Dividends	No Adjustment
Liquidity of the Shares	No Adjustment
Marketing of the Issue	No Adjustment
Management	No Adjustment
Effect of Government Regulations and Regulatory Reform	No Adjustment

Basis of Valuation - Fully-Converted Pricing Ratios

As indicated in Chapter III, the valuation analysis included in this section places the Peer Group institutions on equal footing by restating their financial data and pricing ratios on a “fully-converted” basis. We believe there are a number of characteristics of MHC shares that make them different from the shares of fully-converted companies. These factors include: (1) lower aftermarket liquidity in the MHC shares since less than 50% of the shares are available for trading; (2) no opportunity for public shareholders to exercise voting control; (3) the potential pro forma impact of second-step conversions on the pricing of MHC institutions; (4) the regulatory policies regarding the dividend waiver policy by MHC institutions; and (5) the middle-tier structure maintained by most MHCs facilitates the ability for stock repurchases. The above characteristics of MHC shares have provided MHC shares with different trading characteristics versus fully-converted companies. To account for the unique trading characteristics of MHC shares, RP Financial has placed the financial data and pricing ratios of the Peer Group on a fully-converted basis to make them comparable for valuation purposes. Using the per share and pricing information of the Peer Group on a fully-converted basis accomplishes a number of objectives. First, such figures eliminate distortions that result when trying to compare institutions that have different public ownership interests outstanding. Secondly, such an analysis provides ratios that are comparable to the pricing information of fully-converted public companies, and more importantly, are directly applicable to determining the pro forma market value range of the 100% ownership interest in Lake Shore Savings as an MHC. Lastly, such an analysis allows for consideration of the potential dilutive impact of dividend waiver policies adopted by the Federal agencies. This technique is validated by the investment community’s evaluation of MHC pricing, which also incorporates the pro forma impact of a second-step conversion based on the current market price.

To calculate the fully-converted pricing information for MHCs, the reported financial information for the public MHCs must incorporate the following assumptions, based on completed second-step conversions to date: (1) all shares owned by the MHC are assumed to be sold at the current trading price in a second step-conversion; (2) the gross proceeds from such a sale are adjusted to reflect reasonable offering expenses and standard stock based benefit plan parameters that would be factored into a second-step conversion of MHC institutions; (3) net

proceeds are assumed to be reinvested at market rates on a tax effected basis; and (4) the public ownership interest is adjusted to reflect the pro forma impact of the waived dividends pursuant to applicable regulatory policy. Book value per share and earnings per share figures for the public MHCs were adjusted by the impact of the assumed second step-conversion, resulting in an estimation of book value per share and earnings per share figures on a fully-converted basis. Table 4.4 on the following page shows the calculation of per share financial data (fully-converted basis) for each of the ten public MHC institutions that form the Peer Group.

Valuation Approaches: Fully-Converted Basis

In applying the accepted valuation methodology promulgated by the OTS and adopted by the FDIC, i.e., the pro forma market value approach, including the fully-converted analysis described above, we considered the three key pricing ratios in valuing Lake Shore Savings' to-be-issued stock — price/earnings ("P/E"), price/book ("P/B"), and price/assets ("P/A") approaches — all performed on a pro forma basis including the effects of the stock proceeds. In computing the pro forma impact of the conversion and the related pricing ratios, we have incorporated the valuation parameters disclosed in Lake Shore Savings' prospectus for reinvestment rate, effective tax rate, stock benefit plan assumptions and the Foundation (summarized in Exhibits IV-7 and IV-8). Pursuant to the minority stock offering, we have also incorporated the valuation parameters disclosed in Lake Shore Savings' prospectus for offering expenses. The assumptions utilized in the pro forma analysis in calculating the Association's full conversion value were consistent with the assumptions utilized for the minority stock offering, except expenses were assumed to equal 2.0% of gross proceeds, the MRP was assumed to equal 4.0% of the offering and the stock option plan was assumed to equal 10% of the offering.

In our estimate of value, we assessed the relationship of the pro forma pricing ratios relative to the Peer Group, recent conversions and MHC offerings.

RP Financial's valuation placed an emphasis on the following:

- P/E Approach. The P/E approach is generally the best indicator of long-term value for a stock. Given the similarities between the Association's and the Peer Group's earnings composition and overall financial condition, the P/E approach was carefully

{Table 4.4 is omitted. It has been filed as a paper filing.}

considered in this valuation. At the same time, recognizing that (1) the earnings multiples will be evaluated on a pro forma fully-converted basis for the Association as well as for the Peer Group; and (2) the Peer Group on average has had the opportunity to realize the benefit of reinvesting the minority offering proceeds, we also gave weight to the other valuation approaches.

- P/B Approach. P/B ratios have generally served as a useful benchmark in the valuation of thrift stocks, particularly in the context of an initial public offering, as the earnings approach involves assumptions regarding the use of proceeds. RP Financial considered the P/B approach to be a valuable indicator of pro forma value taking into account the pricing ratios under the P/E and P/A approaches. We have also modified the P/B approach to exclude the impact of intangible assets (i.e., price/tangible book value or “P/TB”), in that the investment community frequently makes this adjustment in its evaluation of this pricing approach.
- P/A Approach. P/A ratios are generally a less reliable indicator of market value, as investors typically assign less weight to assets and attribute greater weight to book value and earnings. Furthermore, this approach as set forth in the regulatory valuation guidelines does not take into account the amount of stock purchases funded by deposit withdrawals, thus understating the pro forma P/A ratio. At the same time, the P/A ratio is an indicator of franchise value, and, in the case of highly capitalized institutions, high P/A ratios may limit the investment community’s willingness to pay market multiples for earnings or book value when ROE is expected to be low.

The Association will adopt Statement of Position (“SOP”) 93-6, which will cause earnings per share computations to be based on shares issued and outstanding excluding unreleased ESOP shares. For purposes of preparing the pro forma pricing analyses, we have reflected all shares issued in the offering, including all ESOP shares, to capture the full dilutive impact, particularly since the ESOP shares are economically dilutive, receive dividends and can be voted. However, we did consider the impact of the adoption of SOP 93-6 in the valuation.

Based on the application of the three valuation approaches, taking into consideration the valuation adjustments discussed above, RP Financial concluded that as of December 22, 2005, the pro forma market value of Lake Shore Savings’ full conversion offering, taking into account the dilutive impact of the stock contribution to the Foundation, equaled \$50,000,000 at the midpoint, equal to 5,000,000 shares at \$10.00 per share.

1. Price-to-Earnings (“P/E”). The application of the P/E valuation method requires calculating the Association’s pro forma market value by applying a valuation P/E multiple (fully-converted basis) to the pro forma earnings base. In applying this

technique, we considered both reported earnings and a recurring earnings base, that is, earnings adjusted to exclude any one-time non-operating items, plus the estimated after-tax earnings benefit of the reinvestment of the net proceeds. The Association’s reported earnings equaled \$2.162 million for the twelve months ended September 30, 2005. In deriving Lake Shore Savings’ core earnings, the only adjustment made to reported earnings was to eliminate net gains on the sale of investments, which equaled \$2,000 for the twelve months ended September 30, 2005. As shown below, on a tax effected basis, assuming an effective marginal tax rate of 38.5% for the gains on sale investments, the Association’s core earnings were determined to equal \$2.161 million for the twelve months ended September 30, 2005. (Note: see Exhibit IV-9 for the adjustments applied to the Peer Group’s earnings in the calculation of core earnings).

	Amount
	<u>(\$000)</u>
Net income	\$2,162
Less: Gain on sale of investments(1)	(1)
	<u> </u>
Core earnings estimate	\$2,161

(1) Tax effected at 38.5%.

Based on Lake Shore Savings’ reported and estimated core earnings and incorporating the impact of the pro forma assumptions discussed previously, the Association’s pro forma reported and core P/E multiples (fully-converted basis) at the \$50.0 million midpoint value both equaled 19.92 times, which provided for discounts of 29.9% and 31.2% relative to the Peer Group’s average reported and core P/E multiples (fully-converted basis) of 28.41 times and 28.97 times, respectively (see Table 4.5). At the top of the superrange, the Association’s reported and core P/E multiples equaled 25.21 times and 25.22 times, respectively. In comparison to the Peer Group’s average reported and core P/E multiples, the Association’s P/E multiples at the top of the superrange reflected discounts of 11.3% and 12.9%, respectively.

On an MHC reported basis, the Association’s reported and core P/E multiples at the midpoint value of \$50.0 million equaled 21.86 times and 21.87 times, respectively. The

{Table 4.5 is omitted. It has been filed as a paper filing.}

Association's reported and core P/E multiples provided for discounts of 20.9% and 25.1% relative to the Peer Group's average reported and core P/E multiples of 27.64 times and 29.18 times, respectively. The Association's implied MHC pricing ratios relative to the MHC pricing ratios for the Peer Group are shown in Table 4.6, and the pro forma calculations are detailed in Exhibits IV-10 and Exhibit IV-11.

2. Price-to-Book ("P/B"). The application of the P/B valuation method requires calculating the Association's pro forma market value by applying a valuation P/B ratio, as derived from the Peer Group's P/B ratio (fully-converted basis), to Lake Shore Savings' pro forma book value (fully-converted basis). Based on the \$50.0 million midpoint valuation, Lake Shore Savings' pro forma P/B and P/TB ratios both equaled 71.98%. In comparison to the average P/B and P/TB ratios for the Peer Group of 87.62% and 91.13%, the Association's ratios reflected a discount of 17.8% on a P/B basis and a discount of 21.0% on a P/TB basis. At the top of the superrange, the Association's P/B and P/TB ratios on a fully-converted basis both equaled 79.74%. In comparison to the Peer Group's average P/B and P/TB ratios, the Company's P/B and P/TB ratios at the top of the superrange reflected discounts of 9.0% and 12.5%, respectively. RP Financial considered the discounts under the P/B approach to be reasonable, in light of the previously referenced valuation adjustments, the nature of the calculation of the P/B ratio which mathematically results in a ratio discounted to book value and the resulting pricing ratios indicated under the earnings approach.

On an MHC reported basis, the Association's P/B and P/TB ratios at the \$50.0 million midpoint value both equaled 108.11%. In comparison to the average P/B and P/TB ratios indicated for the Peer Group of 162.56% and 174.66%, respectively, Lake Shore Savings' ratios were discounted by 33.5% on a P/B basis and 38.1% on a P/TB basis.

3. Price-to-Assets ("P/A"). The P/A valuation methodology determines market value by applying a valuation P/A ratio (fully-converted basis) to the Association's pro forma asset base, conservatively assuming no deposit withdrawals are made to fund stock purchases. In all likelihood there will be deposit withdrawals, which results in understating the pro forma P/A ratio which is computed herein. At the midpoint of the valuation range, Lake Shore Savings' full conversion value equaled 13.30% of pro forma assets. Comparatively, the Peer Group

{Table 4.6 is omitted. It is filed as a paper filing.}

companies exhibited an average P/A ratio (fully-converted basis) of 20.39%, which implies a discount of 34.8% has been applied to the Association's pro forma P/A ratio (fully-converted basis).

On an MHC reported basis, Lake Shore Savings' pro forma P/A ratio at the \$50.0 million midpoint value equaled 14.18%. In comparison to the Peer Group's average P/A ratio of 22.85%, Lake Shore Savings' P/A ratio indicated a discount of 37.9%.

Comparison to Recent Offerings

As indicated at the beginning of this chapter, RP Financial's analysis of recent conversion and MHC offering pricing characteristics at closing and in the aftermarket has been limited to a "technical" analysis and, thus, the pricing characteristics of recent conversion offerings can not be a primary determinate of value. Particular focus was placed on the P/TB approach in this analysis, since the P/E multiples do not reflect the actual impact of reinvestment and the source of the stock proceeds (i.e., external funds vs. deposit withdrawals). The three recently completed MHC offerings closed at an average price/tangible book ratio of 81.6% (fully-converted basis) and, on average, appreciated 2.8% and 3.1% during the first week and first month of trading, respectively. In comparison, the Association's P/TB ratio of 72.0% at the midpoint value reflected an implied discount of 11.8% relative to the average closing P/TB ratio of the recent MHC offerings. At the top of the superrange, the Association's P/TB ratio of 79.7% reflected an implied discount of 2.3% relative to the average closing P/TB ratio of the recent MHC offerings. The current average fully-converted P/TB ratio of the two recent MHC offerings that are traded on NASDAQ equaled 88.0%, based on closing market prices as of December 22, 2005. In comparison to the current P/TB ratio of the publicly-traded MHC offerings, the Association's P/TB ratio at the midpoint value reflects an implied discount of 18.2% and at the top of the superrange the discount narrows to 9.4%.

Valuation Conclusion

Based on the foregoing, it is our opinion that, as of December 22, 2005, the estimated aggregate pro forma market value of the shares to be issued immediately following the

conversion, both shares issued publicly as well as to the MHC, equaled \$50,000,000 at the midpoint, equal to 5,000,000 shares offered at a per share value of \$10.00. Pursuant to conversion guidelines, the 15% offering range indicates a minimum value of \$42,500,000 and a maximum value of \$57,500,000. Based on the \$10.00 per share offering price determined by the Board, this valuation range equates to total shares outstanding of 4,250,000 at the minimum and 5,750,000 at the maximum. In the event the appraised value is subject to an increase, the aggregate pro forma market value may be increased up to a supermaximum value of \$66,125,000 without a resolicitation. Based on the \$10.00 per share offering price, the supermaximum value would result in total shares outstanding of 6,612,500. The Board of Directors has established a public offering range such that the public ownership of the Association will constitute a 45.0% ownership interest prior to the issuance of shares to the Foundation. Accordingly, the offering to the public of the minority stock will equal \$19,125,000 at the minimum, \$22,500,000 at the midpoint, \$25,875,000 at the maximum and \$29,756,250 at the supermaximum of the valuation range. Based on the public offering range and inclusive of the shares issued to the Foundation, equal to 2.0% of the shares issued in the reorganization, the public ownership of shares will represent 47.0% of the shares issued throughout the valuation range. The pro forma valuation calculations relative to the Peer Group (fully-converted basis) are shown in Table 4.5 and are detailed in Exhibit IV-7 and Exhibit IV-8; the pro forma valuation calculations relative to the Peer Group based on reported financials are shown in Table 4.6 and are detailed in Exhibits IV-10 and IV-11.