

# LAKE SHORE BANCORP, INC.

## FORM S-1 (Securities Registration Statement)

Filed 11/4/2005

Address	125 EAST FOURTH STREET DUNKIRK, New York 14048
Telephone	716-366-4070
CIK	0001341318
Fiscal Year	12/31

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

**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)

**To Be Applied For**  
(IRS Employer Identification No.)

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

**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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**Washington, D.C. 20015**  
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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. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) 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)
Common Stock				

\$0.01 par value	3,107,875	\$10.00	\$31,078,750	\$3,657.97
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- (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.

**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.**

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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 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 for trading 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 because 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, 200\_]. We may extend this expiration date without notice to you until [Date 2, 200\_], 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, 200\_]. If the offering is extended beyond [Date 2, 200\_], 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 and will earn interest at our passbook savings rate. If we terminate the offering, or if we extend the offering beyond [Date 2, 200\_] 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 87,600 shares, which equals 3.7% 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	\$ 1,454,000	\$ 1,489,000
Estimated net proceeds	\$ 17,733,000	\$ 24,421,000	\$ 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 23.

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 at \_\_\_\_\_.

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 23. 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 undergoing 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 reorganization and charter conversion, 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 foundation an amount of authorized but unissued shares that will equal 2% of the Lake Shore Bancorp common stock outstanding after the reorganization. After the reorganization, 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 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. We must sell at least 1,912,500 shares. 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 change or cancel your 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 on deposit as of September 30, 2005 (“supplemental eligible account holders”); and

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4. Lake Shore Savings' depositors as of December \_\_, 2005.

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 much 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, 200\_]. 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 at our administrative office, which is located at 31 East Fourth Street, Dunkirk, New York. Stock order forms may not be hand-delivered to our main office in Dunkirk or to Lake Shore Savings branches.

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

A: No. Once we receive your 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 options 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 using them for this type of purchase requires special arrangements and additional processing time. 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 \_\_\_\_\_, 200\_ end of the offering period. 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 intend 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).

**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

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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 (XXX) XXX-XXXX. You may also visit our Stock Information Center, which is located at our administrative office (not our main 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.

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### 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 (XXX) XXX-XXXX.*

### 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 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 offices 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 offices 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. We conduct operations from seven full service branch offices and eleven ATMs located in Chautauqua and Erie Counties, New York. As of June 30, 2005, we had total assets of \$332.0 million, deposits of \$247.4 million and total equity of \$27.8 million.

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Our corporate offices 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](http://www.lakeshoresavings.com).

### The Lake Shore Charitable Foundation

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 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 foundation with 100,000 shares of our common stock at the midpoint of the offering range. Our contribution to the foundation would reduce net earnings by \$615,000, after tax, in the year in which the 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. The amount of common stock that we would offer for sale in the offering would be greater if the offering were to be completed without the contribution to The Lake Shore Charitable Foundation. The establishment of the 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 foundation, including its effect on those who purchase shares in the offering, see "*Comparison of Valuation and Pro Forma Information With and Without Foundation*" on page 45.

### 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.

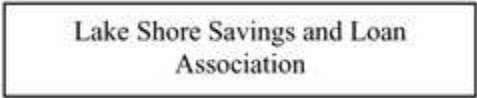
THE REORGANIZATION

Description of the Reorganization

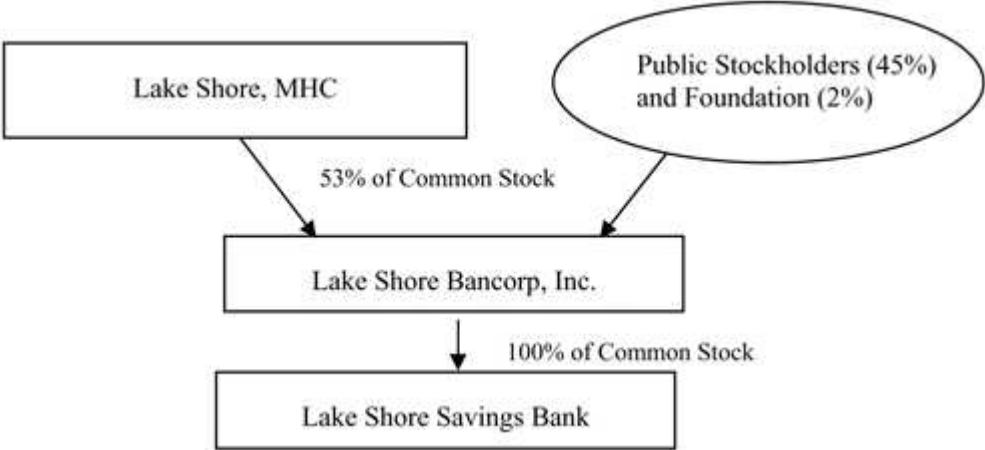
Currently, we are a New York-chartered mutual savings and loan association with no stockholders. Our depositors currently have the right to vote on certain matters such as the election of directors. The mutual holding company reorganization and charter conversion process that we are now undertaking involves a series of transactions by which we will convert our organization 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 charts show our current organizational structure and our organizational structure after the reorganization.

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 the reorganization.

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### Reasons for the Reorganization

Our primary reasons for the reorganization 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 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 this 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 15.0%, 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 rescind 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, LC., a firm experienced in appraisals of financial institutions. RP Financial, LC. is of the opinion that as of September 30, 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, LC. 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, LC. considered the information contained in this prospectus, including Lake Shore Savings’ financial statements. RP Financial, LC. 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, LC., the board of directors considered the methodologies and the appropriateness of the assumptions used by RP Financial, LC. 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 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;
- 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.

Under such circumstances, we will notify you, and, unless we terminate the plan of reorganization, you will have the opportunity to change 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.

The following table presents a summary of selected pricing ratios for the peer group companies in their current structure, as publicly-traded mutual holding companies, and the pro forma pricing ratios for Lake Shore Bancorp as calculated by RP Financial in its appraisal. These ratios are based on earnings for the twelve months ended June 30, 2005 and book value as of June 30, 2005.

	Price To Earnings Multiple	Price To Book Value Ratio
<b>Lake Shore Bancorp (pro forma):</b>		
Maximum	23.89x	116.69%
Minimum	17.86x	98.14%
<b>Peer group companies as of September 30, 2005:</b>		
Average	28.17x	169.69%
Median	27.92x	151.52%

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 September 30, 2005. RP Financial's calculation of the fully-converted pricing multiples for Lake Shore Bancorp assumes the pro forma impact of selling 100% of the shares 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 14.2% on a price-to-earnings basis and a discount of 14.9% on a price-to-book basis. At the minimum and maximum of the valuation range, a share of common stock is priced at 16.92 times and 22.31 times Lake Shore Bancorp's earnings. The peer group companies, as of September 30, 2005, traded on average at 26.01 times earnings. The median trading price of the peer group common stock was at 25.72 times earnings. At the minimum and



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maximum of the valuation range, the common stock is valued at 67.17% and 75.8% 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 September 30, 2005, averaged 89.10%. As of September 30, 2005, the median trading price of peer group companies was 85.87% 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
<b>Lake Shore Bancorp</b>		
Maximum	22.31x	75.86%
Minimum	16.92x	67.17%
<b>Valuation of peer group companies as of September 30, 2005:</b>		
Average	26.01x	89.10%
Medians	25.72x	85.87%

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 5.1% 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 recognition and retention 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 September 30, 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 September 30, 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 September 30, 2005

Company Name	Ticker	IPO Date	Price Performance from Initial Trading Date (1)			
			1 Day	1 Week	1 Month	Through September 30, 2005
Ottawa Savings Bancorp, Inc.	OTTW	07/14/05	4.0%	5.0%	7.0%	7.5%
United Financial Bancorp, Inc.	UBNK	07/13/05	17.5%	16.0%	17.0%	11.1%
Heritage Financial Group	HBOS	06/30/05	7.5%	7.5%	9.3%	10.1%
Colonial Bancshares, Inc.	COBK	06/30/05	6.0%	9.9%	7.5%	5.7%
North Penn Bancorp, Inc.	NPEN	06/02/05	10.0%	2.5%	1.5%	1.5%
Rockville Financial, Inc.	RCKB	05/23/05	4.8%	10.5%	20.0%	33.4%
FedFirst Financial Corp.	FFCO	04/07/05	-6.6%	-9.3%	-14.5%	-12.2%
Brooklyn Federal Bancorp, Inc.	BFSB	04/06/05	-0.5%	-1.0%	-5.0%	16.9%
Prudential Bancorp of PA Inc.	PBIP	03/30/05	-1.5%	-6.5%	-12.5%	19.5%
Kentucky First Federal Bancorp	KFFB	03/03/05	7.9%	12.0%	12.4%	-0.4%
Kearny Financial Corp.	KRNY	02/24/05	13.9%	15.0%	11.3%	25.0%
Home Federal Bancorp of LA	HFBL	01/21/05	-1.0%	0.5%	-0.8%	-2.0%
BV Financial, Inc.	BVFL	01/14/05	-6.5%	-5.0%	-0.7%	-13.0%
Georgetown Bancorp, Inc.	GTWN	01/06/05	2.0%	-0.5%	0.5%	-9.0%
SFSB, Inc.	SFBI	12/31/04	7.5%	-0.9%	-1.5%	-9.0%
Ocean Shore Holding Co.	OSHC	12/22/04	21.5%	22.0%	6.3%	12.0%
Lincoln-Park Bancorp, Inc.	LPBC	12/20/04	10.0%	12.5%	0.0%	-10.0%
Abington Community Bancorp, Inc.	ABBC	12/17/04	33.5%	33.0%	29.0%	25.3%
Home Federal Bancorp, Inc.	HOME	12/07/04	24.9%	26.8%	23.3%	27.0%
Atlantic Coast Federal Corp.	ACFC	10/05/04	5.0%	6.0%	5.0%	5.0%
PSB Holdings, Inc.	PSBH	10/05/04	17.5%	23.1%	30.0%	39.7%
Naugatuck Valley Financial Corp.	NVSL	10/01/04	8.0%	8.1%	8.0%	30.7%
SI Financial Group Inc.	SIFI	10/01/04	12.0%	10.6%	10.3%	23.5%
First Federal Financial Services, Inc.	FFFS	06/29/04	15.0%	22.5%	35.0%	32.5%
Monadnock Community Bancorp, Inc.	MNCK	06/29/04	3.8%	0.0%	-3.8%	-12.5%
Osage Federal Financial, Inc.	OFFO	04/01/04	29.5%	25.0%	12.5%	5.0%
Wawel Savings Bank	WAWL	04/01/04	20.0%	22.5%	9.5%	35.5%
K-Fed Bancorp	KFED	03/31/04	34.9%	29.3%	15.9%	25.1%
Citizens Community Bancorp	CZWI	03/30/04	23.7%	27.5%	18.0%	25.0%
Clifton Savings Bancorp, Inc.	CSBK	03/04/04	22.5%	37.8%	32.9%	3.0%
Cheviot Financial Corp	CHEV	01/06/04	33.2%	33.5%	34.2%	11.2%
Average			12.3%	12.8%	10.2%	11.7%
Median			10.0%	10.6%	9.3%	11.1%

*This table is not intended to be indicative of how our stock may perform. 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

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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 prospectus, including, but not limited to, the section entitled "*Risk Factors*" beginning on page 23.

You should be aware that, in certain market conditions, stock prices of initial public offerings have decreased. For example, as the table above illustrates, the stock of 10 companies traded at or below their initial offering price at various times through September 2005. We can give you no assurance that our 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 our outstanding deposits; or
  - 75% of the amount of all our 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 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.

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

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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 options 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 plan with treasury shares acquired from stock repurchases if the issuance of authorized but unissued shares under the plan 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 sooner 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.

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.

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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 and retention 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	Employees	\$ 2,162
112,700	Stock awards	Directors, officers and employees	1,127
281,750	Stock options	Directors, officers and employees	1,076

- (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 \$3.82 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 4.03% (based on the 10 year Treasury Note rate); and a volatility rate of 15.19% 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	\$ 3.06	\$ 637	\$ 750	\$ 862	\$ 991
\$ 10.00	\$ 3.82	\$ 796	\$ 936	\$ 1,076	\$ 1,238
\$ 12.00	\$ 4.58	\$ 954	\$ 1,122	\$ 1,290	\$ 1,484
\$ 14.00	\$ 5.35	\$ 1,114	\$ 1,311	\$ 1,507	\$ 1,733

### 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 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 U.S. federal tax law, 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 September 30, 2005, “supplemental eligible account holders”; and
4. Lake Shore Savings’ depositors as of December \_\_, 2005.

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 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 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 accounts with check writing privileges (checking and 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. 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 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 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 office in Dunkirk or to 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 your Lake Shore Savings individual retirement account to pay for your shares, 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 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 \_\_\_\_\_, 200\_\_ end of the offering period, 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 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.

### Delivery of Prospectus

To ensure that you receive a prospectus at least 48 hours before \_\_\_\_\_, 200\_\_, 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 [\_\_\_\_\_].

The Office of Thrift Supervision approved the offering on \_\_\_\_\_, 2005; 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 [\_\_\_\_\_].

### Expiration of the Offering

The subscription offering will expire at 11:00 a.m., Eastern time, on \_\_\_\_\_. The community offering, if any, may also 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.

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If the offering extends beyond \_\_\_\_\_, we will be required to resolicit subscribers allowing them an opportunity to increase, decrease, 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 list our common stock for trading on the Nasdaq National Market under the trading symbol "LSBK." Ryan Beck & Co., Inc. currently intends to become a market maker in the 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
	(In thousands)	
Gross offering proceeds	\$ 19,125	\$ 25,875
Less: offering expenses	1,392	1,454
Net offering proceeds	17,733	24,421
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	\$ 9,948

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.

### Directors and Executive Officers Intend to Subscribe for 87,600 Shares

Our directors and executive officers, together with their associates, are expected to subscribe for 87,600 shares, which represents 3.7% 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.

### 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. Lake

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Shore, MHC would cease to exist. Our public stockholders would own approximately the same percentage of Lake Shore Bancorp as they owned before 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 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 (XXX) XXX-XXXX. You may also visit our Stock Information Center, which is located at our administrative office (not our main 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 Opened New Branches And Expect To Open Additional New Branches Which Will Reduce Our Profitability In The Near Term As They Generate New Deposits And Loans.***

We opened two new branches in Orchard Park and East Amherst, New York in 2003 and expect to open 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 proposed 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.

***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.

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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.

***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, earn less income for us 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.

***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 and directors of options to purchase common stock of up to 4.90% of the shares 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 and directors of up to 1.96% of the shares 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 shares. These plans will increase our future costs of compensating our officers and directors, thereby reducing our earnings. In addition, stockholders will experience a reduction in ownership interest in the event newly-issued shares are used to fund stock options and restricted stock awards.

***A Breach Of Information Security Could Negatively Affect Our Business.*** We depend on data processing, communication and information exchange on a variety of computing platforms and networks and over the internet. We cannot be certain all of our systems are entirely free from vulnerability to attack, despite safeguards we have installed. Additionally, we rely on a variety of third-party service providers for our data and communications needs. If information security is breached, information can be lost or misappropriated, resulting in financial loss or costs to us or damages to others. These costs or losses could materially exceed our amount of insurance coverage, if any, which would adversely affect our business.

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***If We Fail To Maintain An Effective System Of Internal Controls, We May Not Be Able To Accurately Report Our Financial Results Or Prevent Fraud. As A Result, Current And Potential Stockholders Could Lose Confidence In Our Financial Reporting, Which Would Harm Our Business.*** Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results could be harmed. We devote significant attention to establishing and maintaining effective internal controls. We will have to document, review and, if appropriate, improve our internal controls and procedures in connection with Section 404 of the Sarbanes-Oxley Act of 2002, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments. Both we and our independent auditors will be testing our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify areas for further attention or improvement. Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers and employees, entail substantial costs in order to modify our existing accounting systems, and take a significant period of time to complete. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial reporting processes and related Section 404 reporting requirements. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. Any such failure could also adversely affect our assessment of the effectiveness of our “internal control over financial reporting” that will be required when the Section 404 requirements become applicable to us beginning with the filing of our Annual Report on Form 10-K for the year ending December 31, 2007. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the market price of our stock.

***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 increased capital from this offering into high-yielding earning assets. 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.

***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.*** 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.

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***Stock Market Volatility May Affect The Price Of Your Common Stock.*** Publicly-traded stocks have recently experienced substantial market price volatility. These market fluctuations may be unrelated to the operating performance of particular companies whose shares are traded. The purchase price of our common stock in the offering is based on the independent appraisal by RP Financial. After your shares begin trading, the trading price of your common stock will be determined by the marketplace, and may be influenced by many factors, including prevailing interest rates, investor perceptions of us, and general industry and economic conditions. If market volatility continues, it may affect the price of your common stock.

***In The Future, We May Issue Additional Shares Of Common Stock Or Securities Convertible Into Common Stock To Raise Additional Capital. If We Are Able To Sell Such Shares, They May Be Issued At A Price That Dilutes The Book Value Of Shares Outstanding At That Time.*** We may make future offerings at a price that dilutes the book value of shares outstanding at that time. Any such issuance of additional capital would most likely be caused by our regulatory capital requirements. Our future capital requirements will depend on many factors including:

- the growth in Lake Shore Savings' interest-earning assets;
- loan quality;
- the cost of deposits and any necessary borrowings; and
- the costs associated with our growth, such as increased salaries and employee benefits expense and office and occupancy costs.

If these or other factors cause Lake Shore Savings' capital levels to fall below the minimum regulatory requirements, or if Lake Shore Savings' existing sources of cash from operations are insufficient to fund its activities or future growth plans, we may need to raise additional capital. If such need arises and we are unable to raise capital, we may not be able to continue our growth strategy and management will be required to reorient its long term strategy. There can be no assurance that we will be able to generate or attract additional capital in the future on favorable terms. In addition, future issuances of stock may cause dilution in our earnings per share and will dilute your ownership interest.

***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*.”



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***Our Certificate Of Incorporation, 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 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 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 some provisions of the 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 Foundation**

***The Donation To The Lake Shore Charitable Foundation Will Hurt Our Profits For Fiscal Year 2006 And Means That A Stockholder's Ownership Interest Will Be Up To 4.3% Less After The Donation.***

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 donation 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 donation to the charitable foundation, see “*Pro Forma Data*” and “*Comparison of Valuation and Pro Forma Information With and Without Foundation.*”

***Our Donation To The Lake Shore Charitable Foundation May Not Be Tax Deductible, Which Could Hurt Our Profits.***

We believe that our donation 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 foundation. If the donation is not deductible, we would not receive any tax benefit from the donation. In addition, even if the donation is tax deductible, we may not have sufficient profits to be able to use the deduction fully.

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### Risks Related To The Banking Industry

***We Operate In A Highly Regulated Environment And We May Be Adversely Affected By Changes In Laws And Regulations.*** We are subject to extensive regulation, supervision and examination by the Office of Thrift Supervision and by the Federal Deposit Insurance Corporation, as insurer of deposits. Such regulation and supervision governs the activities in which we and Lake Shore Savings may engage and are intended primarily for the protection of the insurance fund and deposits of Lake Shore Savings. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of Lake Shore Savings, the classification of its assets and the adequacy of its allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, including changes in the regulations governing holding companies, could have a material impact on the combined operations of us and Lake Shore Savings.

***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.

***Recession And World Events Could Affect Our Earnings.*** The effects of a recession or a weak economy could significantly affect our operations and profitability. For example, higher unemployment and reduced business sales of profits can make it more difficult for borrowers to repay their loans. Similarly, reduced income or confidence can lead consumers to reduce their purchases, and thus reduce loan demand. In addition, we, and the economy as a whole, may be affected by future world events, such as acts of terrorisms, developments in the war on terrorism and U.S. foreign policy.

**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 and prospects and 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 23.

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### 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 June 30, 2005 and for the six months ended June 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 six-month period ended June 30, 2005 are not necessarily indicative of the results that may be expected for the entire year.

	At June 30, 2005	At December 31,					
		2004	2003	2002	2001	2000	
	(Unaudited)	(Dollars in thousands)					
Selected financial condition data:							
Total assets	\$ 332,039	\$ 329,841	\$ 303,511	\$ 238,056	\$ 214,086	\$ 201,759	
Loans, net	200,008	199,525	187,138	156,740	144,600	128,991	
Securities available for sale	96,396	99,170	83,027	52,225	41,934	46,892	
Securities held to maturity	2,320	2,359	371	765	1,118	1,432	
Federal Home Loan Bank stock	2,569	2,709	2,167	1,420	1,162	1,034	
Total cash and cash equivalents	16,017	11,577	16,753	16,238	14,269	13,415	
Total deposits	247,425	243,554	230,495	195,092	182,066	172,062	
Short-term borrowings	9,525	11,725	11,800	4,005	1,115	475	
Long-term debt	41,860	42,260	31,535	11,535	5,540	6,665	
Total equity	27,802	26,915	24,947	23,942	21,705	19,405	
Allowance for loan losses	1,273	1,288	1,293	1,217	924	797	
Non-performing loans	1,048	792	1,052	1,408	1,402	880	
Non-performing assets	1,259	934	1,538	1,524	1,510	891	
	For the six months ended June 30,	For the year ended December 31,					
	2005	2004	2004	2003	2002	2001	2000
	(Unaudited)	(Dollars in thousands)					
Selected operating data:							
Interest income	\$ 7,791	\$ 7,122	\$ 14,744	\$ 12,780	\$ 13,182	\$ 14,215	\$ 13,862
Interest expense	2,989	2,550	5,332	4,694	4,946	7,053	6,860
Net interest income	4,802	4,572	9,412	8,086	8,236	7,162	7,002
Provision for loan losses	20	170	267	345	360	325	201
Net interest income after provision for loan losses	4,782	4,402	9,145	7,741	7,876	6,837	6,801
Total non-interest income	887	909	1,875	1,728	1,646	1,820	1,339
Total non-interest expense	4,080	3,964	7,939	7,218	6,201	5,576	5,449
Income before income taxes	1,589	1,347	3,081	2,251	3,321	3,081	2,691
Income taxes	513	419	902	744	1,085	1,018	898
Net income	\$ 1,076	\$ 928	\$ 2,179	\$ 1,507	\$ 2,236	\$ 2,063	\$ 1,793

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	For the six months ended June 30,		For the year ended December 31,				
	2005	2004	2004	2003	2002	2001	2000
<b>Selected financial ratios and other data(1)</b>							
<b>Performance ratios:</b>							
Return on average assets	0.66%	0.60%	0.68%	0.58%	1.00%	0.99%	0.92%
Return on average equity	7.90%	7.33%	8.45%	6.24%	9.97%	10.37%	10.92%
Interest rate spread(2)	2.98%	3.04%	3.03%	3.18%	3.68%	3.25%	3.58%
Net interest margin(3)	3.13%	3.14%	3.15%	3.32%	3.95%	3.70%	3.91%
Efficiency ratio(4)	71.72%	72.32%	70.34%	73.55%	62.75%	62.08%	65.33%
Non interest expense to average total assets	2.49%	2.54%	2.48%	2.76%	2.77%	2.67%	2.80%
Average interest-earning assets to average interest-bearing liabilities	107.20%	105.89%	106.35%	107.49%	111.21%	112.40%	108.69%
<b>Capital ratios:</b>							
Total risk-based capital to risk weighted assets	16.67%	16.42%	16.34%	16.41%	18.47%	17.84%	15.57%
Tier 1 risk-based capital to risk weighted assets	15.58%	15.21%	15.18%	15.23%	17.10%	16.75%	14.41%
Tangible capital to tangible assets	8.25%	7.91%	7.99%	7.99%	9.56%	9.53%	9.12%
Tier 1 leverage (core) capital to adjustable tangible assets	8.25%	7.91%	7.99%	7.99%	9.56%	9.53%	9.12%
Equity to total assets	8.37%	7.90%	8.16%	8.22%	10.06%	10.14%	9.62%
<b>Asset quality ratios:</b>							
Non-performing loans as a percent of loans	0.52%	0.51%	0.40%	0.56%	0.90%	0.97%	0.68%
Non-performing assets as a percent of total assets	0.38%	0.35%	0.28%	0.50%	0.64%	0.71%	0.44%
Allowance for loan losses as a percent of total net loans	0.64%	0.72%	0.65%	0.69%	0.78%	0.64%	0.62%
Allowance for loan losses as a percent of non-performing loans	121.47%	141.27%	162.63%	122.91%	86.43%	65.91%	90.57%
<b>Other data:</b>							
Number of full service offices	7	7	7	7	5	5	5

(1) Six-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 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 Minimum of Offering Range		2,250,000 Shares at Midpoint of Offering Range		2,587,500 Shares at Maximum of Offering Range		2,975,625 Shares 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	217		248		279		314	
Other estimated offering expenses	1,175		1,175		1,175		1,175	
Total estimated offering expenses	1,392		1,423		1,454		1,489	
Net offering proceeds	17,733	100.0%	21,077	100.0%	24,421	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%	\$ 8,558	40.6%	\$ 9,948	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 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.

Initially, both we 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 debt and equity 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. 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,

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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 or would impair the liquidation account to be established for the benefit of the Lake Shore Savings’ eligible account holders and supplemental eligible account holders at the time of the reorganization and offering. 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 the common stock.



## REGULATORY CAPITAL COMPLIANCE

At June 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 June 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 June 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 ESOP and the cost of shares expected to be acquired by the new 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 June 30, 2005

	Actual, As of June 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	\$27,802	8.37%	\$34,237	10.07%	\$35,480	10.39%	\$36,723	10.70%	\$38,153	11.06%
Tangible Capital (3)	\$27,349	8.25%	\$33,783	9.95%	\$35,026	10.27%	\$36,269	10.58%	\$37,699	10.94%
Requirement	4,974	1.50%	5,095	1.50%	,118	1.50%	5,140	1.50%	5,167	1.50%
Excess	\$22,375	6.75%	\$28,688	8.45%	\$29,908	8.77%	\$31,129	9.08%	\$32,532	9.44%
Tier 1 (Leverage)(4)	\$27,349	8.25%	\$33,783	9.95%	\$35,026	10.27%	\$36,269	10.58%	\$37,699	10.94%
Requirement	13,264	4.00%	13,586	4.00%	13,647	4.00%	13,708	4.00%	13,778	4.00%
Excess	\$14,085	4.25%	\$20,197	5.95%	\$21,379	6.27%	\$22,561	6.58%	\$23,921	6.94%
Tier 1 Risk Based (5)	\$27,349	15.58%	\$33,783	18.82%	\$35,026	19.43%	\$36,269	20.04%	\$37,699	20.72%
Requirement	7,019	4.00%	7,180	4.00%	7,211	4.00%	7,241	4.00%	7,276	4.00%
Excess	\$20,330	11.58%	\$26,603	14.82%	\$27,815	15.43%	\$29,028	16.04%	\$30,423	16.72%
Total Risk-Based	\$29,262	16.68%	\$35,697	19.89%	\$36,940	20.49%	\$38,183	21.09%	\$39,613	21.78%
Risk-Based Requirement	14,039	8.00%	14,360	8.00%	14,421	8.00%	14,482	8.00%	14,552	8.00%
Excess	\$15,223	8.68%	\$21,337	11.89%	\$22,519	12.49%	\$23,701	13.09%	\$25,061	13.78%

- (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.

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### CAPITALIZATION

The following table presents the historical capitalization of Lake Shore Savings at June 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 June 30, 2005			
	Actual, As of June 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)	\$ 247,425	\$247,425	\$247,425	\$247,425	\$ 247,425
Long-term debt	41,860	41,860	41,860	41,860	41,860
Total deposits and borrowed funds.	\$ 289,285	\$289,285	\$289,285	\$289,285	\$ 289,285
Stockholders' equity:					
Common stock, \$0.10 par value, 25,000,000 shares authorized; shares to be issued as reflected(3)	—	43	50	58	66
Additional paid-in capital (4).	—	18,440	21,927	25,413	29,424
Retained earnings (5)	27,349	27,349	27,349	27,349	27,349
Less:					
Expense of stock contribution to foundation	—	(850)	(1,000)	(1,150)	(1,323)
Expense of Cash Contribution to Foundation	—	—	—	—	—
Plus:					
Tax benefit of contribution to foundation	—	327	385	443	509
Accumulated other comprehensive income (6)	453	453	453	453	453
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	\$ 27,802	\$ 43,331	\$ 46,304	\$ 49,277	\$ 52,696

- (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 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 on securities classified as available-for-sale, net of related taxes.
- (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.

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- (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 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;
- 87,600 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 six months ended June 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 3.51% for the six months ended June 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 June 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 2.16% for the six months ended June 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. 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 six months ended June 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)	(1,423)	(1,454)	(1,489)
Estimated net proceeds	\$ 17,733	\$ 21,077	\$ 24,421	\$ 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	\$ 18,117	\$ 21,032	\$ 24,385
For the six months ended June 30, 2005:				
Consolidated net income				
Historical	\$ 1,076	\$ 1,076	\$ 1,076	\$ 1,076
Pro forma income on net proceeds	164	196	227	263
Pro forma employee stock ownership plan adjustment (2)	(17)	(20)	(22)	(25)
Pro forma management recognition plan adjustment (3)	(51)	(60)	(69)	(80)
Pro forma options adjustment (4)	(70)	(83)	(95)	(109)
Pro forma net income	\$ 1,102	\$ 1,109	\$ 1,117	\$ 1,125
Per share net income (reflects SOP 93-6):				
Historical	\$ 0.26	\$ 0.22	\$ 0.19	\$ 0.17
Pro forma income on net proceeds, as adjusted	0.04	0.04	0.04	0.04
Pro forma employee stock ownership plan adjustment (2)	—	—	—	—
Pro forma management recognition plan adjustment (3)	(0.01)	(0.01)	(0.01)	(0.01)
Pro forma stock option adjustment(4)	(0.02)	(0.02)	(0.02)	(0.02)
Pro forma net income per share	\$ 0.27	\$ 0.23	\$ 0.20	\$ 0.18
Offering price as a multiple of pro forma net earnings per share	18.52x	21.74x	25.00x	27.78x
Number of shares outstanding for pro forma net income per share calculations	4,091,532	4,813,567	5,535,602	6,365,942

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At June 30, 2005:

Stockholders' equity:

Historical	\$ 27,802	\$ 27,802	\$ 27,802	\$ 27,802
Estimated net proceeds	17,733	21,077	24,421	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	\$ 43,331	\$ 46,304	\$ 49,277	\$ 52,696

Stockholders' equity per share (does not reflect SOP 93-6)

Historical	\$ 6.54	\$ 5.56	\$ 4.84	\$ 4.20
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	\$ 10.19	\$ 9.26	\$ 8.57	\$ 7.95

Offering price as a percentage of pro forma stockholders' equity per share

	98.14%	107.99%	116.69%	125.79%
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Number of shares outstanding for pro forma book value per share calculations

	4,250,000	5,000,000	5,750,000	6,612,500
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(1) As adjusted to give effect to a 15% increase in the number of shares outstanding after the offering 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 plus 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 six months ended June 30, 2005, and was made at the end of the period; (ii) 2,663 shares at the minimum of the offering range, 3,133 shares at the midpoint of the offering range, 3,603 shares at the maximum of the offering range and 4,144 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 six months ended June 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.

(footnotes continue on next page)

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- (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. 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 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 \$3.82 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 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)	(1,423)	(1,454)	(1,489)
Estimated net proceeds	\$ 17,733	\$ 21,077	\$ 24,421	\$ 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	\$ 18,117	\$ 21,032	\$ 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)	(32)	(39)	(44)	(51)
Pro forma management recognition plan adjustment (3)	(102)	(121)	(139)	(159)
Pro forma stock option adjustment(4)	(141)	(166)	(190)	(219)
Pro forma net income	\$ 2,161	\$ 2,159	\$ 2,162	\$ 2,162
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 earnings per share	18.87x	22.22x	25.64x	29.41x
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	21,077	24,421	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	\$ 45,417	\$ 48,390	\$ 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 after the offering 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 plus 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 six months ended June 30, 2005, and was made at the end of the period; (ii) 5,327 shares at the minimum of the offering range, 6,266 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. 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 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 \$3.82 for each option, the aggregate				

grant-date fair value of the stock options was amortized to expense on a

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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 foundation stockholders.

### COMPARISON OF VALUATION AND PRO FORMA INFORMATION WITH AND WITHOUT 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 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	\$347,568	\$348,430	\$350,541	\$351,555	\$353,514	\$354,680	\$356,933	\$358,273
Total liabilities	\$304,237	\$304,237	\$304,237	\$304,237	\$304,237	\$304,237	\$304,237	\$304,237
Pro forma stockholders' equity	\$ 43,331	\$ 44,193	\$ 46,304	\$ 47,318	\$ 49,277	\$ 50,443	\$ 52,696	\$ 54,036
Pro forma net income (six months ended June 30, 2005)	\$ 1,102	\$ 1,112	\$ 1,109	\$ 1,121	\$ 1,117	\$ 1,131	\$ 1,125	\$ 1,140
Pro forma stockholders' equity per share	\$ 10.19	\$ 10.19	\$ 9.26	\$ 9.27	\$ 8.57	\$ 8.59	\$ 7.95	\$ 8.01
Pro forma net income per share (six months ended June 30, 2005)	\$ 0.27	\$ 0.27	\$ 0.23	\$ 0.23	\$ 0.20	\$ 0.20	\$ 0.18	\$ 0.18

#### Pro Forma Pricing Ratios

Offering price as a percentage of pro forma stockholders' equity per share	98.14%	98.14%	107.99%	107.87%	116.69%	116.41%	125.79%	124.84%
Offering price to pro forma net income per share	18.52	18.52	21.74	21.74	25.00	25.00	27.78	27.78

#### Pro Forma Financial Ratios

Return on assets (annualized)	0.63%	0.64%	0.63%	0.64%	0.63%	0.64%	0.63%	0.64%
Return on equity (annualized)	5.09%	5.03%	4.79%	4.74%	4.53%	4.48%	4.27%	4.22%
Equity/assets	12.47%	12.68%	13.21%	13.46%	13.94%	14.22%	14.76%	15.08%

### 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 six months ended June 30, 2005 and the year ended December 31, 2004, our net income was \$1.1 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 seven branches. Since 1998 our asset size has more than doubled and we have opened two new branches. We expect to open an eighth branch in December 2005.

#### 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 \$27.5 million and \$18.6 million as of June 30, 2005, respectively. We also expect to open an additional new 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 and Orchard Park in Erie County, New York. Saturation of the

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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 June 30, 2005, December 31, 2004 and December 31, 2003, we held \$143.7 million, \$142.2 million and \$135.3 million of residential mortgage loans, respectively, which constituted 71.8%, 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 June 30, 2005 and December 31, 2004, our commercial real estate loan portfolio consisted of loans totaling \$14.6 million and \$15.3 million respectively, or 7.3% 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 June 30, 2005 and December 31, 2004, our commercial loan portfolio consisted of loans totaling \$8.0 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 June 30, 2005, our investment securities totaled \$101.3 million. Investment securities available for sale, which constituted approximately 95% of investment securities, totaled \$96.4 million at June 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 June 30, 2005, we had total Federal Home Loan Bank borrowings of \$51.4 million with an average interest rate of 3.52%. Second, we have engaged a third party financial advisor to assist us in investing such borrowed funds in attractive permissible investment securities. At June 30, 2005, we had \$96.4 million in investment in securities available for sale, the majority of which are mortgage-backed or asset backed securities.

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**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 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. 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 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,



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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.

### 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

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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 June 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 June 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	\$23,571	\$(16,751)	(42%)	\$21,985	\$(17,304)	(44%)
+200	29,687	(10,635)	(26%)	28,435	(10,854)	(28%)
+100	35,504	(4,818)	(12%)	34,441	(4,848)	(12%)
0	40,322	—	—	39,289	—	—
-100	41,743	1,421	4%	40,957	1,668	4%

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

### 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-earnings assets and average cost of interest-bearing liabilities, interest earned and interest paid for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods presented. Average balances are derived from daily balances over the periods indicated. The average balances for loans are net of allowance for loan losses, but include non-accrual loans. Interest income on securities include a tax equivalent adjustment for bank qualified municipals.

<b>At June 30, 2005</b>		<b>For the six months ended June 30, 2005</b>			<b>For the six months ended June 30, 2004</b>			<b>For the Year ended December 31, 2004</b>			<b>For the Year ended December 31, 2003</b>			<b>For th Decer</b>
<b>Actual Balance</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>Interest Expense</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>Interest Expense</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>Interest Income/ Expense</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>	<b>Interest Income/ Expense</b>	<b>Yield/ Rate</b>	<b>Average Balance</b>
(Dollars in thousands)														

Interest-earning assets:

Interest-earning assets:																	
Interest-bearing deposits	\$ 2,593	—	\$ 2,069	—	—	\$ 1,492	—	—	\$ 1,142	—	—	\$ 1,709	—	—	\$ 1,466	—	—
Federal funds sold	6,413	1.90%	4,551	61	2.68%	10,450	52	1.00%	8,251	101	1.22%	10,651	122	1.15%	10,909	—	—
Securities	101,285	3.83%	101,825	1,956	3.84%	90,636	1,639	3.61%	96,075	3,541	3.69%	68,026	2,586	3.80%	46,692	—	—
Loans	200,008	5.77%	198,768	5,774	5.81%	188,342	5,431	5.77%	193,435	11,102	5.74%	162,886	10,072	6.18%	149,418	—	—
Total interest-earning assets	310,299	5.02%	307,213	7,791	5.07%	290,920	7,122	4.90%	298,903	14,744	4.93%	243,272	12,780	5.25%	208,489	—	—
Other assets	21,740		20,855			20,786			20,681			17,965			15,600		
Total assets	\$332,039		\$328,068			\$311,706			\$319,584			\$261,237			\$224,089		

**Interest-bearing liabilities:**

[illegible]

bearing liabilities	365	6.58%	368	12	6.52%	383	12	6.27%	379	25	6.60%	164	25	15.24%	—
Total interest bearing liability	287,148	2.09%	286,580	2,989	2.09%	274,739	2,550	1.86%	281,064	5,332	1.90%	226,315	4,694	2.07%	187,461
Other non-interest bearing liabilities	17,089		14,245			11,662			12,737			10,764			14,190
Equity	27,802		27,243			25,305			25,783			24,158			22,430
Total liability and equity	\$332,039		\$328,068			\$311,706			\$319,584			\$261,237			\$224,081
Net interest income			\$4,802			\$4,572			\$ 9,412			\$ 8,086			
Interest rate spread				2.98%			3.04%			3.03%			3.18%		
Net interest margin				3.13%			3.14%			3.15%			3.32%		

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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.

	Six Months Ended June 30, 2005 Compared to Six Months Ended June 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)									
<b>Interest-earning assets:</b>									
Federal funds sold and other interest-bearing deposits	\$ 40	\$ (31)	\$ 9	\$ 10	\$ (31)	\$ (21)	\$ (61)	\$ —	\$ (61)
Securities	106	211	317	(81)	1,036	955	(870)	943	73
Loans deposits, including fees	40	303	343	(761)	1,791	1,030	(1,311)	897	(414)
<b>Total interest-earning assets</b>	<b>186</b>	<b>483</b>	<b>669</b>	<b>(832)</b>	<b>2,796</b>	<b>1,964</b>	<b>(2,242)</b>	<b>1,840</b>	<b>(402)</b>
<b>Interest-bearing liabilities:</b>									
Demand and NOW accounts	14	(1)	13	(76)	10	(66)	(159)	38	(121)
Money market accounts	6	4	10	(66)	65	(1)	(116)	28	(88)
Savings accounts	—	(3)	(3)	(132)	4	(128)	(169)	39	(130)
Time deposits	155	109	264	(431)	413	(18)	(803)	525	(278)
<b>Total deposits</b>	<b>175</b>	<b>109</b>	<b>284</b>	<b>(705)</b>	<b>492</b>	<b>(213)</b>	<b>(1,247)</b>	<b>630</b>	<b>(617)</b>
<b>Other interest-bearing liabilities:</b>									
Borrowed funds	89	62	151	(81)	927	846	(152)	496	344
Advances from borrowers on taxes and insurance and other interest-bearing liabilities	1	3	4	(22)	27	5	11	10	21

Total interest-bearing liabilities	265	174	439	(808)	1,446	638	(1,388)	1,136	(252)
Net change in interest income	\$ (79)	\$ 309	\$ 230	\$ (24)	\$ 1,350	\$ 1,326	\$ (854)	\$ 704	\$ (150)

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

Total assets at June 30, 2005 were \$332.0 million, an increase of \$2.2 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 \$4.4 million to \$16.0 million at June 30, 2005, from \$11.6 million at December 31, 2004. This is due to an increase in federal funds sold of \$3.6 million from \$2.8 million at December 31, 2004 to \$6.4 million at June 30, 2005 and an increase in our interest-bearing deposits from \$1.6 million at December 31, 2004, to \$2.6 million at June 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 \$2.9 million to \$101.3 million at June 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 June 30, 2005 as compared to \$99.2 million at December 31, 2004.

Loans receivable, net increased by \$483,000 to a total of \$200.0 million at June 30, 2005 from \$199.5 million at December 31, 2004. Home equity loans increased by \$870,000 from December 31, 2004 to June 30, 2005. Home equity loans represented 14.7% of our loan portfolio at June 30, 2005. Commercial real estate loans decreased by \$713,000 from December 31, 2004 to June 30, 2005 while residential mortgage loans increased by \$1.5 million. Mortgage loans and commercial real estate loans represented 71.9% and 7.3%, respectively, of the loan portfolio at June 30, 2005. Deferred loan fees increased by \$80,000 from \$891,000 at December 31, 2004 to \$971,000 at June 30, 2005 due to an increase in our loan volume. The allowance for loan losses decreased slightly by \$15,000 during the period from December 31, 2004 to June 30, 2005. The remainder of the portfolio consists of commercial, consumer and construction loans.

Deposits grew by \$3.8 million, or 1.6%, to \$247.4 million at June 30, 2005, as compared to \$243.6 million at December 31, 2004, primarily due to increased non-interest bearing deposit levels .

Our borrowings, consisting of advances from the Federal Home Loan Bank of New York, decreased by \$2.6 million from \$54.0 million at December 31, 2004 to \$51.4 million at June 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 \$887,000 from \$26.9 million at December 31, 2004 to \$27.8 million at June 30, 2005. The increase in total equity was primarily due to net income of \$1.1 million for the six months ended June 30, 2005 and to changes in the mark-to-market value of our available for sale investment securities for the six months ended June 30, 2005.

### Comparison of Results of Operations for the Six Months Ended June 30, 2005 and 2004

**General.** Net income was \$1.1 million for the six months ended June 30, 2005, an increase of \$148,000, or 15.9%, compared with net income of \$928,000 for the six months ended June 30, 2004. The increase in net income is attributable to increased interest income, offset in part by an increase in interest expense.

**Net Interest Income .** Net interest income increased by \$230,000, or 5.0%, to \$4.8 million for the six months ended June 30, 2005 as compared to \$4.6 million for the six months ended June 30, 2004.

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This increase reflects increased interest income of \$669,000 for the six months ended June 30, 2005, partially offset by an increase in interest expense of \$439,000.

**Interest Income.** Interest income increased \$669,000, or 9.4%, from \$7.1 million for the six months ended June 30, 2004 to \$7.8 million for the six months ended June 30, 2005. Approximately \$343,000 of this increase was attributable to an increase in interest on loans, the average balance of which increased by \$10.4 million over the year and had an average yield of 5.81% as compared to an average yield of 5.77% in the prior year. \$317,000 of the increase was attributable to an increase from interest on investment securities, the average balance of which increased by \$11.2 million over the year and had an average yield of 3.84% as compared to an average yield of 3.61% in the prior year.

**Interest Expense.** Interest expense increased by \$439,000, or 17.2%, from \$2.6 million for the six months ended June 30, 2004 to \$3.0 million for the six months ended June 30, 2005. The interest paid on deposits increased by \$284,000 from \$1.8 million for the six months ended June 30, 2004 to \$2.1 million for the six months ended June 30, 2005. This was due to an increase in the average yield paid on interest-bearing deposits over the year of 0.37% and an increase in the average balance of interest-bearing deposits of \$7.7 million over the year. The interest expense related to advances from the Federal Home Loan Bank of New York increased by \$151,000 from \$742,000 for the six months ended June 30, 2004 to \$893,000 for the six months ended June 30, 2005 as our borrowings increased in comparison to the prior year's six month period.

**Provision for Loan Losses.** For the six months ended June 30, 2005, the provision for loan losses was \$20,000, a decrease as compared to the provision for loan losses for the corresponding period in the prior year which was \$170,000. 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 adequacy of reserves already in place.

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.

**Non-interest Income.** For the six months ended June 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 \$887,000, whereas for the corresponding period in the prior year it totaled \$909,000. Income from fees and service charges increased by \$28,000 while net gains on sales of available for sale securities decreased by \$33,000 as no securities were sold during the current period.

**Non-interest Expense.** Non-interest expense increased \$116,000 from \$4.0 million for the six months ended June 30, 2004 to \$4.1 million for the six months ended June 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 \$66,000, or 76.7%, and salaries which increased \$52,000, or 2.4%. The increase in salaries and employee benefits was primarily due to annual salary increases.

**Income Tax Expense.** Income tax expense increased by \$94,000 from \$419,000 for the six months ended June 30, 2004 to \$513,000 for the six months ended June 30, 2005 due to increased net income.



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### 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. 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 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.

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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.

**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 adequacy of reserves already in place.

**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.

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### 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.

**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 adequacy of loan loss reserves already in place.

**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.

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**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.

**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 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 June 30, 2005, allowed us to borrow up to \$15.7 million on an overnight line of credit and \$15.7 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 June 30, 2005, we had outstanding advances totaling \$51.4 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 six months ended June 30, 2005, we originated loans of approximately \$17.5 million in comparison to approximately \$24.3 million of loans originated in the six months ended June 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 \$9.4 million in the six months ended June 30, 2005 and \$42.8 million in the year ended December 31, 2004.

At June 30, 2005, we had loan commitments to borrowers of approximately \$7.0 million and overdraft lines of protection and unused home equity lines of credit of approximately \$20.3 million.

Total deposits were \$247.4 million at June 30, 2005, as compared to \$243.6 million at December 31, 2004. Time deposit accounts scheduled to mature within one year were \$43.5 million at June 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,

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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 scheduled to open 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.

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

	Total	Payments due by Period:			
		1 year	(Dollars in thousands) 1-3 years	3-5 years	5 years
Long term debt	\$41,860	\$7,340	\$15,020	\$15,900	\$3,600
Capital Leases	552	40	80	86	346
Operating Leases	889	85	170	159	475
Data processing contract	968	261	544	163	—
Total contractual obligations	\$44,269	\$7,726	\$15,814	\$16,308	\$4,421

### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

### 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 seven 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 seven branch offices with an eighth opening in December of this year. 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.

### **Market Area**

Our operations are conducted out of our corporate headquarters in Dunkirk, New York and seven 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

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Park and East Amherst, which opened in April and August of 2003, respectively. We also have four stand-alone ATMs. We plan to open an additional office in Hamburg, New York, which is also in Erie County, in December 2005. 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, slated to open in December 2005, will be in Hamburg, New York, also located in Erie County.

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.

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



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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.
- 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 offices 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 June 30, 2005, we had total loans of \$200.3 million, of which \$143.7 million, or 71.8%, were one-to-four family residential mortgages. Of residential mortgage loans outstanding at that date, 5.7% were adjustable-rate mortgage loans and 94.3% were fixed rate loans.



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At June 30, 2005, 14.6% 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 June 30, 2005, amounting to \$27.3 million, or 13.6% of total loans, consisted of 7.3% commercial real estate loans, 1.1% 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 June 30,		At December 31,									
	2005		2004		2003		2002		2001		2000	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
(Dollars in thousands)												
Mortgage loans:												
One-to-four family	\$143,723	71.75%	\$142,222	71.14%	\$135,293	72.12%	\$107,115	68.01%	\$99,542	68.51%	\$88,427	
Commercial real estate	14,597	7.29	15,310	7.66	14,628	7.80	13,628	8.65	10,866	7.48	9,149	
Construction loans	2,173	1.08	2,463	1.23	2,531	1.35	3,300	2.10	2,739	1.88	2,539	
Home equity loans and lines of credit	29,312	14.63	28,442	14.23	25,876	13.79	23,742	15.07	21,085	14.51	21,042	
	<u>189,805</u>	<u>94.75</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>	
Other loans:												
Commercial loans	8,011	4.00	8,615	4.30	5,957	3.18	6,229	3.96	7,338	5.05	4,798	
Consumer loans	2,494	1.25	2,870	1.44	3,310	1.76	3,482	2.21	3,734	2.57	3,833	
	<u>10,505</u>	<u>5.25</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>	
Total loans	<u>200,310</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>	1
Less:												
Deferred loan costs (fees) (1)	971		891		836		461		220		—	
Allowance for loan losses	<u>(1,273)</u>		<u>(1,288)</u>		<u>(1,293)</u>		<u>(1,217)</u>		<u>(924)</u>		<u>(797)</u>	
Loans, net	<u>\$200,008</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 Six Months Ended June 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	14,649	21,547	40,737	85,146	52,320	43,921	34,472
Commercial and consumer loans	2,830	2,799	8,819	6,595	4,049	7,717	5,197
Total originations	17,479	24,346	49,556	91,741	56,369	51,638	39,669
Deduct:							
Principal repayments:							
Mortgage loans	13,905	15,196	31,235	48,338	39,609	29,535	22,935
Commercial and consumer loans	2,927	2,867	4,724	8,080	3,541	5,447	1,539
Total principal payments	16,832	18,063	35,959	56,418	43,150	34,982	24,474
Transfers to foreclosed real estate	96	129	374	761	302	373	238
Loan sales – Sonyma(1) and Freddie Mac	—	—	—	4,046	—	—	—
Loan sales – guaranteed student loans	121	473	592	603	405	354	1,128
Loans charged off	42	82	304	275	79	193	118
Total deductions	17,091	18,747	37,229	62,103	43,936	35,902	25,958
Balance outstanding at end of period	\$ 200,310	\$ 193,194	\$ 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 June 30, 2005, loans on one-to-four family residential properties accounted for \$143.7 million, or 71.8%, of our total loan portfolio. Of residential mortgage loans outstanding on that date and at December 31, 2004, 5.7% and 5.7%, respectively of our loans were adjustable rate mortgage loans and 94.3% and 94.3%, respectively, were fixed rate loans. At June 30, 2005, approximately 85% 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 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.

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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 \$29.3 million and \$28.4 million at June 30, 2005 and December 31, 2004, respectively. Approximately 20% of such loans have adjustable rates and 80% have fixed rates. At June 30, 2005 and December 31, 2004, such loans constituted 14.6% and 14.2% of our total loan portfolio.

**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 June 30, 2005 and December 31, 2004, our commercial real estate loan portfolio consisted of loans totaling \$14.6 million and \$15.3 million respectively, or 7.3% and 7.7%, respectively, of total loans. Of the commercial real estate portfolio at June 30, 2005, 94% consisted of loans that are collateralized by properties in Chautauqua County and 6% 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

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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 June 30, 2005 and December 31, 2004, our construction loan portfolio consisted of loans totaling \$2.2 million and \$2.5 million, respectively, or 1.1% 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 June 30, 2005 and December 31, 2004, our commercial loan portfolio consisted of loans totaling \$8.0 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.

**Consumer Loans.** We offer a variety of consumer loans. At June 30, 2005 and December 31, 2004, our consumer loan portfolio totaled \$2.5 million and \$2.9 million, respectively, or 1.3% 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;

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- 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, 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.

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**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 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 30<sup>th</sup> 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.** Loans are reviewed on a regular basis, and generally are placed on nonaccrual status when either the principal or interest is 90 days or more past due. Any payments made to a charged-off loan are credited to the allowance for loan losses reserve account. 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.

Non-performing assets totaled \$1.3 million at June 30, 2005 and \$934,000 at December 31, 2004.



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

	At June 30,		At December 31,			
	2005	2004	2003	2002	2001	2000
(Dollars in thousands)						
<b>Loans past due 90 days or more but still accruing:</b>						
Mortgage loans on real estate:						
One-to-four family	\$ 341	\$ 419	\$ 368	\$ 417	\$ 733	\$ 462
Construction	—	—	—	—	—	—
Commercial real estate	217	101	55	—	—	—
Home equity loans and lines of credit	23	106	31	81	151	16
Other loans:						
Commercial loans	33	—	—	7	—	—
Consumer loans	5	24	14	—	5	1
<b>Total</b>	<b>\$ 619</b>	<b>\$ 650</b>	<b>\$ 468</b>	<b>\$ 505</b>	<b>\$ 889</b>	<b>\$ 479</b>
<b>Loans accounted for on a nonaccrual basis:</b>						
Mortgage loans on real estate:						
One-to-four family	\$ 322	\$ 127	\$ 230	\$ 674	\$ 237	\$ 120
Construction	—	—	194	—	90	—
Commercial real estate	71	—	—	—	—	268
Home equity loans and lines of credit	35	6	8	118	—	—
Other loans:						
Commercial loans	—	—	126	94	161	—
Consumer loans	1	9	26	17	25	13
<b>Total non-accrual loans</b>	<b>429</b>	<b>142</b>	<b>584</b>	<b>903</b>	<b>513</b>	<b>401</b>
<b>Total nonperforming loans</b>	<b>1,048</b>	<b>792</b>	<b>1,052</b>	<b>1,408</b>	<b>1,402</b>	<b>880</b>
Foreclosed real estate	211	142	486	116	108	11
Restructured loans	—	—	—	—	—	—
<b>Total nonperforming assets</b>	<b>\$1,259</b>	<b>\$ 934</b>	<b>\$1,538</b>	<b>\$1,524</b>	<b>\$1,510</b>	<b>\$ 891</b>
<b>Ratios:</b>						
Nonperforming loans as a percent of gross loans:	0.52%	0.40%	0.56%	0.89%	0.97%	0.68%
Nonperforming assets as a percent of total assets:	0.38%	0.28%	0.51%	0.64%	0.71%	0.44%

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On a case by case basis, we stop accruing income on loans when interest or principal payments are 90 days in arrears. 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. We define non-performing loans as loans that are both non-accruing and accruing loans whose payments are 90 days or more past due.

We define impaired loans to be all “problem loans” where, based on current information and events, it is probable that we will not receive full payment of both principal and interest on the loan according to the contractual terms of the loan agreement. “Problem Loans” include:

- loans classified as Watch/Special Mention, Substandard or Doubtful/Loss/Impaired;
- all loans on non-accrual status;
- all other real estate owned assets resulting from foreclosure of collateral on former problem loans; and
- all lending relationships criticized or specially mentioned in our most recent audit.

We calculate a specific reserve on impaired credits to cover any anticipated loss. We consider a charge-off of the loan depending on the severity of the situation. Our recorded investment in loans that are considered impaired totaled \$429,000 and \$142,000 at June 30, 2005 and December 31, 2004, respectively. If all non-accrual loans had been current in accordance with their terms during the six months ended June 30, 2005 and the years ended December 31, 2004 and 2003, interest income on such loans would have amounted to \$46,000, \$51,000 and \$19,000, respectively. At June 30, 2005, we did not have any loans not included above which are “troubled debt restructurings” as defined in SFAS No. 15.

**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 June 30, 2005, classified assets consisted of special mention assets of \$602,000, substandard assets of \$1.7 million, doubtful assets of \$8,000 and no loans classified as loss assets. The classified assets total includes \$1.0 million of nonperforming loans.

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

		At December 31,		
	At June 30, 2005	2004	2003	2002
		(Dollars in thousands)		
Special mention assets	\$ 602	\$ 680	\$1,089	\$1,287
Substandard assets	1,712	1,522	1,618	2,056
Doubtful assets	8	13	337	465
Loss assets	—	—	—	—
Total classified assets	\$ 2,322	\$2,215	\$3,044	\$3,808

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

	At June 30,		At December 31,					
	2005		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)	\$487	\$ 721	\$524	\$658	\$230	\$ 637	\$184	\$1,290
Commercial real estate	39	288	111	101	—	249	—	7
Commercial business	—	33	39	—	39	126	—	94
Consumer loans	23	6	18	33	26	40	18	17
<b>Total</b>	<b>\$549</b>	<b>\$1,048</b>	<b>\$692</b>	<b>\$792</b>	<b>\$295</b>	<b>\$1,052</b>	<b>\$202</b>	<b>\$1,408</b>

(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, 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.

For the six months ended June 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

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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. In addition to the non-performing loans, management has identified, through normal internal credit review procedures, \$549,000 in potential problem loans at June 30, 2005. Payments are current on \$141,000 or 25.7% of these loans. These problem loans are defined as loans not included as non-performing loans, but about which management has developed information regarding possible credit problems, which may cause the borrowers future difficulties in complying with loan repayments. We will continue to be aggressive in identifying, monitoring and resolving potential problem loans. See “ *Management’s Discussion and Analysis of Financial Condition and Results of Operations—Comparison of Operating Results for the Six-Month Periods Ended June 30, 2005 and 2004—Provision for Loan Losses* .”

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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 Six Months Ended At June 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	170	267	345	360	325	201
Charge-offs:							
Mortgage loans on real estate:							
One-to-four family	10	69	24	200	43	34	24
Construction	—	—	—	—	—	—	—
Commercial real estate	—	—	117	—	—	—	—
Home equity loans and lines of credit	7	—	—	—	8	—	12
Other loans:							
Commercial loans	12	—	126	17	5	141	49
Consumer loans	13	13	37	58	23	43	46
Total charge-offs:	42	82	304	275	79	218	131
Recoveries:							
Mortgage loans on real estate:							
One-to-four family	—	—	23	4	4	6	—
Construction	—	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—	—
Home equity loans and lines of credit	—	—	—	—	1	4	3
Other loans:							
Commercial loans	6	—	—	—	—	1	8
Consumer loans	1	2	9	2	7	9	8
Total Recoveries	7	2	32	6	12	20	19
Net charge-offs	35	80	272	269	67	198	112
Balance at end of period	\$ 1,273	\$ 1,383	\$ 1,288	\$ 1,293	\$ 1,217	\$ 924	\$ 797
Average loans outstanding	198,767	188,324	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.

		At December 31,																		
		At June 30, 2005			2004			2003			2002			2001						
		Amount	% of Allow- ance to Total Allow- ance	% of Loans in Cate- gory to Total Loans	Amount	% of Allow- ance to Total Allow- ance	% of Loans in Cate- gory to Total Loans	Amount	% of Allow- ance to Total Allow- ance	% of Loans in Cate- gory to Total Loans	Amount	% of Allow- ance to Total Allow- ance	% of Loans in Cate- gory to Total Loans	Amount	% of Allow- ance to Total Allow- ance	% of Loans in Cate- gory to Total Loans				
(Dollars in thousands)																				
Mortgage loans																				
One-to-four family	\$	257	20.2%	71.8%	\$	239	18.6%	71.2%	\$	174	13.5%	72.1%	\$	447	36.7%	68.0%	\$	353	38.2%	68.5%
Home equity loans and lines of credit		60	4.7%	14.6%		62	4.8%	14.2%		30	2.3%	13.8%		90	7.4%	15.0%		86	9.3%	14.5%
Commercial real estate		188	14.8%	7.3%		160	12.4%	7.7%		395	30.5%	7.8%		157	12.9%	8.7%		143	15.5%	7.5%
Construction		—	—	1.0%		—	—	1.2%		—	—	1.3%		—	—	2.1%		—	—	1.8%
		505	39.7%	94.7%		461	35.8%	94.3%		599	46.3%	95.0%		694	57.0%	93.8%		582	63.0%	92.3%
Other loans																				
Commercial loans		90	7.0%	4.0%		98	7.6%	4.3%		156	12.1%	3.2%		144	11.8%	4.0%		119	12.9%	5.1%
Consumer loans		25	2.0%	1.3%		28	2.2%	1.4%		35	2.7%	1.8%		25	2.1%	2.2%		43	4.6%	2.6%
		115	9.0%	5.3%		126	9.8%	5.7%		191	14.8%	5.0%		169	13.9%	6.2%		162	17.5%	7.7%
Total allocated	\$	620	48.7%	100.0%		587	45.6%	100.0%		790	61.1%	100.0%		863	70.9%	100.0%		744	80.5%	100.0%
Total unallocated		653	51.3%			701	54.4%			503	38.9%			354	29.1%			180	19.5%	
Balance at end of period	\$	1,273	100.0%			\$	1,288	100.0%		\$	1,293	100.0%		\$	1,217	100.0%		\$	924	100.0%

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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 December 31,							
	At June 30, 2005		2004		2003		2002	
	(Unaudited)				(Dollars in thousands)			
	Amortized	Fair Value	Amortized	Fair Value	Amortized	Fair Value	Amortized	Fair Value
	Cost		Cost		Cost		Cost	
<b>Securities available for sale:</b>								
U.S. Government agencies	—	—	—	—	\$ 1,000	\$ 1,063	\$ 1,000	\$ 1,109
U.S. Government obligations	\$ 2,116	\$ 2,360	\$ 2,118	\$ 2,162	2,123	2,084	—	—
State and municipal obligations	1,444	1,464	—	—	—	—	—	—
Mortgage-backed securities:								
Collateralized mortgage obligations	48,662	48,165	47,306	46,933	34,160	33,879	16,443	16,530
Federal Home Loan Mortgage Association	8,149	8,105	9,158	9,175	6,322	6,398	3,985	4,099
Federal Home Loan Mortgage Corporation	17,696	17,387	19,151	18,923	14,193	14,201	5,169	5,287
Asset-backed securities:	17,589	17,456	20,395	20,328	23,828	24,097	23,454	23,879
<b>Total available for sale</b>	<b>\$ 95,656</b>	<b>\$94,937</b>	<b>\$ 98,128</b>	<b>\$ 97,521</b>	<b>\$ 81,626</b>	<b>\$81,722</b>	<b>\$ 50,051</b>	<b>\$50,904</b>
<b>Securities held to maturity:</b>								
Mortgage-backed securities:								
Government National Mortgage Association	\$ 75	\$ 81	\$ 80	\$ 88	\$ 86	\$ 95	\$ 144	\$ 158
Federal Home Loan Mortgage Association	116	118	136	139	176	182	414	439
Federal Home Loan Mortgage Corporation	68	69	76	80	109	112	207	221
U.S. Government obligations:	2,061	2,379	2,067	2,196	—	—	—	—
<b>Total held to maturity</b>	<b>2,320</b>	<b>2,647</b>	<b>2,359</b>	<b>2,503</b>	<b>371</b>	<b>389</b>	<b>765</b>	<b>818</b>
<b>Total investment securities</b>	<b>\$ 97,976</b>	<b>\$97,584</b>	<b>\$100,487</b>	<b>\$100,024</b>	<b>\$ 81,997</b>	<b>\$82,111</b>	<b>\$ 50,816</b>	<b>\$51,722</b>



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At June 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)	
<b>Asset backed securities</b>		
Chase Funding Mortgage Asset Backed	\$ 3,944	\$ 3,913
Residential Asset Securities Corporation	5,849	5,784
<b>Total</b>	<b>\$ 9,793</b>	<b>\$ 9,697</b>

**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 June 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	\$ —	—	\$ —	—	\$ —	—	\$ 2,116	4.96%	\$ 2,116	\$ 2,360	4.96%
State and municipal obligations(1)	—	—	—	—	1,041	3.61%	403	3.82%	1,444	1,464	3.67%
Mortgage-backed securities	49	5.83%	6,260	3.01%	21,538	3.93%	46,660	3.89%	74,507	73,657	3.83%
Asset-backed securities	—	—	845	3.64%	—	—	16,744	3.83%	17,589	17,456	3.82%

### Held to Maturity securities:

U.S. Government securities	\$ —	—	\$ —	—	—	—	\$ 2,061	5.43%	2,061	2,379	5.43%
Mortgage-backed securities	—	—	\$ 40	8.25%	22	6.49%	\$ 197	7.67%	259	268	7.66%
<b>Total debt securities:</b>	<b>\$ 49</b>	<b>5.83%</b>	<b>\$ 7,145</b>	<b>3.11%</b>	<b>\$ 22,601</b>	<b>3.92%</b>	<b>\$ 68,181</b>	<b>3.97%</b>	<b>\$ 97,976</b>	<b>\$ 97,584</b>	<b>3.89%</b>

(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 June 30, 2005 and December 31, 2004. These accounts provide interest-earning checking, with a weighted average rate at June 30, 2005 of 0.35%.

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 44.7% and 45.6% of total deposits on June 30, 2005 and December 31, 2004, respectively. At June 30, 2005 and December 31, 2004, time deposits with remaining terms to maturity of less than one year amounted to \$43.5 million and \$32.9 million, respectively.

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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 June 30, 2005, December 30, 2004 and 2003.

Interest Rate Range	Period to maturity from June 30, 2005				At June 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	\$ 15,992	\$ 662	\$ 33	\$ 21	\$ 16,708	\$ 36,591	\$ 48,497
2.00% to 2.99%	38,546	20,913	190	168	59,817	66,497	41,299
3.00% to 3.99%	22,692	17,807	13,297	3,097	56,893	27,226	19,740
4.00% to 4.99%	220	750	795	252	2,017	1,141	14,233
5.00% to 5.99%	102	329	—	151	582	572	773
6.00% and above	—	—	—	—	—	59	182
Total	\$ 77,552	\$ 40,461	\$ 14,315	\$ 3,689	\$136,017	\$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 June 30, 2005		At December 31,					
			2004		2003		2002	
	Amount	Percent of total deposits	Amount	Percent of total deposits	Amount	Percent of total deposits	Amount	Percent of total deposits
(Dollars in thousands)								
<b>Deposit type:</b>								
Savings	\$ 30,582	12.36%	\$ 30,007	12.32%	\$ 31,483	13.66%	\$ 28,546	14.63%
Money market	29,006	11.72%	30,765	12.63%	26,219	11.38%	23,448	12.02%
Interest bearing demand	37,742	15.25%	39,488	16.21%	37,076	16.09%	32,771	16.80%
Noninterest bearing demand	14,078	5.69%	11,208	4.60%	10,993	4.77%	9,869	5.06%
<b>Total core deposits</b>	<b>111,408</b>	<b>45.02%</b>	<b>111,468</b>	<b>45.77%</b>	<b>105,771</b>	<b>45.90%</b>	<b>94,634</b>	<b>48.51%</b>
<b>Time deposits with original maturities of:</b>								
Three months or less	1,738	0.70%	1,861	0.76%	2,763	1.20%	2,614	1.34%
Over three months to twelve months	36,701	14.83%	31,069	12.77%	35,889	15.57%	42,425	21.75%
Over twelve months to twenty-four months	50,031	20.22%	57,634	23.66%	70,934	30.78%	49,480	25.36%
Over twenty-four months to thirty-six months	40,708	16.45%	35,692	14.65%	12,283	5.33%	3,465	1.78%
Over thirty-six months to forty-eight months	5,340	2.16%	4,416	1.81%	1,568	0.68%	1,309	0.67%
Over forty-eight months to sixty months	1,082	0.44%	1,100	0.45%	1,258	0.55%	1,137	0.58%
Over sixty months	417	0.18%	314	0.13%	29	0.01%	28	0.01%
<b>Total time deposits</b>	<b>136,017</b>	<b>54.98%</b>	<b>132,086</b>	<b>54.23%</b>	<b>124,724</b>	<b>54.10%</b>	<b>100,458</b>	<b>51.49%</b>
<b>Total deposits</b>	<b>\$247,425</b>	<b>100.00%</b>	<b>\$243,554</b>	<b>100.00%</b>	<b>\$230,495</b>	<b>100.00%</b>	<b>\$195,092</b>	<b>100.00%</b>

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At June 30, 2005, we had \$30.2 million in time deposits with balances of \$100,000 or more maturing as follows:

<u>Maturity Period</u>	<u>Amount</u>
	(In thousands)
Three months or less	\$ 5,945
Over three months through six months	7,881
Over six months through twelve months	5,519
Over twelve months	10,827
<b>Total</b>	<b>\$ 30,172</b>

**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 a line of credit of \$15.7 million at June 30, 2005 and a one month overnight repricing line of credit of \$15.7 million.

	<u>At June 30,</u>	<u>At December 31,</u>	
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(Dollars in thousands)		
<b>At December 31 or June 30</b>			
Amount outstanding	\$ 9,525	\$11,725	\$11,800
Weighted average interest rate	3.27%	2.30%	1.35%
<b>For the period ended December 31 or June 30</b>			
Highest amount at a month-end	\$ 11,625	\$13,700	\$12,100
Daily average amount outstanding	9,334	12,501	4,073
Weighted average interest rate	2.44%	2.24%	2.90%

### 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 office headquarters, administrative offices, and seven 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)
<b>Corporate Headquarters</b>			
125 East Fourth Street Dunkirk, NY 14048	Owned	1995	\$ 99
<b>Branch Offices:</b>			
Chautauqua County			
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
Erie County			
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(5)	0
<b>Administrative Offices:</b>			
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.

(5) Planned opening is December 2005.

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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 June 30, 2005, we had 96 full-time employees and 10 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.

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### 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 June 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 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



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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 June 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.

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

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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 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

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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 June 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 BIF. 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) 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 June 30, 2005 of \$2.6 million. Any

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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 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

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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.

### 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

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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;
- 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;



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- 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
- 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;



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- 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 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.

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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;
- 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;

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- 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 is currently under audit by the Internal Revenue Service.

**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

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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 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

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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 nine directors. Our Certificate of Incorporation 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 June 30, 2005, their positions, the years they began serving as directors and the years their terms as directors of Lake Shore Bancorp will expire:

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	2006
David C. Mancuso	59	Chief Executive Officer and President	1998	2006
Thomas E. Reed	63	Director	1988	2008
Daniel P. Reininga	46	Vice Chairman of the Board	1994	2008
Gary W. Winger	60	Director	1997	2006
Nancy L. Yocum	58	Director	1995	2008

### 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.

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*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.

### 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.

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### 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 reviews 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.

*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.



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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.

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;



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- 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 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, Robert L. Smith, our Chief Financial Officer and one other 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.

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### 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. 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

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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 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.

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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 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.

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- 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.

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 87,600 shares, or 3.7% 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 430,600 shares, or 18.3% 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	40,000	4,000
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>	876,000	87,600

## 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 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*."

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### 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 and since 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. 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 our 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*."



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### 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;
- 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 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.

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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 its ownership of a majority 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 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

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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.

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;

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- 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 \$287 million;
- average nonperforming assets of 0.35% of total assets;
- average loans of 63.6% of total assets;
- average equity of 15.0% of total assets; and
- average income of 0.66% of average assets.

On the basis of the analysis in its report, RP Financial has advised us that, in its opinion, as of September 30, 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.

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 issued 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

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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. 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 September 30, 2005 (“supplemental eligible account holders”).
4. Persons with deposits at Lake Shore Savings as of December \_\_, 2005 (“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);

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- 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.

**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.

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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 September 30, 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 December \_\_, 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.

**Expiration Date for the Subscription Offering .** The subscription offering is expected to terminate at 11:00 a.m., Eastern Time, on [Date 1, 200 \_\_\_\_]. 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



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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 violations 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.

### 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.



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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.**

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.

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### 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.

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.

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- 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. 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.
- 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.

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- 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
- 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."

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### 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 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 (XXX) XXX-XXXX.**

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, 200 \_**. 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 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 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

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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. 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 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.

We will waive any applicable penalties for early withdrawal from 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 lent 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

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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 \_\_\_\_\_, 200 \_\_, 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.



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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.

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.



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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.

Based in part upon certain factual representations of Lake Shore Savings or its officers, Thacher Proffitt & Wood LLP has issued its opinion regarding certain 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

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(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;

(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.

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### **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 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 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 six months ended June 30, 2005, and the year ended December 31, 2004, we contributed \$55,000 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 foundation will inure to the benefit of, or be distributable to, its directors, officers or members.

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We will select two of our current directors to serve on the initial Board of Directors of the 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 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 foundation may alter the size and composition of its Board of Directors. For five years after the reorganization, one seat on the 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 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 foundation's charitable goals, to protect its assets and to act in a manner consistent with the charitable purposes for which the foundation is established. The directors of The Lake Shore Charitable Foundation also will be responsible for directing the activities of the foundation, including the management and voting of the common stock held by the 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 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 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 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.

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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 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 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 foundation.

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 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 foundation;
- the foundation must comply with all supervisory directives imposed by the Office of Thrift Supervision;
- the foundation must provide annually to the Office of Thrift Supervision a copy of the annual report that the foundation submits to the IRS;
- the foundation must operate according to written policies adopted by its Board of Directors, including a conflict of interest policy;
- the 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

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- the 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 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.



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***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.

***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

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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.



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**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 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 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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**LAKE SHORE BANCORP, INC.**  
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Financial statements of Lake Shore Bancorp, Inc. have not been provided because it has conducted no operations.	

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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

	June 30,	December 31,	
	2005	2004	2003
	(Unaudited)		
	(Dollars In Thousands)		
A SSETS			
Cash and due from banks	\$ 7,011	\$ 7,203	\$ 7,982
Interest bearing deposits	2,593	1,617	71
Federal funds sold	6,413	2,757	8,700
Cash and Cash Equivalents	16,017	11,577	16,753
Securities available for sale	96,396	99,170	83,027
Securities held to maturity, fair value 2005 \$2,647 (unaudited); 2004 \$2,503; 2003 \$389	2,320	2,359	371
Federal Home Loan Bank stock, at cost	2,569	2,709	2,167
Loans receivable, net of allowance for loan losses 2005 \$1,273 (unaudited); 2004 \$1,288; 2003 \$1,293	200,008	199,525	187,138
Premises and equipment, net	6,655	6,645	6,469
Accrued interest receivable	1,216	1,195	1,042
Bank owned life insurance	5,623	5,520	5,317
Other assets	1,235	1,141	1,227
Total Assets	\$ 332,039	\$ 329,841	\$ 303,511
L IABILITIES AND E QUITY			
L IABILITIES			
Deposits:			
Interest bearing	\$ 233,347	\$ 232,346	\$ 219,502
Non-interest bearing	14,078	11,208	10,993
Total Deposits	247,425	243,554	230,495
Short-term borrowings	9,525	11,725	11,800
Long-term debt	41,860	42,260	31,535
Advances from borrowers for taxes and insurance	2,051	2,098	1,924
Other liabilities	3,376	3,289	2,810
Total Liabilities	304,237	302,926	278,564
C OMMITMENTS AND C ONTINGENCIES			
E QUITY			
Retained earnings	27,349	26,272	24,093
Accumulated other comprehensive income	453	643	854
Total Equity	27,802	26,915	24,947
Total Liabilities and Equity	\$ 332,039	\$ 329,841	\$ 303,511

See notes to financial statements.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### STATEMENTS OF INCOME

	Six Months Ended June 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)		(In Thousands)		
<b>INTEREST INCOME</b>					
Loans, including fees	\$ 5,774	\$ 5,431	\$11,102	\$10,072	\$10,486
Investment securities, taxable	1,956	1,639	3,541	2,586	2,513
Other	61	52	101	122	183
<b>Total Interest Income</b>	<b>7,791</b>	<b>7,122</b>	<b>14,744</b>	<b>12,780</b>	<b>13,182</b>
<b>INTEREST EXPENSE</b>					
Deposits	2,064	1,780	3,674	3,887	4,504
Short-term borrowings	146	87	197	68	7
Long-term debt	747	655	1,396	679	396
Other	32	28	65	60	39
<b>Total Interest Expense</b>	<b>2,989</b>	<b>2,550</b>	<b>5,332</b>	<b>4,694</b>	<b>4,946</b>
<b>Net Interest Income</b>	<b>4,802</b>	<b>4,572</b>	<b>9,412</b>	<b>8,086</b>	<b>8,236</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>20</b>	<b>170</b>	<b>267</b>	<b>345</b>	<b>360</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>4,782</b>	<b>4,402</b>	<b>9,145</b>	<b>7,741</b>	<b>7,876</b>
<b>NON-INTEREST INCOME</b>					
Service charges and fees	715	687	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	103	100	203	223	253
Other	67	87	167	263	73
<b>Total Non-Interest Income</b>	<b>887</b>	<b>909</b>	<b>1,875</b>	<b>1,728</b>	<b>1,646</b>
<b>NON-INTEREST EXPENSES</b>					
Salaries and employee benefits	2,229	2,177	4,468	3,854	3,247
Occupancy and equipment	653	649	1,310	1,107	879
Data processing	207	188	374	436	464
Advertising	152	86	193	338	147
Postage and supplies	145	159	274	351	278
Professional services	246	213	410	280	278
Other	448	492	910	852	908
<b>Total Non-Interest Expenses</b>	<b>4,080</b>	<b>3,964</b>	<b>7,939</b>	<b>7,218</b>	<b>6,201</b>
<b>Income before Income Taxes</b>	<b>1,589</b>	<b>1,347</b>	<b>3,081</b>	<b>2,251</b>	<b>3,321</b>
<b>INCOME TAXES</b>	<b>513</b>	<b>419</b>	<b>902</b>	<b>744</b>	<b>1,085</b>
<b>Net Income</b>	<b>\$ 1,076</b>	<b>\$ 928</b>	<b>\$ 2,179</b>	<b>\$ 1,507</b>	<b>\$ 2,236</b>

See notes to financial statements.



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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### STATEMENTS OF EQUITY

Six Months Ended June 30, 2005 (Unaudited) and  
Years Ended December 31, 2004, 2003 and 2002

	Retained Earnings	Accumulated Other Comprehensive Income	Total
		(In Thousands)	
<b>BALANCE - JANUARY 1, 2001</b>	\$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
<b>Total Comprehensive Income</b>			2,237
<b>BALANCE - DECEMBER 31, 2002</b>	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)
<b>Total Comprehensive Income</b>			1,005
<b>BALANCE - DECEMBER 31, 2003</b>	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)
<b>Total Comprehensive Income</b>			1,968
<b>BALANCE - DECEMBER 31, 2004</b>	26,272	643	26,915
Comprehensive income:			
Net income	1,076	—	1,076
Change in unrealized net gains on securities available for sale, net of tax and reclassification adjustment	—	(189)	(189)
<b>Total Comprehensive Income</b>			887
<b>BALANCE - JUNE 30, 2005</b>	\$27,348	\$ 454	\$27,802

See notes to financial statements.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)		(In Thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Net income	\$ 1,076	\$ 928	\$ 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	37	50	81	(145)	(284)
Provision for loan losses	20	170	267	345	360
Depreciation and amortization	301	303	607	445	365
Deferred income tax expense (benefit)	(118)	(82)	(57)	81	(110)
Earnings on bank owned life insurance	(103)	(100)	(203)	(223)	(253)
(Increase) decrease in accrued interest receivable	—	—	(153)	(107)	147
(Increase) decrease in other assets	(169)	265	517	(522)	272
Increase (decrease) in other liabilities	371	(792)	622	891	(50)
<b>Net Cash Provided by Operating Activities</b>	<b>1,413</b>	<b>707</b>	<b>3,825</b>	<b>2,152</b>	<b>2,505</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Activity in available for sale securities:					
Sales	—	1,033	1,033	2,024	3,176
Maturities, prepayments and calls	11,753	13,241	24,408	25,215	26,274
Purchases	(9,313)	(23,081)	(41,979)	(58,408)	(39,283)
Activity in held to maturity securities:					
Maturities, prepayments and calls	34	44	80	396	356
Purchases	—	(2,073)	(2,075)	—	—
Net (increase) decrease in investment in Federal Home Loan Bank stock	140	(279)	(542)	(747)	(258)
Proceeds from sales of loans	121	471	592	4,649	403
Loan origination and principal collections, net	(622)	(6,175)	(13,618)	(35,200)	(12,901)
Additions to premises and equipment	(311)	(333)	(783)	(3,115)	(430)
<b>Net Cash Provided by (Used in) Investing Activities</b>	<b>1,802</b>	<b>(17,152)</b>	<b>(32,884)</b>	<b>(65,186)</b>	<b>(22,663)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Net increase in deposits	3,871	9,068	13,059	35,396	13,026
Net increase (decrease) in advances from borrowers for taxes and insurance	(47)	(130)	174	287	(18)
Net increase (decrease) in short-term borrowings	(2,200)	(975)	(75)	9,670	2,890
Proceeds from issuance of long-term debt	—	6,600	12,600	20,000	10,000
Repayment of long-term debt	(400)	(450)	(1,875)	(1,875)	(4,005)
<b>Net Cash Provided by Financing Activities</b>	<b>1,224</b>	<b>14,113</b>	<b>23,883</b>	<b>63,478</b>	<b>21,893</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>4,439</b>	<b>(2,332)</b>	<b>(5,176)</b>	<b>444</b>	<b>1,735</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING</b>	<b>11,577</b>	<b>16,753</b>	<b>16,753</b>	<b>16,309</b>	<b>14,574</b>
<b>CASH AND CASH EQUIVALENTS - ENDING</b>	<b>\$ 16,017</b>	<b>\$ 14,421</b>	<b>\$ 11,577</b>	<b>\$ 16,753</b>	<b>\$ 16,309</b>
<b>SUPPLEMENTARY CASH FLOWS INFORMATION</b>					
Interest paid	\$ 2,971	\$ 2,528	\$ 5,299	\$ 4,711	\$ 4,953
Income taxes paid	\$ 485	\$ 560	\$ 960	\$ 710	\$ 1,468

See notes to financial statements.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

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#### 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 June 30, 2005 and for the six months ended June 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 six months ended June 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 a method that approximates 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

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#### 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 for the foreseeable future or 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 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 or 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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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

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#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

###### 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 \$210,000, \$140,000 and \$454,000 at June 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 six months ended June 30, 2005 and 2004 and the years ended December 31, 2004, 2003 and 2002 are as follows:

	Six Months Ended June 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)				
	(In Thousands)				
Unrealized holding (gains) losses on securities available for sale	\$ (302)	\$ 1,450	\$(325)	\$(782)	\$ 179
Reclassification adjustment for (gains) losses realized in income	—	(33)	(33)	9	(176)
<b>Net Unrealized (Gains) Losses</b>	<b>(302)</b>	<b>1,417</b>	<b>(358)</b>	<b>(773)</b>	<b>3</b>
Income tax effect	<b>113</b>	<b>(513)</b>	<b>147</b>	<b>271</b>	<b>(2)</b>
<b>Net of Tax Amount</b>	<b>\$ (189)</b>	<b>\$ 904</b>	<b>\$(211)</b>	<b>\$(502)</b>	<b>\$ 1</b>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

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#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

###### 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 June 30, 2005 (unaudited), December 31, 2004 and 2003 was \$1,120,000, \$1,348,000 and \$1,035,000, respectively.

###### Reclassifications

Certain amounts in the 2003 and 2002 financial statements have been reclassified to conform with the 2004 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:

	June 30, 2005 (Unaudited)			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
	(In Thousands)			
<b>SECURITIES AVAILABLE FOR SALE :</b>				
U.S. Treasury bonds	\$ 2,116	\$ 244	\$ —	\$ 2,360
Municipal bonds	1,444	20	—	1,464
Mortgage-backed securities:				
Collateralized mortgage obligations	48,662	37	(534)	48,165
Federal National Mortgage Association	8,149	10	(54)	8,105
Federal Home Loan Mortgage Corporation	17,696	7	(316)	17,387
Asset-backed securities	17,589	17	(150)	17,456
Equity securities	22	1,437	—	1,459
	<u>\$ 95,678</u>	<u>\$ 1,772</u>	<u>\$ (1,054)</u>	<u>\$96,396</u>
<b>SECURITIES HELD TO MATURITY :</b>				
U.S. Treasury bonds	\$ 2,061	\$ 318	\$ —	\$ 2,379
Mortgage-backed securities:				
Government National Mortgage Association	75	6	—	81
Federal National Mortgage Association	116	2	—	118
Federal Home Loan Mortgage Corporation	68	2	(1)	69
	<u>\$ 2,320</u>	<u>\$ 328</u>	<u>\$ (1)</u>	<u>\$ 2,647</u>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

#### NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

	December 31, 2004			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
	(In Thousands)			
<b>SECURITIES AVAILABLE FOR SALE :</b>				
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>
<b>SECURITIES HELD TO MATURITY :</b>				
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>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

#### NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

	December 31, 2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
<b>SECURITIES AVAILABLE FOR SALE :</b>				
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
	<u>\$ 81,648</u>	<u>\$ 1,854</u>	<u>\$ (475)</u>	<u>\$83,027</u>
<b>SECURITIES HELD TO MATURITY :</b>				
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
	<u>\$ 371</u>	<u>\$ 18</u>	<u>\$ —</u>	<u>\$ 389</u>

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)					
<b>June 30, 2005 (Unaudited):</b>						
Mortgage-backed securities	\$23,913	\$ (182)	\$36,114	\$ (723)	\$60,027	\$ (905)
Asset-backed securities	7,379	(59)	7,545	(91)	14,924	(150)
	<u>\$31,292</u>	<u>\$ (241)</u>	<u>\$43,659</u>	<u>\$ (814)</u>	<u>\$74,951</u>	<u>\$ (1,055)</u>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

#### NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

	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)						
<b>December 31, 2004:</b>						
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>

In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. At June 30, 2005 (unaudited), there were 26 securities in the less than twelve months category and 37 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. None of the individual unrealized losses is significant. The Association has the ability to hold these securities until maturity or market price recovery. Management believes that the unrealized losses represent temporary impairments of the securities.

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)				
<b>June 30, 2005 (Unaudited):</b>				
Within one year	\$ —	\$ —	\$ —	\$ —
After one year through five years	—	—	—	—
After five years through ten years	1,041	1,052	—	—
After ten years	2,519	2,772	2,061	2,379
Mortgage-backed securities	74,507	73,657	259	268
Asset-backed securities	17,589	17,456	—	—
Equity securities	22	1,459	—	—
	<u>\$ 95,678</u>	<u>\$96,396</u>	<u>\$ 2,320</u>	<u>\$2,647</u>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

#### NOTE 3 - INVESTMENT SECURITIES (CONTINUED)

	Available for Sale		Held to Maturity	
	Amortized	Fair Value	Amortized	Fair Value
	Cost		Cost	
	(In Thousands)			
<b>December 31, 2004:</b>				
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	—	—
	<b>\$ 98,150</b>	<b>\$ 99,170</b>	<b>\$ 2,359</b>	<b>\$ 2,503</b>

During the six months ended June 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 June 30, 2005, December 31, 2004 and 2003, equity securities consisted of 22,368 shares of Federal Home Loan Mortgage Corporation common stock.

At June 30, 2005 (unaudited), two asset-backed securities and one government security with a cost of \$2,031,000 and fair value of \$2,223,000 were pledged under a collateral agreement with the Federal Reserve for liquidity borrowing. Two mortgage-backed securities with a cost of \$1,572,000 and fair value of \$1,544,000 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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### L AKE S HORE S AVINGS AND L OAN A SSOCIATION

#### N OTES TO F INANCIAL S TATEMENTS

##### N OTE 4 - L OANS R ECEIVABLE

Loans receivable, net consist of the following:

	June 30,	December 31,	
	2005	2004	2003
	(Unaudited)	(In Thousands)	
Real estate loans:			
Residential	\$ 143,723	\$142,222	\$135,293
Home equity	29,312	28,442	25,876
Commercial	14,597	15,310	14,628
Construction	2,173	2,463	2,531
	<u>189,805</u>	<u>188,437</u>	<u>178,328</u>
Commercial loans	8,011	8,615	5,957
Consumer loans	2,494	2,870	3,310
	<u>200,310</u>	<u>199,922</u>	<u>187,595</u>
Allowance for loan losses	(1,273)	(1,288)	(1,293)
Net deferred loan costs	971	891	836
	<u>200,008</u>	<u>\$199,525</u>	<u>\$187,138</u>
<b>Loans Receivable, Net</b>			

An analysis of changes in the allowance for loan losses is as follows:

	Six Months Ended June 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	170	267	345	360
Charge-offs	(42)	(82)	(304)	(275)	(79)
Recoveries	7	2	32	6	12
	<u>\$1,273</u>	<u>\$1,383</u>	<u>\$1,288</u>	<u>\$1,293</u>	<u>\$1,217</u>
Balance, ending					

Residential real estate loans serviced for others by the Association totaled \$16,711,000, \$18,017,000 and \$20,901,000 at June 30, 2005 (unaudited), December 31, 2004, and 2003, respectively.

At June 30, 2005 (unaudited), December 31, 2004, and 2003, the Association's nonaccrual loans were \$429,000, \$142,000, and \$584,000. The Association had loans which were past due ninety days or more and still accruing interest of \$619,000, \$650,000, and \$468,000 as of June 30, 2005 (unaudited), December 31, 2004, and 2003, respectively. There was no related valuation allowance for impaired loans included in the allowance for loan losses at June 30, 2005 (unaudited), December 31, 2004, and 2003.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 4 - LOANS RECEIVABLE (CONTINUED)

At June 30, 2005 (unaudited), December 31, 2004 and 2003, loans to directors and executive officers and their affiliated entities in excess of \$60,000, totaled \$2,802,000, \$2,871,000, and \$3,030,000, respectively. During the six months ended June 30, 2005 (unaudited) and the year ended December 31, 2004, total principal additions were \$92,000 and \$100,000 and total principal payments were \$161,000 and \$181,000, respectively. Furthermore, director retirements in 2004 resulted in the decline of total principal of \$78,000.

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.

##### NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment consist of the following:

	June 30,	December 31,	
	2005	2004	2003
	(Unaudited)		
	(In Thousands)		
Land	\$ 658	\$ 658	\$ 658
Buildings and improvements	6,181	6,019	5,442
Furniture and equipment	3,515	3,385	3,393
	10,354	10,062	9,493
Accumulated depreciation	(3,699)	(3,417)	(3,024)
	\$ 6,655	\$ 6,645	\$ 6,469

Depreciation and amortization of premises and equipment amounted to \$301,000 and \$303,000 for the six months ended June 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-, \$10,000, \$22,000, \$62,000 and \$-0- in the six months ended June 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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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 7 - DEPOSITS

Deposits consist of the following (dollars in thousands):

	June 30,		December 31,			
	2005		2004		2003	
	Weighted		Weighted		Weighted	
	Amount	Average Rate	Amount	Average Rate	Amount	Average Rate
	(Unaudited)					
Demand deposits:						
Non-interest bearing	\$ 14,078	— %	\$ 11,208	— %	\$ 10,993	— %
Interest bearing	37,742	0.42	39,488	0.33	37,076	0.23
Money market accounts	29,006	0.91	30,765	0.93	26,219	0.84
Savings accounts	30,582	0.51	30,007	0.50	31,483	0.50
Time deposits	136,017	2.94	132,086	2.57	124,724	2.60
	<b>\$247,425</b>	<b>1.97%</b>	<b>\$243,554</b>	<b>1.71%</b>	<b>\$230,495</b>	<b>1.62%</b>

Scheduled maturities of time deposits are as follows:

	June 30,	December 31,
	2005	2004
	(Unaudited)	
	(In Thousands)	
2005	\$ 38,439	\$ 32,930
2006	50,031	57,634
2007	40,708	35,692
2008	5,340	4,416
2009	1,082	1,100
Thereafter	417	314
	<b>\$ 136,017</b>	<b>\$ 132,086</b>

Time deposits in amounts of \$100,000 or more amounted to \$30,172,000, \$29,312,000 and \$22,241,000 at June 30, 2005 (unaudited), December 31, 2004 and 2003, respectively.



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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 7 - DEPOSITS (CONTINUED)

Interest expense on deposits was as follows:

	Six Months Ended June 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)		(In Thousands)		
Interest bearing checking accounts	\$ 65	\$ 52	\$ 110	\$ 176	\$ 297
Money market accounts	138	128	275	276	364
Savings accounts	76	79	159	287	417
Time deposits	1,785	1,521	3,130	3,148	3,426
	<b>\$2,064</b>	<b>\$1,780</b>	<b>\$3,674</b>	<b>\$3,887</b>	<b>\$4,504</b>

##### NOTE 8 - BORROWINGS

At June 30, 2005 (unaudited), December 31, 2004 and 2003, the Association had short-term borrowings from the Federal Home Loan Bank of New York of \$9,525,000, \$11,725,000 and \$11,800,000, respectively. The short-term borrowings had fixed rates of interest ranging from 1.41% and 2.83% and mature within one year. The weighted average interest rate was 3.27%, 2.30% and 1.35% as of June 30, 2005, December 31, 2004 and 2003, respectively.

At June 30, 2005 (unaudited) and December 31, 2004, the Association had a \$15,699,100 unsecured line of credit with the Federal Home Loan Bank 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 29, 2006. The Association also has a \$15,699,100 unsecured stand-by line of credit with the Federal Home Loan Bank. The Association had no outstanding borrowings on either line at June 30, 2005 (unaudited), December 31, 2004 and 2003.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

#### NOTE 8 - BORROWINGS (CONTINUED)

Long-term debt consisted of the following:

Maturity	Interest Rate	June 30,	December 31,	
		2005	2004	2003
(Unaudited) (Dollars In Thousands)				
November 8, 2004	2.23%	\$ —	\$ —	\$ 1,000
August 8, 2005	2.06%	1,000	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 6.28%			
	through 6.32%	1,800	2,000	2,400
Matures on a quarterly basis through August 1, 2011	Rates vary from 5.47%			
	to 6.55%	1,460	1,660	2,135
		<u>\$ 41,860</u>	<u>\$42,260</u>	<u>\$31,535</u>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 8 - BORROWINGS (CONTINUED)

Contractual maturities of long-term debt at June 30, 2005 and December 31, 2004 are as follows:

	June 30, 2005	December 31, 2004
	(Unaudited)	
	(In Thousands)	
2005	\$ 4,380	\$ 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
	<b>\$ 41,860</b>	<b>\$42,260</b>

##### 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 \$40,000 and \$39,000 for the six months ended June 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 \$365,000, \$373,000 and \$387,000 at June 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 \$67,000 and \$53,000 at June 30, 2005 (unaudited) and December 31, 2004, respectively.

Minimum future lease payments for the operating and capital leases are as follows:

	June 30, 2005		December 31, 2004	
	Operating	Capital	Operating	Capital
	Leases	Lease	Leases	Lease
	(Unaudited)			
	(In Thousands)			
2005	\$ 41	\$ 20	\$ 80	\$ 39
2006	87	39	87	39
2007	86	39	86	39
2008	80	43	80	43
2009	79	43	79	43
Thereafter	516	368	516	368
<b>Total Minimum Lease Payments</b>	<b>\$ 889</b>	<b>\$ 552</b>	<b>\$ 928</b>	<b>\$ 571</b>

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### L AKE S HORE S AVINGS AND L OANA S SOCIATION

#### N OTES TO F INANCIAL S TATEMENTS

##### N OTE 10 - I NCOME T AXES

The provision for income taxes consists of the following:

	Six Months Ended June 30,		Years Ended December 31,		
	2005	2004	2004	2003	2002
	(Unaudited)				
	(In Thousands)				
Current:					
Federal	\$ 579	\$ 460	\$959	\$663	\$1,176
State	51	41	—	—	19
	<u>630</u>	<u>501</u>	<u>959</u>	<u>663</u>	<u>1,195</u>
Deferred:					
Federal	(114)	(63)	(57)	24	(171)
State	(3)	(19)	—	57	61
	<u>(117)</u>	<u>(82)</u>	<u>(57)</u>	<u>81</u>	<u>(110)</u>
	<u>\$ 513</u>	<u>\$ 419</u>	<u>\$902</u>	<u>\$744</u>	<u>\$1,085</u>

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:

	Six Months Ended June 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	2.0	1.0	0.0	1.7	1.6
Life insurance income	(2.2)	(2.5)	(2.2)	(3.4)	(2.6)
Other	(1.5)	(1.4)	(2.5)	0.8	(0.3)
	<u>32.3%</u>	<u>31.1%</u>	<u>29.3%</u>	<u>33.1%</u>	<u>32.7%</u>

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 10 - INCOME TAXES (CONTINUED)

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities are as follows:

	June 30,	December 31,	
	2005	2004	2003
	(Unaudited)		
	(In Thousands)		
Deferred tax assets:			
Deferred compensation	\$ 893	\$ 892	\$ 714
Allowance for loan losses	267	273	275
Capital loss carryforward	56	56	56
Other	78	7	61
<b>Total Deferred Tax Assets</b>	<b>1,294</b>	<b>1,228</b>	<b>1,106</b>
Deferred tax liabilities:			
Unrealized gains on securities available for sale	(265)	(378)	(525)
Depreciation	(373)	(412)	(382)
Deferred loan origination costs	(359)	(329)	(309)
Unrealized gains on deferred compensation investment	(13)	(55)	(40)
<b>Total Deferred Tax Liabilities</b>	<b>(1,010)</b>	<b>(1,174)</b>	<b>(1,256)</b>
	<b>\$ 284</b>	<b>\$ 54</b>	<b>\$ (150)</b>

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.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

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#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 10 - INCOME TAXES (CONTINUED)

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 June 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 six months ended June 30, 2005 and 2004 (unaudited) and the years ended December 31, 2004, 2003 and 2002 was \$152,000, \$144,000, \$297,000, \$255,000 and \$220,000, respectively.

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 \$5,623,000, \$5,520,000 and \$5,317,000 at June 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 \$1,311,000, \$1,211,000 and \$962,000 at June 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.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

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#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 11 - EMPLOYEE AND DIRECTOR BENEFIT PLANS (CONTINUED)

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 June 30, 2005 (unaudited) and December 31, 2004, the Association has set aside U.S. Treasury bonds with an amortized cost of \$2,060,000 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 \$602,000, \$533,000 and \$371,000 at June 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 six months ended June 30, 2005 and 2004 (unaudited) and the years ended December 31, 2004, 2003 and 2002 was \$199,000, \$219,000, \$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 \$667,000, \$665,000 and \$597,000 invested in such investment options and recorded as other assets at June 30, 2005 (unaudited), December 31, 2004 and 2003, respectively. The Association's net expense for the deferred compensation plan for the six months ended June 30, 2005 and 2004 (unaudited) and the years ended December 31, 2004, 2003 and 2002 was \$18,000, \$36,000, \$77,000, \$148,000 and \$(41,000), respectively.

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### 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:

	June 30,		December 31,			
	2005		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	\$ 16,017	\$ 16,017	\$ 11,577	\$ 11,577	\$ 16,753	\$ 16,753
Securities available for sale	96,396	96,396	99,170	99,170	83,027	83,027
Securities held to maturity	2,320	2,647	2,359	2,503	371	389
Federal Home Loan Bank stock	2,569	2,569	2,709	2,709	2,167	2,167
Loans receivable	200,008	202,809	199,525	202,712	187,138	192,418
Accrued interest receivable	1,216	1,216	1,195	1,195	1,042	1,042
Financial liabilities:						
Deposits	247,425	246,611	243,554	243,183	230,495	231,955
Short-term borrowings	9,525	9,525	11,725	11,725	11,800	11,800
Long-term debt	41,860	41,526	42,260	42,103	31,535	31,817
Accrued interest payable	178	178	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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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

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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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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 13 - REGULATORY CAPITAL REQUIREMENTS (CONTINUED)

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 June 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)						
<b>As of June 30, 2005 (Unaudited):</b>						
Total capital (to risk weighted assets)	\$29,262	16.67%	\$14,039	8.0%	\$ ≥ 17,548	≥ 10.0%
Tier 1 capital (to adjusted total assets)	27,349	8.25	13,284	4.0	≥ 16,581	≥ 5.0
Tangible equity (to tangible assets)	27,349	8.25	4,974	1.5	N/A	N/A
Tier 1 capital (to risk weighted assets)	27,349	15.58	N/A	N/A	≥ 10,528	≥ 6.0
<b>As of December 31, 2004:</b>						
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
<b>As of December 31, 2003:</b>						
Total capital (to risk weighted assets)	\$26,020	16.41%	\$12,686	8.0%	\$ ≥ 15,858	≥ 10.0%
Tier 1 capital (to adjusted total assets)	24,155	7.99	12,088	4.0	≥ 15,110	≥ 5.0
Tangible equity (to tangible assets)	24,155	7.99	4,533	1.5	N/A	N/A
Tier 1 capital (to risk weighted assets)	24,155	15.23	N/A	N/A	≥ 9,515	≥ 6.0

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### LAKE SHORE SAVINGS AND LOAN ASSOCIATION

#### NOTES TO FINANCIAL STATEMENTS

##### NOTE 14 - COMMITMENTS TO EXTEND CREDIT

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		
	June 30,	December 31,	
	2005	2004	2003
	(Unaudited)	(In Thousands)	
Commitments to grant loans	\$ 7,049	\$ 3,969	\$ 3,656
Unfunded commitments under lines of credit	20,313	19,224	17,708

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.

##### NOTE 15 - SUBSEQUENT EVENT

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.

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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.  
\_\_\_\_\_, \_\_2005

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.

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### 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
<b>TOTAL</b>	<b>\$ 1,453,900</b>

\* 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 Thatcher Proffitt & Wood LLP regarding legality of securities to be registered
8.1	Form of Opinion of Thatcher Proffitt & Wood LLP regarding federal tax matters
8.2	Form of 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 Thatcher Proffitt & Wood LLP (included in Exhibits 5.1 and 8.1 to this Registration Statement)
23.2	Consent of Beard Miller & Company LLP
23.3	Consent of PricewaterhouseCoopers LLP
23.4	Consent of RP Financial, LC
24.1	Powers of Attorney (included in Signature Page of this 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*

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\* 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.



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## 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 October 31, 2005.

Lake Shore Bancorp, Inc.

By: /s/ David C. Mancuso  
David C. Mancuso  
President and Chief Executive Officer  
(Duly Authorized Representative)

## POWER OF ATTORNEY

KNOW ALL MEN BY THE PRESENTS, that each person whose signature appears below constitutes and appoints David C. Mancuso, as their true and lawful attorney-in-fact in any and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities to sign the Form S-1 Registration Statement and any and all amendments thereto, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the U.S. Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or either one of his or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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/ <b>D AVID C. M ANCUSO</b>	President, Chief Executive Officer and Director (Principal Executive Officer)	October 31, 2005
<b>David C. Mancuso</b>		
/ s/ <b>R OBERT L. S MITH</b>	Chief Financial Officer (Principal Financial and Accounting Officer)	October 31, 2005
<b>Robert L. Smith</b>		

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<u>Name</u>	<u>Title</u>	<u>Date</u>
/ s / S H A R O N E. B R A U T I G A M <hr/> Sharon E. Brautigam	Director	October 31, 2005
/ s / M I C H A E L E. B R U N E C Z <hr/> Michael E. Brunecz	Director	October 31, 2005
/ s / J A M E S P. F O L E Y D D S <hr/> James P. Foley DDS	Director	October 31, 2005
/ s / T H O M A S E. R E E D <hr/> Thomas E. Reed	Director	October 31, 2005
/ s / D A N I E L P. R E I N I N G A <hr/> Daniel P. Reininga	Director	October 31, 2005
/ s / G A R Y W. W I N G E R <hr/> Gary W. Winger	Director	October 31, 2005
/ s / N A N C Y L. Y O C U M <hr/> Nancy L. Yocum	Director	October 31, 2005

**Exhibit 1.1**

June 2, 2005

Mr. David C. Mancuso  
President & CEO  
Lake Shore Savings  
128 E. 4<sup>th</sup> Street  
Dunkirk, NY 14048

### **CONFIDENTIAL**

Re: Proposed Conversion and Reorganization–Advisory, Administrative and Marketing Services

Dear Mr. Mancuso:

Ryan Beck & Co., Inc. (“RBCO”) is pleased to submit this engagement letter setting forth the terms of the proposed engagement between RBCO and Lake Shore Savings (the “Institution” or the “Company”) in connection with the potential corporate reorganization of the Institution and sale of common stock by the Institution.

#### **1. BACKGROUND ON RYAN BECK**

Ryan Beck & Co., Inc. was organized in 1946 and is one of the nation’s leading investment bankers for financial institutions. The firm is a registered broker-dealer with the Securities and Exchange Commission, a member of the National Association of Securities Dealers, Inc., Securities Industry Association and a member of the Securities Investor Protection Corporation. RBCO’s Financial Institutions Group is one of the nation’s largest such groups devoted solely to investment banking services for financial institutions.

#### **2. MUTUAL HOLDING COMPANY FORMATION AND STOCK OFFERING**

The Institution is considering reorganization into a two-tier mutual holding company structure by forming a mutual holding company and middle-tier holding company (“Holding Company”) pursuant to applicable regulations. The common stock (the “Common Stock”) would be offered in a subscription offering with any remaining shares expected to be sold in a community offering and, if necessary, a syndicated community offering (collectively the “Offering”). In connection therewith, the Institution’s Board of Directors would adopt a stock issuance plan (the “Plan”) regarding the reorganization and the

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Offering. RBCO proposes to act as financial advisor to the Institution with respect to the reorganization and Offering and as selling agent with respect to the Offering. Specific terms of services shall be set forth in a definitive agency agreement (the “Definitive Agreement”) between RBCO and the Institution to be executed on the date the offering document is declared effective by the regulatory authorities. In the event that an acquisition or merger is planned, this letter shall cover our services for a Full Conversion.

### **3. SERVICES TO BE PROVIDED BY RYAN BECK**

RBCO provides and helps coordinate advisory, administrative and marketing services in connection with thrift reorganizations and related stock offerings. Our existing team has worked together on numerous such transactions.

a. Advisory Services - As your investment banker, RBCO will work with you and your counsel to evaluate financial, marketing and regulatory issues. Our working knowledge of the law and “lore” of bank regulators, securities regulators and NASD is essential. Our legal, accounting and regulatory background is equally important.

Our specific advisory responsibilities include:

- Advise with respect to business planning issues in preparation for a public offering;
- Advise with respect to the choice of charter and form of organization;
- Review and advise with respect to the stock issuance plan (e.g. sizes of benefit plan purchases; max purchase limits for investors);
- Advise with respect to which trading venue the shares should trade on;
- Review and provide input with respect to the business plan to be prepared in connection with the Offering;
- Discuss the appraisal process and analyze the appraisal with the Board of Directors;
- Participate in drafting the offering document and any proxy materials, and assist in obtaining all requisite regulatory approvals;
- Develop a marketing plan for the subscription and community offerings, considering various sales method options, including direct mail, advertising, community meetings and telephone solicitation;
- Develop a proxy solicitation plan, to include telephone calls and mailings;
- RBCO does not offer data processing agent, printing and transfer agent functions. Costs of such services will be borne by the Institution and are subject to agreements signed by the Institution and each service provider. RBCO will work with the Institution to provide specifications and assistance in selecting these and any other professionals that will perform administrative functions in connection with the offering and the proxy solicitation process;
- Develop a layout for the Stock Information Center (the “Center”), where stock order and proxy card processing occur;
- Provide a list of equipment, staff and supplies needed for the Center; and
- Draft marketing materials including letters, order form, advertisement, brochure. If a community meeting or road show is anticipated, we will help draft the presentation – saving you time and legal expense; and

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- Consulting with management, determine whether and when to assemble a selling group of selected local broker-dealers to assist in selling stock after the community offering;

b. Administrative Services and Stock Information Center Management – RBCO will manage all aspects of a thrift reorganization's stock offering and proxy solicitation. Successful stock sale and vote results require thorough planning and an enormous amount of attention to detail. Our efforts are meant to avoid mistakes, costly surprises and lost opportunities. We identify key logistics, define responsibilities and create timetables to help avoid confusion among the many members of the working group. An offering also requires accurate and timely record keeping and reporting. Furthermore, customers must be handled professionally and their questions must be answered accurately.

The Stock Information Center is the "command center" during a stock offering. RBCO staff's experience in managing many thrift minority stock offerings and full conversion offerings will help them minimize the burden on your management and staff. They will train and supervise the staff that you assign to the Center to help record stock orders, answer customer inquiries and participate in other activities of the Center.

Our administrative services include the following:

- Provide experienced on-site RBCO registered representatives to manage and supervise the Center. All substantive stock offering and proxy vote matters and customer inquiries will be handled by RBCO;
- Prepare procedures for processing proxies, stock orders and cash, and for handling requests for material;
- Provide scripts and training for the telephone team who will solicit proxies and, if needed, help conduct a stock sales telemarketing effort;
- Educate the Institution's directors, officers and employees about the reorganization and Offering, their roles and relevant securities laws;
- Train branch managers and customer-contact employees on the proper response to stock purchase and proxy vote inquiries;
- Coordinate functions with and between the data processing agent, printer, transfer agent, stock certificate printer and other professionals;
- Design and implement procedures for handling IRA and Keogh orders;
- Supervise Center staff in proxy card and order processing and in proxy solicitation calling efforts;
- Prepare daily vote and sales reports for management, ensuring funds received balance to the reports;
- Manage the pro-ration process in the event of oversubscription;
- Coordinate with the stock exchange and DTC to ensure a smooth closing and stock trading; Provide post-offering subscriber assistance.

c. Securities Marketing Services - RBCO uses various sales techniques including direct mail, advertising, community investor meetings, telephone solicitation, and if necessary, assembling a selling

group of broker-dealers for a syndicated community offering. The sales approach for your stock offering will be tailored to fit your specific situation, in order to best manage the offering and attract a stockholder base comprised largely of community-oriented individuals loyal to the Institution.

Our specific marketing services include:

- If applicable, assist management in developing a list of potential investors who are viewed as priority prospects;
- The RBCO registered representatives at the Center will solicit orders from the eligible prospects described above;
- Respond to questions related to information in the offering document and in any proxy materials, and answer investment-related questions;
- If the sales plan calls for community meetings, participate in them. Community meetings can relieve customer anxiety and generate local publicity for the Offering;
- Continually advise management on sales progress, market conditions and customer/community responsiveness to the Offering;
- Prepare broker “fact sheets” and arrange “road shows” for the purpose of stimulating interest in the stock and informing the brokerage community of the particulars of the Offering; and
- Contact other market-makers to trade the stock in the after-market.

#### **4. COMPENSATION**

For its services hereunder, the Institution will pay to RBCO a the following compensation:

- a. A reorganization and proxy vote advisory and administrative services fee of \$50,000 in connection with certain services set forth in section 3.a. and 3.b. hereof. In view of the long preparation phase prior to commencement of the Offering, this fee shall be payable as follows: \$25,000 upon executing this letter; \$15,000 upon the initial filing of the offering document and \$10,000 upon closing of the reorganization and Offering.
- b. A sales fee of one percent (1.00%) of the dollar amount of the Common Stock 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 stock to officers, directors, employees or immediate family of such persons (“Insiders”) and qualified and non-qualified employee benefit plans of the Institution or the Insiders.
- c. For stock sold by a group of selected dealers (including RBCO) pursuant to a syndicated community offering solely managed by RBCO (the “Selling Group”), a fee equal to one percent (1.00%) of the aggregate dollar amount of Common Stock sold in the syndicated community offering, which fee paid to RBCO, along with the fee payable directly by the Institution to the other selected dealers shall not exceed six percent (6.00%) of the aggregate dollar amount of Common Stock so sold. In consultation with RBCO, the Institution will determine which NASD member firms will participate in the Selling Group and the extent of their participation. RBCO will not commence sales of the Common Stock through the Selling Group without the specific prior approval of the Institution.
- d. If, pursuant to a resolicitation of subscribers undertaken by the Institution, RBCO is required to provide significant additional services, the parties shall mutually agree to the dollar amount of any additional compensation due.

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The above compensation, less the amount of advance payments described in subparagraph a., is to be paid to RBCO at the closing of the Offering.

If, after adoption of the Plan, (i) the Plan is abandoned or terminated by the Institution; (ii) the Offering is not consummated by June 30, 2006; (iii) RBCO terminates this relationship because there has been a material adverse change in the financial condition or operations of the Institution since March 31, 2005; or (iv) immediately prior to commencement of the Offering, RBCO terminates this relationship because in its opinion, which shall have been formed in good faith after reasonable determination and consideration of all relevant factors, there has been a failure to satisfactorily disclose all relevant information in the offering document or other disclosure documents or market conditions exist which might render the sale of the Common Stock inadvisable; RBCO shall not be entitled to the compensation set forth above, but in addition to reimbursement of its actual accountable out-of-pocket expenses as set forth in paragraph 7 below, shall be entitled to payment of \$40,000 for its reorganization and proxy vote advisory services.

## **5. MARKET MAKING**

If applicable, RBCO agrees to use its best efforts to maintain a market and to solicit other broker-dealers to make a market in the Common Stock so that there will be at least three market makers for the Common Stock after the Offering.

## **6. DOCUMENTS**

The Institution and its counsel will complete, file with the appropriate regulatory authorities and, as appropriate, amend from time to time, the information to be contained in the Institution's applications to banking and securities regulators and any related exhibits thereto. In this regard, the Institution and its counsel will prepare an offering document and any other necessary disclosure documents relating to the offering of the Common Stock in conformance with applicable rules and regulations. As the Institution's financial advisor, RBCO will, in conjunction with counsel, conduct an examination of the relevant documents and records of the Institution and will make such other reasonable investigations as deemed necessary and appropriate under the circumstances. The Institution agrees to make all documents, records and other information deemed necessary by RBCO, or its counsel, available to them upon reasonable notice. RBCO's counsel will prepare, subject to the approval of Institution's counsel, the Definitive Agreement. RBCO's counsel shall be selected by RBCO, subject to the approval of the Institution.

## **7. EXPENSES AND REIMBURSEMENT**

The Institution will bear all of its expenses in connection with the reorganization and the Offering of Common Stock including, but not limited to: appraisal and business plan preparation; the Institution's attorney fees; NASD filing fees; "blue sky" legal fees and state filing fees; services of the data processing agent, transfer agent, financial and stock certificate printers, auditors and accountants; advertising; postage; "road show" and other syndicated community offering costs; and all costs of

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operating the Stock Information Center, including hiring temporary personnel, if necessary. In the event RBCO incurs such expenses on behalf of the Institution, the Institution shall reimburse RBCO for such actual accountable fees and expenses regardless of whether the Reorganization is successfully completed. RBCO will not incur any single expense of more than \$1,000, pursuant to this paragraph without the prior approval of the Institution.

The Institution also agrees to reimburse RBCO for its actual accountable out-of-pocket expenses, including legal fees and expenses, incurred by RBCO in connection with the services contemplated hereunder. In the subscription and community offering, RBCO will not incur legal fees (excluding the out-of-pocket expenses of counsel) in excess of \$100,000 without the approval of the Institution. RBCO will not incur reimbursable direct out-of-pocket expenses in excess of \$20,000 without the consent of the Institution. The parties acknowledge, however, that such cap may be increased by the mutual consent of the Institution and RBCO, including in the event of a material delay in the Offering which would require an update of the financial information in tabular form to reflect a period later than that set forth in the original filing of the offering document. In addition, in the event of a syndicated community offering, the Institution will reimburse all actual accountable out-of-pocket expenses incurred in connection with that offering phase. Not later than two days before closing, RBCO will provide the Institution with a detailed accounting of all reimbursable expenses of RBCO and its counsel to be paid at closing.

## **8. BLUE SKY**

To the extent required by applicable state law, RBCO and the Institution must obtain or confirm exemptions, qualifications or registration of the Common Stock under applicable state securities laws and NASD policies. The cost of such legal work and related state filing fees will be paid by the Institution to the law firm furnishing such legal work. The Institution will instruct the counsel performing such services to prepare a Blue Sky memorandum related to the Offering including RBCO's participation therein and shall furnish RBCO a copy thereof, regarding which such counsel shall state RBCO may rely.

## **9. AVAILABILITY OF "STARS" PROGRAM**

As an additional service to the Institution, RBCO will make available for a period of 1 year following the completion of the Offering, advisory services through the RBCO Strategic Advisory Services ("STARS") program. The undersigned will serve as the senior relationship manager for this program. If the Institution elects to avail itself of the STARS program, RBCO will meet with the Institution at its request. RBCO also will provide opinions and recommendations, upon request, for the areas covered below:

- Valuation Analysis
- Merger and Acquisition Planning and Analysis
- Merger and Acquisition Trends
- Planning, Forecasting & Competitive Strategy
- Capital, Asset & Liability Structure & Management
- Stock Repurchase Programs
- Dividend Policy
- Dividend Reinvestment Programs
- Market Development and Sponsorship of Bank Securities

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Financial Disclosure  
Financial Relations  
Financial Reports  
Branch Sales and Purchases  
Stock Benefit Plan Analysis and Advisory  
Stockholder & Investor Relations Presentations & Programs  
Fairness Opinions  
Scanning of Potential Acquisition Candidates  
Based on Published Statement Information

(This screening does not extend to any in-depth merger and acquisition analyses or studies which are available under RBCO's normal fee schedule, and does not include retention of RBCO by the Institution for any specific merger/acquisition situation.)

If the Institution elects to utilize the STARS program RBCO will waive the regular retainer fee and hourly charges for this program for the first year. The Institution also will reimburse RBCO's actual accountable out-of-pocket expenses incurred in conjunction with the performance of these services. Such out-of-pocket expenses shall include travel, legal and other miscellaneous expenses. RBCO will not incur any single expense in excess of \$1,000 pursuant to this paragraph without the prior approval of the Institution.

#### **10. INDEMNIFICATION**

The Definitive Agreement will provide for indemnification of the type usually found in underwriting agreements as to certain liabilities, including liabilities under the Securities Act of 1933. The Institution also agrees to defend, indemnify and hold harmless RBCO and its officers, directors, employees and agents against all claims, losses, actions, judgments, damages or expenses, including but not limited to reasonable attorneys' fees, arising solely out of the engagement described herein, except that such indemnification shall not apply to RBCO's own bad faith, willful misconduct or gross negligence or any indemnification that the Institution is prohibited from making by law to which contribution shall apply in accordance with standard contribution language.

#### **11. CONFIDENTIALITY**

To the extent consistent with legal requirements and except as otherwise set forth in the offering document, all information given to RBCO by the Institution, unless publicly available or otherwise available to RBCO without restriction to breach of any confidentiality agreement ("Confidential Information"), will be held by RBCO in confidence and will not be disclosed to anyone other than RBCO's agents without the Institution's prior approval or used for any purpose other than those referred to in this engagement letter. Upon the termination of its engagement, RBCO will promptly deliver to the Institution all materials specifically produced for it and will return to the Institution all Confidential Information provided to RBCO during the course of its engagement hereunder.



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## **12. NASD MATTERS**

RBCO has an obligation to file certain documents and to make certain representations to the National Association of Security Dealers (“NASD”) in connection with the Offering. The Institution agrees to cooperate with RBCO and provide such information as may be necessary for RBCO to comply with all NASD requirements applicable to its participation in the Offering. RBCO is and will remain through completion of the Offering a member in a good standing of the NASD and will comply with all applicable NASD requirements.

## **13. OBLIGATIONS**

Except as set forth below, this engagement letter is merely a statement of intent. While RBCO and the Institution agree in principle to the contents hereof and propose to proceed promptly and in good faith to work out the arrangements with respect to the Offering, any legal obligations between RBCO and the Institution shall be only: (i) those set forth herein in paragraphs 2, 3 and 4 regarding services and payments; (ii) those set forth in paragraph 7 regarding reimbursement for certain expenses; (iii) those set forth in paragraph 10 regarding indemnification; (iv) those set forth in paragraph 11 regarding confidentiality; and (v) as set forth in a duly negotiated and executed Definitive Agreement.

The obligation of RBCO to enter into the Definitive Agreement shall be subject to there being, in RBCO’s opinion, which shall have been formed in good faith after reasonable determination and consideration of all relevant factors: (i) no material adverse change in the condition or operation of the Institution; (ii) satisfactory disclosure of all relevant information in the disclosure documents and a determination that the sale of stock is reasonable given such disclosures; (iii) no market conditions which might render the sale of the shares by the Institution hereby contemplated inadvisable; and (iv) agreement that the price established by the independent appraiser is reasonable in the then-prevailing market conditions.

## **14. INDEPENDENT CONTRACTOR; NO FIDUCIARY DUTY**

The Institution acknowledges and agrees that it is a sophisticated business enterprise and that RBCO has been retained pursuant to this engagement letter to act as financial advisor to the Institution solely with respect to the matters set forth herein. In such capacity, RBCO shall act as an independent contractor, and any duties of RBCO arising out of this engagement pursuant to this letter shall be contractual in nature and shall be owed solely to the Institution. Each party disclaims any intention to impose any fiduciary duty on the other.

## **15. GOVERNING LAW**

This engagement letter shall be governed by and construed in accordance with the laws of the State of New Jersey applicable to contracts executed and to be wholly performed therein without giving effects to its conflicts of laws principles or rules. Any dispute here under shall be brought in a court in the State of New Jersey.

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**16. WAIVER OF TRIAL BY JURY**

**BOTH RBCO AND THE INSTITUTION WAIVE ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING, CLAIM OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT OR OTHERWISE) RELATED TO OR ARISING OUT OF THIS AGREEMENT.**

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Please acknowledge your agreement to the foregoing by signing in the place provided below and returning one copy of this letter to our office together with the retainer payment in the amount of \$25,000. We look forward to working with you.

**RYAN BECK & CO., INC.**

By:                     /s/  M A R K B. C O H E N                      
                    **Mark B. Cohen**  
                    **Managing Director**

Accepted and Agreed to this 14<sup>th</sup> Day of June, 2005

**LAKE SHORE SAVINGS**

By:                     /s/  D A V I D C. M A N C U S O                      
                    **David C. Mancuso**  
                    **President & Chief Executive Officer**

Cc: V. Gerard Comizio  
Thacher Proffitt & Wood

**Exhibit 2.1**

**A M E N D E D A N D R E S T A T E D**  
**P L A N O F R E O R G A N I Z A T I O N A N D M I N O R I T Y S T O C K I S S U A N C E**  
**L A K E S H O R E S A V I N G S A N D L O A N A S S O C I A T I O N**  
**D U N K I R K , N E W Y O R K**  
**A S A M E N D E D B Y T H E B O A R D O F D I R E C T O R S O N O C T O B E R 1 1 , 2 0 0 5**

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## Introduction.

For purposes of this section, all capitalized terms have the meanings ascribed to them in Section 1.

The Board of Directors of the Bank has unanimously adopted this Plan of Reorganization and Minority Stock Issuance pursuant to which the Bank will reorganize into a mutual holding company structure under the laws of the United States. In accordance with the Plan, the Bank will convert from a New York State savings and loan association charter to a federal stock savings bank charter. The Charter Conversion is subject to approval by the affirmative vote of either (i) sixty six and two thirds percent in amount of book value of all outstanding deposits of the Bank, or (ii) at least seventy five percent in amount of all outstanding deposits of the Bank represented at the Special Meeting of depositors. Conversion to a federal charter will allow the Bank to take advantage of federal preemption of state law regulating the Bank's activities and result in the Bank being subject to regulation by a single primary federal regulator, the OTS.

As part of the Reorganization and in accordance with this Plan, a mutual holding company to be known as Lake Shore, MHC (the "MHC") will be established, as well as Lake Shore Bancorp, Inc. (the "Stock Holding Company"), which will be a federal corporation. In addition, a federally-chartered stock savings bank, which will be named Lake Shore Savings Bank, will also be established. The Stock Holding Company will be a majority-owned subsidiary of the MHC at all times so long as the MHC remains in existence, and the Bank will be a wholly-owned subsidiary of the Stock Holding Company. The Plan also provides that non-transferable subscription rights to purchase up to 49.99% of the common stock of the Stock Holding Company ("Conversion Stock") shall be granted to certain deposit account holders of the Bank pursuant to the Plan and in accordance with the regulations of the OTS. The Reorganization and the Offerings will permit the Bank to control the amount of capital being raised to enable the Bank to more prudently deploy the proceeds, while at the same time enabling the Bank to: (1) support future lending and operational growth, including branching activities and acquisitions of other financial institutions or financial services companies; (2) increase its ability to render services to the communities it serves; (3) compete more effectively with commercial banks and other financial institutions for new business opportunities; and (4) increase its equity capital base and access the capital markets when needed.

In furtherance of the Bank's commitment to its community, the Plan provides for the establishment of a charitable foundation as part of the Reorganization and Offerings. The charitable foundation is intended to complement the Bank's existing community reinvestment activities in a manner that will allow the Bank's local communities to share in the growth and profitability of the Stock Holding Company and the Bank over the long term. Consistent with the Bank's goal, the Stock Holding Company intends to donate to the charitable foundation immediately following the Offerings a number of shares of its authorized but previously unissued Stock Holding Company Common Stock in an amount to equal an aggregate of up to 2% of the outstanding Stock Holding Company Common Stock (after such donation).

This Plan is subject to the approval of the OTS and must be adopted by at least a majority of the total number of outstanding votes eligible to be cast by Voting Depositors at the Special Meeting.

Pursuant to Section 10(o) of the Home Owner's Loan Act, as amended ("HOLA"), 12 U.S.C. 1470(o), and Section 6022(i)(1) of the HOLA, the Reorganization will be accomplished in accordance with the procedures contained in this Plan, the rules and regulations of the OTS, and as may otherwise be required by the OTS.

1. Definitions.

As used in this Plan, the terms set forth below have the following meaning:

Acting In Concert means (i) 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 (ii) a combination or pooling of voting or other interests in the securities of an issuer for a common purpose pursuant to any contract, understanding, relationship, agreement or other arrangement, whether written or otherwise. A person or company which acts in concert with another Person or company ("other party") shall also be deemed to be acting in concert with any Person who is also acting in concert with that other party, except that any Tax-Qualified Employee Stock Benefit Plan will not be deemed to be acting in concert with its trustee or a person who serves in a similar capacity solely for the purpose of determining whether stock held by the trustee and stock held by the plan will be aggregated and participants or beneficiaries of any such Tax-Qualified Employee Stock Benefit Plan will not be deemed to be acting in concert solely as a result of their common interests as participants or beneficiaries. When Persons act together for such purpose, their group is deemed to have acquired their stock. The determination of whether a group is Acting in Concert shall be made solely by the Board of Directors of the Bank or by Officers designated by such Board and may be based on any evidence upon which the Board or such designees chooses to rely, including, without limitation, joint account relationships or the fact that such Persons have filed joint Schedules 13D or Schedules 13G with the SEC with respect to other companies. Directors of the Stock Holding Company, the Bank and the MHC shall not be deemed to be Acting in Concert solely as a result of their membership on any such board or boards.

Actual Purchase Price means the price per share at which the Conversion Stock is ultimately sold by the Stock Holding Company in the Offerings in accordance with the terms hereof.

Affiliate means a Person who, directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with the Person specified.

Associate, when used to indicate a relationship with any Person, means (i) a corporation or organization (other than the MHC, the Stock Holding Company, the Bank or a majority-owned subsidiary of the MHC, the Stock Holding Company or the Bank) 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, (ii) 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, provided, however, that such term shall not include any Tax-Qualified Employee Stock Benefit Plan in which such Person has a substantial beneficial interest or serves as a trustee or in a similar fiduciary capacity, and (iii) any relative or spouse of such Person, or any relative of such spouse, who has the same home as such Person or who is a director or officer of the MHC, the Stock Holding Company or the Bank or any of their subsidiaries.

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Bank means Lake Shore Savings and Loan Association, a New York-chartered savings and loan association, or Lake Shore Savings Bank, a federally-chartered stock savings bank, as the context of this Plan requires.

Bank Benefit Plans includes, but is not limited to, Tax-Qualified Employee Stock Benefit Plans and Non-Tax-Qualified Employee Stock Benefit Plans.

Bank Common Stock means the common stock of the Bank, par value \$0.01 per share, which stock will not be insured by the FDIC or any other governmental authority, all of which will be held by the Stock Holding Company.

Charter Conversion means the conversion of the Bank's charter from a New York state-chartered savings and loan association charter to a federally-chartered stock savings bank charter.

Code means the Internal Revenue Code of 1986, as amended.

Community Offering means the offering for sale by the Stock Holding Company of any shares of Conversion Stock not subscribed for in the Subscription Offering to such Persons within or without counties of Chautauqua, Erie and Cattaraugus Counties, New York as may be selected by the Stock Holding Company and the Bank in their sole discretion and to whom a copy of the Prospectus is delivered by or on behalf of the Stock Holding Company.

Control (including the terms "controlling," "controlled by," and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

Conversion Stock means the Stock Holding Company Common Stock to be issued to the MHC, to be contributed by the Stock Holding Company to the Foundation and to be sold by the Stock Holding Company in the Offerings pursuant to the Plan. The Conversion Stock will not be insured by the FDIC or any other governmental authority.

Deposit Account means any withdrawable account as defined in Section 561.42 of the Rules and Regulations of the OTS, including a demand account as defined in Section 561.16 of the Rules and Regulations of the OTS.

Depositor means any person or entity who is the holder of a Deposit Account at the Bank.

Eligible Account Holder means any Person holding a Qualifying Deposit on the Eligibility Record Date for purposes of determining Subscription Rights.

Eligibility Record Date means the date for determining Eligible Account Holders and is the close of business on June 30, 2004.

ESOP means a Tax-Qualified Employee Stock Benefit Plan adopted by the MHC, Stock Holding Company or the Bank in connection with the Reorganization, the purpose of which shall be to acquire capital stock of the Stock Holding Company, including Conversion Stock.

Estimated Price Range means the range of the estimated aggregate pro forma market value of the total number of shares of Conversion Stock to be issued in the Offerings, as determined by the Independent Appraiser in accordance with Section 4 hereof.

Foundation means a charitable foundation that will qualify as an exempt organization under Section 501(c)(3) of the Code the establishment and funding of which is contemplated by Section 3 herein.

FDIC means the Federal Deposit Insurance Corporation or any successor thereto.

Independent Appraiser means the independent investment banking or financial consulting firm retained by the Stock Holding Company and the Bank to prepare an appraisal of the estimated pro forma market value of the Conversion Stock.

Management Person means any Officer or director of the Bank or any Affiliate of the Bank and any person Acting in Concert with such Officer or director.

Member means any Person qualifying as a member of the MHC in accordance with its federal mutual charter and bylaws adopted in connection with the Plan; the members of the MHC shall be existing and future Depositors of the Bank and Stock Bank.

MHC means Lake Shore, MHC, a company organized under the laws of the United States. Upon completion of the Reorganization, the MHC shall hold at least 50.01% of the outstanding Stock Holding Company Common Stock.

Minority Stockholder means any owner of the Stock Holding Company's Common Stock other than the MHC and the Foundation.

Offerings mean the offering of Conversion Stock to Persons other than the MHC and the Foundation in the Subscription Offering, the Community Offering and the Syndicated Community or Public Offering.

Officer means the president, chief executive officer, vice-president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any other person performing similar functions with respect to any organization whether incorporated or unincorporated.

Order Form means the form or forms to be provided by the Stock Holding Company, containing all such terms and provisions as set forth in Section 11 hereof, to a Participant or other Person by which Conversion Stock may be ordered in the Subscription Offering and Community Offering.

Other Depositor means a Voting Depositor who is not an Eligible Account Holder or a Supplemental Eligible Account Holder.

OTS means the Office of Thrift Supervision or any successor thereto.



Participant means any Eligible Account Holder, Tax-Qualified Employee Stock Benefit Plan, Supplemental Eligible Account Holder or Other Depositor, but does not include the MHC or the Foundation.

Person means an individual, a corporation, a partnership, an association, a joint stock company, a limited liability company, a limited liability partnership, a trust, an unincorporated organization or a government or any political subdivision thereof.

Plan and Plan of Reorganization mean this Plan of Reorganization and Minority Stock Issuance as adopted by the Board of Directors of the Bank and any amendment hereto approved as provided herein.

Prospectus means the one or more documents to be used in offering the Conversion Stock in the Offerings.

Proxy Statement means the document used to solicit approval of the Plan and the funding of the Foundation by Voting Depositors.

Public Offering means an underwritten firm commitment offering to the public through one or more underwriters.

Qualifying Deposit means the aggregate balance of all Deposit Accounts in the Bank of (i) an Eligible Account Holder at the close of business on the Eligibility Record Date, provided such aggregate balance is not less than \$50, and (ii) a Supplemental Eligible Account Holder at the close of business on the Supplemental Eligibility Record Date, provided such aggregate balance is not less than \$50.

Reorganization means the reorganization of the Bank into the MHC and the organization of the Stock Holding Company as a subsidiary of the MHC and the Stock Bank as a subsidiary of the Stock Holding Company pursuant to this Plan.

SEC means the United States Securities and Exchange Commission.

Special Meeting means the Special Meeting of Depositors of the Bank called for the purpose of soliciting the Depositors' approval of this Plan, the Charter Conversion, possibly, and the funding of the Foundation, including any adjournments or postponements of such meeting.

Stock Bank means the federally-chartered stock savings bank resulting from the conversion of the Bank to stock form pursuant to this Plan.

Stock Holding Company means Lake Shore Bancorp, Inc., a stock corporation to be organized under the laws of the United States. Upon completion of the Reorganization, the Stock Holding Company shall hold all of the outstanding capital stock of the Bank.

Stock Holding Company Common Stock means the common stock of the Stock Holding Company, par value \$.01 per share, which stock cannot and will not be insured by the FDIC or any other governmental authority.

Subscription Offering means the offering of the Conversion Stock to Participants.

Subscription Rights mean nontransferable rights to subscribe for Conversion Stock granted to Participants pursuant to the terms of this Plan.

Supplemental Eligible Account Holder means any Person, except directors and Officers of the Bank and their Associates, holding a Qualifying Deposit at the close of business on the Supplemental Eligibility Record Date.

Supplemental Eligibility Record Date, if applicable, means the date for determining Supplemental Eligible Account Holders and shall be required if the Eligibility Record Date is more than 15 months prior to the date of the approval of the Plan by the OTS. If applicable, the Supplemental Eligibility Record Date shall be the last day of the calendar quarter preceding OTS approval of the Plan.

Syndicated Community Offering means the offering for sale by a syndicate of broker-dealers to the general public of shares of Conversion Stock not purchased in the Subscription Offering and the Community Offering.

Tax-Qualified Employee Stock Benefit Plan means any defined benefit plan or defined contribution plan, such as an employee stock ownership plan, stock bonus plan, profit-sharing plan or other plan, which is established for the benefit of the employees of the MHC, the Stock Holding Company and/or the Bank and any Affiliate thereof and which, with its related trust, meets the requirements to be “qualified” under Section 401 of the Code as from time to time in effect. A “Non-Tax-Qualified Employee Stock Benefit Plan” is any stock benefit plan that is not so qualified.

Voting Depositor means a Person who at the close of business on the Voting Record Date is entitled to vote as a Depositor of the Bank in accordance with its federal mutual charter and bylaws adopted in connection with the Plan of Charter Conversion.

Voting Record Date means the date for determining the eligibility of Depositors to vote at the Special Meeting.

2. General Procedure for Reorganization.

(a) Organization of the Holding Companies and Charter Conversion of the Bank

The Reorganization will occur immediately or as soon as practicable after the Charter Conversion. The Reorganization will be effected as follows: (i) the Bank will exchange its New York mutual savings association charter for a federal mutual savings bank charter; (ii) the Bank will organize an interim federal stock savings bank as a wholly-owned subsidiary (“Interim One”); (iii) Interim One will organize a stock corporation as a wholly-owned subsidiary (“Stock Holding Company”); (iv) Interim One will organize an interim federal stock savings bank as a wholly owned subsidiary (“Interim Two”); (v) the Bank will exchange its federal mutual savings bank charter for a federal stock savings bank charter and Interim One will exchange its charter for a federal mutual holding company charter to become the MHC with any issued and outstanding stock of Interim One to be cancelled; (vi) simultaneously with step (v), Interim Two will merge with and into the Stock Bank with the Stock Bank as the resulting institution; (vii) former Depositors of the Bank will become Members of the MHC; (viii) MHC will contribute 100% of the issued common stock of the Stock Bank to the Stock Holding Company; and (ix) the Stock Holding Company will issue a majority of its common stock to the MHC.

Contemporaneously with the Reorganization, the Stock Holding Company will offer for sale in the Offerings shares of Stock Holding Company Common Stock representing up to 49.99% the pro forma market value of the Stock Holding Company and the Bank. 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 Accounts, as defined in the OTS regulations) of the Bank that are not expressly retained by the MHC shall become the assets and liabilities of the Stock Bank, which will thereupon become an operating savings association subsidiary of the Stock Holding Company and of the MHC. The Bank will apply to the OTS to have the Stock Holding 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 Stock Holding Company following the Reorganization, subject to the OTS regulations governing capital distributions.

The Board of Director of the Bank also intend to take all necessary steps to establish the Foundation and to fund the Foundation in the manner set forth in Section 3 hereof.

(b) Effect on Deposit Accounts and Borrowings

Each deposit account in the Bank on the effective date of the Reorganization will remain a deposit account in the Stock Bank in the same amount and upon the same terms and conditions, and will continue to be federally insured up to the legal maximum by the FDIC in the same manner as each deposit account existed in the Bank immediately prior to the Reorganization. Upon consummation of the Reorganization, all loans and other borrowings from the Bank shall retain the same status with the Stock Bank after the Reorganization as they had with the Bank immediately prior to the Reorganization.

(c) The Bank

Upon completion of the Reorganization, the Stock Bank will be authorized to exercise any and all powers, rights and privileges of, and will be subject to all limitations applicable to, capital stock savings associations under federal law and regulations. A copy of the proposed charter and bylaws of the Stock Bank is attached hereto as Exhibit A and made a part of this Plan. The Reorganization will not result in any reduction of the amount of retained earnings and

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general loss reserves will be accounted for by the MHC, the Stock Holding Company and the Stock Bank on a consolidated basis in accordance with generally accepted accounting principles.

The initial members of the Board of Directors of the Stock Bank will be the members of the existing Board of Directors of the Bank. The Stock Bank will be wholly-owned by the Stock Holding Company. The Stock Holding Company will be wholly-owned by its stockholders who will consist of the MHC and, initially, the persons who purchase Conversion Stock. Upon the effective date of the Reorganization, the voting and membership rights of Depositors will be transferred to the MHC, subject to the conditions specified below.

(d) The Stock Holding Company

The Stock Holding Company will be authorized to exercise any and all powers, rights and privileges, and will be subject to all limitations applicable to savings and loan holding companies and mutual holding companies under federal law and regulations. The initial members of the Board of Directors of the Stock Holding Company will be appointed by the Bank. Thereafter, the voting stockholders of the Stock Holding Company will elect approximately one-third of the Stock Holding Company's directors annually. A copy of the proposed charter and bylaws of the Stock Holding Company is attached hereto as Exhibit B and made a part of this Plan.

The Stock Holding Company will have the power to issue shares of Stock Holding Company Common Stock to persons other than the MHC. However, so long as the MHC is in existence, the MHC will be required to own at least a majority of the Stock Holding Company Common Stock. The Stock Holding Company may issue any amount of non-voting stock to persons other than the MHC. The Stock Holding Company will be authorized to undertake one or more minority stock offerings of less than 50% in the aggregate of the total outstanding Stock Holding Company Common Stock, and the Stock Holding Company intends to offer for sale up to 49.9% of Stock Holding Company Common Stock in the Offerings.

(e) The Mutual Holding Company

As a mutual corporation, the MHC will have no stockholders. The Members of the MHC will have exclusive voting authority as to all matters requiring a vote of Members under the charter of the MHC. Persons who have membership rights with respect to the Bank under its existing charter immediately prior to the Reorganization shall continue to have such rights solely with respect to the MHC after Reorganization so long as such persons remain depositors of the Stock Bank after the Reorganization. In addition, all persons who become depositors of the Stock Bank following the Reorganization will have membership rights with respect to the MHC. The rights and powers of the MHC will be defined by the MHC's charter and bylaws as attached hereto as Exhibit C and by the statutory and regulatory provisions applicable to savings and loan holding companies and mutual holding companies. In particular, the MHC shall be subject to the limitations and restrictions imposed on savings and loan holding companies by Section 10(o)(5) of the HOLA.

The initial members of the Board of Directors of the MHC will be the existing Board of Directors of the Bank. Thereafter, approximately one-third of the directors of the MHC will be

elected annually by the Members of the MHC who will consist of the former Depositors of the Bank and all persons who become depositors of the Stock Bank after the Reorganization.

(f) Charters and Bylaws

Copies of the proposed charter and bylaws of the Stock Bank, the Stock Holding Company and the MHC are attached hereto as Exhibit A, Exhibit B and Exhibit C, respectively, and made a part of this Plan. By their approval of this Plan, the Voting Depositors shall have approved and adopted the charter and bylaws of the Stock Bank, the Stock Holding Company and the MHC. The total shares of Stock Holding Company Common Stock authorized under the Stock Holding Company charter will exceed the shares of Stock Holding Company Common Stock to be issued to the MHC and the Minority Stockholders in the Reorganization.

(g) Rights of Owners of the MHC

Following the Reorganization, all persons who had membership or liquidation rights with respect to the Bank as of the effective date of the Reorganization will continue to have such rights solely with respect to the MHC. All existing proxies granted by Depositors of the Bank to the Board of Directors of the Bank shall automatically become proxies granted to the Board of Directors of the MHC; provided, however, such proxies may not be voted by the Board of Directors of the Bank at the Special Meeting. In addition, all persons who become depositors of the Stock Bank subsequent to the Reorganization also will have membership and liquidation rights with respect to the MHC. In each case, no person who ceases to be the holder of a Deposit Account with the Stock Bank shall have any membership or liquidation rights with respect to the MHC.

(h) Conversion of MHC to Stock Form

Following the completion of the Reorganization, the MHC may elect to convert to stock form in accordance with applicable law and regulation (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur, and the Board of Directors has no present intent or plan to undertake a Conversion Transaction. If the Conversion Transaction does not occur, the MHC will continue to own a majority of the Stock Holding Company Common Stock of the Stock Holding Company.

In a Conversion Transaction, the MHC would merge with and into the Stock Bank or the Stock Holding Company (at the discretion of the MHC), and certain depositors of the Stock Bank would receive the right to subscribe for a number of shares of common stock of the new stock holding company formed in connection with the Conversion Transaction, as determined by the formula set forth in the following paragraphs. The additional shares of Stock Holding Company Common Stock of the new stock holding company issued in the Conversion Transaction would be sold at their aggregate pro forma market value determined by an independent appraisal.

Any Conversion Transaction shall be fair and equitable to Minority Stockholders. In any Conversion Transaction, Minority Stockholders, if any, will be entitled to maintain the same percentage ownership interest in the new stock holding company after the Conversion Transaction as their ownership interest in the Stock Holding Company immediately prior to the

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Conversion Transaction (i.e., the Minority Ownership Interest), subject only to the adjustments (if required by federal or state law, regulation, or regulatory policy) to reflect the market value of assets of the MHC (other than common stock of the Stock Holding Company).

At the sole discretion of the Board of Directors of the MHC and the Stock Holding Company, a Conversion Transaction may be effected in any other manner necessary to qualify the Conversion Transaction as a tax-free reorganization under applicable federal and state tax laws, provided such Conversion Transaction does not diminish the rights and ownership interest of Minority Stockholders as set forth in the preceding paragraphs.

A Conversion Transaction would require the approval of applicable federal regulators, and would be presented to a vote of the Members of the MHC. Under current OTS policy, if a Conversion Transaction were to occur, the transaction would require the approval of a majority of the holders of the Stock Holding Company Common Stock, other than the MHC. In addition, federal regulatory policy requires that in any Conversion Transaction the Members of the MHC will be accorded the same stock purchase priorities as if the MHC were a mutual savings association converting to stock form.

(i) Applications and Regulatory and Depositor Approval

The Bank will take the necessary steps to prepare and file the Notice of Reorganization and Application for Approval of a Minority Stock Issuance, including the Plan, together with all requisite material, with the OTS for approval. The Bank also will cause copies of the Plan to be made available at each office of the Bank for inspection by Depositors. Once the Notice of Reorganization and Application for Approval of a Minority Stock Issuance are filed, the Bank will cause to be published, in accordance with the requirements of applicable regulations of the OTS, notice of the filing with the OTS of the Notice of Reorganization and Application for Approval of a Minority Stock Issuance, and will post notice of the filing of the Notice of Reorganization and Application for Approval of a Minority Stock Issuance in each office of the Bank.

Promptly following receipt of requisite approval of the OTS, this Plan, including the Charter Conversion, and the funding of the Foundation will be submitted to the Voting Depositors for their consideration and approval at the Special Meeting. The Special Meeting shall be held upon written notice given no less than ten days prior to the date of the Special Meeting. The Bank shall mail to all Voting Depositors as of the Voting Record Date, at their last known address appearing on the records of the Bank, a proxy statement describing the Plan, including the Charter Conversion, and the funding of the Foundation which will be submitted to a vote of the Voting Depositors at the Special Meeting.

At the Special Meeting, Depositor shall be entitled to cast one vote in person or by proxy for every \$100.00, or fraction thereof, of the aggregate withdrawal value of all of his deposit accounts in the Bank as of the Eligibility Record Date and, to the extent required by applicable law as to any particular matter that may come before the meeting, each borrower as of the Eligibility Record Date shall be entitled to one vote; provided, however, that no Person shall be eligible to cast more than the lesser of 1,000 votes or the maximum number of votes permitted under the Bank's charter, bylaws and applicable law.

Pursuant to OTS regulations, an affirmative vote of no less than a majority of the total votes of Depositors eligible to be cast is required for approval of this Plan, including adoption of the charter and bylaws of the Stock Holding Company, the MHC and the Stock Bank.

Either at the Special Meeting, or at a separate meeting held prior to the Special Meeting, the Depositors as of the Eligibility Record Date shall vote upon the Charter Conversion. The approval of the Charter Conversion shall be a precondition to the consummation of the Reorganization. In order to satisfy the requirements for such conversion of the Bank under New York State Law, this charter conversion must be approved by either (i) sixty-six and two-thirds percent in amount of the book value of all outstanding Deposits of the Bank or (ii) at least seventy-five percent in amount of all outstanding Deposits of the Bank represented at the Special Meeting. Voting may be in person or by proxy in accordance with the charter and bylaws of the Bank. The Bank shall give notice of such meeting and conduct such meeting in accordance with the applicable provisions of the Bank's organization certificate and bylaws and applicable law.

If the Plan and the funding of the Foundation are approved at the Special Meeting, the Bank shall take all other necessary organizational steps pursuant to applicable laws and regulations to amend its charter and bylaws to authorize the issuance of its capital stock to the Stock Holding Company and to fund the Foundation at the time the Reorganization is consummated.

As soon as practicable after the adoption of the Plan by the Board of Directors of the Bank, the proposed Board of Directors of the Stock Holding Company shall adopt the Plan by at least a two-thirds vote. The proposed Board of Directors of the Stock Holding Company shall cause to be submitted to the OTS such applications as may be required for approval of the acquisition by the MCH and the Stock Holding Company of the common stock of the Bank and a Registration Statement to the SEC to register the Conversion Stock under the Securities Act of 1933, as amended. The proposed Board of Directors of the Stock Holding Company shall also register the Conversion Stock under any applicable state securities laws, subject to Section 13 hereof. Upon registration and after the receipt of all required regulatory approvals, the Conversion Stock shall be first offered for sale in a Subscription Offering to Eligible Account Holders, Tax-Qualified Employee Stock Benefit Plans, Supplemental Eligible Account Holders and Other Depositors. It is anticipated that any shares of Conversion Stock remaining unsold after the Subscription Offering may be sold through a Community Offering or a Syndicated Community Offering. The purchase price per share for the Conversion Stock shall be a uniform price determined in accordance with Section 4 hereof. The Stock Holding Company shall purchase all of the capital stock of the Bank with an amount of the net proceeds received by the Stock Holding Company from the sale of Conversion Stock as shall be determined by the Boards of Directors of the Stock Holding Company and the Bank and as shall be approved by the OTS.

(j) Expenses

The Stock Holding Company and the Bank may retain and pay for the services of financial and other advisors and investment bankers to assist in connection with any or all aspects of the Reorganization, including in connection with the Subscription Offering, Community Offering and/or any Syndicated Community Offering or Public Offering, the payment of fees to brokers and investment bankers for assisting Persons in completing and/or submitting Order Forms. All fees, expenses, retainers and similar items shall be reasonable.

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3. Establishment and Funding of Charitable Foundation.

As part of the Reorganization, the Bank intends to establish a charitable foundation that will qualify as an exempt organization under Section 501(c)(3) of the Code and to donate to the Foundation from authorized but unissued shares of Stock Holding Company Common Stock, an amount to equal an aggregate of up to 2% of the outstanding Stock Holding Company Common Stock (after such donation). The Foundation is being formed in connection with the Reorganization to complement the Bank's existing community reinvestment activities and to share with the Bank's local community a part of the Bank's financial success as a locally headquartered, community minded, financial services institution. The funding of the Foundation with Stock Holding Company Common Stock accomplishes this goal as it enables the community to share in the growth and profitability of the Stock Holding Company and the Bank over the long-term.

The Foundation will be dedicated to the promotion of charitable purposes including community development, grants or donations to support housing assistance, not-for-profit community groups and other types of organizations or civic minded projects. The Foundation will annually distribute total grants to assist charitable organizations or to fund projects within its local community of not less than 5% of the average fair value of Foundation assets each year, less certain expenses. To serve the purposes for which it was formed and maintain its Section 501(c)(3) qualification, the Foundation may sell, on an annual basis, a limited portion of the Stock Holding Company Common Stock contributed to it by the Stock Holding Company.

The Board of Directors of the Foundation will be comprised of individuals who are Officers and/or Directors of the Stock Holding Company or the Bank. Additionally, for at least five years after the Foundation's organization, one member of the Foundation's Board of Directors must be a member of the local community that is not an officer, director or employee of the MHC, the Stock Holding Company, the Bank or any of its Affiliates and who has experience with local charitable organizations and grant making. The Board of Directors of the Foundation will be responsible for establishing the policies of the Foundation with respect to grants or donations, consistent with the stated purposes of the Foundation.

4. Total Number of Shares and Purchase Price of Conversion Stock.

(a) The aggregate price at which shares of Conversion Stock shall be sold in the Offerings shall be based on a pro forma valuation of the aggregate market value of the Conversion Stock prepared by the Independent Appraiser. The valuation shall be based on financial information relating to the Stock Holding Company and the Bank, market, financial and economic conditions, a comparison of the Stock Holding Company and the Bank with selected publicly-held financial institutions and holding companies and with comparable financial institutions and holding companies and such other factors as the Independent Appraiser may deem to be important, including, but not limited to, the projected operating results and financial condition of the Stock Holding Company and Bank. The valuation shall be stated in terms of an Estimated Price Range, the maximum of which shall generally be no more than 15% above the average of the minimum and maximum of such price range and the minimum of which shall generally be no more than 15% below such average. The valuation shall be updated during the pendency of the Reorganization as market and financial conditions warrant and as may be required by the OTS.



(b) Based upon the independent valuation, the Boards of Directors of the Stock Holding Company and the Bank shall fix the purchase price and the number of shares of Conversion Stock to be offered in the Subscription Offering, Community Offering and/or Syndicated Community Offering. The Actual Purchase Price per share for the Stock Holding Company Common Stock shall be a uniform price determined in accordance with applicable OTS rules and regulations. The Actual Purchase Price and the total number of shares of Conversion Stock to be issued in the Offerings shall be determined by the Boards of Directors of the Stock Holding Company and the Bank in consultation with the Independent Appraiser and any financial advisor or investment banker retained by the Stock Holding Company and the Bank in connection with such Offerings.

(c) Subject to the approval of the OTS, the Estimated Price Range may be increased or decreased to reflect market, financial and economic conditions prior to completion of the Reorganization or to fill the Order of the Tax-Qualified Employee Stock Benefit Plans, and under such circumstances the Stock Holding Company and the Bank may increase or decrease the total number of shares of Conversion Stock to be issued in the Reorganization to reflect any such change. Notwithstanding anything to the contrary contained in this Plan, no resolicitation of subscribers shall be required and subscribers shall not be permitted to modify or cancel their subscriptions unless the gross proceeds from the sale of the Conversion Stock in the Offerings are less than the minimum or more than 15% above the maximum of the Estimated Price Range set forth in the Prospectus. In the event of an increase in the total number of shares offered in the Offerings due to an increase in the Estimated Price Range, the priority of share allocation shall be as set forth in this Plan.

5. Subscription Rights of Eligible Account Holders (First Priority).

(a) Each Eligible Account Holder shall receive, as first priority and without payment, Subscription Rights to purchase up to the greater of (i) \$200,000 of Conversion Stock, (ii) one-tenth of 1% of the total offering of shares in the Subscription Offering, or (iii) 15 times the product (rounded down to the next whole number) obtained by multiplying the total number of shares of Conversion Stock to be sold by a fraction, of which the numerator is the amount of the Qualifying Deposits of the Eligible Account Holder and the denominator is the total amount of all Qualifying Deposits of all Eligible Account Holders, in each case subject to Sections 10 and 13 hereof.

(b) In the event of an oversubscription for shares of Conversion Stock pursuant to Section 5(a), available shares shall be allocated among subscribing Eligible Account Holders so as to permit each such Eligible Account Holder, to the extent possible, to purchase a number of shares which will make his or her total allocation equal to the lesser of the number of shares subscribed for or 100 shares. Any available shares remaining after each subscribing Eligible Account Holder has been allocated the lesser of the number of shares subscribed for or 100 shares shall be allocated among the subscribing Eligible Account Holders whose subscriptions remain unsatisfied in the proportion that the Qualifying Deposit of each such subscribing Eligible Account Holder bears to the total Qualifying Deposits of all such subscribing Eligible Account Holders whose orders are unfilled, provided that no fractional shares shall be issued. Subscription Rights of Eligible Account Holders who are also directors or Officers of the Stock Holding Company or the Bank and their Associates shall be subordinated to those of other

Eligible Account Holders to the extent that they are attributable to increased deposits during the one-year period preceding the Eligibility Record Date.

6. Subscription Rights of Tax-Qualified Employee Stock Benefit Plans (Second Priority).

Tax-Qualified Employee Stock Benefit Plans shall receive, without payment, Subscription Rights to purchase in the aggregate up to 10% of the Stock Holding Company Common Stock issued in the Offerings and contributed to the Foundation, including any shares of Stock Holding Company Common Stock to be issued as a result of an increase in the Estimated Price Range after commencement of the Subscription Offering and prior to completion of the Reorganization. The subscription rights granted to Tax-Qualified Employee Stock Benefit Plans shall be subject to the availability of shares of Conversion Stock after taking into account the shares of Conversion Stock purchased by Eligible Account Holders; provided, however, that in the event that the total number of shares of Conversion Stock is increased to any amount greater than the number of shares representing the maximum of the Estimated Price Range as set forth in the Prospectus ("Maximum Shares"), the Tax-Qualified Employee Stock Benefit Plans shall have a priority right to purchase any such shares exceeding the Maximum Shares up to an aggregate of 10% of Stock Holding Company Common Stock issued in the Offerings and contributed to the Foundation. Shares of Conversion Stock purchased by any individual participant ("Plan Participant") in a Tax-Qualified Employee Stock Benefit Plan using funds therein pursuant to the exercise of subscription rights granted to such Participant in his individual capacity as an Eligible Account Holder and/or Supplemental Eligible Account Holder and/or purchases by such Plan Participant in the Community Offering shall not be deemed to be purchases by a Tax-Qualified Employee Stock Benefit Plan for purposes of calculating the maximum amount of Conversion Stock that Tax-Qualified Employee Stock Benefit Plans may purchase pursuant to the first sentence of this Section 6 if the individual Plan Participant controls or directs the investment authority with respect to such account or subaccount. Consistent with applicable laws and regulations and policies and practices of the OTS, the Tax-Qualified Employee Stock Benefit Plans may use funds contributed by the Stock Holding Company or the Bank and/or borrowed from an independent financial institution to exercise such Subscription Rights, and the Stock Holding Company and the Bank may make scheduled discretionary contributions thereto, provided that such contributions do not cause the Stock Holding Company or the Bank to fail to meet any applicable regulatory capital requirement.

The Tax-Qualified Employee Stock Benefit Plans shall not be deemed to be an Associate or Affiliate of or Person Acting in Concert with any Management Person.

7. Subscription Rights of Supplemental Eligible Account Holders (Third Priority).

(a) In the event that the Eligibility Record Date is more than 15 months prior to the date of the OTS approval, then, and only in that event, a Supplemental Eligibility Record Date shall be set and each Supplemental Eligible Account Holder shall receive, without payment, Subscription Rights to purchase up to the greater of (i) \$200,000 of Conversion Stock in the Subscription Offering, (ii) one-tenth of 1% of the total offering of shares in the Subscription Offering and (iii) 15 times the product (rounded down to the next whole number) obtained by multiplying the total number of shares of Conversion Stock to be sold by a fraction, of which the numerator is the amount of the Qualifying Deposits of the Supplemental Eligible Account Holder and the denominator is the total amount of all Qualifying Deposits of all Supplemental

Eligible Account Holders, in each case subject to Sections 10 and 13 hereof and the availability of shares of Conversion Stock for purchase after taking into account the shares of Conversion Stock purchased by Eligible Account Holders and Tax-Qualified Employee Stock Benefit Plans.

(b) In the event of an oversubscription for shares of Conversion Stock pursuant to Section 7(a), available shares shall be allocated among subscribing Supplemental Eligible Account Holders so as to permit each such Supplemental Eligible Account Holder, to the extent possible, to purchase a number of shares sufficient to make his or her total allocation equal to the lesser of the number of shares subscribed for or 100 shares. Any remaining available shares shall be allocated among subscribing Supplemental Eligible Account Holders whose subscriptions remain unsatisfied in the proportion that the amount of their respective Qualifying Deposits bears to the total amount of the Qualifying Deposits of all such subscribing Supplemental Eligible Account Holders whose orders are unfilled, provided that no fractional shares shall be issued.

8. Subscription Rights of Other Depositors (Fourth Priority).

(a) Each Other Depositor shall receive, without payment, Subscription Rights to purchase up to the greater of (i) \$200,000 of Conversion Stock in the Subscription Offering (or such maximum purchase limitation as may be established for the Community Offering and/or Syndicated Community Offering) and (ii) one-tenth of 1% of the total offering of shares in the Subscription Offering, subject to Section 10 hereof and the availability of shares of Conversion Stock for purchase after taking into account the shares of Conversion Stock purchased by Eligible Account Holders, Tax-Qualified Employee Stock Benefit Plans and Supplemental Eligible Account Holders.

(b) If, pursuant to this Section 8, Other Depositors subscribe for a number of shares of Conversion Stock in excess of the total number of shares of Conversion Stock remaining, available shares shall be allocated among subscribing Other Depositors so as to permit each such Other Depositor, to the extent possible, to purchase a number of shares which will make his or her total allocation equal to the lesser of the number of shares subscribed for or 100 shares. Any remaining available shares shall be allocated among subscribing Other Depositors whose subscriptions remain unsatisfied on a pro rata basis in the same proportion as each such Other Depositor's subscription bears to the total subscriptions of all such subscribing Other Depositors, provided that no fractional shares shall be issued.

9. Community Offering, Syndicated Community Offering, Public Offering and Other Offerings.

(a) If less than the total number of shares of Conversion Stock are sold in the Subscription Offering, remaining shares of Conversion Stock may be sold in a Community Offering. Subject to the requirements set forth herein, the manner in which the Conversion Stock is sold in the Community Offering shall have as the objective the achievement of the widest possible distribution of such stock.

(b) In the event of a Community Offering, shares of Conversion Stock which are not subscribed for in the Subscription Offering shall be offered for sale by means of a direct community marketing program, which may provide for the use of brokers, dealers or investment banking firms experienced in the sale of financial institution securities. Shares in excess of those

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not subscribed for in the Subscription Offering will be available for purchase by members of the general public to whom a Prospectus is delivered by the Stock Holding Company or on its behalf, with preference given first to natural persons and trusts of natural persons residing in Chautauqua, Erie and Cattaraugus Counties, New York ("Preferred Subscribers").

(c) A Prospectus and Order Form shall be furnished to such Persons as the Stock Holding Company and the Bank may select in connection with the Community Offering, and each order for Conversion Stock in the Community Offering shall be subject to the absolute right of the Stock Holding Company and the Bank to accept or reject any such order in whole or in part either at the time of receipt of an order or as soon as practicable following completion of the Community Offering. Available shares will be allocated first to each Preferred Subscriber whose order is accepted in an amount equal to the lesser of 100 shares or the number of shares subscribed for by each such Preferred Subscriber, if possible. Thereafter, unallocated shares shall be allocated among the Preferred Subscribers whose accepted orders remain unsatisfied in the same proportion that the unfilled order bears to the total unfilled orders of all Preferred Subscribers whose accepted orders remain unsatisfied, provided that no fractional shares shall be issued. If there are any shares remaining after all accepted orders by Preferred Subscribers have been satisfied, such remaining shares shall be allocated to other members of the general public who purchase in the Community Offering, applying the same allocation described above for Preferred Subscribers.

(d) The amount of Conversion Stock that any Person may purchase in the Community Offering shall not exceed \$200,000 of Conversion Stock. Orders for Conversion Stock in the Community Offering shall first be filled to a maximum of 2% of the total number of shares of Conversion Stock sold in the Offerings and thereafter any remaining shares shall be allocated on an equal number of shares basis per order until all shares have been allocated, provided no fractional shares shall be issued. The Stock Holding Company and the Bank may commence the Community Offering concurrently with, at any time during, or as soon as practicable after the end of, the Subscription Offering, and the Community Offering must be completed within 45 days after the completion of the Subscription Offering, unless extended by the Stock Holding Company and the Bank with any required regulatory approval.

(e) Subject to such terms, conditions and procedures as may be determined by the Stock Holding Company and the Bank, shares of Conversion Stock not subscribed for in the Subscription Offering or ordered in the Community Offering may be sold by a syndicate of broker-dealers to the general public in a Syndicated Community Offering. Each order for Conversion Stock in the Syndicated Community Offering shall be subject to the absolute right of the Stock Holding Company and the Bank to accept or reject any such order in whole or in part either at the time of receipt of an order or as soon as practicable after completion of the Syndicated Community Offering. The amount of Conversion Stock that any Person may purchase in the Syndicated Community Offering shall not exceed \$200,000 of Conversion Stock. The Stock Holding Company and the Bank may commence the Syndicated Community Offering concurrently with, at any time during, or as soon as practicable after the end of, the Subscription Offering and/or Community Offering, and the Syndicated Community Offering must be completed within 45 days after the completion of the Subscription Offering, unless extended by the Stock Holding Company and the Bank with any required regulatory approval.

(f) The Stock Holding Company and the Bank may sell any shares of Conversion Stock remaining following the Subscription Offering and Community Offering in a Public Offering instead of a Syndicated Community Offering. The provisions of Section 10 hereof shall not be applicable to the sales to underwriters for purposes of the Public Offering but shall be applicable to sales by the underwriters to the public. The price to be paid by the underwriters in such an offering shall be equal to the Actual Purchase Price less an underwriting discount to be negotiated among such underwriters and the Bank and the Stock Holding Company, subject to any required regulatory approval or consent.

(g) If for any reason a Syndicated Community Offering or Public Offering of shares of Conversion Stock not sold in the Subscription Offering and the Community Offering cannot be effected, or in the event that any insignificant residue of shares of Conversion Stock is not sold in the Subscription Offering, Community Offering or Syndicated Community Offering or Public Offering, the Stock Holding Company and the Bank shall use their best efforts to obtain other purchasers for such shares in such manner and upon such conditions as may be satisfactory to the OTS.

10. Limitations on Subscriptions and Purchases of Conversion Stock.

The following limitations shall apply to all purchases of Stock Holding Company Common Stock in the Offerings:

(a) The aggregate amount of outstanding Stock Holding Company Common Stock owned or controlled by persons other than the MHC at the close of the Offerings shall be less than 50% of all outstanding Stock Holding Company Common Stock.

(b) Except in the case of Tax-Qualified Employee Stock Benefit Plans in the aggregate, as set forth in Section 10(h) hereof, and in addition to the other restrictions and limitations set forth herein, the maximum amount of Stock Holding Company Common Stock that any Person, together with any Associates, or Persons otherwise Acting in Concert may, directly or indirectly, subscribe for or purchase in the Offerings, shall not exceed \$400,000 of Conversion Stock in the Subscription Offering.

(c) No Person may purchase fewer than 25 shares of Stock Holding Company Common Stock in the Offerings.

(d) The aggregate amount of Stock Holding Company Common Stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by any Non-Tax-Qualified Employee Stock Benefit Plan or any Management Person and his or her Associates, exclusive of any shares of Stock Holding Company 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 Stock Holding Company Common Stock at the conclusion of the Offerings. In calculating the number of shares held by any Management Person and his or her Associates under this paragraph, shares held by any Tax-Qualified Employee Stock Benefit Plan or Non-Tax-Qualified Employee Stock Benefit Plan of the Stock Holding Company or the Bank that are attributable to such Person shall not be counted.

(e) The aggregate amount of Stock Holding Company Common Stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by any Non-Tax-Qualified Employee Stock Benefit Plan or any Management Person and his or her Associates, exclusive of any Stock Holding Company 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 stockholders' equity of the Stock Holding Company at the conclusion of the Offerings. In calculating the number of shares held by any Management Person and his or her Associates under this paragraph, shares held by any Tax-Qualified Employee Stock Benefit Plan or Non-Tax-Qualified Employee Stock Benefit Plan of the Stock Holding Company or the Bank that are attributable to such Person shall not be counted.

(f) The aggregate amount of Stock Holding Company Common Stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by any one or more Tax-Qualified Employee Stock Benefit Plans, exclusive of any shares of Stock Holding Company Common Stock acquired by such plans in the secondary market, shall not exceed 4.9% of the outstanding shares of Stock Holding Company Common Stock at the conclusion of the Offerings.

(g) The aggregate amount of Stock Holding Company Common Stock stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by one or more Tax-Qualified Employee Stock Benefit Plans, exclusive of any shares of Stock Holding Company Common Stock acquired by such plans in the secondary market, shall not exceed 4.9% of the stockholders' equity of the Stock Holding Company at the conclusion of the Offerings.

(h) The aggregate amount of Stock Holding Company Common Stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by all stock benefit plans of the Stock Holding Company or the Bank, other than employee stock ownership plans, shall not exceed 25% of the outstanding Stock Holding Company Common Stock held by persons other than the MHC.

(i) The aggregate amount of Stock Holding Company Common Stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by all Non-Tax-Qualified Employee Stock Benefit Plans or Management Persons and their Associates, exclusive of any Stock Holding Company Common Stock acquired by such plans or Management Persons and their Associates in the secondary market, shall not exceed 30% of the outstanding shares of Stock Holding Company Common Stock, held by persons other than that MHC, at the conclusion of the Offerings. In calculating the number of shares held by Management Persons and their Associates under this paragraph or paragraph (j) below, shares held by any Tax-Qualified Employee Stock Benefit Plan or Non-Tax-Qualified Employee Stock Benefit Plan that are attributable to such persons shall not be counted.

(j) The aggregate amount of Stock Holding Company Common Stock or preferred stock acquired in the Offerings, plus all prior issuances by the Stock Holding Company, by all Non-Tax-Qualified Employee Stock Benefit Plans or Management Persons and their Associates, exclusive of any Stock Holding Company Common Stock acquired by such plans or Management Persons and their Associates in the secondary market, shall not exceed 30% of the stockholders' equity of the Stock Holding Company, held by persons other than MHC, at the conclusion of the Offerings.

(k) For purposes of the foregoing limitations and the determination of Subscription Rights, (i) directors, Officers and employees of the Stock Holding Company, the Bank or their subsidiaries shall not be deemed to be Associates or a group Acting in Concert solely as a result of their capacities as such, (ii) shares purchased by Tax-Qualified Employee Stock Benefit Plans shall not be attributable to the individual trustees or beneficiaries of any such plan for purposes of determining compliance with the limitations set forth in Section 10(b) hereof, and (iii) shares purchased by a Tax-Qualified Employee Stock Benefit Plan pursuant to instructions of an individual in an account in such plan in which the individual has the right to direct the investment, including any plan of the Bank qualified under Section 401(k) of the Code, shall be aggregated and included in that individual's purchases and not attributed to the Tax-Qualified Employee Stock Benefit Plan.

(l) Subject to any required regulatory approval and the requirements of applicable laws and regulations, but without further approval of the Depositors or resolicitation of subscribers, the Stock Holding Company and the Bank may increase or decrease any of the individual or aggregate purchase limitations set forth herein to a percentage which does not exceed 5% of the total offering of shares of Stock Holding Company Common Stock in the Offerings whether prior to, during or after the Subscription Offering, Community Offering and/or Syndicated Community Offering. In the event that an individual purchase limitation is increased after commencement of the Subscription Offering or any other offering, the Stock Holding Company and the Bank shall permit any Person who subscribed for the maximum number of shares of Conversion Stock to purchase an additional number of shares, so that such Person shall be permitted to subscribe for the then maximum number of shares permitted to be subscribed for by such Person, subject to the rights and preferences of any Person who has priority Subscription Rights. In the event that any of the individual or aggregate purchase limitations are decreased after commencement of the Subscription Offering or any other offering, the orders of any Person who subscribed for more than the new purchase limitation shall be decreased by the minimum amount necessary so that such Person shall be in compliance with the then maximum number of shares permitted to be subscribed for by such Person.

(m) The Stock Holding Company and the Bank shall have the right to take all such action as they may, in their sole discretion, deem necessary, appropriate or advisable in order to monitor and enforce the terms, conditions, limitations and restrictions contained in this Section 10 and elsewhere in this Plan and the terms, conditions and representations contained in the Order Form, including, but not limited to, the absolute right (subject only to any necessary regulatory approvals or concurrences) to reject, limit or revoke acceptance of any subscription or order and to delay, terminate or refuse to consummate any sale of Conversion Stock that they believe might violate, or is designed to, or is any part of a plan to, evade or circumvent such terms, conditions, limitations, restrictions and representations. Any such action shall be final, conclusive and binding on all persons, and the Stock Holding Company and the Bank and their respective Boards shall be free from any liability to any Person on account of any such action.

11. Timing of Subscription Offering; Manner of Exercising Subscription Rights and Order Forms.

(a) The Offerings shall be conducted in compliance with 12 C.F.R. Part 563g and, to the extent applicable, Form OC. The Subscription Offering may be commenced concurrently with or at any time after the mailing of the Proxy Statement. The Subscription Offering may be

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closed before the Special Meeting, provided that the offer and sale of the Conversion Stock shall be conditioned upon the approval of the Plan by the Voting Depositors at the Special Meeting.

(b) The exact timing of the commencement of the Subscription Offering shall be determined by the Stock Holding Company and the Bank in consultation with the Independent Appraiser and any financial or advisory or investment banking firm retained by them in connection with the Reorganization. The Stock Holding Company and the Bank may consider a number of factors, including, but not limited to, their current and projected future earnings, local and national economic conditions, and the prevailing market for stocks in general and stocks of financial institutions in particular. The Stock Holding Company and the Bank shall have the right to withdraw, terminate, suspend, delay, revoke or modify any such Subscription Offering, at any time and from time to time, as they in their sole discretion may determine, without liability to any Person, subject to compliance with applicable securities laws and any necessary regulatory approval or concurrence.

(c) The Stock Holding Company and the Bank shall, promptly after the SEC has declared the Registration Statement, which includes the Prospectus, effective and all required regulatory approvals have been obtained, distribute or make available the Prospectus, together with Order Forms for the purchase of Conversion Stock, to all Participants for the purpose of enabling them to exercise their respective Subscription Rights, subject to Section 13 hereof. To the extent permitted by applicable law and regulation, the Stock Holding Company and the Bank may elect to mail a Prospectus and Order Form only to those Participants who request such materials by returning a postage-paid card to the Stock Holding Company and the Bank by a date specified in the letter informing them of their Subscription Rights. Under such circumstances, the Subscription Offering shall not be closed prior to the expiration of 30 days after the mailing by the Stock Holding Company and the Bank of the postage-paid card to Participants.

(d) A single Order Form for all Deposit Accounts maintained with the Bank by an Eligible Account Holder and any Supplemental Eligible Account Holder may be furnished, irrespective of the number of Deposit Accounts maintained with the Bank on the Eligibility Record Date and Supplemental Eligibility Record Date, respectively. No person holding a Subscription Right may exceed any otherwise applicable purchase limitation by submitting multiple orders for Conversion Stock. Multiple orders are subject to equitable adjustment.

(e) The recipient of an Order Form shall have no less than 20 days and no more than 45 days from the date of mailing of the Order Form (with the exact termination date to be set forth on the Order Form) to properly complete and execute the Order Form and deliver it to the Stock Holding Company and the Bank. The Stock Holding Company and the Bank may extend such period by such amount of time as they determine is appropriate. Failure of any Participant to deliver a properly executed Order Form to the Stock Holding Company and the Bank, along with full payment (or authorization for full payment by deposit account withdrawal) for the shares of Conversion Stock subscribed for, within the time limits prescribed, shall be deemed a waiver and release by such person of any rights to subscribe for shares of Conversion Stock. Each Participant shall be required to confirm to the Stock Holding Company and the Bank by executing an Order Form that such Person has fully complied with all of the terms, conditions, limitations and restrictions in the Plan.



(f) The Stock Holding Company and the Bank shall have the absolute right, in their sole discretion and without liability to any Participant or other Person, to reject any Order Form, including, but not limited to, any Order Form that is (i) improperly completed or executed; (ii) not timely received; (iii) not accompanied by the proper and full payment (or authorization of withdrawal for full payment) or, in the Bank's discretion, in the case of institutional investors in the Community Offering, not accompanied by an irrevocable order together with a legally binding commitment to pay the full amount of the purchase price prior to 48 hours before the completion of the Offerings; or (iv) submitted by a Person whose representations the Stock Holding Company and the Bank believe to be false or who they otherwise believe, either alone, or Acting in Concert with others, is violating, evading or circumventing, or intends to violate, evade or circumvent, the terms and conditions of the Plan. Furthermore, in the event Order Forms (i) are not delivered by the United States Postal Service, or (ii) are not mailed pursuant to a "no mail" order placed in effect by the account holder, the Subscription Rights of the person to which such rights have been granted will lapse as though such person failed to return the contemplated Order Form within the time period specified thereon. The Stock Holding Company and the Bank may, but will not be required to, waive any irregularity on any Order Form or may require the submission of corrected Order Forms or the remittance of full payment for shares of Conversion Stock by such date as they may specify. The interpretation of the Stock Holding Company and the Bank of the terms and conditions of the Order Forms shall be final and conclusive.

12. Payment for Conversion Stock.

(a) Payment for shares of Conversion Stock subscribed for by Participants in the Subscription Offering and payment for shares of Conversion Stock ordered by Persons in the Community Offering shall be equal to the Initial Purchase Price multiplied by the number of shares that are being subscribed for or ordered, respectively. Such payment may be made by check or money order at the time the Order Form is delivered to the Bank. The Bank, in its sole and absolute discretion, may also elect to receive payment for shares of Conversion Stock by wire transfer. In addition, the Stock Holding Company and the Bank may elect to provide Participants and/or other Persons who have a Deposit Account with the Bank the opportunity to pay for shares of Conversion Stock by authorizing the Bank to withdraw from such Deposit Account an amount equal to the aggregate Initial Purchase Price of such shares. Payment may also be made by a Participant using funds held for such Participant's benefit by a Bank Benefit Plan to the extent that such plan allows participants or any related trust established for the benefit of such participants to direct that some or all of their individual accounts or sub-accounts be invested in Conversion Stock.

(b) Notwithstanding the above, if the Tax-Qualified Employee Stock Benefit Plans subscribe for shares during the Subscription Offering, such plans will not be required to pay for the shares at the time they subscribe but rather may pay for such shares of Stock Holding Company Common Stock subscribed for by such plans at the Actual Purchase Price upon consummation of the Offerings, provided that, in the case of the ESOP, there is in force from the time of its subscription until the consummation of the Offerings, a loan commitment to lend to the ESOP, at such time, the aggregated price of the shares for which it subscribed.

(c) If a Participant or other Person authorizes the Bank to withdraw the amount of the Initial Purchase Price from his or her Deposit Account, the Bank shall have the right to make

such withdrawal or to freeze funds equal to the aggregate Initial Purchase Price upon receipt of the Order Form. Notwithstanding any regulatory provisions regarding penalties for early withdrawals from certificate accounts, the Bank may allow payment by means of withdrawal from certificate accounts without the assessment of such penalties. In the case of an early withdrawal of only a portion of such account, the certificate evidencing such account shall be canceled if any applicable minimum balance requirement ceases to be met. In such case, the remaining balance will earn interest at the regular passbook rate. However, where any applicable minimum balance is maintained in such certificate account, the rate of return on the balance of the certificate account shall remain the same as prior to such early withdrawal. This waiver of the early withdrawal penalty applies only to withdrawals made in connection with the purchase of Conversion Stock and is entirely within the discretion of the Stock Holding Company and the Bank.

(d) The Bank shall pay interest, at not less than the passbook rate, for all amounts paid by check or money order to purchase shares of Conversion Stock in the Subscription Offering and the Community Offering from the date payment is received until the date the Reorganization is completed or terminated and all such amounts shall be held in a segregated account.

(e) The Stock Holding Company will not offer or sell any of the Stock Holding Company Common Stock proposed to be issued to any Person whose purchase would be financed by funds loaned, directly or indirectly, to the Person by the Bank.

(f) Each share of Conversion Stock shall be non-assessable upon payment in full of the Actual Purchase Price.

13. Account Holders in Nonqualified States or Foreign Countries.

The Stock Holding Company and the Bank shall make reasonable efforts to comply with the securities laws of all jurisdictions in the United States in which Participants reside. However, no Participant will be offered or receive any Conversion Stock under the Plan if such Participant resides in a foreign country or resides in a jurisdiction of the United States with respect to which all of the following apply: (a) there are few Participants otherwise eligible to subscribe for shares under this Plan who reside in such jurisdiction; (b) the granting of Subscription Rights or the offer or sale of shares of Conversion Stock to such Participants would require any of the Stock Holding Company or the Bank or their respective directors and Officers, under the laws of such jurisdiction, to register as a broker-dealer, salesman or selling agent or to register or otherwise qualify the Conversion Stock for sale in such jurisdiction, or any of the Stock Holding Company or the Bank would be required to qualify as a foreign corporation or file a consent to service of process in such jurisdiction; and (c) such registration, qualification or filing in the judgment of the Stock Holding Company and the Bank would be impracticable or unduly burdensome for reasons of cost or otherwise.

14. Voting Rights of Shareholders.

Following consummation of the Reorganization, voting rights with respect to the Bank shall be held and exercised exclusively by the Stock Holding Company as holder of all of the Bank's outstanding voting capital stock, voting rights with respect to the Stock Holding

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Company shall be held and exercised exclusively by the holders of the Stock Holding Company's voting capital stock, and voting rights with respect to the MHC shall be held and exercised exclusively by its eligible Members.

15. Transfer of Deposit Accounts.

Each Deposit Account in the Bank at the time of the consummation of the Reorganization shall become, without further action by the holder, a Deposit Account in the Bank equivalent in withdrawable amount to the withdrawal value (as adjusted to give effect to any withdrawal made for the purchase of Conversion Stock), and subject to the same terms and conditions (except as to voting and liquidation rights) as such Deposit Account in the Bank immediately preceding consummation of the Reorganization. Holders of Deposit Accounts in the Bank shall not, as such holders, have any voting rights.

16. Requirements Following Reorganization for Registration, Market Making and Stock Exchange Listing.

In connection with the Reorganization, the Stock Holding Company shall register the Stock Holding Company Common Stock pursuant to Section 12 of the Securities Exchange Act of 1934, as amended, and shall undertake not to deregister such stock for a period of three years thereafter. The Stock Holding Company also shall use its best efforts to (i) encourage and assist a market maker to establish and maintain a market for the Stock Holding Company Common Stock, and (ii) list the Stock Holding Company Common Stock on a national or regional securities exchange or to have quotations for such stock disseminated on the Nasdaq Stock Market.

17. Directors and Officers of the Bank.

Each person serving as a director or Officer of the Bank at the effective time of the Reorganization shall continue to serve as a director or Officer of the Bank for the balance of the term for which the person was elected prior to the Reorganization, and until a successor is elected and qualified.

18. Requirements for Stock Purchases by Directors and Officers Following the Reorganization.

For a period of three years following the Reorganization, the directors and Officers of the Stock Holding Company and the Bank and their Associates may not purchase, without the prior written approval of the OTS, Stock Holding Company Common Stock except from a broker-dealer registered with the SEC. This prohibition shall not apply, however, to (i) a negotiated transaction and involving more than 1% of the outstanding Stock Holding Company Common Stock, and (ii) purchases of stock made by and held by any Tax-Qualified Employee Stock Benefit Plan (and purchases of stock made by and held by any Non-Tax-Qualified Employee Stock Benefit Plan following the receipt of shareholder approval of such plan) even if such Stock Holding Company Common Stock may be attributable to individual Officers or directors and their Associates. The foregoing restriction on purchases of Stock Holding Company Common Stock shall be in addition to any restrictions that may be imposed by federal and state securities laws.

19. Restrictions on Transfer of Stock.

All shares of Conversion Stock which are purchased by Persons other than directors and Officers of the Stock Holding Company or the Bank shall be transferable without restriction. Shares of Conversion Stock purchased by directors and Officers of the Stock Holding Company or the Bank on original issue from the Stock Holding Company (by subscription or otherwise) shall be subject to the restriction that such shares shall not be sold or otherwise disposed of for value for a period of one year following the date of purchase, except for any disposition of such shares following the death of the original purchaser. The shares of Conversion Stock issued by the Stock Holding Company to such directors and Officers shall bear the following legend giving appropriate notice of such one-year restriction:

“The shares of stock evidenced by this Certificate are restricted as to transfer for a period of one year from the date of this Certificate pursuant to Part 575 of the Rules and Regulations of the Office of Thrift Supervision. These shares may not be transferred during such one-year period without a legal opinion of counsel for the Company that said transfer is permissible under the provisions of applicable law and regulation. This restrictive legend shall be deemed null and void after one year from the date of this Certificate.”

In addition, the Stock Holding Company shall give appropriate instructions to the transfer agent for the Stock Holding Company Common Stock with respect to the applicable restrictions relating to the transfer of restricted stock. Any shares issued at a later date as a stock dividend, stock split or otherwise with respect to any such restricted stock shall be subject to the same holding period restrictions as may then be applicable to such restricted stock. The foregoing restriction on transfer shall be in addition to any restrictions on transfer that may be imposed by federal and state securities laws.

20. Restrictions on Voting Stock Holding Company Common Stock.

The Charter of the Stock Holding Company shall provide that in no event shall any record owner of any outstanding shares of Stock Holding Company Common Stock who beneficially owns in excess of 10% of such outstanding shares, except the MHC, shall be entitled or permitted to any vote in respect to any shares held in excess of 10%. In addition, the Charter and Bylaws of the Stock Holding Company will include provisions that eliminate cumulative voting for the election of directors and prohibit persons other than the Board of Directors of the Stock Holding Company from calling special meetings of the stockholders of the Stock Holding Company.

21. Adoption of Federal Stock Charter and Bylaws.

As part of the Reorganization, the Bank shall take all appropriate steps to adopt a federal stock charter and bylaws to authorize the issuance of capital stock and otherwise to read in a form consistent with a federally chartered stock form savings bank.

22. Tax Rulings or Opinions.

Consummation of the Reorganization is conditioned upon prior receipt by the Stock Holding Company and the Bank of either a ruling or an opinion of counsel with respect to federal tax laws, and either a ruling or an opinion with respect to New York tax laws, to the

effect that consummation of the transactions contemplated hereby will not result in a taxable reorganization under the provisions of the applicable codes or otherwise result in any adverse tax consequences to the Stock Holding Company and the Bank or to account holders receiving Subscription Rights before or after the Reorganization, except in each case to the extent, if any, that Subscription Rights are deemed to have fair market value on the date such rights are issued.

23. Stock Compensation Plans.

(a) The Stock Holding Company and the Bank are authorized to adopt Tax-Qualified Employee Stock Benefit Plans in connection with the Reorganization, including without limitation an employee stock ownership plan.

(b) Subsequent to the Reorganization, the Stock Holding Company and the Bank are authorized to adopt Non-Tax-Qualified Employee Stock Benefit Plans, including without limitation, stock option plans and restricted stock plans, provided however that, with respect to any such plan, the total number of shares of common stock for which options may be granted and the total amount of common stock granted as restricted stock must not exceed limitations set forth in Section 10 hereof. In addition, any such plan implemented during the one-year period subsequent to the date of consummation of the Reorganization: (i) shall be disclosed in the proxy solicitation materials for the Special Meeting of Depositors and in the Prospectus; (ii) in the case of stock option plans and employee recognition or grant plans, shall be submitted for approval by the holders of the Stock Holding Company Common Stock no earlier than six months following consummation of the Reorganization; and (iii) shall comply with all other applicable requirements of the OTS.

(c) Existing, as well as any newly-created, Tax-Qualified Employee Stock Benefit Plans may purchase shares of Conversion Stock in the Offerings, to the extent permitted by the terms of such benefit plans and this Plan.

(d) The Stock Holding Company and the Bank are authorized to enter into employment or severance agreements with their executive officers.

24. Dividend and Repurchase Restrictions on Stock.

The Stock Holding Company may not declare or pay a cash dividend on its Stock Holding Company Common Stock if the effect thereof would cause the regulatory capital of the Bank to be reduced below the amount required under Section 567.2 of the Regulations. Otherwise, the Stock Holding Company may declare dividends or make other capital distributions in accordance with Section 563b.520 of the Regulations. Following completion of the Offerings, the Stock Holding Company may repurchase its Stock Holding Company Common Stock consistent with Section 563b.510 and Section 563b.515 of the Regulations relating to stock repurchases, as long as such repurchases do not cause the regulatory capital of the Bank to be reduced below the amount required under Section 567.2 of the Regulations. The MHC may from time to time purchase Stock Holding Company Common Stock. Subject to any notice or approval requirements of the OTS under the Regulations, the MHC may waive its right to receive dividends declared by the Stock Holding Company.

25. Payment of Fees to Brokers.

The Bank may elect to offer to pay fees on a per share basis to securities brokers who assist purchasers of Conversion Stock in the Offerings.

26. Effective Date.

The effective date of the Reorganization shall be the date of the closing of the sale of all shares of Conversion Stock. The closing of the sale of all shares of Conversion Stock sold in the Offerings shall occur simultaneously and shall be conditioned upon the prior receipt of all requisite regulatory and other approvals.

27. Amendment or Termination of the Plan.

If deemed necessary or desirable by the Board of Directors of the Bank, this Plan may be substantively amended, as a result of comments from regulatory authorities or otherwise, at any time prior to the solicitation of proxies from Depositors to vote on the Plan and at any time thereafter with the concurrence of the OTS. Any amendment to this Plan made after approval by the Depositors with the concurrence of the OTS shall not necessitate further approval by the Depositors unless otherwise required by the OTS. This Plan shall terminate if the sale of all shares of Conversion Stock is not completed within 24 months from the date of the Special Meeting. Prior to the earlier of the Special Meeting, this Plan may be terminated by the Board of Directors of the Bank without approval of the OTS; after the Special Meeting, the Board of Directors may terminate this Plan only with the approval of the OTS.

28. Interpretation of the Plan.

All interpretations of this Plan and application of its provisions to particular circumstances by a majority of each of the Boards of Directors of the Stock Holding Company and Bank shall be final, subject to the authority of the OTS.

**FEDERAL MHC SUBSIDIARY HOLDING COMPANY CHARTER  
OF  
LAKE SHORE BANCORP, INC.**

**Section 1. Corporate Title.** The full corporate title of the MHC subsidiary holding company is Lake Shore Bancorp, Inc. (the “Holding Company”).

**Section 2. Domicile.** The domicile of the Holding Company is in the City of Dunkirk, in the State of New York.

**Section 3. Duration.** The duration of the Holding Company is perpetual.

**Section 4. Purpose and Powers.** The purpose of the Holding Company is to pursue any or all of the lawful objectives of a federal mutual holding company subsidiary chartered under Section 10(o) of the Home Owners’ Loan Act, 12 U.S.C. 1467a(o), and to exercise all the express, implied, and incidental powers conferred thereby and by all acts amendatory thereof and supplemental thereto, subject to the Constitution and laws of the United States as they are now in effect, or as they may hereafter be amended, and subject to all lawful and applicable rules, regulations, and orders of the Office of Thrift Supervision (the “Office”).

**Section 5. Capital Stock.** The total number of shares of all classes of the capital stock that the Holding Company has the authority to issue is twenty-six million shares (26,000,000), of which twenty-five million (25,000,000) shall be common stock of par value of \$.01 per share and one million (1,000,000) shall be preferred stock of par value \$.01 per share. The shares may be issued from time to time as authorized by the board of directors without the approval of the shareholders, except as otherwise provided in this Section 5 or to the extent that such approval is required by governing law, rule, or regulation. The consideration for the issuance of the shares shall be paid in full before their issuance and shall not be less than the par value. Neither promissory notes nor future services shall constitute payment or part payment for the issuance of shares of the Holding Company. The consideration for the shares shall be cash, tangible or intangible property (to the extent direct investment in such property would be permitted to the Holding Company), labor, or services actually performed for the Holding Company, or any combination of the foregoing. In the absence of actual fraud in the transaction, the value of such property, labor, or services, as determined by the board of directors of the Holding Company, shall be conclusive. Upon payment of such consideration, such shares shall be deemed to be fully paid and nonassessable. In the case of a stock dividend, that part of the retained earnings of the Holding Company that is transferred to common stock or paid-in capital accounts upon the issuance of shares as a stock dividend shall be deemed to be the consideration for their issuance.

Except for the shares issued in the initial organization of the Holding Company, no shares of capital stock (including shares issuable upon conversion, exchange or exercise of other securities) shall be issued, directly or indirectly, to officers, directors, or controlling persons of the Holding Company other than as part of a general public offering or as qualifying shares to a director, unless their issuance or the plan under which they would be issued has been approved by a majority of the total votes eligible to be cast at a legal meeting.

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Nothing contained in this Section 5 (or in any supplementary sections hereto) shall entitle the holders of any class or series of capital stock to vote as a separate class or series or to more than one vote per share, except as to the accumulation of votes for the election of directors (unless the charter otherwise provides that there shall be no such cumulative voting); *Provided*, that this restriction on voting separately by class or series shall not apply:

- (i) To any provision which would authorize the holders of preferred stock, voting as a class or series, to elect some members of the board of directors, less than a majority thereof, in the event of default in the payment of dividends on any class or series of preferred stock;
- (ii) To any provision which would require the holders of preferred stock, voting as a class or series, to approve the merger or consolidation of the Holding Company with another corporation or the sale, lease, or conveyance (other than by mortgage or pledge) of properties or business in exchange for securities of a corporation other than the Holding Company if the preferred stock is exchanged for securities of such other corporation; *Provided*, That no provision may require such approval for transactions undertaken with the assistance or pursuant to the direction of the Office, or the Federal Deposit Insurance Corporation;
- (iii) To any amendment which would adversely change the specific terms of any class or series of capital stock as set forth in this Section 5 (or in any supplementary sections hereto), including any amendment which would create or enlarge any class or series ranking prior thereto in rights and preferences. An amendment which increases the number of authorized shares of any class or series of capital stock, or substitutes the surviving Holding Company in a merger or consolidation for the Holding Company, shall not be considered to be such an adverse change.

A description of the different classes and series (if any) of the Holding Company's capital stock and a statement of the designations, and the relative rights, preferences, and limitations of the shares of each class of and series (if any) of capital stock are as follows:

**A. Common Stock.** Except as provided in this Section 5 (or in any supplementary sections hereto) the holders of the common stock shall exclusively possess all voting power. Each holder of shares of common stock shall be entitled to one vote for each share held by each holder, except as to the accumulation of votes for the election of directors, unless the charter otherwise provides that there shall be no such cumulative voting.

Whenever there shall have been paid, or declared and set aside for payment, to the holders of the outstanding shares of any class of stock having preference over the common stock as to payment of dividends, the full amount of dividends and of sinking fund, retirement fund, or other retirement payments, if any, to which such holders are respectively entitled in preference to the common stock, then dividends may be paid on the common stock and on any class or series of stock entitled to participate therewith as to dividends out of any assets legally available for the payment of dividends.

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In the event of any liquidation, dissolution, or winding up of the Holding Company, the holders of the common stock (and the holders of any class or series of stock entitled to participate with the common stock in the distribution of assets) shall be entitled to receive, in cash or in kind, the assets of the Holding Company available for distribution remaining after: (i) Payment or provision for payment of the Holding Company's debts and liabilities; (ii) distributions or provision for distributions in settlement of its liquidation account; and (iii) distributions or provision for distributions to holders of any class or series of stock having preference over the common stock in the liquidation, dissolution, or winding up of the Holding Company. Each share of common stock shall have the same relative rights as and be identical in all respects with all the other shares of common stock.

**B. Preferred Stock.** The Holding Company may provide in supplementary sections to its charter for one or more classes of preferred stock, which shall be separately identified. The shares of any class may be divided into and issued in series, with each series separately designated so as to distinguish the shares thereof from the shares of all other series and classes. The terms of each series shall be set forth in a supplementary section to the charter. All shares of the same class shall be identical except as to the following relative rights and preferences, as to which there may be variations between different series:

- (a) The distinctive serial designation and the number of shares constituting such series;
- (b) The dividend rate or the amount of dividends to be paid on the shares of such series, whether dividends shall be cumulative and, if so, from which date(s), the payment date(s) for dividends, and the participating or other special rights, if any, with respect to dividends;
- (c) The voting powers, full or limited, if any, of shares of such series;
- (d) Whether the shares of such series shall be redeemable and, if so, the price(s) at which, and the terms and conditions on which, such shares may be redeemed;
- (e) The amount(s) payable upon the shares of such series in the event of voluntary or involuntary liquidation, dissolution, or winding up of the Holding Company;
- (f) Whether the shares of such series shall be entitled to the benefit of a sinking or retirement fund to be applied to the purchase or redemption of such shares, and if so entitled, the amount of such fund and the manner of its application, including the price(s) at which such shares may be redeemed or purchased through the application of such fund;
- (g) Whether the shares of such series shall be convertible into, or exchangeable for, shares of any other class or classes of stock of the Holding Company and, if so, the conversion price(s) or the rate(s) of exchange, and the adjustments thereof, if any, at which such conversion or exchange may be made, and any other terms and conditions of such conversion or exchange;
- (h) The price or other consideration for which the shares of such series shall be issued; and



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(i) Whether the shares of such series which are redeemed or converted shall have the status of authorized but unissued shares of serial preferred stock and whether such shares may be reissued as shares of the same or any other series of serial preferred stock.

Each share of each series of serial preferred stock shall have the same relative rights as and be identical in all respects with all the other shares of the same series.

The board of directors shall have authority to divide, by the adoption of supplementary charter sections, any authorized class of preferred stock into series and, within the limitations set forth in this section and the remainder of this charter, fix and determine the relative rights and preferences of the shares of any series so established.

Prior to the issuance of any preferred shares of a series established by a supplementary charter section adopted by the board of directors, the Holding Company shall file with the Secretary of the Office a dated copy of that supplementary section of this charter establishing and designating the series and fixing and determining the relative rights and preferences thereof.

**Section 6. Preemptive Rights .** Holders of the capital stock of the Holding Company are not entitled to preemptive rights with respect to any shares of the Holding Company that may be issued.

**Section 7. Directors.** The Holding Company shall be under the direction of a Board of Directors. The authorized number of directors, as stated in the Holding Company's bylaws, shall be not be fewer than five nor more than fifteen except when a greater or lesser number is approved by the Director of the Office, or his or her delegate.

**Section 8: Beneficial Ownership Limitation.** Notwithstanding anything contained in the Holding Company's charter or bylaws to the contrary, for a period of five years from the date of completion of the conversion from mutual to stock form of Lake Shore Savings Bank, no person shall directly or indirectly offer to acquire or acquire the beneficial ownership of more than 10 percent of any class of an equity security of the Holding Company. This limitation shall not apply to a transaction in which the Holding Company reorganizes or recapitalizes without change in the respective beneficial ownership interests of its shareholders other than pursuant to the exercise of any dissenter and appraisal rights, the purchase of shares by underwriters in connection with a public offering, or the purchase of shares by a tax-qualified employee stock benefit plan which is exempt from the approval requirements under 574.3(c)(1)(vii) of the Office's regulations.

In the event shares are acquired in violation of this Section 8, all shares beneficially owned by any person in excess of 10% shall be considered "excess shares" and shall not be counted as shares entitled to vote and shall not be voted by any person or counted as voting shares in connection with any matters submitted to the shareholders for a vote.

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For the purposes of this Section 8, the following definitions apply:

(1) The term “person” includes an individual, a group acting in concert, a corporation, a partnership, an association, a joint stock company, a trust, an unincorporated organization or similar company, a syndicate or any other group formed for the purpose of acquiring, holding or disposing of the equity securities of the Holding Company.

(2) The term “offer” includes every offer to buy or otherwise acquire, solicitation of an offer to sell, tender offer for, or request or invitation for tenders of, a security or interest in a security for value.

(3) The term “acquire” includes every type of acquisition, whether effected by purchase, exchange, operation of law or otherwise.

(4) The term “acting in concert” means (a) knowing participation in a joint activity or conscious parallel action towards a common goal whether or not pursuant to an express agreement, or (b) a combination or pooling of voting or other interests in the securities of an issuer for a common purpose pursuant to any contract, understanding, relationship, agreement or other arrangements, whether written or otherwise.

**Section 9. Cumulative Voting Limitation.** Shareholders shall not be permitted to cumulate their votes for election of directors.

**Section 10. Call for Special Meetings.** Special meetings of shareholders relating to changes in control of the Holding Company or amendments to its charter shall be called only upon direction of the board of directors.

**Section 11. Standards for Board of Directors’ Evaluation of Offers.** The Board of Directors of the Holding Company, in determining whether the interests of the Holding Company and its shareholders will be served by any offer of another Person, including an individual, group acting in concert, a corporation, a partnership, an association, a joint venture, a pool, a joint stock company, a trust, an unincorporated organization or similar company, a syndicate or any other group formed for the purpose of acquiring, holding or disposing of securities or any other entity, to (i) make a tender or exchange offer for any equity security of the Holding Company (i) merge or consolidate the Holding Company with or into another institution, or (ii) purchase or otherwise acquire all or substantially all of the properties and assets of the Holding Company, may consider the interests of the employees, suppliers, creditors and customers of the Holding Company and its direct and indirect subsidiaries, the economy of the state, region and nation, community and societal considerations, and the long-term and short-term interests of the Holding Company and its shareholders, including the possibility that these interests may be best served by the continued independence of the Holding Company.

**Section 12. Limitation of Liability of Officers and Directors.** A director or officer of the Holding Company shall not be personally liable to the Holding Company or its shareholders for damages for breach of any duty owed to the Holding Company or its shareholders, except that this provision shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (a) in breach of such person’s duty of loyalty to the Holding Company or its shareholders or (b) not in good faith or involved in a knowing violation of law,

or resulting in receipt by such person of an improper personal benefit. If the regulations of the Office are amended after the date hereof to authorize action further eliminating or limiting the personal liability of directors or officers, then the liability of a director or officer of the Holding Company shall be eliminated or limited to the fullest extent permitted by the Office’s regulations, as so amended. Any repeal or modification of this Section 12 by the directors of the Holding Company will be prospective only and shall not adversely affect any right or protection of a director or officer existing at the time of such repeal or modification.

**Section 13. Amendment of Charter.** Except as provided in Section 5, no amendment, addition, alteration, change, or repeal of this charter shall be made, unless such is proposed by the Board of Directors of the Holding Company, approved by the shareholders by a majority of the votes eligible to be cast at a legal meeting, unless a higher vote is otherwise required, and approved or pre-approved by the Office.

Attest: \_\_\_\_\_  
Beverly J. Mulkin  
Secretary  
Lake Shore Bancorp, Inc.

By: \_\_\_\_\_  
David C. Mancuso  
President and Chief Executive Officer  
Lake Shore Bancorp, Inc.

**OFFICE OF THRIFT SUPERVISION**

Attest: \_\_\_\_\_  
Secretary of the Office

By: \_\_\_\_\_  
Director of the Office

Effective Date: \_\_\_\_\_

**Exhibit 3.2**

**BYLAWS OF  
LAKE SHORE BANCORP, INC.**

**ARTICLE I - Home Office**

The home office of Lake Shore Bancorp, Inc. (the “Holding Company”) shall be at 125 East 4<sup>th</sup> Street, in the City of Dunkirk, in the State of New York.

**ARTICLE II - Shareholders**

**Section 1. Place of Meetings.** All annual and special meetings of shareholders shall be held at the domicile of the Holding Company or at such other place in the State of New York as the Board of Directors may determine.

**Section 2. Annual Meeting.** A meeting of the shareholders of the Holding Company for the election of directors and for the transaction of any other business of the Holding Company shall be held annually within 150 days after the end of the Holding Company’s fiscal year at a date and time as the Board of Directors may determine.

**Section 3. Special Meetings.** Special meetings of the shareholders for any purpose or purposes, unless otherwise prescribed by the regulations of the Office of Thrift Supervision (the “Office”), may be called at any time by the chairman of the board, the president, or a majority of the Board of Directors, and shall be called by the chairman of the board, the president, or the secretary upon the written request of the holders of not less than 10% of all of the outstanding capital stock of the Holding Company entitled to vote at the meeting. Such written request shall state the purpose or purposes of the meeting and shall be delivered to the home office of the Holding Company addressed to the chairman of the board, the president or the secretary. The business conducted at any special meeting shall be limited to that set forth in the notice of such meeting.

**Section 4. Conduct of Meetings.** Annual and special meetings shall be conducted in accordance with the most current edition of Robert’s Rules of Order unless otherwise prescribed by regulations of the Office or these bylaws or the board of directors adopts another written procedure for the conduct of meetings. The board of directors shall designate, when present, either the chairman of the board or president to preside at such meetings.

**Section 5. Notice of Meetings.** Written notice stating the place, day, and hour of the meeting and the purpose(s) for which the meeting is called shall be delivered not fewer than 20 nor more than 50 days before the date of the meeting, either personally or by mail, by or at the direction of the chairman of the board, the president, or the secretary, directors or other persons calling the meeting, to each shareholder of record entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the mail, addressed to the shareholder at the address as it appears on the stock transfer books or records of the Holding Company as of the record date prescribed in Section 6 of this Article II with postage thereon prepaid. When any shareholders’ meeting, either annual or special, is adjourned for 30 days or more, notice of the adjourned meeting shall be given as in the case of an original meeting. It shall not be necessary to give any notice of the time and place of any meeting adjourned for less

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than 30 days or of the business to be transacted at the meeting, other than an announcement at the meeting at which such adjournment is taken.

**Section 6. Fixing of Record Date.** For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment, or shareholders entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the Board of Directors shall fix in advance a date as the record date for any such determination of shareholders. Such date in any case shall be not more than 60 days and, in case of a meeting of shareholders, not fewer than 10 days prior to the date on which the particular action, requiring such determination of shareholders, is to be taken. When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this Section, such determination shall apply to any adjournment thereof.

**Section 7. Voting List.** At least 20 days before each meeting of the shareholders, the officer or agent having charge of the stock transfer books for shares of the Holding Company shall make a complete list of the shareholders entitled to vote at such meeting, or any adjournment thereof, arranged in alphabetical order, with the address and the number of shares held by each. This list of shareholders shall be kept on file at the home office of the Holding Company and shall be subject to inspection by any shareholder of record or such shareholder's agent at any time during usual business hours for a period of 20 days prior to such meeting. Such list shall also be produced and kept open at the time and place of the meeting and shall be subject to inspection by any shareholder or such shareholder's agent of record during the entire time of the meeting. The original stock transfer book shall constitute *prima facie* evidence of the shareholders entitled to examine such list or transfer books or to vote at any meeting of shareholders.

In lieu of making the shareholder list available for inspection by shareholders as provided in the preceding paragraph, the board of directors may elect to follow the procedures prescribed in § 552.6(d) of the Office's regulations as now or hereafter in effect.

**Section 8. Quorum.** A majority of the outstanding shares of the Holding Company entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of shareholders. If less than a majority of the outstanding shares is represented at a meeting, a majority of the shares so represented may adjourn the meeting from time to time without further notice. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally notified. The shareholders present at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal of enough shareholders to constitute less than a quorum. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on the subject matter shall be the act of the shareholders, unless the vote of a greater number of shareholders voting together or voting by classes is required by law or the charter. Directors, however, are elected by a plurality of the votes cast at an election of directors.

**Section 9. Proxies.** At all meetings of shareholders, a shareholder may vote by proxy executed in writing by the shareholder or by his or her duly authorized attorney in fact. Proxies may be given telephonically or electronically as long as the holder uses a procedure for

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verifying the identity of the shareholder. Proxies solicited on behalf of the management shall be voted as directed by the shareholder or, in the absence of such direction, as determined by a majority of the Board of Directors. No proxy shall be valid more than eleven months from the date of its execution except for a proxy coupled with an interest.

**Section 10. Voting of Shares in the Name of Two or More Persons.** When ownership stands in the name of two or more persons, in the absence of written directions to the Holding Company to the contrary, at any meeting of the shareholders of the Holding Company, any one or more of such shareholders may cast, in person or by proxy, all votes to which such ownership is entitled. In the event an attempt is made to cast conflicting votes, in person or by proxy, by the several persons in whose names shares of stock stand, the vote or votes to which those persons are entitled shall be cast as directed by a majority of those holding such stock and present in person or by proxy at such meeting, but no votes shall be cast for such stock if a majority cannot agree.

**Section 11. Voting of Shares of Certain Holders.** Shares standing in the name of another corporation may be voted by any officer, agent, or proxy as the bylaws of such corporation may prescribe, or, in the absence of such provision, as the Board of Directors of such corporation may determine. Shares held by an administrator, executor, guardian, or conservator may be voted by him or her, either in person or by proxy, without a transfer of such shares into his or her name. Shares held in trust in an IRA or Keogh Account, however, may be voted by the Holding Company if no other instructions are received. Shares standing in the name of a trustee may be voted by him or her, either in person or by proxy, but no trustee shall be entitled to vote shares held by him or her without a transfer of such shares into his or her name. Shares standing in the name of a receiver may be voted by such receiver, and shares held by or under the control of a receiver may be voted by such receiver without the transfer thereof into his name if authority to do so is contained in an appropriate order of the court or other public authority by which such receiver was appointed.

A shareholder whose shares are pledged shall be entitled to vote such shares until the shares have been transferred into the name of the pledgee, and thereafter the pledgee shall be entitled to vote the shares so transferred.

Neither treasury shares of its own stock held by the Holding Company nor shares held by another corporation, if a majority of the shares entitled to vote for the election of directors of such other corporation are held by the Holding Company, shall be voted at any meeting, or counted in determining the total number of outstanding shares at any given time for purposes of any meeting.

**Section 12. No Cumulative Voting.** Shareholders shall not be entitled to cumulate their votes for election of directors.

**Section 13. Inspectors of Election.** In advance of any meeting of shareholders, the Board of Directors may appoint any persons other than nominees for office as inspectors of election to act at such meeting or any adjournment thereof. The number of inspectors shall be either one or three. Any such appointment shall not be altered at the meeting. If inspectors of election are not so appointed, the chairman of the board or the president may, or

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on the request of not fewer than 10 percent of the votes represented at the meeting shall, make such appointment at the meeting. If appointed at the meeting, the majority of the votes present shall determine whether one or three inspectors are to be appointed. In case any person appointed as inspector fails to appear or fails or refuses to act, the vacancy may be filled by appointment by the Board of Directors in advance of the meeting or at the meeting by the chairman of the board or the president.

Unless otherwise prescribed by regulations of the Office, the duties of such inspectors shall include: determining the number of shares of stock and the voting power of each share, the shares represented at the meeting, the existence of a quorum, and the authenticity, validity and effect of proxies; receiving votes, ballots, or consents; hearing and determining all challenges and questions in any way arising in connection with the rights to vote; counting and tabulating all votes or consents; determining the result; and such acts as may be proper to conduct the election or vote with fairness to all shareholders.

**Section 14. Nominating Committee.** The Board shall have a nominating committee comprised of at least three directors each of whom shall be “independent” as such term is defined by the listing standards of any securities exchange on which shares of the common stock of the Holding Company trade. Except in the case of a nominee substituted as a result of the death or other incapacity of a management nominee, the nominating committee shall deliver written nominations to the secretary at the principal executive offices of the Holding Company at least 20 days prior to the date of the annual meeting. Upon delivery, such nominations shall be posted in a conspicuous place in each office of the Holding Company. No nominations for director except those made by the nominating committee shall be voted upon at the annual meeting unless other nominations by shareholders are made in writing and delivered to the secretary at the principal executive offices of the Holding Company at least thirty (30) days prior to the date of the annual meeting; provided however, that in the event less than 40 days notice of the annual meeting is given, a written nomination may be accepted from a shareholder not later than the close of business on the 10<sup>th</sup> day following notice of the annual meeting. Upon delivery, such nominations shall be posted in a conspicuous place in each office of the Holding Company. Ballots bearing the names of all the persons nominated by the nominating committee and by shareholders shall be provided for use at the annual meeting. However, if the nominating committee shall fail or refuse to act at least 20 days prior to the annual meeting, nominations for directors may be made at the annual meeting by any shareholder entitled to vote and shall be voted upon.

**Section 15. New Business.** Any new business to be taken up at the annual meeting shall be stated in writing and filed with the secretary of the Holding Company at least thirty (30) days before the date of the annual meeting, provided, however, that in the event less than 40 days notice of the annual meeting is given, a written proposal may be accepted from a shareholder not later than the close of business on the 10<sup>th</sup> day following notice of the annual meeting, and all business so stated, proposed, and filed shall be considered at the annual meeting so long as the business relates to a proper matter for shareholder action. Any shareholder may make any other proposal at the annual meeting and the same may be discussed and considered, but unless stated in writing and filed with the secretary at least thirty (30) days before the meeting, such proposal shall be laid over for action at an adjourned, special or annual meeting of the shareholders taking place 30 days or more thereafter. A shareholder’s notice to the secretary

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shall set forth as to each such matter the shareholder proposes to bring before the annual meeting (a) a brief description of the proposal desired to be brought and (b) the name and address of such shareholder and the number of shares of common stock of the Holding Company that such shareholder owns of record. This provision shall not prevent the consideration and approval or disapproval at the annual meeting of reports of officers, directors, and committees; but in connection with such reports, no new business shall be acted upon at such annual meeting unless stated and filed as herein provided.

**Section 16. Informal Action by Shareholders.** Any action required to be taken at a meeting of the shareholders, or any other action which may be taken at a meeting of the shareholders, may be taken without a meeting if consent in writing, setting forth the action so taken, shall be given by all of the shareholders entitled to vote with respect to the subject matter thereof.

### **ARTICLE III - Board of Directors**

**Section 1. General Powers.** The business and affairs of the Holding Company shall be under the direction of its Board of Directors. The Board of Directors shall annually elect a chairman of the board and a president from among its members and shall designate, when present, either the chairman of the board or the president to preside at its meetings.

**Section 2. Number and Term.** The Board of Directors shall consist of not fewer than five nor more than fifteen members and shall be divided into three classes as nearly equal in number as possible. The members of each class shall be elected for a term of three years and until their successors are elected and qualified. One class shall be elected by ballot annually.

**Section 3. Regular Meetings.** A regular meeting of the Board of Directors shall be held without other notice than this bylaw immediately after, and at the same place as, the annual meeting of shareholders. The Board of Directors may provide, by resolution, the time and place, for the holding of additional regular meetings without other notice than such resolution. Directors may participate in a meeting by means of conference telephone or similar communications device through which all persons participating can hear each other at the same time. Such participation shall constitute presence in person for all purposes.

**Section 4. Qualification.** Each director shall at all times be the beneficial owner of not less than 100 shares of capital stock of the Holding Company unless the Holding Company is a wholly owned subsidiary of a holding company. A person is not qualified to serve as a director if he or she: (1) is under indictment for, or has ever been convicted of, a criminal offense involving dishonesty or breach of trust and the penalty for such offense could be imprisonment for more than one year, or (2) is a person against whom a banking agency has, within the past ten years, issued a cease and desist order for conduct involving dishonesty or breach of trust and that order is final and subject to appeal, or (3) has been found either by a regulatory agency whose decision is final and not subject to appeal or by a court to have (i) breached a fiduciary duty involving personal profit or (ii) committed a willful violation of any law, rule or regulation governing banking, securities, commodities or insurance, or any final

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cease and desist order issued by a banking, securities, commodities or insurance regulatory agency.

**Section 5. Special Meetings.** Special meetings of the Board of Directors may be called by or at the request of the chairman of the board, the president, or one-third of the directors. The persons authorized to call special meetings of the Board of Directors may fix any place, within the Holding Company's normal lending territory, as the place for holding any special meeting of the Board of Directors called by such persons.

Directors may participate in special meetings by means of a conference telephone or similar communications device through which all persons participating can hear each other. Such participation shall constitute presence in person for all purposes, including the purpose of compensation pursuant to Section 12 of this Article.

**Section 6. Notice.** Written notice of any special meeting shall be given to each director at least twenty-four (24) hours prior thereto when delivered personally or by telegram or at least five days prior thereto when delivered by mail at the address at which the director is most likely to be reached. Such notice shall be deemed to be delivered when deposited in the mail so addressed, with postage thereon prepaid if mailed or when delivered to the telegraph company if sent by telegram, or when the Holding Company receives notice of delivery if electronically transmitted. Any director may waive notice of any meeting by a writing filed with the secretary. The attendance of a director at a meeting shall constitute a waiver of notice of such meeting, except where a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any meeting of the Board of Directors need be specified in the notice or waiver of notice of such meeting.

**Section 7. Quorum.** A majority of the number of directors fixed by Section 2 of this Article III shall constitute a quorum for the transaction of business at any meeting of the Board of Directors; but if less than such majority is present at a meeting, a majority of the directors present may adjourn the meeting from time to time. Notice of any adjourned meeting shall be given in the same manner as prescribed by Section 6 of this Article III.

**Section 8. Manner of Acting.** The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors, unless a greater number is prescribed by regulation of the Office or by these bylaws

**Section 9. Action Without a Meeting.** Any action required or permitted to be taken by the Board of Directors at a meeting may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the directors.

**Section 10. Resignation.** Any director may resign at any time by sending a written notice of such resignation to the home office of the Holding Company addressed to the chairman of the board or the president. Unless otherwise specified, such resignation shall take effect upon receipt thereof by the chairman of the board or the president. More than three consecutive absences from regular meetings of the Board of Directors, unless excused by



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resolution of the Board of Directors, shall automatically constitute a resignation, effective when such resignation is accepted by the Board of Directors.

**Section 11. Vacancies.** Any vacancy occurring on the Board of Directors may be filled by the affirmative vote of a majority of the remaining directors although less than a quorum of the Board of Directors. A director elected to fill a vacancy shall be elected to serve until the next election of directors by the shareholders. Any directorship to be filled by reason of an increase in the number of directors may be filled by election by the Board of Directors for a term of office continuing only until the next election of directors by the shareholders.

**Section 12. Compensation.** Directors, as such, may receive a stated salary for their services. By resolution of the Board of Directors, a reasonable fixed sum, and reasonable expenses of attendance, if any, may be allowed for actual attendance at each regular or special meeting of the Board of Directors. Members of either standing or special committees may be allowed such compensation for actual attendance at committee meetings as the Board of Directors may determine.

**Section 13. Presumption of Assent.** A director of the Holding Company who is present at a meeting of the Board of Directors at which action on any the Holding Company matter is taken shall be presumed to have assented to the action taken unless his or her dissent or abstention shall be entered in the minutes of the meeting or unless he or she shall file a written dissent to such action with the person acting as the secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the secretary of the Holding Company within five days after the date a copy of the minutes of the meeting is received. Such right to dissent shall not apply to a director who voted in favor of such action.

**Section 14. Removal of Directors.** At a meeting of shareholders called expressly for that purpose, any director may be removed for cause by a vote of the holders of a majority of the shares then entitled to vote at an election of directors. Whenever the holders of the shares of any class are entitled to elect one or more directors by the provisions of the charter or supplemental sections thereto, the provisions of this Section shall apply, in respect to the removal of a director or directors so elected, to the vote of the holders of the outstanding shares of that class and not to the vote of the outstanding shares as a whole.

For purposes of this section, removal for cause includes, as defined in 12 C.F.R. §563.39, or any successor regulation enacted by the Office, personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, or a willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease-and-desist order.

**Section 15. Age Limitation.** No person 75 years of age shall be eligible for election, reelection, appointment, or reappointment to the board of the Holding Company. No director shall serve as such beyond the annual meeting of the Holding Company following the director becoming 75. This age limitation does not apply to an advisory director.

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## ARTICLE IV - Executive And Other Committees

**Section 1. Appointments.** The board of directors, by resolution adopted by a majority of the full board, may designate three or more of the other directors to constitute an executive committee. The designation of any committee pursuant to this Article IV and the delegation of authority shall not operate to relieve the board of directors, or any director, of any responsibility imposed by law or regulation.

**Section 2. Authority .** The executive committee, when the board of directors is not in session, shall have and may exercise all of the authority of the board of directors except to the extent, if any, that such authority shall be limited by the resolution appointing the executive committee; and except also that the executive committee shall not have the authority of the board of directors with reference to: the declaration of dividends; the amendment of the charter or bylaws of the Holding Company, or recommending to the shareholders a plan of merger, consolidation, or conversion; the sale, lease, or other disposition of all or substantially all of the property and assets of the Holding Company otherwise than in the usual and regular course of its business; a voluntary dissolution of the Holding Company; a revocation of any of the foregoing; or the approval of a transaction in which any member of the executive committee, directly or indirectly, has any material beneficial interest.

**Section 3. Tenure.** Subject to the provisions of Section 8 of this article IV, each member of the executive committee shall hold office for a term fixed by resolution of the board of directors and until a successor is designated as a member of the executive committee.

**Section 4. Meetings.** Regular meetings of the executive committee may be held without notice at such times and places as the executive committee may fix from time to time by resolution. Special meetings of the executive committee may be called by any member thereof upon not less than one day's notice stating the place, date, and hour of the meeting, which notice may be written or oral. Any member of the executive committee may waive notice of any meeting and no notice of any meeting need be given to any member thereof who attends in person. The notice of a meeting of the executive committee need not state the business proposed to be transacted at the meeting.

**Section 5. Quorum.** A majority of the members of the executive committee shall constitute a quorum for the transaction of business at any meeting thereof, and action of the executive committee must be authorized by the affirmative vote of a majority of the members present at a meeting at which a quorum is present.

**Section 6. Action Without a Meeting.** Any action required or permitted to be taken by the executive committee at a meeting may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the members of the executive committee.

**Section 7. Vacancies.** Any vacancy in the executive committee may be filled by a resolution adopted by a majority of the full board of directors.

**Section 8. Resignations and Removal.** Any member of the executive committee may be removed at any time with or without cause by resolution adopted by a

majority of the full board of directors. Any member of the executive committee may resign from the executive committee at any time by giving written notice to the president or secretary of the Holding Company. Unless otherwise specified, such resignation shall take effect upon its receipt; the acceptance of such resignation shall not be necessary to make it effective. No notice of any meeting need be given to any member thereof who attends in person. The notice of a meeting of the executive committee need not state the business proposed to be transacted at the meeting.

**Section 9. Procedure.** The executive committee shall elect a presiding officer from its members and may fix its own rules of procedure which shall not be inconsistent with these bylaws. It shall keep regular minutes of its proceedings and report the same to the board of directors for its information at the meeting held next after the proceedings shall have occurred.

**Section 10. Other Committees .** The board of directors may by resolution establish an audit, loan, or other committee composed of directors as they may determine to be necessary or appropriate for the conduct of the business of the Holding Company and may prescribe the duties, constitution, and procedures thereof.

## **ARTICLE V - Officers**

**Section 1. Positions.** The officers of the Holding Company shall be a chief executive officer, president, one or more vice presidents, a secretary, and a treasurer or comptroller, each of whom shall be elected by the Board of Directors. The Board of Directors also may designate the chairman of the board as an officer. The president shall be the chief executive officer, unless the Board of Directors designates the chairman of the board as chief executive officer. The president shall be a director of the Holding Company. The offices of the secretary and treasurer or comptroller may be held by the same person and a vice president may also be either the secretary or the treasurer or comptroller. The Board of Directors may designate one or more vice presidents as executive vice president or senior vice president. The Board of Directors also may elect or authorize the appointment of such other officers as the business of the Holding Company may require. The officers shall have such authority and perform such duties as the Board of Directors may from time to time authorize or determine. In the absence of action by the Board of Directors, the officers shall have such powers and duties as generally pertain to their respective offices.

**Section 2. Election and Term of Office.** The officers of the Holding Company shall be elected annually at the first meeting of the Board of Directors held after each annual meeting of the shareholders. If the election of officers is not held at such meeting, such election shall be held as soon thereafter as possible. Each officer shall hold office until a successor has been duly elected and qualified or until the officer's death, resignation, or removal in the manner hereinafter provided. Election or appointment of an officer, employee, or agent shall not of itself create contractual rights. The Board of Directors may authorize the Holding Company to enter into an employment contract with any officer in accordance with regulations of the Office; but no such contract shall impair the right of the Board of Directors to remove any officer at any time in accordance with Section 3 of this Article V.

**Section 3. Removal.** Any officer may be removed by the Board of Directors whenever, in its judgment, the best interests of the Holding Company will be served thereby, but

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such removal, other than for cause, shall be without prejudice to any contractual rights, if any, of the person so removed.

For purposes of this section, removal for cause includes, as defined in 12 C.F.R. §563.39 or any successor regulation enacted by the Office, removal because of the officer's "personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease-and-desist order."

**Section 4. Vacancies.** A vacancy in any office because of death, resignation, removal, disqualification, or otherwise, may be filled by the Board of Directors for the unexpired portion of the term.

**Section 5. Remuneration.** The remuneration of the officers shall be fixed from time to time by the Board of Directors.

## **ARTICLE VI - Contracts, Loans, Checks, and Deposits**

**Section 1. Contracts.** To the extent permitted by regulations of the Office, and except as otherwise prescribed by these bylaws with respect to certificates for shares, the Board of Directors may authorize any officer, employee or agent of the Holding Company to enter into any contract or execute and deliver any instrument in the name of and on behalf of the Holding Company. Such authority may be general or confined to specific instances.

**Section 2. Loans.** No loans shall be contracted on behalf of the Holding Company and no evidence of indebtedness shall be issued in its name unless authorized by the Board of Directors. Such authority may be general or confined to specific instances.

**Section 3. Checks, Drafts, Etc.** All checks, drafts, or other orders for the payment of money, notes, or other evidences of indebtedness issued in the name of the Holding Company shall be signed by one or more officers, employees, or agents of the Holding Company in such manner as shall from time to time be determined by the Board of Directors.

**Section 4. Deposits.** All funds of the Holding Company not otherwise employed shall be deposited from time to time to the credit of the Holding Company in any duly authorized depositories as the Board of Directors may select.

## **ARTICLE VII - Certificates for Shares and Their Transfer**

**Section 1. Certificates for Shares.** Certificates representing shares of capital stock of the Holding Company shall be in such form as shall be determined by the Board of Directors and approved by the Office. Such certificates shall be signed by the chief executive officer or by any other officer of the Holding Company authorized by the Board of Directors, attested by the secretary or an assistant secretary, and sealed with the corporate seal or a facsimile thereof. The signatures of such officers upon a certificate may be facsimiles if the certificate is manually signed on behalf of a transfer agent or a registrar, other than the Holding Company itself or one of its employees. Each certificate for shares of capital stock shall be consecutively numbered or otherwise identified. The name and address of the person to whom

the shares are issued, with the number of shares and date of issue, shall be entered on the stock transfer books of the Holding Company. All certificates surrendered to the Holding Company for transfer shall be canceled and no new certificate shall be issued until the former certificate for a like number of shares has been surrendered and canceled, except that in the case of a lost or destroyed certificate, a new certificate may be issued upon such terms and indemnity to the Holding Company as the Board of Directors may prescribe.

**Section 2. Transfer of Shares.** Transfer of shares of capital stock of the Holding Company shall be made only on its stock transfer books. Authority for such transfer shall be given only by the holder of record thereof or by his legal representative, who shall furnish proper evidence of such authority, or by his attorney thereunto authorized by a duly executed power of attorney and filed with the Holding Company. Such transfer shall be made only on surrender for cancellation of the certificate for such shares. The person in whose name the shares of capital stock stand on the books of the Holding Company shall be deemed by the Holding Company to be the owner for all purposes.

#### **ARTICLE VII - Fiscal Year; Annual Audit**

The fiscal year of the Holding Company shall end on the 31st day of December of each year. The appointment of such accountants shall be subject to annual ratification by the shareholders.

#### **ARTICLE IX - Dividends**

Subject only to the terms of the Holding Company's charter and the regulations and orders of the Office, the Board of Directors may, from time to time, declare, and the Holding Company may pay, dividends on its outstanding shares of capital stock.

#### **ARTICLE X - Corporate Seal**

The Board of Directors shall provide a corporate seal which shall be two concentric circles between which shall be the name of the Holding Company. The year of incorporation or an emblem may appear in the center.

#### **ARTICLE XI - Amendments**

These bylaws may be amended in a manner consistent with regulations of the Office and shall be effective after: (i) approval of the amendment by a majority vote of the authorized board of directors, or by a majority vote of the votes cast by the shareholders of the Holding Company at any legal meeting, and (ii) receipt of any applicable regulatory approval. When the Holding Company fails to meet its quorum requirements, solely due to vacancies on the board, then the affirmative vote of a majority of the sitting board will be required to amend the bylaws.

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**Exhibit 5.1**

[Thacher Proffitt & Wood LLP letterhead]

\_\_\_\_\_, 2006

Lake Shore Bancorp, Inc.  
125 East Fourth Street  
Dunkirk, New York 14048

Re: Lake Shore Bancorp, Inc.

Ladies and Gentlemen:

We have acted as special counsel to Lake Shore Bancorp, Inc., a federal corporation (the "Company"), in connection with the proposed registration under the Securities Act of 1933, as amended, by the Company of an aggregate of \_\_\_\_\_ shares of common stock, \$0.01 par value per share, of the Company (the "Shares"), and the related preparation and filing by the Company with the Securities and Exchange Commission of a Registration Statement on Form S-1 (the "Registration Statement") pursuant to the Amended Plan of Reorganization and Minority Stock Issuance (the "Plan"). In rendering the opinion set forth below, we do not express any opinion concerning law other than the federal law of the United States.

We have examined originals or copies, certified or otherwise identified, of such documents, corporate records and other instruments, and have examined such matters of law, as we have deemed necessary or advisable for purposes of rendering the opinion set forth below. As to matters of fact, we have examined and relied upon the factual representations of the Company contained in the Registration Statement and, where we have deemed appropriate, representations or certificates of officers of the Company or public officials. We have assumed the authenticity of all documents submitted to us as originals, the genuineness of all signatures, the legal capacity of natural persons and the conformity to the originals of all documents submitted to us as copies. In making our examination of any documents, we have assumed that all parties, other than the Company, had the corporate power and authority to enter into and perform all obligations thereunder, and, as to such parties, we have also assumed the due authorization by all requisite action, the due execution and delivery of such documents, and the validity and binding effect and enforceability thereof.

Based on the foregoing, we are of the opinion that the Shares have been duly authorized and, when issued as contemplated in the Registration Statement and the Plan, will be validly issued and outstanding, fully paid and non-assessable.

In rendering the opinion set forth above, we have not passed upon and do not purport to pass upon the application of securities or “blue-sky” laws of any jurisdiction (except federal securities laws).

This opinion is given solely for the benefit of the Company and investors who purchase Shares of common stock of the Company pursuant to the Registration Statement, and may not be relied upon by any other person or entity, nor quoted in whole or in part, or otherwise referred to in any document without our express written consent.

We consent to the filing of this opinion as an Exhibit to the Registration Statement and to the reference to our name in the Prospectus contained in the Registration Statement under the heading “Legal and Tax Opinions.”

Very truly yours,

T HACHER P ROFFITT & W OOD LLP

**Exhibit 8.1**

[Thacher Proffitt & Wood LLP Letterhead]

\_\_\_\_\_, 2006

Lake Shore Savings & Loan Association  
128 East Fourth Street  
P.O. Box 512  
Dunkirk, NY 14048-2291

Ladies and Gentlemen:

You have requested our opinion regarding certain federal income tax consequences of the proposed transactions (collectively, the “Reorganization”), more fully described below, pursuant to which (i) Lake Shore Savings and Loan Association will convert from a New York chartered mutual savings and loan association (the “Bank”) into a federal stock savings bank (“Stock Bank”) and become the wholly-owned subsidiary of Lake Shore Bancorp, Inc., a newly formed federal capital stock corporation (the “Company”) and (ii) 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”). These transactions and the related sale of Company common stock, also discussed below, will be effected pursuant to the Amended and Restated Plan of Reorganization and Minority Stock Issuance initially adopted by the Board of Directors of the Bank on August 9, 2005 (the “Plan”). The Reorganization and its component and related transactions are described in the Plan and in the Prospectus filed with the Securities and Exchange Commission in connection with the Reorganization (the “Prospectus”). 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.

In connection with the opinions expressed below, we have examined and relied upon originals, or copies certified or otherwise identified to our satisfaction, of the Plan and the Prospectus and of such corporate records of the parties to the Reorganization as we have deemed appropriate. We have also relied, without independent verification, upon the factual representations of the Bank contained in its letter to us dated of even date herewith. We have assumed that such representations are true and that the parties to the Reorganization will act in accordance with the Plan. In addition, we have made such investigations of law as we have deemed appropriate to form a basis for the opinions expressed below.

Based on and subject to the foregoing, it is our opinion that for federal income tax purposes, under current law:

(a) as regards the Charter Conversion:

1. The Charter Conversion will constitute a reorganization under Section 368(a)(1)(F) of the Code; and

2. The Bank, in either its status as the state mutual savings and loan association or the federal mutual savings bank, will recognize no gain or loss as a result of the Charter Conversion.

(b) as regards the Conversion:

3. the Conversion will constitute a reorganization under section 368(a)(1)(F) of the Code, and the Bank (in either its status as the Bank or Stock Bank) will recognize no gain or loss as a result of the Reorganization;

4. the basis of each asset of the Bank held by Stock Bank immediately after the Conversion will be the same as the Bank's basis for such asset immediately prior to the Conversion;

5. the holding period of each asset of the Bank held by Stock Bank immediately after the Conversion will include the period during which such asset was held by the Bank prior to the Conversion;

6. for purposes of Code section 381(b), Stock Bank will be treated as if there had been no reorganization and, accordingly, the taxable year of the Bank will not end on the effective date of the Reorganization and the tax attributes of the Bank (subject to application of Code sections 381, 382, and 384), including the Bank's tax bad debt reserves and earnings and profits, will be taken into account by Stock Bank as if the Reorganization had not occurred;

7. no Bank Member will recognize gain or loss upon the constructive receipt of shares of Stock Bank stock solely in exchange for such Bank Member's membership interests in the Bank;

8. a Bank Member's basis in the shares of Stock Bank stock constructively received in the Conversion will be the same as the basis of the Bank membership interests constructively surrendered in exchange therefor;

9. a Bank Member's holding period for the shares of Stock Bank stock constructively received in the Conversion will include the holding period of the membership interests constructively surrendered in exchange therefor, provided such membership interests were held as capital assets on the date of the Exchange; and

10. no Bank Member will recognize gain or loss upon the issuance to such Bank Member of deposits in Stock Bank in the same dollar amount as such Bank Member's deposits in the Bank.

(c) as regards the Exchange:

11. the Exchange will qualify as an exchange of property for stock under Code section 351;



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

13. the basis of the membership interests in the 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;

14. the holding period of the membership interests in the 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;

15. the 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 MHC;

16. the MHC's basis for each share of Stock Bank stock received from a shareholder of Stock Bank in exchange for membership interests in the MHC will be equal to the basis of such share of stock in the hands of such Stock Bank shareholder; and

17. the MHC's holding period for each share of Stock Bank stock received from a shareholder of Stock Bank in exchange for membership interests in the 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.

(d) as regards the offering under the Plan:

18. no gain or loss will be recognized by the Company upon the sale of shares of the Company common stock under the Plan;

19. it is more likely than not that the fair market value of the nontransferable Subscription Rights to purchase shares of common stock of the Company to be issued to Bank Members is zero and, accordingly, that no income will be recognized by Bank Members upon the issuance to them of Subscription Rights or upon the exercise of the Subscription Rights;

20. it is more likely than not that the tax basis to the holders of shares of Company 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 (19) and (20) 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 the Company 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.

Except as set forth above, we express no opinion to any party as to the tax consequences, whether federal, state, local or foreign, of the Charter Conversion, the Conversion and the Exchange, or of any transaction related thereto or contemplated by the Plan. This opinion is given solely for the benefit of the parties to the Plan, the shareholders of Stock Bank and Eligible Account Holders, Supplemental Eligible Account Holders and other investors who purchase shares pursuant to the Plan, and may not be relied upon by any other party or entity or referred to in any document 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,

**Exhibit 10.1**

#### **E M P L O Y M E N T A G R E E M E N T**

This **E M P L O Y M E N T A G R E E M E N T** (the "Agreement") is made and entered into as of \_\_\_\_\_, 2005 by and between **L A K E S H O R E B A N C O R P , I N C .**, a federally-chartered corporation having an office at 128 East 4th Street, Dunkirk, New York 14048 (the "Company") and **D A V I D C. M A N C U S O**, an individual residing at [ \_\_\_\_\_ ] (the "Executive").

#### **I N T R O D U C T O R Y S T A T E M E N T**

**L A K E S H O R E S A V I N G S B A N K**, a federally-chartered savings bank having an office at 128 East 4th Street, Dunkirk, New York 14048 (the "Bank") has reorganized from a New York-chartered mutual savings and loan association to a federally-chartered stock savings bank and has become a wholly-owned subsidiary of the Company, a mid-tier stock holding company, which is majority owned by **L A K E S H O R E , M H C**, a mutual holding company (the "Reorganization"). In connection with the Reorganization, certain shares of the Company's common stock were sold in an initial public stock offering. The Executive has served the Bank in an executive capacity for many years and is familiar with the Bank's operations.

The Board of Directors of the Company has concluded that it is in the best interests of the Company and their prospective shareholders to secure a continuity in management following the Reorganization. They also consider it desirable to establish a working environment for the Executive which minimizes the personal distractions that might result from possible business combinations in which the Company might be involved. For these reasons, the Board of Directors of the Company has decided to offer to enter into a contract with the Executive for his future services. The Executive has accepted this offer.

The terms and conditions which the Company and the Executive have agreed to are as follows.

#### **A G R E E M E N T**

##### *Section 1. Employment.*

The Company hereby continues to employ the Executive, and the Executive hereby accepts such continued employment, during the period and upon the terms and conditions set forth in this Agreement.

##### *Section 2. Employment Period; Remaining Unexpired Employment Period.*

(a) The Company shall employ the Executive during an initial period of three (3) years beginning on the effective date of the Reorganization (the "Employment Commencement Date") and ending on the day before the third (3rd) anniversary of the Employment Commencement Date, and during the period of any additional extensions described in section 2(b) (the "Employment Period").

(b) The Board of Directors of the Company shall conduct an annual review of the Executive's performance on or about each anniversary of the Employment Commencement Date (each, an "Anniversary Date") and may, on the basis of such review and by written notice to the Executive, offer to extend the Employment Period through the day before the third (3rd) anniversary of the relevant Anniversary Date. In such event, the Employment Period shall be deemed extended in the absence of objection from the Executive by written notice to the Company given within ten (10) business days after his receipt of the Company's offer of extension.

(c) Except as otherwise expressly provided in this Agreement, any reference in this Agreement to the term "Remaining Unexpired Employment Period" as of any date shall mean the period beginning on such date and ending on the day before the third (3rd) anniversary of the Employment Commencement Date or, if later, on the day before the third (3rd) anniversary of the last Anniversary Date as of which the Employment Period was extended pursuant to section 2(b).

(d) Nothing in this Agreement shall be deemed to prohibit the Company from terminating the Executive's employment before the end of the Employment Period with or without notice for any reason. This Agreement shall determine the relative rights and obligations of the Company and the Executive in the event of any such termination. In addition, nothing in this Agreement shall require the termination of the Executive's employment at the expiration of the Employment Period. Any continuation of the Executive's employment beyond the expiration of the Employment Period shall be on an "at-will" basis unless the Company and the Executive agree otherwise.

### *Section 3. Duties.*

The Executive shall serve as Chief Executive Officer and President of the Company, having such power, authority and responsibility and performing such duties as are prescribed by or under the Company's By-Laws and as are customarily associated with such positions. The Executive shall devote his full business time and attention (other than during weekends, holidays, approved vacation periods, and periods of illness or approved leaves of absence) to the business and affairs of the Company and shall use his best efforts to advance their respective best interests.

### *Section 4. Cash Compensation.*

In consideration for the services to be rendered by the Executive hereunder, the Company shall pay to him a salary at an initial annual rate of TWO HUNDRED THIRTEEN THOUSAND FIVE HUNDRED FIFTY DOLLARS (\$213,550), payable in approximately equal installments in accordance with their respective customary payroll practices for senior officers. The Company's Board of Directors shall review the Executive's annual rate of salary at such times during the Employment Period as it deems appropriate, but not less frequently than once every twelve (12) months, and may, at its discretion, approve a salary increase. In addition to salary, the Executive may receive other cash compensation from the Company for services hereunder at such times, in such amounts and on such terms and conditions as the Board of Directors of the Company may determine.

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*Section 5. Employee Benefit Plans and Programs.*

During the Employment Period, the Executive shall be treated as an employee of the Company and shall be entitled to participate in and receive benefits under any and all qualified or non-qualified retirement, pension, savings, profit-sharing or stock bonus plans, any and all group life, health (including hospitalization, medical and major medical), dental, accident and long-term disability insurance plans, and any other employee benefit and compensation plans (including, but not limited to, any incentive compensation plans or programs, stock option and appreciation rights plans and restricted stock plans) as may from time to time be maintained by, or cover employees of, the Company, in accordance with the terms and conditions of such employee benefit plans and programs and compensation plans and programs and consistent with the Company's customary practices.

*Section 6. Indemnification and Insurance.*

(a) To the maximum extent permitted under applicable law, during the Employment Period and for a period of six years thereafter, the Company shall cause the Executive to be covered by and named as an insured under any policy or contract of insurance obtained by them to insure their directors and officers against personal liability for acts or omissions in connection with service as an officer or director of the Company or the Bank or service in other capacities at their request. The coverage provided to the Executive pursuant to this section 6 shall be of the same scope and on the same terms and conditions as the coverage (if any) provided to other officers or directors of the Company.

(b) To the maximum extent permitted under applicable law, during the Employment Period and for a period of six years thereafter, the Company shall indemnify the Executive against and hold him harmless from any costs, liabilities, losses and exposures to the fullest extent and on the most favorable terms and conditions that similar indemnification is offered to any director or officer of the Company or any subsidiary or affiliate thereof.

*Section 7. Outside Activities.*

The Executive may serve as a member of the boards of directors of such business, community and charitable organizations as he may disclose to and as may be approved by the Board of Directors of the Company (which approval shall not be unreasonably withheld); provided, however, that such service shall not materially interfere with the performance of his duties under this Agreement nor shall it violate any applicable laws or regulations. The Executive may also engage in personal business and investment activities which do not materially interfere with the performance of his duties hereunder; provided, however, that such activities are not prohibited under any code of conduct or investment or securities trading policy established by the Company and generally applicable to all similarly situated executives and that such activities are not prohibited by any applicable laws or regulations.

*Section 8. Working Facilities and Expenses.*

The Executive's principal place of employment shall be at the Company's executive offices at the address first above written, or at such other location as the Company and the Executive may mutually agree upon. The Company shall provide the Executive at his

principal place of employment with a private office, secretarial services and other support services and facilities suitable to his positions with the Company and necessary or appropriate in connection with the performance of his assigned duties under this Agreement. The Company shall reimburse the Executive for his ordinary and necessary business expenses, including, without limitation, fees for memberships in such clubs and organizations that are necessary and appropriate for business purposes as mutually agreed by the Company and the Executive, and his travel and entertainment expenses incurred in connection with the performance of his duties under this Agreement, in each case only if such expenses are presented and approved in accordance with the Company's business reimbursement policy then in effect.

*Section 9. Termination Due to Death.*

The Executive's employment with the Company shall terminate, automatically and without any further action on the part of any party to this Agreement, on the date of the Executive's death. In such event:

(a) The Company shall pay to the Executive's estate his earned but unpaid compensation (including, without limitation, salary and all other items which constitute wages under applicable law) as of the date of his termination of employment. This payment shall be made at the time and in the manner prescribed by law applicable to the payment of wages but in no event later than thirty (30) days after the date of the Executive's termination of employment.

(b) The Company shall provide the benefits, if any, due to the Executive's estate, surviving dependents or his designated beneficiaries under the employee benefit plans and programs and compensation plans and programs maintained for the benefit of the officers and employees of the Company. The time and manner of payment or other delivery of these benefits and the recipients of such benefits shall be determined according to the terms and conditions of the applicable plans and programs.

The payments and benefits described in sections 9(a) and (b) shall be referred to in this Agreement as the "Standard Termination Entitlements."

*Section 10. Termination Due to Disability.*

The Company may terminate the Executive's employment upon a determination, by vote of a majority of the members of the Board of Directors of the Company, acting in reliance on the written advice of a medical professional acceptable to them, that the Executive is suffering from a physical or mental impairment which, at the date of the determination, has prevented the Executive from performing his assigned duties on a substantially full-time basis for a period of at least one hundred and eighty (180) days during the period of one (1) year ending with the date of the determination or is likely to result in death or prevent the Executive from performing his assigned duties on a substantially full-time basis for a period of at least one hundred and eighty (180) days during the period of one (1) year beginning with the date of the determination. In such event:

(a) The Company shall pay and deliver to the Executive (or in the event of his death before payment, to his estate and surviving dependents and beneficiaries, as applicable) the Standard Termination Entitlements.

(b) In addition to the Standard Termination Entitlements, the Company shall continue to pay the Executive his base salary, at the annual rate in effect for him immediately prior to the termination of his employment, during a period ending on the earliest of: (i) the expiration of one hundred and eighty (180) days after the date of termination of his employment; (ii) the date on which long-term disability insurance benefits are first payable to him under any long-term disability insurance plan covering employees of the Company (the "LTD Eligibility Date"); (iii) the date of his death; and (iv) the expiration of the Remaining Unexpired Employment Period (the "Initial Continuation Period"). If the end of the Initial Continuation Period is neither the LTD Eligibility Date nor the date of his death, the Company shall continue to pay the Executive his base salary, at an annual rate equal to sixty percent (60%) of the annual rate in effect for him immediately prior to the termination of his employment, during an additional period ending on the earliest of the LTD Eligibility Date, the date of his death and the expiration of the Remaining Unexpired Employment Period.

A termination of employment due to disability under this section 10 shall be effected by joint notice of termination given to the Executive by the Company and shall take effect on the later of the effective date of termination specified in such notice or the date on which the notice of termination is deemed given to the Executive.

*Section 11. Discharge with Cause.*

(a) The Company may terminate the Executive's employment during the Employment Period, and such termination shall be deemed to have occurred with "Cause", only if:

(i) The Board of Directors of the Company, by majority vote of their entire membership, determine that the Executive should be discharged because of personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease and desist order, or any material breach of this Agreement; and

(ii) at least forty-five (45) days prior to the votes contemplated by section 11(a)(i), the Company has provided the Executive with notice of its intent to discharge the Executive for Cause, detailing with particularity the facts and circumstances which are alleged to constitute Cause (the "Notice of Intent to Discharge"); and

(iii) after the giving of the Notice of Intent to Discharge and before the taking of the votes contemplated by section 11(a)(i), the Executive (together with his legal counsel, if he so desires) is afforded a reasonable opportunity to make both written and oral presentations before the Board of Directors of the Company for the purpose of refuting the alleged grounds for Cause for his discharge; and

(iv) after the votes contemplated by section 11(a)(i), the Company have furnished to the Executive a notice of termination which shall specify the

effective date of his termination of employment (which shall in no event be earlier than the date on which such notice is deemed given) and include a copy of a resolution or resolutions adopted by the Board of Directors of the Company, certified by its corporate secretary and signed by each member of the Board of Directors voting in favor of adoption of the resolution(s), authorizing the termination of the Executive's employment with Cause and stating with particularity the facts and circumstances found to constitute Cause for his discharge (the "Final Discharge Notice").

(b) If the Executive is discharged during the Employment Period with Cause, the Company shall pay and provide to him (or, in the event of his death, to his estate, his surviving beneficiaries and his dependents) the Standard Termination Entitlements only. Following the giving of a Notice of Intent to Discharge, the Company shall temporarily suspend the Executive's duties and authority and, in such event, shall also suspend the payment of salary and other cash compensation, but not the Executive's participation in retirement, insurance and other employee benefit plans. If the Executive is not discharged, or is discharged without Cause, within forty-five (45) days after the giving of a Notice of Intent to Discharge, payments of salary and cash compensation shall resume, and all payments withheld during the period of suspension shall be promptly restored. If the Executive is discharged with Cause not later than forty-five (45) days after the giving of the Notice of Intent to Discharge, all payments withheld during the period of suspension shall be deemed forfeited and shall not be included in the Standard Termination Entitlements. If the Company does not give a Final Discharge Notice to the Executive within ninety (90) days after giving a Notice of Intent to Discharge, the Notice of Intent to Discharge shall be deemed withdrawn and any future action to discharge the Executive with Cause shall require the giving of a new Notice of Intent to Discharge.

*Section 12. Discharge without Cause.*

The Company may discharge the Executive at any time during the Employment Period and, unless such discharge constitutes a discharge with Cause:

(a) The Company shall pay and deliver to the Executive (or in the event of his death before payment, to his estate and surviving dependents and beneficiaries, as applicable) the Standard Termination Entitlements.

(b) During the Remaining Unexpired Employment Period, the Company shall provide for the Executive and his dependents continued group life, health (including hospitalization, medical and major medical), dental, accident and long-term disability insurance benefits on substantially the same terms and conditions (including any required premium-sharing arrangements, co-payments and deductibles) in effect for similarly situated employees of the Company. The coverage provided under this section 12(b) may, at the election of the Company, be secondary to the coverage provided as part of the Standard Termination Entitlements and to any employer-paid coverage provided by a subsequent employer or through Medicare, with the result that benefits under the other coverages will offset the coverage required by this section 12(b).

(c) The Company shall make a lump sum payment to the Executive (or, in the event of his death before payment, to his estate), in an amount equal to the value of the salary, bonus, short-term and long-term cash compensation that the Executive received in the calendar year preceding that in which the termination of employment with the Company occurs divided by twelve and then multiplied by the number of months remaining in the Remaining Unexpired Employment Period to compensate the Executive for the payments the Executive would have received during the Remaining Unexpired Employment Period. Such lump sum shall be paid in lieu of all other payments of salary, bonus, short-term and long-term cash compensation provided for under this Agreement in respect of the period following any such termination. Such payment shall be made (without discounting for early payment) within thirty (30) days following the Executive's termination of employment.

The payments and benefits described in sections 12(b) and 12(c) are referred to in this Agreement as the "Additional Termination Entitlements".

*Section 13. Resignation.*

(a) The Executive may resign from his employment with the Company at any time. A resignation under this section 13 shall be effected by notice of resignation given by the Executive to the Company and shall take effect on the later of the effective date of termination specified in such notice or the date on which the notice of termination is deemed given by the Executive. The Executive's resignation of any of the positions within the Bank or the Company to which he has been assigned shall be deemed a resignation from all such positions.

(b) The Executive's resignation shall be deemed to be for "Good Reason" if the effective date of resignation occurs within ninety (90) days after any of the following:

(i) the failure of the Company (whether by act or omission of its Board of Directors, or otherwise) to appoint or re-appoint or elect or re-elect the Executive to the position(s) with the Company, specified in section 3 of this Agreement or to a more senior office;

(ii) if the Executive is or becomes a member of the Board of Directors of the Company or the Bank, the failure of their respective shareholders (whether in an election in which the Executive stands as a nominee or in an election where the Executive is not a nominee) to elect or re-elect the Executive to membership at the expiration of his term of membership, unless such failure is a result of the Executive's refusal to stand for election;

(iii) a material failure by the Company, whether by amendment of its certificate of incorporation or organization, by-laws, action of its Board of Directors or otherwise, to vest in the Executive the functions, duties, or responsibilities prescribed in section 3 of this Agreement; provided that the Executive shall have given notice of such failure to the Company, and the Company has not fully cured such failure within thirty (30) days after such notice is deemed given;



(iv) any reduction of the Executive's rate of base salary in effect from time to time, whether or not material, or any failure (other than due to reasonable administrative error that is cured promptly upon notice) to pay any portion of the Executive's compensation as and when due;

(v) any change in the terms and conditions of any compensation or benefit program in which the Executive participates which, either individually or together with other changes, has a material adverse effect on the aggregate value of his total compensation package; provided that the Executive shall have given notice of such material adverse effect to the Company, and the Company has not fully cured such failure within thirty (30) days after such notice is deemed given; provided; however, that this section 13(b)(v) shall not apply if the change in the terms and conditions of the compensation or benefit program affects all participants in such program equally;

(vi) any material breach by the Company of any material term, condition or covenant contained in this Agreement; provided that the Executive shall have given notice of such material adverse effect to the Company, and the Company has not fully cured such failure within thirty (30) days after such notice is deemed given; or

(vii) a change in the Executive's principal place of employment to a place that is not the principal executive office of the Company, or a relocation of the Company's principal executive office to a location that is both more than thirty-five (35) miles away from the Executive's principal residence and more than thirty-five (35) miles away from the location of the Company's principal executive office on the date of this Agreement.

In all other cases, a resignation by the Executive shall be deemed to be without Good Reason.

(c) In the event of the Executive's resignation before the expiration of the Employment Period, the Company shall pay and deliver the Standard Termination Entitlements. In addition, if the Executive's resignation is deemed to be a resignation with Good Reason, the Company shall also pay and deliver the Additional Termination Entitlements.

*Section 14. Terms and Conditions of the Additional Termination Entitlements.*

The Company and the Executive hereby stipulate that the damages which may be incurred by the Executive following any termination of employment are not capable of accurate measurement as of the date first above written and that the Additional Termination Entitlements constitute reasonable damages under the circumstances and shall be payable without any requirement of proof of actual damage and without regard to the Executive's efforts, if any, to mitigate damages. The Company and the Executive further agree that the Company may condition the payment and delivery of the Additional Termination Entitlements on (i) the receipt of the Executive's resignation from any and all positions which he holds as an officer, director or

committee member with respect to the Company, the Bank or any subsidiary or affiliate of either of them and (ii) a release of the Company and its officers, directors, shareholders, subsidiaries and affiliates, in form and substance satisfactory to the Company, of any liability to the Executive, whether for compensation or damages, in connection with his employment with the Company and the termination of such employment except for the Standard Termination Entitlements and the Additional Termination Entitlements.

*Section 15. Termination Upon or Following a Change of Control.*

(a) A "Change of 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) For purposes of this Agreement, a "Pending Change of Control" shall mean: (i) the signing of a definitive agreement for a transaction which, if consummated, would result in a Change of Control; (ii) the commencement of a tender offer which, if successful, would result in a Change of Control; or (iii) the circulation of a proxy statement seeking proxies in opposition to management in an election contest which, if successful, would result in a Change of Control.

(c) Notwithstanding anything in this Agreement to the contrary, for purposes of computing the Additional Termination Entitlements due upon a termination of employment that occurs, or is deemed to have occurred, after a Change of Control, the Remaining Unexpired Employment Period shall be deemed to be three (3) full years.

#### *Section 16. Covenant Not To Compete.*

The Executive hereby covenants and agrees that, in the event of his termination of employment with the Company prior to the expiration of the Employment Period, for a period of one year following the date of his termination of employment with the Company, he shall not,

without the written consent of the Company, become an officer, employee, consultant, director or trustee of any savings bank, savings and loan association, savings and loan holding company, bank or bank holding company, any other entity engaged in the business of accepting deposits or making loans or any direct or indirect subsidiary or affiliate of any such entity, that entails working within the State of New York or any city or county in any other state in which the Company or the Bank maintains an office; provided, however, that this section 16 shall not apply if the Executive is entitled to the Additional Termination Entitlements due to a Change of Control or after a Pending Change of Control.

*Section 17. Confidentiality.*

Unless he obtains the prior written consent of the Company, the Executive shall keep confidential and shall refrain from using for the benefit of himself, or any person or entity other than the Company or any entity which is a subsidiary of the Company or of which the Company is a subsidiary, any material document or information obtained from the Company, or from its parent or subsidiaries, in the course of his employment with any of them concerning their properties, operations or business (unless such document or information is readily ascertainable from public or published information or trade sources or has otherwise been made available to the public through no fault of his own) until the same ceases to be material (or becomes so ascertainable or available); provided, however, that nothing in this section 17 shall prevent the Executive, with or without the Company's consent, from participating in or disclosing documents or information in connection with any judicial or administrative investigation, inquiry or proceeding to the extent that such participation or disclosure is required under applicable law.

*Section 18. Solicitation.*

The Executive hereby covenants and agrees that, for a period of one year following his termination of employment with the Company or the Bank, he shall not, without the written consent of the Company, either directly or indirectly:

(a) solicit, offer employment to, or take any other action intended, or that a reasonable person acting in like circumstances would expect, to have the effect of causing any officer or employee of the Company, the Bank or any of their respective subsidiaries or affiliates to terminate his or her employment and accept employment or become affiliated with, or provide services for compensation in any capacity whatsoever to, any savings bank, savings and loan association, bank, bank holding company, savings and loan holding company, or other institution engaged in the business of accepting deposits, making loans or doing business within the counties specified in section 16;

(b) provide any information, advice or recommendation with respect to any such officer or employee of any savings bank, savings and loan association, bank, bank holding company, savings and loan holding company, or other institution engaged in the business of accepting deposits, making loans or doing business within the counties specified in section 16; that is intended, or that a reasonable person acting in like circumstances would expect, to have the effect of causing any officer or employee of the Company, the Bank, or any of their respective subsidiaries or affiliates to terminate his employment and accept employment or become affiliated with, or provide services for compensation in any capacity whatsoever to, any savings bank, savings and loan association, bank, bank holding company, savings and loan holding company, or other institution engaged in the business of accepting deposits, making loans or doing business within the counties specified in section 16;

(c) solicit, provide any information, advice or recommendation or take any other action intended, or that a reasonable person acting in like circumstances would expect, to have the effect of causing any customer of the Company or the Bank to terminate an existing business or commercial relationship with the Company or the Bank;

*provided however*, that this section 18 shall not apply if the Executive is entitled to the Additional Termination Entitlements due to a Change of Control or after a Pending Change of Control.

*Section 19. No Effect on Employee Benefit Plans or Programs.*

The termination of the Executive's employment during the term of this Agreement or thereafter, whether by the Company or by the Executive, shall have no effect on the rights and obligations of the parties hereto under the Company's or the Bank's qualified or non-qualified retirement, pension, savings, thrift, profit-sharing or stock bonus plans, group life, health (including hospitalization, medical and major medical), dental, accident and long term disability insurance plans or such other employee benefit plans or programs, or compensation plans or programs, as may be maintained by, or cover employees of, the Company or the Bank from time to time; provided, however, that nothing in this Agreement shall be deemed to duplicate any compensation or benefits provided under any agreement, plan or program covering the Executive to which the Company is a party and any duplicative amount payable under any such agreement, plan or program shall be applied as an offset to reduce the amounts otherwise payable hereunder.

*Section 20. Successors and Assigns.*

This Agreement will inure to the benefit of and be binding upon the Executive, his legal representatives and testate or intestate distributees, and the Company and their respective successors and assigns, including any successor by merger or consolidation or a statutory receiver or any other person or firm or corporation to which all or substantially all of the assets and business of the Company may be sold or otherwise transferred. Failure of the Company to obtain from any successor its express written assumption of the Company's obligations hereunder at least sixty (60) days in advance of the scheduled effective date of any such succession shall be deemed a material breach of this Agreement.

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*Section 21. Notices.*

Any communication required or permitted to be given under this Agreement, including any notice, direction, designation, consent, instruction, objection or waiver, shall be in writing and shall be deemed to have been given at such time as it is delivered personally, or five (5) days after mailing if mailed, postage prepaid, by registered or certified mail, return receipt requested, addressed to such party at the address listed below or at such other address as one such party may by written notice specify to the other party:

If to the Executive:

David C. Mancuso  
[Address]  
[Address]

If to the Company:

Lake Shore Bancorp, Inc.  
128 East 4th Street  
Dunkirk, New York 14048

Attention: Chairman, Compensation Committee  
of the Board of Directors

*Section 22. Waiver.*

Failure to insist upon strict compliance with any of the terms, covenants or conditions hereof shall not be deemed a waiver of such term, covenant, or condition. A waiver of any provision of this Agreement must be made in writing, designated as a waiver, and signed by the party against whom its enforcement is sought. Any waiver or relinquishment of any right or power hereunder at any one or more times shall not be deemed a waiver or relinquishment of such right or power at any other time or times.

*Section 23. Counterparts.*

This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, and all of which shall constitute one and the same Agreement.

*Section 24. Governing Law.*

This Agreement shall be governed by and construed and enforced in accordance with the federal laws of the United States and, to the extent that federal law is inapplicable, in accordance with the laws of the State of New York applicable to contracts entered into and to be performed entirely within the State of New York.

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*Section 25. Headings and Construction.*

The headings of sections in this Agreement are for convenience of reference only and are not intended to qualify the meaning of any section. Any reference to a section number shall refer to a section of this Agreement, unless otherwise stated.

*Section 26. Entire Agreement; Modifications.*

This instrument contains the entire agreement of the parties relating to the subject matter hereof, and supersedes in its entirety any and all prior agreements, understandings or representations relating to the subject matter hereof. No modifications of this Agreement shall be valid unless made in writing and signed by the parties hereto.

*Section 27. Non-duplication.*

In the event that the Executive shall perform services for the Bank or any other direct or indirect subsidiary or affiliate of the Company or the Bank, any compensation or benefits provided to the Executive by such other employer shall be applied to offset the obligations of the Company hereunder, it being intended that this Agreement set forth the aggregate compensation and benefits payable to the Executive for all services to the Company and all of its respective direct or indirect subsidiaries and affiliates.

*Section 28. Survival.*

The provisions of sections 6, 16, 17, 18 and 19 shall survive the expiration of the Employment Period or termination of the Agreement.

*Section 29. Indemnification for Attorneys' Fees.*

The Company shall indemnify, hold harmless and defend Executive against reasonable costs, including legal fees, incurred by him in connection with or arising out of any action, suit or proceeding in which he may be involved, as a result of his efforts, in good faith, to defend or enforce the terms of this Agreement; provided, however, that Executive shall have substantially prevailed on the merits pursuant to a judgment, decree or order of a court of competent jurisdiction or of an arbitrator in an arbitration proceeding. The determination whether the Executive shall have substantially prevailed on the merits and is therefore entitled to such indemnification, shall be made by the court or arbitrator, as applicable. In the event of a settlement pursuant to a settlement agreement, any indemnification payment under this section 29 shall be made only after a determination by the members of the Board (other than the Executive and any other member of the Board to which the Executive is related by blood or marriage) that the Executive has acted in good faith and that such indemnification payment is in the best interests of the Company.

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*Section 30. Required Regulatory Provisions.*

The following provisions are included for the purposes of complying with various laws, rules and regulations applicable to the Company:

(a) Notwithstanding anything herein contained to the contrary, in no event shall the aggregate amount of compensation payable to the Executive under section 12(b) hereof exceed the three times the Executive's average annual compensation (within the meaning of OTS Regulatory Bulletin 27a or any successor thereto) for the last five consecutive calendar years to end prior to his termination of employment with the Company (or for his entire period of employment with the Company if less than five calendar years). The compensation payable to the Executive hereunder shall be further reduced (but not below zero) if such reduction would avoid the assessment of excise taxes on excess parachute payments (within the meaning of section 280G of the Code).

(b) Notwithstanding anything herein contained to the contrary, any payments to the Executive by the Company, whether pursuant to this Agreement or otherwise, are subject to and conditioned upon their compliance with section 18(k) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §1828(k), and any regulations promulgated thereunder.

(c) Notwithstanding anything herein contained to the contrary, if the Executive is suspended from office and/or temporarily prohibited from participating in the conduct of the affairs of the Company pursuant to a notice served under section 8(e)(3) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(3) or 1818(g)(1), the Company's obligations under this Agreement shall be suspended as of the date of service of such notice, unless stayed by appropriate proceedings. If the charges in such notice are dismissed, the Company, in its discretion, may (i) pay to the Executive all or part of the compensation withheld while the Company's obligations hereunder were suspended and (ii) reinstate, in whole or in part, any of the obligations which were suspended.

(d) Notwithstanding anything herein contained to the contrary, if the Executive is removed and/or permanently prohibited from participating in the conduct of the Company's affairs by an order issued under section 8(e)(4) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(4) or (g)(1), all prospective obligations of the Company under this Agreement shall terminate as of the effective date of the order, but vested rights and obligations of the Company and the Executive shall not be affected.

(e) Notwithstanding anything herein contained to the contrary, if the Company is in default (within the meaning of section 3(x)(1) of the FDI Act, 12 U.S.C. §1813(x)(1), all prospective obligations of the Company under this Agreement shall terminate as of the date of default, but vested rights and obligations of the Company and the Executive shall not be affected.

(f) Notwithstanding anything herein contained to the contrary, all prospective obligations of the Company hereunder shall be terminated, except to the extent that a continuation of this Agreement is necessary for the continued operation of the Company: (i) by the Director of the OTS or his designee or the Federal Deposit Insurance Corporation ("FDIC"), at the time the FDIC enters into an agreement to provide assistance to or on behalf of the Company under the authority contained in section 13(c) of the FDI Act, 12 U.S.C. §1823(c); (ii) by the Director of the OTS or his designee at the time such Director or designee approves a supervisory merger to resolve problems related to the operation of the Company or when the



Company is determined by such Director to be in an unsafe or unsound condition. The vested rights and obligations of the parties shall not be affected.

If and to the extent that any of the foregoing provisions shall cease to be required or by applicable law, rule or regulation, the same shall become inoperative as though eliminated by formal amendment of this Agreement.

*Section 31. Guarantee; Non-Duplication.*

The Company hereby agrees to guarantee the payment by the Bank of any benefits and compensation to which the Executive is or may be entitled to under the terms and conditions of the employment agreement of even date herewith between the Bank and the Executive. In the event that the Executive shall perform services for the Bank or any other direct or indirect subsidiary of the Company, any compensation or benefits provided to the Executive by such other employer shall be applied to offset the obligations of the Company hereunder, it being intended that this Agreement set forth the aggregate compensation and benefits payable to the Executive for all services to the Company and all of its direct or indirect subsidiaries.

*Section 32. Effective Date.*

This Agreement shall become effective (the "Effective Date") upon the later of the following two dates: (a) the effective date of the Bank's conversion from a New York-chartered mutual savings and loan association to a stock form savings bank pursuant to the Reorganization or (b) the date the OTS advises the Company or Bank in writing that it either approves or has no objection to the terms and conditions of this Agreement. The Company and the Executive each hereby acknowledge and agree that the terms of this Agreement shall have no force or effect prior to such Effective Date.

**I N W I T N E S S W H E R E O F** , the Company has caused this Agreement to be executed and the Executive has hereunto set his hand, all as of the day and year first above written.

\_\_\_\_\_  
**D A V I D C. M A N C U S O**

**L A K E S H O R E B A N C O R P , I N C .**

Attest:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

[Seal]

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**Exhibit 10.2**

**E M P L O Y M E N T A G R E E M E N T**

This **E M P L O Y M E N T A G R E E M E N T** (the "Agreement") is made and entered into as of \_\_\_\_\_, 2005 by and between **L A K E S H O R E S A V I N G S B A N K** , a federally-chartered savings bank having an office at 128 East 4<sup>th</sup> Street, Dunkirk, New York 14048 (the "Bank") and **D A V I D C. M A N C U S O** , an individual residing at [ \_\_\_\_\_ ] (the "Executive").

**I N T R O D U C T O R Y S T A T E M E N T**

The Bank has reorganized from a New York-chartered mutual savings and loan association to a federally-chartered stock savings bank and has become a wholly-owned subsidiary of **L A K E S H O R E B A N C O R P , I N C .** , a federally-chartered corporation and a mid-tier stock holding company having an office at 128 East 4<sup>th</sup> Street, Dunkirk, New York 14048 (the "Company"), which is majority owned by **L A K E S H O R E , M H C** , a mutual holding company (the "Reorganization"). In connection with the Reorganization, certain shares of the Company's common stock were sold in an initial public stock offering. The Executive has served the Bank in an executive capacity for many years and is familiar with the Bank's operations.

The Board of Directors of the Bank has concluded that it is in the best interests of the Bank and their prospective shareholders to secure a continuity in management following the Reorganization. They also consider it desirable to establish a working environment for the Executive which minimizes the personal distractions that might result from possible business combinations in which the Bank might be involved. For these reasons, the Board of Directors of the Bank has decided to offer to enter into a contract with the Executive for his future services. The Executive has accepted this offer.

The terms and conditions which the Bank and the Executive have agreed to are as follows.

**A G R E E M E N T**

***Section 1. Employment.***

The Bank hereby continues to employ the Executive, and the Executive hereby accepts such continued employment, during the period and upon the terms and conditions set forth in this Agreement.

***Section 2. Employment Period; Remaining Unexpired Employment Period.***

(a) The Bank shall employ the Executive during an initial period of three (3) years beginning on the effective date of the Reorganization (the “Employment Commencement Date”) and ending on the day before the third (3<sup>rd</sup>) anniversary of the Employment Commencement Date, and during the period of any additional extensions described in section 2(b) (the “Employment Period”).

(b) The Board of Directors of the Bank shall conduct an annual review of the Executive's performance on or about each anniversary of the Employment Commencement Date (each, an "Anniversary Date") and may, on the basis of such review and by written notice to the Executive, offer to extend the Employment Period through the day before the third (3<sup>rd</sup>) anniversary of the relevant Anniversary Date. In such event, the Employment Period shall be deemed extended in the absence of objection from the Executive by written notice to the Bank given within ten (10) business days after his receipt of the Bank's offer of extension.

(c) Except as otherwise expressly provided in this Agreement, any reference in this Agreement to the term "Remaining Unexpired Employment Period" as of any date shall mean the period beginning on such date and ending on the day before the third (3<sup>rd</sup>) anniversary of the Employment Commencement Date or, if later, on the day before the third (3<sup>rd</sup>) anniversary of the last Anniversary Date as of which the Employment Period was extended pursuant to section 2(b).

(d) Nothing in this Agreement shall be deemed to prohibit the Bank from terminating the Executive's employment before the end of the Employment Period with or without notice for any reason. This Agreement shall determine the relative rights and obligations of the Bank and the Executive in the event of any such termination. In addition, nothing in this Agreement shall require the termination of the Executive's employment at the expiration of the Employment Period. Any continuation of the Executive's employment beyond the expiration of the Employment Period shall be on an "at-will" basis unless the Bank and the Executive agree otherwise.

### ***Section 3. Duties.***

The Executive shall serve as Chief Executive Officer and President of the Bank, having such power, authority and responsibility and performing such duties as are prescribed by or under the Bank's By-Laws and as are customarily associated with such positions. The Executive shall devote his full business time and attention (other than during weekends, holidays, approved vacation periods, and periods of illness or approved leaves of absence) to the business and affairs of the Bank and shall use his best efforts to advance their respective best interests.

### ***Section 4. Cash Compensation.***

In consideration for the services to be rendered by the Executive hereunder, the Bank shall pay to him a salary at an initial annual rate of TWO HUNDRED THIRTEEN THOUSAND FIVE HUNDRED FIFTY DOLLARS (\$213,550), payable in approximately equal installments in accordance with their respective customary payroll practices for senior officers. The Bank's Board of Directors shall review the Executive's annual rate of salary at such times during the Employment Period as it deems appropriate, but not less frequently than once every twelve (12) months, and may, in its discretion, approve a salary increase. In addition to salary, the Executive may receive other cash compensation from the Bank for services hereunder at such times, in such amounts and on such terms and conditions as the Board of Directors of the Bank may determine.

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***Section 5. Employee Benefit Plans and Programs .***

During the Employment Period, the Executive shall be treated as an employee of the Bank and shall be entitled to participate in and receive benefits under any and all qualified or non-qualified retirement, pension, savings, profit-sharing or stock bonus plans, any and all group life, health (including hospitalization, medical and major medical), dental, accident and long-term disability insurance plans, and any other employee benefit and compensation plans (including, but not limited to, any incentive compensation plans or programs, stock option and appreciation rights plans and restricted stock plans) as may from time to time be maintained by, or cover employees of, the Bank, in accordance with the terms and conditions of such employee benefit plans and programs and compensation plans and programs and consistent with the Bank's customary practices.

***Section 6. Indemnification and Insurance .***

(a) To the maximum extent permitted under applicable law, during the Employment Period and for a period of six years thereafter, the Bank shall cause the Executive to be covered by and named as an insured under any policy or contract of insurance obtained by them to insure their directors and officers against personal liability for acts or omissions in connection with service as an officer or director of the Company or the Bank or service in other capacities at their request. The coverage provided to the Executive pursuant to this section 6 shall be of the same scope and on the same terms and conditions as the coverage (if any) provided to other officers or directors of the Bank.

(b) To the maximum extent permitted under applicable law, during the Employment Period and for a period of six years thereafter, the Bank shall indemnify the Executive against and hold him harmless from any costs, liabilities, losses and exposures to the fullest extent and on the most favorable terms and conditions that similar indemnification is offered to any director or officer of the Bank or any subsidiary or affiliate thereof.

***Section 7. Outside Activities .***

The Executive may serve as a member of the boards of directors of such business, community and charitable organizations as he may disclose to and as may be approved by the Board of Directors of the Bank (which approval shall not be unreasonably withheld); *provided, however*, that such service shall not materially interfere with the performance of his duties under this Agreement nor shall it violate any applicable laws or regulations. The Executive may also engage in personal business and investment activities which do not materially interfere with the performance of his duties hereunder; *provided, however*, that such activities are not prohibited under any code of conduct or investment or securities trading policy established by the Bank and generally applicable to all similarly situated executives and that such activities are not prohibited by any applicable laws or regulations.

***Section 8. Working Facilities and Expenses .***

The Executive's principal place of employment shall be at the Bank's executive offices at the address first above written, or at such other location as the Bank and the Executive may mutually agree upon. The Bank shall provide the Executive at his principal place of

employment with a private office, secretarial services and other support services and facilities suitable to his positions with the Bank and necessary or appropriate in connection with the performance of his assigned duties under this Agreement. The Bank shall reimburse the Executive for his ordinary and necessary business expenses, including, without limitation, fees for memberships in such clubs and organizations that are necessary and appropriate for business purposes as mutually agreed by the Company and the Executive, and his travel and entertainment expenses incurred in connection with the performance of his duties under this Agreement, in each case only if such expenses are presented and approved in accordance with the Bank's business reimbursement policy then in effect.

**Section 9. Termination Due to Death.**

The Executive's employment with the Bank shall terminate, automatically and without any further action on the part of any party to this Agreement, on the date of the Executive's death. In such event:

(a) The Bank shall pay to the Executive's estate his earned but unpaid compensation (including, without limitation, salary and all other items which constitute wages under applicable law) as of the date of his termination of employment. This payment shall be made at the time and in the manner prescribed by law applicable to the payment of wages but in no event later than thirty (30) days after the date of the Executive's termination of employment.

(b) The Bank shall provide the benefits, if any, due to the Executive's estate, surviving dependents or his designated beneficiaries under the employee benefit plans and programs and compensation plans and programs maintained for the benefit of the officers and employees of the Bank. The time and manner of payment or other delivery of these benefits and the recipients of such benefits shall be determined according to the terms and conditions of the applicable plans and programs.

The payments and benefits described in sections 9(a) and (b) shall be referred to in this Agreement as the "Standard Termination Entitlements."

**Section 10. Termination Due to Disability.**

The Bank may terminate the Executive's employment upon a determination, by vote of a majority of the members of the Board of Directors of the Bank, acting in reliance on the written advice of a medical professional acceptable to them, that the Executive is suffering from a physical or mental impairment which, at the date of the determination, has prevented the Executive from performing his assigned duties on a substantially full-time basis for a period of at least one hundred and eighty (180) days during the period of one (1) year ending with the date of the determination or is likely to result in death or prevent the Executive from performing his assigned duties on a substantially full-time basis for a period of at least one hundred and eighty (180) days during the period of one (1) year beginning with the date of the determination. In such event:

(a) The Bank shall pay and deliver to the Executive (or in the event of his death before payment, to his estate and surviving dependents and beneficiaries, as applicable) the Standard Termination Entitlements.

(b) In addition to the Standard Termination Entitlements, the Bank shall continue to pay the Executive his base salary, at the annual rate in effect for him immediately prior to the termination of his employment, during a period ending on the earliest of: (i) the expiration of one hundred and eighty (180) days after the date of termination of his employment; (ii) the date on which long-term disability insurance benefits are first payable to him under any long-term disability insurance plan covering employees of the Bank (the "LTD Eligibility Date"); (iii) the date of his death; and (iv) the expiration of the Remaining Unexpired Employment Period (the "Initial Continuation Period"). If the end of the Initial Continuation Period is neither the LTD Eligibility Date nor the date of his death, the Bank shall continue to pay the Executive his base salary, at an annual rate equal to sixty percent (60%) of the annual rate in effect for him immediately prior to the termination of his employment, during an additional period ending on the earliest of the LTD Eligibility Date, the date of his death and the expiration of the Remaining Unexpired Employment Period.

A termination of employment due to disability under this section 10 shall be effected by joint notice of termination given to the Executive by the Bank and shall take effect on the later of the effective date of termination specified in such notice or the date on which the notice of termination is deemed given to the Executive.

***Section 11. Discharge with Cause.***

(a) The Bank may terminate the Executive's employment during the Employment Period, and such termination shall be deemed to have occurred with "Cause", only if:

(i) the Board of Directors of the Bank, by majority vote of their entire membership, determine that the Executive should be discharged because of personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease and desist order, or any material breach of this Agreement; and

(ii) at least forty-five (45) days prior to the votes contemplated by section 11(a)(i), the Bank has provided the Executive with notice of its intent to discharge the Executive for Cause, detailing with particularity the facts and circumstances which are alleged to constitute Cause (the "Notice of Intent to Discharge"); and

(iii) after the giving of the Notice of Intent to Discharge and before the taking of the votes contemplated by section 11(a)(i), the Executive (together with his legal counsel, if he so desires) is afforded a reasonable opportunity to make both written and oral presentations before the Board of Directors of the Bank for the purpose of refuting the alleged grounds for Cause for his discharge; and

(iv) after the votes contemplated by section 11(a)(i), the Bank has furnished to the Executive a notice of termination which shall specify the effective date of his termination of employment (which shall in no event be earlier than the date on which such notice is deemed given) and include a copy of a resolution or resolutions

adopted by the Board of Directors of the Bank certified by its corporate secretary and signed by each member of the Board of Directors voting in favor of adoption of the resolution(s), authorizing the termination of the Executive's employment with Cause and stating with particularity the facts and circumstances found to constitute Cause for his discharge (the "Final Discharge Notice").

(b) If the Executive is discharged during the Employment Period with Cause, the Bank shall pay and provide to him (or, in the event of his death, to his estate, his surviving beneficiaries and his dependents) the Standard Termination Entitlements only. Following the giving of a Notice of Intent to Discharge, the Bank shall temporarily suspend the Executive's duties and authority and, in such event, shall also suspend the payment of salary and other cash compensation, but not the Executive's participation in retirement, insurance and other employee benefit plans. If the Executive is not discharged, or is discharged without Cause, within forty-five (45) days after the giving of a Notice of Intent to Discharge, payments of salary and cash compensation shall resume, and all payments withheld during the period of suspension shall be promptly restored. If the Executive is discharged with Cause not later than forty-five (45) days after the giving of the Notice of Intent to Discharge, all payments withheld during the period of suspension shall be deemed forfeited and shall not be included in the Standard Termination Entitlements. If the Bank does not give a Final Discharge Notice to the Executive within ninety (90) days after giving a Notice of Intent to Discharge, the Notice of Intent to Discharge shall be deemed withdrawn and any future action to discharge the Executive with Cause shall require the giving of a new Notice of Intent to Discharge.

***Section 12. Discharge without Cause .***

The Bank may discharge the Executive at any time during the Employment Period and, unless such discharge constitutes a discharge with Cause:

(a) The Bank shall pay and deliver to the Executive (or in the event of his death before payment, to his estate and surviving dependents and beneficiaries, as applicable) the Standard Termination Entitlements.

(b) During the Remaining Unexpired Employment Period, the Bank shall provide for the Executive and his dependents continued group life, health (including hospitalization, medical and major medical), dental, accident and long-term disability insurance benefits on substantially the same terms and conditions (including any required premium-sharing arrangements, co-payments and deductibles) in effect for similarly situated employees of the Bank. The coverage provided under this section 12(b) may, at the election of the Bank, be secondary to the coverage provided as part of the Standard Termination Entitlements and to any employer-paid coverage provided by a subsequent employer or through Medicare, with the result that benefits under the other coverages will offset the coverage required by this section 12(b).

(c) The Bank shall make a lump sum payment to the Executive (or, in the event of his death before payment, to his estate), in an amount equal to the value of the salary, bonus, short-term and long-term cash compensation that the Executive received in the calendar year preceding that in which the termination of employment with the Bank occurs divided by twelve and then multiplied by the number of months remaining in the Remaining Unexpired

Employment Period to compensate the Executive for the payments the Executive would have received during the Remaining Unexpired Employment Period. Such lump sum shall be paid in lieu of all other payments of salary, bonus, short-term and long-term cash compensation provided for under this Agreement in respect of the period following any such termination. Such payment shall be made (without discounting for early payment) within thirty (30) days following the Executive's termination of employment.

The payments and benefits described in sections 12(b) and 12(c) are referred to in this Agreement as the "Additional Termination Entitlements".

***Section 13. Resignation.***

(a) The Executive may resign from his employment with the Bank at any time. A resignation under this section 13 shall be effected by notice of resignation given by the Executive to the Bank and shall take effect on the later of the effective date of termination specified in such notice or the date on which the notice of termination is deemed given by the Executive. The Executive's resignation of any of the positions within the Bank or the Company to which he has been assigned shall be deemed a resignation from all such positions.

(b) The Executive's resignation shall be deemed to be for "Good Reason" if the effective date of resignation occurs within ninety (90) days after any of the following:

(i) the failure of the Bank (whether by act or omission of its Board of Directors, or otherwise) to appoint or re-appoint or elect or re-elect the Executive to the position(s) with the Bank, specified in section 3 of this Agreement or to a more senior office;

(ii) if the Executive is or becomes a member of the Board of Directors of the Company or the Bank, the failure of their respective shareholders (whether in an election in which the Executive stands as a nominee or in an election where the Executive is not a nominee) to elect or re-elect the Executive to membership at the expiration of his term of membership, unless such failure is a result of the Executive's refusal to stand for election;

(iii) a material failure by the Bank, whether by amendment of its certificate of incorporation or organization, by-laws, action of its Board of Directors or otherwise, to vest in the Executive the functions, duties, or responsibilities prescribed in section 3 of this Agreement; *provided* that the Executive shall have given notice of such failure to the Bank, and the Bank has not fully cured such failure within thirty (30) days after such notice is deemed given;

(iv) any reduction of the Executive's rate of base salary in effect from time to time, whether or not material, or any failure (other than due to reasonable administrative error that is cured promptly upon notice) to pay any portion of the Executive's compensation as and when due;

(v) any change in the terms and conditions of any compensation or benefit program in which the Executive participates which, either individually or together



with other changes, has a material adverse effect on the aggregate value of his total compensation package; *provided* that the Executive shall have given notice of such material adverse effect to the Bank, and the Bank has not fully cured such failure within thirty (30) days after such notice is deemed given; *provided, however*, that this section 13(b)(v) shall not apply if the change in the terms and conditions of the compensation or benefit program affects all participants in such program equally;

(vi) any material breach by the Bank of any material term, condition or covenant contained in this Agreement; *provided* that the Executive shall have given notice of such material adverse effect to the Bank, and the Bank has not fully cured such failure within thirty (30) days after such notice is deemed given; or

(vii) a change in the Executive's principal place of employment to a place that is not the principal executive office of the Bank, or a relocation of the Bank's principal executive office to a location that is both more than thirty-five (35) miles away from the Executive's principal residence and more than thirty-five (35) miles away from the location of the Bank's principal executive office on the date of this Agreement.

In all other cases, a resignation by the Executive shall be deemed to be without Good Reason.

(c) In the event of the Executive's resignation before the expiration of the Employment Period, the Bank shall pay and deliver the Standard Termination Entitlements. In addition, if the Executive's resignation is deemed to be a resignation with Good Reason, the Bank shall also pay and deliver the Additional Termination Entitlements.

**Section 14. Terms and Conditions of the Additional Termination Entitlements .**

The Bank and the Executive hereby stipulate that the damages which may be incurred by the Executive following any termination of employment are not capable of accurate measurement as of the date first above written and that the Additional Termination Entitlements constitute reasonable damages under the circumstances and shall be payable without any requirement of proof of actual damage and without regard to the Executive's efforts, if any, to mitigate damages. The Bank and the Executive further agree that the Bank may condition the payment and delivery of the Additional Termination Entitlements on (i) the receipt of the Executive's resignation from any and all positions which he holds as an officer, director or committee member with respect to the Company, the Bank or any subsidiary or affiliate of either of them and (ii) a release of the Bank and its officers, directors, shareholders, subsidiaries and affiliates including the Company, in form and substance satisfactory to the Bank, of any liability to the Executive, whether for compensation or damages, in connection with his employment with the Bank and the termination of such employment except for the Standard Termination Entitlements and the Additional Termination Entitlements.

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***Section 15. Termination Upon or Following a Change of Control.***

(a) A "Change of 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) For purposes of this Agreement, a "Pending Change of Control" shall mean: (i) the signing of a definitive agreement for a transaction which, if consummated, would result in a Change of Control; (ii) the commencement of a tender offer which, if successful, would result in a Change of Control; or (iii) the circulation of a proxy statement seeking proxies in opposition to management in an election contest which, if successful, would result in a Change of Control.

(c) Notwithstanding anything in this Agreement to the contrary, for purposes of computing the Additional Termination Entitlements due upon a termination of employment that occurs, or is deemed to have occurred, after a Change of Control, the Remaining Unexpired Employment Period shall be deemed to be three (3) full years.

#### ***Section 16. Covenant Not To Compete.***

The Executive hereby covenants and agrees that, in the event of his termination of employment with the Bank prior to the expiration of the Employment Period, for a period of one year following the date of his termination of employment with the Bank, he shall not, without the written consent of the Bank, become an officer, employee, consultant, director or trustee of any savings bank, savings and loan association, savings and loan holding company, bank or bank holding company, any other entity engaged in the business of accepting deposits or making loans or any direct or indirect subsidiary or affiliate of any such entity, that entails working within the State of New York or any city or county in any other state in which the Company or the Bank maintains an office; *provided, however*, that this section 16 shall not apply if the Executive is entitled to the Additional Termination Entitlements due to a Change of Control or after a Pending Change of Control or after a Pending Change of Control.

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**Section 17. Confidentiality.**

Unless he obtains the prior written consent of the Bank, the Executive shall keep confidential and shall refrain from using for the benefit of himself, or any person or entity other than the Bank or the Company or any entity which is a subsidiary of the Company or of which the Company is a subsidiary, any material document or information obtained from the Company, or from its parent or subsidiaries, in the course of his employment with any of them concerning their properties, operations or business (unless such document or information is readily ascertainable from public or published information or trade sources or has otherwise been made available to the public through no fault of his own) until the same ceases to be material (or becomes so ascertainable or available); *provided, however*, that nothing in this section 17 shall prevent the Executive, with or without the Bank's consent, from participating in or disclosing documents or information in connection with any judicial or administrative investigation, inquiry or proceeding to the extent that such participation or disclosure is required under applicable law.

**Section 18. Solicitation.**

The Executive hereby covenants and agrees that, for a period of one year following his termination of employment with the Company or the Bank, he shall not, without the written consent of the Bank, either directly or indirectly:

(a) solicit, offer employment to, or take any other action intended, or that a reasonable person acting in like circumstances would expect, to have the effect of causing any officer or employee of the Company, the Bank or any of their respective subsidiaries or affiliates to terminate his or her employment and accept employment or become affiliated with, or provide services for compensation in any capacity whatsoever to, any savings bank, savings and loan association, bank, bank holding company, savings and loan holding company, or other institution engaged in the business of accepting deposits, making loans or doing business within the counties specified in section 16;

(b) provide any information, advice or recommendation with respect to any such officer or employee of any savings bank, savings and loan association, bank, bank holding company, savings and loan holding company, or other institution engaged in the business of accepting deposits, making loans or doing business within the counties specified in section 16; that is intended, or that a reasonable person acting in like circumstances would expect, to have the effect of causing any officer or employee of the Company, the Bank, or any of their respective subsidiaries or affiliates to terminate his employment and accept employment or become affiliated with, or provide services for compensation in any capacity whatsoever to, any savings bank, savings and loan association, bank, bank holding company, savings and loan holding company, or other institution engaged in the business of accepting deposits, making loans or doing business within the counties specified in section 16;

(c) solicit, provide any information, advice or recommendation or take any other action intended, or that a reasonable person acting in like circumstances would expect, to have the effect of causing any customer of the Company or the Bank to terminate an existing business or commercial relationship with the Company or the Bank;

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provided however, that this section 18 shall not apply if the Executive is entitled to the Additional Termination Entitlements due to a Change of Control or after a Pending Change of Control.

**Section 19. No Effect on Employee Benefit Plans or Programs.**

The termination of the Executive's employment during the term of this Agreement or thereafter, whether by the Bank or by the Executive, shall have no effect on the rights and obligations of the parties hereto under the Company's or the Bank's qualified or non-qualified retirement, pension, savings, thrift, profit-sharing or stock bonus plans, group life, health (including hospitalization, medical and major medical), dental, accident and long term disability insurance plans or such other employee benefit plans or programs, or compensation plans or programs, as may be maintained by, or cover employees of, the Company or the Bank from time to time; *provided, however*, that nothing in this Agreement shall be deemed to duplicate any compensation or benefits provided under any agreement, plan or program covering the Executive to which the Bank is a party and any duplicative amount payable under any such agreement, plan or program shall be applied as an offset to reduce the amounts otherwise payable hereunder.

**Section 20. Successors and Assigns.**

This Agreement will inure to the benefit of and be binding upon the Executive, his legal representatives and testate or intestate distributees, and the Bank and their respective successors and assigns, including any successor by merger or consolidation or a statutory receiver or any other person or firm or corporation to which all or substantially all of the assets and business of the Bank may be sold or otherwise transferred. Failure of the Bank to obtain from any successor its express written assumption of the Bank's obligations hereunder at least sixty (60) days in advance of the scheduled effective date of any such succession shall be deemed a material breach of this Agreement.

**Section 21. Notices.**

Any communication required or permitted to be given under this Agreement, including any notice, direction, designation, consent, instruction, objection or waiver, shall be in writing and shall be deemed to have been given at such time as it is delivered personally, or five (5) days after mailing if mailed, postage prepaid, by registered or certified mail, return receipt requested, addressed to such party at the address listed below or at such other address as one such party may by written notice specify to the other party:

If to the Executive:

David C. Mancuso

[Address]

[Address]

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If to the Bank:

Lake Shore Savings Bank  
128 East 4<sup>th</sup> Street  
Dunkirk, New York 14048

Attention: Chairman, Compensation Committee  
of the Board of Directors

***Section 22. Waiver.***

Failure to insist upon strict compliance with any of the terms, covenants or conditions hereof shall not be deemed a waiver of such term, covenant, or condition. A waiver of any provision of this Agreement must be made in writing, designated as a waiver, and signed by the party against whom its enforcement is sought. Any waiver or relinquishment of any right or power hereunder at any one or more times shall not be deemed a waiver or relinquishment of such right or power at any other time or times.

***Section 23. Counterparts.***

This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, and all of which shall constitute one and the same Agreement.

***Section 24. Governing Law.***

This Agreement shall be governed by and construed and enforced in accordance with the federal laws of the United States and, to the extent that federal law is inapplicable, in accordance with the laws of the State of New York applicable to contracts entered into and to be performed entirely within the State of New York.

***Section 25. Headings and Construction.***

The headings of sections in this Agreement are for convenience of reference only and are not intended to qualify the meaning of any section. Any reference to a section number shall refer to a section of this Agreement, unless otherwise stated.

***Section 26. Entire Agreement; Modifications.***

This instrument contains the entire agreement of the parties relating to the subject matter hereof, and supersedes in its entirety any and all prior agreements, understandings or representations relating to the subject matter hereof. No modifications of this Agreement shall be valid unless made in writing and signed by the parties hereto.

***Section 27. Non-duplication.***

In the event that the Executive shall perform services for the Bank or any other direct or indirect subsidiary or affiliate of the Company or the Bank, any compensation or

benefits provided to the Executive by such other employer shall be applied to offset the obligations of the Bank hereunder, it being intended that this Agreement set forth the aggregate compensation and benefits payable to the Executive for all services to the Bank and all of its respective direct or indirect subsidiaries and affiliates.

**Section 28. Survival.**

The provisions of sections 6, 16, 17, 18 and 19 shall survive the expiration of the Employment Period or termination of the Agreement.

**Section 29. Indemnification for Attorneys' Fees.**

The Bank shall indemnify, hold harmless and defend Executive against reasonable costs, including legal fees, incurred by him in connection with or arising out of any action, suit or proceeding in which he may be involved, as a result of his efforts, in good faith, to defend or enforce the terms of this Agreement; provided, however, that Executive shall have substantially prevailed on the merits pursuant to a judgment, decree or order of a court of competent jurisdiction or of an arbitrator in an arbitration proceeding. The determination whether the Executive shall have substantially prevailed on the merits and is therefore entitled to such indemnification, shall be made by the court or arbitrator, as applicable. In the event of a settlement pursuant to a settlement agreement, any indemnification payment under this section 29 shall be made only after a determination by the members of the Board (other than the Executive and any other member of the Board to which the Executive is related by blood or marriage) that the Executive has acted in good faith and that such indemnification payment is in the best interests of the Bank.

**Section 30. Required Regulatory Provisions.**

The following provisions are included for the purposes of complying with various laws, rules and regulations applicable to the Bank:

(a) Notwithstanding anything herein contained to the contrary, in no event shall the aggregate amount of compensation payable to the Executive under section 12(b) hereof exceed the three times the Executive's average annual compensation (within the meaning of OTS Regulatory Bulletin 27a or any successor thereto) for the last five consecutive calendar years to end prior to his termination of employment with the Bank (or for his entire period of employment with the Bank if less than five calendar years). The compensation payable to the Executive hereunder shall be further reduced (but not below zero) if such reduction would avoid the assessment of excise taxes on excess parachute payments (within the meaning of section 280G of the Code).

(b) Notwithstanding anything herein contained to the contrary, any payments to the Executive by the Bank, whether pursuant to this Agreement or otherwise, are subject to and conditioned upon their compliance with section 18(k) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §1828(k), and any regulations promulgated thereunder.

(c) Notwithstanding anything herein contained to the contrary, if the Executive is suspended from office and/or temporarily prohibited from participating in the conduct of the affairs of the Bank pursuant to a notice served under section 8(e)(3) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(3) or 1818(g)(1), the Bank's obligations under this Agreement shall be suspended as of the date of service of such notice, unless stayed by appropriate proceedings. If the charges in such notice are dismissed, the Bank, in its discretion, may (i) pay to the Executive all or part of the compensation withheld while the Bank's obligations hereunder were suspended and (ii) reinstate, in whole or in part, any of the obligations which were suspended.

(d) Notwithstanding anything herein contained to the contrary, if the Executive is removed and/or permanently prohibited from participating in the conduct of the Bank's affairs by an order issued under section 8(e)(4) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(4) or (g)(1), all prospective obligations of the Bank under this Agreement shall terminate as of the effective date of the order, but vested rights and obligations of the Bank and the Executive shall not be affected.

(e) Notwithstanding anything herein contained to the contrary, if the Bank is in default (within the meaning of section 3(x)(1) of the FDI Act, 12 U.S.C. §1813(x)(1), all prospective obligations of the Bank under this Agreement shall terminate as of the date of default, but vested rights and obligations of the Bank and the Executive shall not be affected.

(f) Notwithstanding anything herein contained to the contrary, all prospective obligations of the Bank hereunder shall be terminated, except to the extent that a continuation of this Agreement is necessary for the continued operation of the Bank: (i) by the Director of the OTS or his designee or the Federal Deposit Insurance Corporation ("FDIC"), at the time the FDIC enters into an agreement to provide assistance to or on behalf of the Bank under the authority contained in section 13(c) of the FDI Act, 12 U.S.C. §1823(c); (ii) by the Director of the OTS or his designee at the time such Director or designee approves a supervisory merger to resolve problems related to the operation of the Bank or when the Bank is determined by such Director to be in an unsafe or unsound condition. The vested rights and obligations of the parties shall not be affected.

If and to the extent that any of the foregoing provisions shall cease to be required or by applicable law, rule or regulation, the same shall become inoperative as though eliminated by formal amendment of this Agreement.

### ***Section 31. Effective Date.***

This Agreement shall become effective (the "Effective Date") upon the later of the following two dates: (a) the effective date of the Bank's conversion from a New York-chartered mutual savings and loan association to a stock form savings bank pursuant to the Reorganization or (b) the date the OTS advises the Bank or Company in writing that it either approves or has no objection to the terms and conditions of this Agreement. The Bank and the Executive each hereby acknowledge and agree that the terms of this Agreement shall have no force or effect prior to such Effective Date.



**I N W ITNESS W HEREOF** , the Bank has caused this Agreement to be executed and the Executive has hereunto set his hand, all as of the day and year first above written.

\_\_\_\_\_  
**D AVID C. M ANCUSO**

**L AKE S HORE S AVINGS B ANK**

Attest:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

[Seal]

**Exhibit 10.3**

**O NE -Y EAR C HANGE OF C ONTROL A GREEMENT**

This **C HANGE OF C ONTROL A GREEMENT** (the “Agreement”) is made and entered into as of \_\_\_\_\_, 2005 by and among **L AKE S HORE S AVINGS B ANK** , a federally-chartered savings bank having an office at 128 East 4<sup>th</sup> Street, Dunkirk, New York 14048 (the “Bank”), **L AKE S HORE B ANCORP , I NC .** , a federally-chartered corporation having an office at 128 East 4<sup>th</sup> Street, Dunkirk, New York 14048 (the “Company”) and **[I NSERT N AME ]** (the “Officer”).

**I NTRODUCTORY S TATEMENT**

The Bank has reorganized from a New York-chartered mutual savings and loan association to a federally-chartered stock savings bank and has become a wholly-owned subsidiary of the Company, a mid-tier stock holding company, which is majority owned by Lake Shore, MHC, a mutual holding company (the “Reorganization”). In connection with the Reorganization, certain shares of the Company’s common stock were sold in an initial public stock offering. The Officer has served the Bank in an executive capacity prior to the Reorganization and is familiar with the Bank’s operations.

The Board of Directors of the Bank has concluded that it is in the best interests of the Bank, the Company and their prospective shareholders to establish a working environment for the Officer which minimizes the personal distractions that might result from possible business combinations in which the Company or the Bank might be involved following the Reorganization. To this end, the Bank has decided to provide the Officer with assurance that his compensation will be continued for a minimum period of one (1) year following termination of employment (the “Assurance Period”) if his employment terminates under specified circumstances related to a business combination. The Board of Directors of the Bank has decided to formalize this assurance by entering into this Change of Control Agreement with the Officer. The Board of Directors of the Company has authorized the Company to guarantee the Bank’s obligations under this Agreement.

The terms and conditions which the Bank, the Company and the Officer have agreed to are as follows.

**A GREEMENT**

***Section 1 . Effective Date; Term; Change of Control and Pending Change of Control Defined .***

(a) This Agreement shall take effect on the effective date of the Reorganization (the “Effective Date”) and shall be in effect during the period (the “Term”) beginning on the Effective Date of the Reorganization and ending on the first anniversary of the date on which the Bank notifies the Officer of its intent to discontinue the Agreement (the “Initial Expiration Date”) or, if later, the first anniversary of the latest Change of Control or Pending Change of Control, as defined below, that occurs after the Effective Date and before the Initial Expiration Date.

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(b) For all purposes of this Agreement, a “Change of 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 1(b)(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 1(b)(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 1(b), the term "person" shall have the meaning assigned to it under sections 13(d)(3) or 14(d)(2) of the Exchange Act.

(c) For purposes of this Agreement, a "Pending Change of Control" shall mean: (i) the signing of a definitive agreement for a transaction which, if consummated, would result in a Change of Control; (ii) the commencement of a tender offer which, if successful, would result in a Change of Control; or (iii) the circulation of a proxy statement seeking proxies in opposition to management in an election contest which, if successful, would result in a Change of Control; *provided, however*, that the Change of Control contemplated does, in fact, occur.

**Section 2. Discharge Prior to a Pending Change of Control.**

The Bank may discharge the Officer at any time prior to the occurrence of a Pending Change of Control for any reason or for no reason. In such event:

(a) The Bank shall pay to the Officer (or, in the event of his death, his estate) his earned but unpaid compensation (including, without limitation, salary and all other items which constitute wages under applicable law) as of the date of his termination of employment. This payment shall be made at the time and in the manner prescribed by law applicable to the payment of wages but in no event later than 30 days after the date of the Officer's termination of employment.

(b) The Bank shall provide the benefits, if any, due to the Officer (or, in the event of his death, his estate, surviving dependents or his designated beneficiaries) under the employee benefit plans and programs and compensation plans and programs maintained for the benefit of the officers and employees of the Bank. The time and manner of payment or other delivery of these benefits and the recipients of such benefits shall be determined according to the terms and conditions of the applicable plans and programs.

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The payments and benefits described in sections 2(a) and (b) shall be referred to in this Agreement as the “Standard Termination Entitlements.”

**Section 3. Termination of Employment Due to Death.**

The Officer’s employment with the Bank shall terminate, automatically and without any further action on the part of any party to this Agreement, on the date of the Officer’s death. In such event, the Bank shall pay and deliver to his estate and surviving dependents and beneficiaries, as applicable, the Standard Termination Entitlements.

**Section 4. Termination Due to Disability after Change of Control or Pending Change of Control.**

The Bank may terminate the Officer’s employment during the Term and after the occurrence of a Change of Control or a Pending Change of Control upon a determination, by a majority vote of the members of the Board of Directors of the Bank, acting in reliance on the written advice of a medical professional acceptable to it, that the Officer is suffering from a physical or mental impairment which, at the date of the determination, has prevented the Officer from performing his assigned duties on a substantially full-time basis for a period of at least one hundred and eighty (180) days during the period of one (1) year ending with the date of the determination or is likely to result in death or prevent the Officer from performing his assigned duties on a substantially full-time basis for a period of at least one hundred and eighty (180) days during the period of one (1) year beginning with the date of the determination. In such event:

(a) The Bank shall pay and deliver to the Officer (or in the event of his death before payment, to his estate and surviving dependents and beneficiaries, as applicable) the Standard Termination Entitlements.

(b) In addition to the Standard Termination Entitlements, the Bank shall continue to pay the Officer his base salary, at the annual rate in effect for him immediately prior to the termination of his employment, during a period ending on the earliest of: (i) the expiration of one hundred and eighty (180) days after the date of termination of his employment; (ii) the date on which long-term disability insurance benefits are first payable to him under any long-term disability insurance plan covering employees of the Bank (the “LTD Eligibility Date”); (iii) the date of his death; and (iv) the expiration of the Assurance Period (the “Initial Continuation Period”). If the end of the Initial Continuation Period is neither the LTD Eligibility Date nor the date of his death, the Bank shall continue to pay the Officer his base salary, at an annual rate equal to sixty percent (60%) of the annual rate in effect for him immediately prior to the termination of his employment, during an additional period ending on the earliest of the LTD Eligibility Date, the date of his death and the expiration of the Assurance Period.

A termination of employment due to disability under this section 4 shall be effected by a notice of termination given to the Officer by the Bank and shall take effect on the later of the effective date of termination specified in such notice or the date on which the notice of termination is deemed given to the Officer.

*Section 5. Discharge with Cause after Change of Control or Pending Change of Control.*

(a) The Bank may terminate the Officer's employment with "Cause" during the Term and after the occurrence of a Change of Control or Pending Change of Control, but a termination shall be deemed to have occurred with "Cause" only if:

(i) the Board of Directors of the Bank and the Board of Directors of the Company, by separate majority votes of their entire membership, determine that the Officer should be discharged because of personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease and desist order, or any material breach of this Agreement; and

(ii) at least forty-five (45) days prior to the vote contemplated by section 1(b)(i), the Bank has provided the Officer with notice of its intent to discharge the Officer for Cause, detailing with particularity the facts and circumstances which are alleged to constitute Cause (the "Notice of Intent to Discharge"); and

(iii) after the giving of the Notice of Intent to Discharge and before the taking of the vote contemplated by section 5(a)(i), the Officer (together with his legal counsel, if he so desires) is afforded a reasonable opportunity to make both written and oral presentations before the Board of Directors of the Bank for the purpose of refuting the alleged grounds for Cause for his discharge; and

(iv) after the vote contemplated by section 5(a)(i), the Bank has furnished to the Officer a notice of termination which shall specify the effective date of his termination of employment (which shall in no event be earlier than the date on which such notice is deemed given) and include a copy of a resolution or resolutions adopted by the Board of Directors of the Bank, certified by its corporate secretary and signed by each member of the Board of Directors voting in favor of adoption of the resolution(s), authorizing the termination of the Officer's employment with Cause and stating with particularity the facts and circumstances found to constitute Cause for his discharge (the "Final Discharge Notice").

(b) If the Officer is discharged with Cause during the Term and after a Change of Control or Pending Change of Control, the Bank shall pay and provide to him (or, in the event of his death, to his estate, his surviving beneficiaries and his dependents) the Standard Termination Entitlements only. Following the giving of a Notice of Intent to Discharge, the Bank shall temporarily suspend the Officer's duties and authority and, in such event, shall also suspend the payment of salary and other cash compensation, but not the Officer's participation in retirement, insurance and other employee benefit plans. If the Officer is not discharged, or is discharged without Cause, within forty-five (45) days after the giving of a Notice of Intent to Discharge, payments of salary and cash compensation shall resume, and all payments withheld during the period of suspension shall be promptly restored. If the Officer is discharged with Cause not later than forty-five (45) days after the giving of the Notice of Intent to Discharge, all

payments withheld during the period of suspension shall be deemed forfeited and shall not be included in the Standard Termination Entitlements. If the Bank does not give a Final Discharge Notice to the Officer within ninety (90) days after giving a Notice of Intent to Discharge, the Notice of Intent to Discharge shall be deemed withdrawn and any future action to discharge the Officer with Cause shall require the giving of a new Notice of Intent to Discharge.

*Section 6. **Discharge without Cause.***

The Bank may discharge the Officer without Cause at any time after the occurrence of a Change of Control or Pending Change of Control, and in such event:

(a) The Bank shall pay and deliver to the Officer (or in the event of his death before payment, to his estate and surviving dependents and beneficiaries, as applicable) the Standard Termination Entitlements.

(b) In addition to the Standard Termination Entitlements:

(i) During the Assurance Period, the Bank shall provide for the Officer and his dependents continued group life, health (including hospitalization, medical and major medical), dental, accident and long-term disability insurance benefits on substantially the same terms and conditions (including any required premium-sharing arrangements, co-payments and deductibles) in effect for them immediately prior to the Officer's resignation. The coverage provided under this section 6(b)(i) may, at the election of the Bank, be secondary to the coverage provided as part of the Standard Termination Entitlements and to any employer-paid coverage provided by a subsequent employer or through Medicare, with the result that benefits under the other coverages will offset the coverage required by this section 6 (b)(i).

(ii) The Bank shall make a lump sum payment to the Officer (or, in the event of his death before payment, to his estate), in an amount equal to the value of the salary, bonus, short-term and long-term cash compensation that the Officer received in the calendar year preceding that in which the termination of employment with the Bank occurs to compensate the Officer for the payments the Officer would have received during the Assurance Period. Such lump sum shall be paid in lieu of all other payments of salary, bonus, short-term and long-term cash compensation provided for under this Agreement in respect of the period following any such termination. Such payment shall be made (without discounting for early payment) within thirty (30) days following the Officer's termination of employment.

The payments and benefits described in section 6(b) are referred to in this Agreement as the "Additional Change of Control Entitlements".

*Section 7. **Resignation.***

(a) The Officer may resign from his employment with the Bank at any time. A resignation under this section 7 shall be effected by notice of resignation given by the Officer to the Bank and shall take effect on the later of the effective date of termination specified in such notice or the date on which the notice of termination is deemed given to the Officer. The

Officer's resignation of any of the positions within the Bank or the Company to which he has been assigned shall be deemed a resignation from all such positions.

(b) The Officer's resignation shall be deemed to be for "Good Reason" if the effective date of resignation occurs during the Term, but on or after the effective date of a Change of Control, and is on account of:

(i) the failure of the Bank (whether by act or omission of the Board of Directors, or otherwise) to appoint or re-appoint or elect or re-elect the Officer to the position with Bank that he held immediately prior to the Change of Control (the "Assigned Office") or to a more senior office;

(ii) a material failure by the Bank, whether by amendment of the certificate of incorporation or organization, by-laws, action of the Board of Directors of the Bank or otherwise, to vest in the Officer the functions, duties, or responsibilities customarily associated with the Assigned Office; *provided* that the Officer shall have given notice of such failure to the Bank, and the Bank has not fully cured such failure within thirty (30) days after such notice is deemed given;

(iii) any reduction of the Officer's rate of base salary in effect from time to time, whether or not material, or any failure (other than due to reasonable administrative error that is cured promptly upon notice) to pay any portion of the Officer's compensation as and when due;

(iv) any change in the terms and conditions of any compensation or benefit program in which the Officer participates which, either individually or together with other changes, has a material adverse effect on the aggregate value of his total compensation package; *provided* that the Officer shall have given notice of such material adverse effect to the Bank, and the Bank has not fully cured such material adverse effect within thirty (30) days after such notice is deemed given; *provided, however*, that this section 7(b)(iv) shall not apply if the change in the terms and conditions of the compensation or benefit program affects all participants in such program equally;

(v) any material breach by the Bank of any material term, condition or covenant contained in this Agreement; *provided* that the Officer shall have given notice of such material adverse effect to the Bank, and the Bank has not fully cured such material adverse effect within thirty (30) days after such notice is deemed given; or

(vi) a change in the Officer's principal place of employment to a place that is not the principal executive office of the Bank, or a relocation of the Bank's principal executive office to a location that is both more than thirty-five (35) miles away from the Officer's principal residence and more than thirty-five (35) miles away from the location of the Bank's principal executive office on the day before the occurrence of the Change of Control.

In all other cases, a resignation by the Officer shall be deemed to be without Good Reason. In the event of resignation, the Officer shall state in his notice of resignation whether he considers his resignation to be a resignation with Good Reason, and if he does, he shall state in such notice the

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grounds which constitute Good Reason. The Officer's determination of the existence of Good Reason shall be conclusive in the absence of fraud, bad faith or manifest error.

(c) In the event of the Officer's resignation for any reason, the Bank shall pay and deliver the Standard Termination Entitlements. In the event of the Officer's resignation with Good Reason, the Bank shall also pay and deliver the Additional Termination Entitlements.

***Section 8. Terms and Conditions of the Additional Termination Entitlements.***

The Bank and the Officer hereby stipulate that the damages which may be incurred by the Officer following any termination of employment are not capable of accurate measurement as of the date first above written and that the Additional Termination Entitlements constitute reasonable damages under the circumstances and shall be payable without any requirement of proof of actual damage and without regard to the Officer's efforts, if any, to mitigate damages. The Bank and the Officer further agree that the Bank may condition the payment and delivery of the Additional Termination Entitlements on the receipt of: (a) the Officer's resignation from any and all positions which he holds as an officer, director or committee member with respect to the Bank or the Company or any subsidiary or affiliate of either of them; and (b) a release of the Bank and its officers, directors, shareholders, subsidiaries and affiliates including the Company, in form and substance satisfactory to the Bank, of any liability to the Officer, whether for compensation or damages, in connection with his employment with the Bank and the termination of such employment except for the Standard Termination Entitlements and the Additional Termination Entitlements.

***Section 9. No Effect on Employee Benefit Plans or Programs.***

The termination of the Officer's employment during the Assurance Period or thereafter, whether by the Bank or by the Officer, shall have no effect on the rights and obligations of the parties hereto under the Bank's qualified or non-qualified retirement, pension, savings, thrift, profit-sharing or stock bonus plans, group life, health (including hospitalization, medical and major medical), dental, accident and long term disability insurance plans or such other employee benefit plans or programs, or compensation plans or programs, as may be maintained by, or cover employees of, the Bank from time to time; *provided, however*, that nothing in this Agreement shall be deemed to duplicate any compensation or benefits provided under any agreement, plan or program covering the Officer to which the Bank or Company is a party and any duplicative amount payable under any such agreement, plan or program shall be applied as an offset to reduce the amounts otherwise payable hereunder.

***Section 10. Successors and Assigns.***

This Agreement will inure to the benefit of and be binding upon the Officer, his legal representatives and testate or intestate distributees, and the Company and the Bank and their respective successors and assigns, including any successor by merger or consolidation or a statutory receiver or any other person or firm or corporation to which all or substantially all of the assets and business of the Company or the Bank may be sold or otherwise transferred. Failure of the Bank to obtain from any successor its express written assumption of the



Company's or Bank's obligations hereunder at least 60 days in advance of the scheduled effective date of any such succession shall, if such succession constitutes a Change of Control, constitute Good Reason for the Officer's resignation on or at any time during the Term following the occurrence of such succession.

*Section 11. **Notices.***

Any communication required or permitted to be given under this Agreement, including any notice, direction, designation, consent, instruction, objection or waiver, shall be in writing and shall be deemed to have been given at such time as it is delivered personally, or five days after mailing if mailed, postage prepaid, by registered or certified mail, return receipt requested, addressed to such party at the address listed below or at such other address as one such party may by written notice specify to the other party:

If to the Officer:

[Insert Executive Name]  
[Address]  
[Address]

If to the Company or the Bank:

Lake Shore Bancorp, Inc.  
128 East 4<sup>th</sup> Street  
Dunkirk, New York 14048

Attention: Chairman, Compensation Committee  
of the Board of Directors

*Section 12. **Indemnification for Attorneys' Fees.***

The Bank shall indemnify, hold harmless and defend the Officer against reasonable costs, including legal fees, incurred by him in connection with or arising out of any action, suit or proceeding in which he may be involved, as a result of his efforts, in good faith, to defend or enforce the terms of this Agreement; provided, however, that the Officer shall have substantially prevailed on the merits pursuant to a judgment, decree or order of a court of competent jurisdiction or of an arbitrator in an arbitration proceeding. The determination whether the Officer shall have substantially prevailed on the merits and is therefore entitled to such indemnification, shall be made by the court or arbitrator, as applicable. In the event of a settlement pursuant to a settlement agreement, any indemnification payment under this section 12 shall be made only after a determination by the members of the Board (other than the Officer and any other member of the Board to which the Officer is related by blood or marriage) that the Officer has acted in good faith and that such indemnification payment is in the best interests of the Bank.

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*Section 13. **Severability**.*

A determination that any provision of this Agreement is invalid or unenforceable shall not affect the validity or enforceability of any other provision hereof.

*Section 14. **Waiver**.*

Failure to insist upon strict compliance with any of the terms, covenants or conditions hereof shall not be deemed a waiver of such term, covenant, or condition. A waiver of any provision of this Agreement must be made in writing, designated as a waiver, and signed by the party against whom its enforcement is sought. Any waiver or relinquishment of any right or power hereunder at any one or more times shall not be deemed a waiver or relinquishment of such right or power at any other time or times.

*Section 15. **Counterparts**.*

This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, and all of which shall constitute one and the same Agreement.

*Section 16. **Governing Law**.*

This Agreement shall be governed by and construed and enforced in accordance with the federal laws of the United States and, to the extent that federal law is inapplicable, in accordance with the laws of the State of New York applicable to contracts entered into and to be performed entirely within the State of New York.

*Section 17. **Headings and Construction**.*

The headings of sections in this Agreement are for convenience of reference only and are not intended to qualify the meaning of any section. Any reference to a section number shall refer to a section of this Agreement, unless otherwise stated.

*Section 18. **Entire Agreement; Modifications**.*

This instrument contains the entire agreement of the parties relating to the subject matter hereof, and supersedes in its entirety any and all prior agreements, understandings or representations relating to the subject matter hereof. No modifications of this Agreement shall be valid unless made in writing and signed by the parties hereto.

*Section 19. **Required Regulatory Provisions**.*

The following provisions are included for the purposes of complying with various laws, rules and regulations applicable to the Bank:

(a) Notwithstanding anything herein contained to the contrary, in no event shall the aggregate amount of compensation payable to the Officer hereunder exceed three times the Officer's average annual compensation (within the meaning of OTS Regulatory Bulletin 27a or any successor thereto) for the last five consecutive calendar years to end prior to his

termination of employment with the Bank (or for his entire period of employment with the Bank if less than five calendar years). The compensation payable to the Officer hereunder shall be further reduced (but not below zero) if such reduction would avoid the assessment of excise taxes on excess parachute payments (within the meaning of section 280G of the Code).

(b) Notwithstanding anything herein contained to the contrary, any payments to the Officer by the Bank, whether pursuant to this Agreement or otherwise, are subject to and conditioned upon their compliance with section 18(k) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §1828(k), and any regulations promulgated thereunder.

(c) Notwithstanding anything herein contained to the contrary, if the Officer is suspended from office and/or temporarily prohibited from participating in the conduct of the affairs of the Bank pursuant to a notice served under section 8(e)(3) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(3) or 1818(g)(1), the Bank's obligations under this Agreement shall be suspended as of the date of service of such notice, unless stayed by appropriate proceedings. If the charges in such notice are dismissed, the Bank, in its discretion, may (i) pay to the Officer all or part of the compensation withheld while the Bank's obligations hereunder were suspended and (ii) reinstate, in whole or in part, any of the obligations which were suspended.

(d) Notwithstanding anything herein contained to the contrary, if the Officer is removed and/or permanently prohibited from participating in the conduct of the Bank's affairs by an order issued under section 8(e)(4) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(4) or (g)(1), all prospective obligations of the Bank under this Agreement shall terminate as of the effective date of the order, but vested rights and obligations of the Bank and the Officer shall not be affected.

(e) Notwithstanding anything herein contained to the contrary, if the Bank is in default (within the meaning of section 3(x)(1) of the FDI Act, 12 U.S.C. §1813(x)(1), all prospective obligations of the Bank under this Agreement shall terminate as of the date of default, but vested rights and obligations of the Bank and the Officer shall not be affected.

(f) Notwithstanding anything herein contained to the contrary, all prospective obligations of the Bank hereunder shall be terminated, except to the extent that a continuation of this Agreement is necessary for the continued operation of the Bank: (i) by the Director of the OTS or his designee or the Federal Deposit Insurance Corporation ("FDIC"), at the time the FDIC enters into an agreement to provide assistance to or on behalf of the Bank under the authority contained in section 13(c) of the FDI Act, 12 U.S.C. §1823(c); (ii) by the Director of the OTS or his designee at the time such Director or designee approves a supervisory merger to resolve problems related to the operation of the Bank or when the Bank is determined by such Director to be in an unsafe or unsound condition. The vested rights and obligations of the parties shall not be affected.

If and to the extent that any of the foregoing provisions shall cease to be required or by applicable law, rule or regulation, the same shall become inoperative as though eliminated by formal amendment of this Agreement.

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*Section 20. **Guaranty**.*

The Company hereby irrevocably and unconditionally guarantees to the Officer the payment of all amounts, and the performance of all other obligations, due from the Bank in accordance with the terms of this Agreement as and when due without any requirement of presentment, demand of payment, protest or notice of dishonor or nonpayment.

*Section 21. **Effective Date**.*

This Agreement shall become effective (the "Effective Date") upon the later of the following two dates: (a) the effective date of the Bank's conversion from a New York-chartered mutual savings and loan association to a stock form savings bank pursuant to the Reorganization or (b) the date the OTS advises the Bank in writing that it either approves or has no objection to the terms and conditions of this Agreement. The Bank, the Company and the Officer each hereby acknowledge and agree that the terms of this Agreement shall have no force or effect prior to such Effective Date.

**I N W ITNESS W HEREOF** , the Bank and the Company have caused this Agreement to be executed and the Officer has hereunto set his hand, all as of the day and year first above written.

Attest:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
  
[Seal]

\_\_\_\_\_

**[E XECUTIVE N AME ]**  
  
**L AKE S HORE S AVINGS B ANK**

Attest:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
  
[Seal]

\_\_\_\_\_

**L AKE S HORE B ANCORP , I NC .**  
  
By: \_\_\_\_\_  
Name: **David C. Mancuso**  
Title: **President and Chief Executive Officer**

**Exhibit 10.4**

**S EVERANCE P AY P LAN**  
  
**OF**  
  
**L AKE S HORE S AVINGS B ANK**  
  
**Effective on [date of Reorganization]**

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**SEVERANCE PAY PLAN**  
**OF**  
**LAKE SHORE SAVINGS BANK**

**ARTICLE I**

**PURPOSE**

*Section 1.1 Statement of Purpose.*

(a) Lake Shore Savings Bank adopts this Severance Pay Plan for the benefit of its eligible Employees and those of other Participating Employers. The Bank recognizes that, as a wholly owned subsidiary of a public company, it will be subject to the possibility of a negotiated or unsolicited change of control which may result in a loss of employment for some of its Employees. The purpose of the Plan is to encourage the Bank's Employees and those of other Participating Employers to continue working for their employers with their full time and attention devoted to their employer's affairs by providing a severance benefit in the event of an Involuntary Severance following a Change of Control.

(b) The Bank also recognizes that it may be appropriate in certain circumstances other than a Change of Control to provide a severance benefit to Employees in the event of an Involuntary Severance, and thus the Plan provides for the payment of a severance benefit in circumstances other than a Change of Control as determined in the discretion of the Plan Administrator.

*Section 1.2 Other Severance Plans, Policies, and Practices Superseded.*

As of the Effective Date hereof, this Plan supersedes in its entirety any plan, policy, or practice of the Bank for the provision of the severance benefit to Employees, whether written or oral or formal or informal, and no severance benefit shall be provided to any person whose employment terminates with the Bank on or after the Effective Date, except as provided under the terms of the Plan or as provided under the terms of a written, complete and fully executed employment agreement or change of control agreement specifically providing for the payment of a severance benefit following termination of employment with the Bank.

**ARTICLE II**

**DEFINITIONS**

For purposes of the Plan, the following terms shall have the meanings assigned to them below, unless a different meaning is plainly indicated by the context:

*Section 2.1 Affiliated Employer* means the Bank; any corporation which is a member of a controlled group of corporations (as defined in section 414(b) of the Internal Revenue Code of 1986, as amended, (the "Code") that includes the Bank; any trade or business (whether or not incorporated) that is under common control (as defined in section 414(c) of the



Code) with the Bank; 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 Bank; 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 Bank; and any other entity that is required to be aggregated with the Bank pursuant to regulations under section 414(o) of the Code.

*Section 2.2 Bank* means Lake Shore Savings Bank (or its successors or assigns, whether by merger, consolidation, sale of assets, statutory receivership, operation of law or otherwise).

*Section 2.3 Board* means the Board of Directors of Lake Shore Savings Bank.

*Section 2.4 Cause* means, with respect to the conduct of an Employee in connection with his employment with any Participating Employer, personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease and desist order in each case as measured against standards generally prevailing at the relevant time in the savings and community banking industry.

*Section 2.5 Change of Control* means 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 Effective Date; or

(B) individuals who first became members of the Board of Directors of the Company after the Effective Date 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; or

(v) any event which would be described in section 2.5(i), (ii), (iii) or (iv) if the term "Bank" were substituted for the term "Company" therein; and

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 2.5, the term "person" shall have the meaning assigned to it under sections 13(d)(3) or 14(d)(2) of the Exchange Act.

*Section 2.6 Committee* means the Compensation Committee described in section 4.3.

*Section 2.7 Company* means Lake Shore Bancorp, Inc. (or its successors or assigns, whether by merger, consolidation, sale of assets, statutory receivership, operation of law or otherwise).

*Section 2.8 Effective Date* means [date of Reorganization].

*Section 2.9 Employee* means any person who is employed on a full-time or part-time basis by a Participating Employer, other than: (a) a person who is classified as an

“independent contractor” by a Participating Employer even if considered an employee under applicable law; (b) an Employee receiving long-term disability benefits; or (c) a person who has an employment contract, change of control agreement or other agreement with the Bank or a Participating Company who is covered by other programs which provide severance benefits or by their terms exclude such person from participation in this Plan.

*Section 2.10 FDI Act* means the Federal Deposit Insurance Act, as the same may be amended from time to time, and the corresponding provisions of any successor statute.

*Section 2.11 Involuntary Severance* means (a) the discharge or dismissal of an Employee by a Participating Employer other than for Cause, or the resignation by the Employee from his position with a Participating Employer, which resignation the Employee is asked or compelled by a Participating Employer to tender other than for Cause; or (b) termination of employment at an Employee’s election within sixty (60) days after any action following a Change of Control which, either alone or together with other actions, results in: (i) the reduction in the Employee’s Salary without his or her consent; (ii) the assignment of the Employee’s principal place of employment outside a 30 mile radius of his or her principal place of employment at the time of the Change of Control; or (iii) a material adverse change in the Employee’s title, position or responsibilities at a Participating Employer.

*Section 2.12 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 Savings Bank and subject to such terms and conditions as may be imposed by the Board of Directors of Lake Shore Savings Bank, shall adopt this Plan.

*Section 2.13 Plan* means this Severance Pay Plan of Lake Shore Savings Bank, as the same may be amended from time to time.

*Section 2.14 Plan Administrator* means the Committee or any person, committee, corporation or organization designated in section 4.2, or appointed pursuant to section 4.2, to perform the responsibilities of that office.

*Section 2.15 Salary* means the Employee’s annual rate of base salary for his or her services to a Participating Employer (excluding overtime and other forms of additional compensation) plus the average annual commissions and bonuses earned by the Employee for the three (3) calendar years (or if shorter, the Employee’s period of employment) preceding the Employee’s Involuntary Severance. If the Employee is paid on an hourly-rate basis, Salary shall mean the weekly amount of base wages paid for the number of hours of work contemplated by such person’s normal weekly work schedule.

*Section 2.16 Service* means service rendered by an Employee that is, or would be, recognized under the 401(k) Plan maintained by Lake Shore Savings Bank for vesting purposes as of the date of the Employee’s Involuntary Severance.

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## ARTICLE III

### BENEFIT

#### *Section 3.1 Severance Benefit for Employees.*

(a) An Employee with at least one (1) year of Service whose employment with all Participating Employers is terminated under circumstances constituting an Involuntary Severance, other than for Cause, as a result of, within twelve (12) months following or within three (3) months prior to a Change of Control shall be entitled, as severance pay, to a lump sum payment in an amount equal to three (3) weeks' Salary multiplied by the number of the Employee's whole years of Service if such Employee was designated as an Officer or a lump sum payment in an amount equal to one (1) weeks' salary multiplied by the number of the Employee's whole years of Service otherwise. Notwithstanding the foregoing, no Employee who is entitled to receive benefits under this Plan shall receive a severance benefit equal to less than two (2) weeks' Salary nor shall any Employee who is an Officer and is entitled to a severance benefit receive a severance benefit equal to less than twelve (12) weeks' salary. Similarly, no Officer shall be entitled to receive more than fifty-two (52) weeks' Salary under this Plan and no Employee shall be entitled to receive more than twenty-six (26) weeks' Salary under this Plan. The lump sum severance payment shall be made as soon as practicable after, but in no case later than five (5) business days following, the Employee's Involuntary Severance.

(b) For purposes of section 3.1(a) an "Officer" shall mean, in the case of an Employee, an Employee who was designated as an Officer at the last regularly scheduled organizational meeting of the Board.

#### *Section 3.2 Vesting.*

The benefit to be provided under section 3.1(a) of the Plan to an Employee shall be completely vested and nonforfeitable upon the occurrence of a Change of Control as described in section 2.5.

#### *Section 3.3 Discretionary Severance Benefit.*

An Employee with at least one year of Service whose employment with all Participating Employers is terminated under circumstances constituting an Involuntary Severance but not related to a Change of Control as provided under section 3.1 who is selected for eligibility under the Plan in the sole discretion of the Plan Administrator shall be entitled to such severance as the Plan Administrator may determine.

#### *Section 3.4 Benefit Contingent on Execution of Release.*

The severance benefit provision under the Plan (including the discretionary severance benefit under section 3.3) to any Employee shall be subject to the condition that the Employee execute and deliver to the Plan Administrator an instrument, in such form as the Plan Administrator shall prescribe, which shall include a release in favor of the Participating Employers. Such release shall include, but not be limited to, a release of any claims which the Employee may have against any Participating Employer under the Age Discrimination in

Employment Act of 1967, as amended; the Fair Labor Standards Act, as amended; the Worker Adjustment Retraining and Notification Act, as amended; the Civil Rights Act of 1964, as amended; Title VII of the Civil Rights Act of 1866, as amended; and any other federal, state or local law, rule or regulation under which the Employee may have a claim arising out of his employment with a Participating Employer or the termination of such employment. No Participating Employer shall have any obligation to provide a benefit under this Plan to any Employee who fails or refuses to sign and deliver such a release.

## **ARTICLE IV**

### **ADMINISTRATION**

#### *Section 4.1 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 and the Board. This Article IV 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 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 4.2 Plan Administrator.*

There shall be a Plan Administrator, who shall be the Personnel Committee of the Board of Directors of the 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. 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 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 or evidence of any matter from any person 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

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Labor and employee communications as shall be required of the Plan Administrator under ERISA;

(f) To determine any question arising in connection with the Plan, including any question of Plan interpretation, and the Plan Administrator's decision or action in respect thereof shall be final and conclusive and binding upon all persons 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) To review and dispose of claims under the Plan filed pursuant to section 4.4 and appeals of claims decisions pursuant to section 4.5;

(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 the person entitled thereto, to direct the application of any amount so payable to the use or benefit of such person in any manner that the Plan Administrator may deem advisable or to direct in the Plan Administrator's 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 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 4.3 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 4.5 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 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;

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(e) To report and make recommendations to the Board regarding changes in the Plan, including changes in the operation and management of the Plan;

(f) To designate an Alternate Plan Administrator to serve in the event that the Plan Administrator is absent or otherwise unable to discharge his responsibilities;

(g) To remove and replace the Plan Administrator or Alternate, or both of them, and to fill a vacancy in either office;

(h) To discharge such other responsibilities or follow such directions as may be assigned or given by the Board; and

(i) To perform any duty or to 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 4.4 Claims Procedure.*

Any claim relating to a benefit under the Plan shall be filed with the Plan Administrator on a form prescribed by it. 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 4.5 Claims Review Procedure.*

Any person whose claim filed pursuant to section 4.4 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 4.4, or, if such notice is not provided, within 60 days after such claim is deemed denied pursuant to section 4.4. 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 Participating Employer, and the Plan Administrator shall take appropriate action to carry out such decision.

*Section 4.6 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 a Participating Employer.

*Section 4.7 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 4.5 prior to initiating any claim for judicial review.

(b) No bond or other security shall be required of the Plan Administrator, or any officer or employee of a Participating 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 4.7(c) pursuant to ERISA, neither the Plan Administrator, nor any officer or employee of a Participating 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 4.5, 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 Committee, or taking any other action under the Plan.



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(e) Any person, group of persons, committee, corporation or organization may serve in more than one fiduciary capacity with respect to the Plan.

(f) 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 the Bank and 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 V

### MISCELLANEOUS

#### *Section 5.1 Rights of Employees.*

No Employee shall have any right or claim to any benefit under the Plan except in accordance with the provisions of the Plan. The establishment of the Plan shall not be construed as conferring upon any Employee or other person any legal right to a continuation of employment or to any terms or conditions of employment, nor as limiting or qualifying the right of a Participating Employer to discharge any Employee.

#### *Section 5.2 Non-alienation of Benefit.*

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.

#### *Section 5.3 Non-duplication of Benefit.*

No provisions in this Plan shall be deemed to duplicate any compensation or benefits provided under any agreement, plan or program covering the Employee to which a Participating Employer is a party and any duplicative amount payable under any such agreement, plan or program shall be applied as an offset to reduce the amounts otherwise payable hereunder.

#### *Section 5.4 Construction.*

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 the masculine gender may be read as referring equally to the feminine gender or the neuter. Any reference to an Article or section number shall refer to an Article or section of the Plan, unless otherwise indicated.

#### *Section 5.5 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.

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*Section 5.6 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 5.7 Severability.*

The invalidity or unenforceability, in whole or in part, of any provision of this Plan shall in no way affect the validity or enforceability of the remainder of such provision or of any other provision of this Plan, and any provision, or part thereof, deemed to be invalid or unenforceable shall be reformed as necessary to render it valid and enforceable to the maximum possible extent.

*Section 5.8 Termination or Amendment.*

(a) The Participating Employers expect to continue the Plan indefinitely, but, subject to the provisions of this section 5.8 hereunder, the Participating Employers expressly reserve the right to terminate or amend the Plan, in whole or in part, at any time by action of the Board; *provided, however*, that no such amendment or termination which adversely affects the current or prospective rights of any Employee shall be effective earlier than six (6) months after written notice thereof is given to such Employee.

(b) In the event that a corporation or trade or business other than Lake Shore Savings Bank shall adopt this Plan, such corporation or trade or business shall, by adopting the Plan, empower Lake Shore Savings Bank 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 this section 5.8(b); *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.

*Section 5.9 Required Regulatory Provisions.*

The following provision is included for the purposes of complying with various laws, rules and regulations applicable to the Bank:

(a) Notwithstanding anything herein contained to the contrary, in no event shall the aggregate amount of compensation payable to an Employee hereunder exceed the three times the Employee's average annual compensation (within the meaning of OTS Regulatory Bulletin 27a or any successor thereto) for the last five consecutive calendar years to end prior to his or her termination of employment with the Bank (or for his or her entire period of employment with the Bank if less than five calendar years). The compensation payable to the Employee hereunder shall be further reduced (but not below zero) if such reduction would avoid the assessment of excise taxes on excess parachute payments (within the meaning of section 280G of the Code).

(b) Notwithstanding anything herein contained to the contrary, any payments to the Employee by the Bank, whether pursuant to this Agreement or otherwise, are subject to and conditioned upon their compliance with section 18(k) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §1828(k), and any regulations promulgated thereunder.

(c) Notwithstanding anything herein contained to the contrary, if the Employee is suspended from office and/or temporarily prohibited from participating in the conduct of the affairs of the Bank pursuant to a notice served under section 8(e)(3) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(3) or 1818(g)(1), the Bank's obligations under this Agreement shall be suspended as of the date of service of such notice, unless stayed by appropriate proceedings. If the charges in such notice are dismissed, the Bank, in its discretion, may (i) pay to the Employee all or part of the compensation withheld while the Bank's obligations hereunder were suspended and (ii) reinstate, in whole or in part, any of the obligations which were suspended.

(d) Notwithstanding anything herein contained to the contrary, if the Employee is removed and/or permanently prohibited from participating in the conduct of the Bank's affairs by an order issued under section 8(e)(4) or 8(g)(1) of the FDI Act, 12 U.S.C. §1818(e)(4) or (g)(1), all prospective obligations of the Bank under this Plan shall terminate as of the effective date of the order, but vested rights and obligations of the Bank and the Employee shall not be affected.

(e) Notwithstanding anything herein contained to the contrary, if the Bank is in default (within the meaning of section 3(x)(1) of the FDI Act, 12 U.S.C. §1813(x)(1), all prospective obligations of the Bank under this Plan shall terminate as of the date of default, but vested rights and obligations of the Bank and the Employee shall not be affected.

(f) Notwithstanding anything herein contained to the contrary, all prospective obligations of the Bank hereunder shall be terminated, except to the extent that a continuation of this Plan is necessary for the continued operation of the Bank: (i) by the Director of the OTS or his designee or the Federal Deposit Insurance Corporation ("FDIC"), at the time the FDIC enters into an agreement to provide assistance to or on behalf of the Bank under the authority contained in section 13(c) of the FDI Act, 12 U.S.C. §1823(c); (ii) by the Director of the OTS or his designee at the time such Director or designee approves a supervisory merger to resolve problems related to the operation of the Bank or when the Bank is determined by such Director to be in an unsafe or unsound condition. The vested rights and obligations of the parties shall not be affected.

If and to the extent that the foregoing provision shall cease to be required by applicable law, rule or regulation, the same shall become inoperative automatically as though eliminated by formal amendment of the Plan.

#### *Section 5.10 Withholding.*

Payments from this Plan shall be subject to all applicable federal, state and local income withholding taxes.

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*Section 5.11 Status as Welfare Benefit Plan Under ERISA.*

This Plan is an “employee welfare benefit plan” within the meaning of section 3(1) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) and shall be construed, administered and enforced according to the provisions of ERISA.

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**Exhibit 10.5**

EXECUTIVES  
SUPPLEMENTAL BENEFIT PLAN  
LAKE SHORE SAVINGS AND LOAN ASSOCIATION

October 1, 1999

Financial Institution Consulting Corporation  
700 Colonial Road, Suite 260  
Memphis, Tennessee 38117  
WATS: 1-800-8730089  
FAX: (901) 684-7411  
(901) 684-7400

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## EXECUTIVES SUPPLEMENTAL BENEFIT PLAN

This Executives Supplemental Benefit Plan (the “Plan”), executed as of the 1st day of October, 1999, formalizes the understanding by and between LAKE SHORE SAVINGS AND LOAN ASSOCIATION (the “Association”), a mutual savings association, and its Executives, hereinafter referred to as “Executive(s)”, who shall be eligible to participate in this Plan by execution of an Executives Supplemental Benefit Plan Joinder Agreement (“Joinder Agreement”) in a form provided by the Association.

### WITNESSETH:

**WHEREAS**, the Executives are employed by the Association; and

**WHEREAS**, the Association recognizes the valuable services heretofore performed for it by such Executives and wishes to encourage their continued employment and to provide them with additional incentive to achieve corporate objectives; and

**WHEREAS**, the Association wishes to provide the terms and conditions upon which the Association shall pay additional retirement benefits to the Executives; and

**WHEREAS**, the Association intends this Plan to be considered an unfunded arrangement, maintained primarily to provide supplemental retirement income for its Executives, members of a select group of management or highly compensated employees of the Association, for tax purposes and for purposes of the Employee Retirement Income Security Act of 1974, as amended; and

**WHEREAS**, the Association has adopted this Executives Supplemental Benefit Plan which controls all issues relating to Supplemental Benefits as described herein;

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**NOW, THEREFORE,** in consideration of the premises and of the mutual promises herein contained, the Association and the Executives agree as follows:

**SECTION I**

**DEFINITIONS**

When used herein, the following words and phrases shall have the meanings below unless the context clearly indicates otherwise:

- 1.1 “Accrued Benefit” means, with respect to any Plan Year, that portion of the Supplemental Benefit which is expensed and accrued as of the Valuation Date of such Plan Year under generally accepted accounting principles (GAAP) utilizing the benefits/years of service method. The Accrued Benefit for each Plan Year shall be set forth in each Executive’s Joinder Agreement.
- 1.2 “Act” means the Employee Retirement Income Security Act of 1974, as amended from time to time.
- 1.3 “Administrator” means the Committee.
- 1.4 “Annuitized Value” means the value of the Participant’s Accrued Benefit increased by monthly compounding using the Interest Factor and expressed as a stream of annual benefits payments.
- 1.5 “Association” means LAKE SHORE SAVINGS AND LOAN ASSOCIATION and any successor thereto.
- 1.6 “Beneficiary” means the person or persons (and their heirs) designated as Beneficiary in the Executive’s Joinder Agreement to whom the deceased Executive’s benefits are

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payable. If no Beneficiary is so designated, then the Executive's Spouse, if living, will be deemed the Beneficiary. If the Executive's Spouse is not living, then the Children of the Executive will be deemed the Beneficiaries and will take on a per stirpes basis. If there are no living Children, then the Estate of the Executive will be deemed the Beneficiary.

- 1.7 "Benefit Age" shall be the age at which the Executive becomes eligible to receive the Supplemental Benefit under the Plan. Such age shall be designated in the Executive's Joinder Agreement.
- 1.8 "Benefit Eligibility Date" shall be the date on which an Executive is entitled to receive his Supplemental Benefit. An Executive's "Benefit Eligibility Date" shall occur on the 1st day of the month coincident with or next following the month in which the Executive attains his Benefit Age designated in the Joinder Agreement.
- 1.9 "Benefits Determiner" shall mean financial Institutions Consulting Corporation, or its successor or assign.
- 1.10 "Cause" means personal dishonesty, willful misconduct, willful malfeasance, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, regulation (other than traffic violations or similar offenses), or final cease-and-desist order, material breach of any provision of this Plan, or gross negligence in matters of material importance to the Association.

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1.11 "Change in Control" shall mean and include the following, with respect to the Association:

- (i) a reorganization, merger, merger conversion, consolidation or sale of all or substantially all of the assets of the Association to another entity which is not controlled by the Association, or a similar transaction occurs in which the Association, is not the resulting entity; or
- (ii) individuals who constitute the Board of Directors of the Association, on the date hereof (the "Incumbent Board") cease for any reason to constitute at least a majority thereof, provided that any person becoming a Director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the Directors comprising the Incumbent Board; shall be, for purposes of this clause (ii) considered as though he were a member of the Incumbent Board.

1.12 "Children" means the Executive's children, or the issue of any deceased child of the Executive, then living at the time payments are due the Children under this Plan. The term "Children" shall include both natural and adopted Children.

1.13 "Committee" means the Committee appointed by the Board of Directors to administer the Plan.

1.14 "Disability Benefit" means the monthly benefit payable to the Executive following a determination, in accordance with Subsection 3.6, that he is no longer able, properly and satisfactorily, to perform his duties as Executive.

1.15 "Effective Date" of the Executives Supplemental Benefit Plan shall be October 1, 1999.

1.16 "Estate" means the estate of the Executive.



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- 1.17 "Executive" means a senior executive officer of the Association who is selected to participate in the Plan by the Board of Directors of the Association.
- 1.18 "Interest Factor" means monthly compounding or discounting, as applicable, at seven percent (7%) per annum.
- 1.19 "Payout Period" means the time frame during which certain benefits payable hereunder shall be distributed. Payments shall be made in equal monthly installments commencing within thirty (30) days following the occurrence of the event which triggers distribution and continuing for One Hundred Eighty (180) consecutive months. For purposes of the Survivor's Benefits payable hereunder, the Payout Period shall be One Hundred Eighty (180) consecutive months.
- 1.20 "Plan Year" shall mean each October 1 to September 30, commencing October 1, 1999.
- 1.21 "Spouse" means the individual to whom the Executive is legally married at the time of the Executive's death.
- 1.22 "Supplemental Benefit" means an annual amount payable to the Executive pursuant to the Plan. The Supplemental Benefit to which an Executive will become entitled upon the satisfaction of the applicable conditions shall be equal to the amount set forth in the Executive's Joinder Agreement.
- 1.23 "Survivor's Benefit" means an annual amount payable to the Beneficiary in monthly installments throughout the Payout Period, equal to the amount designated in the Executive's Joinder Agreement and subject to Subsection 3.2.

- 1.24 "Valuation Date" shall mean the date during the Plan Year on which the Executive's Accrued Benefit is determined for the Plan Year. The Valuation Date shall be September 30<sup>th</sup> of each Plan Year, and any other date so determined by the Committee.

## **SECTION II**

### **ELIGIBILITY AND PARTICIPATION**

#### **2.1 Eligibility and Participation**

- (a) Eligibility - Eligibility to participate in the Plan shall be limited to those employees of the Association who are designated by the Board of Directors and who are members of a select group of management and highly compensated employees within the meaning of Department of Labor Regulation Section 2520.104-23.
- (b) Participation - An Executive's participation in the Plan shall be effective upon notification of the employee of eligibility to participate, completion of a Joinder Agreement by the Executive and acceptance of the Joinder Agreement by the Committee. Executive's participation in the Plan shall continue until such time as the Executive terminates employment with the Association, and as long thereafter as the Executive is eligible to receive benefits under this Plan.

#### **2.2 Change in Employment Status** . If the Board of Directors determines that a Participant's employment performance is no longer at a level which deserves reward through participation in this Plan, but does not terminate the Participant's employment with the Association, participation herein and eligibility to receive benefits hereunder shall be

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limited to the Participant's Accrued Benefit Account as of the date designated by the Board.

### **SECTION III**

#### **BENEFITS**

- 3.1 Supplemental Benefit. If the Executive is in the employ of the Association until reaching his Benefit Age, the Executive shall be entitled to the Supplemental Benefit. Such Supplemental Benefit shall commence on the 1<sup>st</sup> day of the month following the Executive's attainment of his Benefit Age and shall be payable in monthly installments throughout the Payout Period. In the event an Executive dies after commencement of the Supplemental Benefit payments but before completion of all such payments due, and owing hereunder, the Association shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
- 3.2 Death Prior to Benefit Age. If the Executive dies prior to attaining his Benefit Age but while employed by the Association, the Executive's Beneficiary shall be entitled to the Survivor's Benefit. The Survivor's Benefit shall commence within thirty (30) days of the Executive's death and shall be payable in monthly installments throughout the Payout Period.
- 3.3 Voluntary or Involuntary Termination Other Than for Cause.
- (a) If the Executive's employment with the Association is voluntarily or involuntarily terminated prior to the attainment of his Benefit Eligibility Date, for any reason other than for Cause, the Executive's death, disability, or following a Change in Control (as defined), the Executive (or his Beneficiary) shall be entitled to the

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annuitized value (using the Interest Factor) of his Accrued Benefit, asset forth in the Executive's Joinder Agreement. Such benefit shall commence on the Executive's Benefit Eligibility Date and shall be payable in monthly installments throughout the Payout Period. In the event the Executive dies at anytime after commencement of payments hereunder, but prior to completion of all such payments due and owing hereunder, the Association shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If the Executive dies after his voluntary or involuntary termination of employment occurring prior to his Benefit Eligibility Date, and prior to the commencement of benefits hereunder, the Executive's Beneficiary shall be entitled to the annuitized value (using the Interest Factor) of his Accrued Benefit, which shall be calculated by the Benefits Determiner. The payment of such benefit shall commence within thirty (30) days of the Executive's death. The benefit shall be payable in monthly installments over the Payout Period.

3.4 Termination of Employment Related to a Change in Control.

- (a) If the Executive's employment is terminated (either voluntarily or involuntarily) following or coincident with a Change in Control, the Executive shall be entitled to his full Supplemental Benefit (as if he had remained in employment until his Benefit Age). Such benefit shall commence on the 1st day of the month following his termination of service and shall be payable in monthly installments throughout the Payout Period. In the event that the Executive dies at any time after

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commencement of the payments, but prior to completion of all such payments due and owing hereunder, the Association, or its successor, shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If, after such termination, the Executive dies prior to commencement of the benefits hereunder, the Executive's Beneficiary shall be entitled to the Survivor's Benefit which shall commence within thirty (30) days of the Executive's death. The Survivor's Benefit shall be payable in monthly installments over the Payout Period.

3.5 Termination for Cause . If the Executive is terminated for Cause, all benefits under the Executive's Joinder Agreement shall be forfeited and the Joinder Agreement shall become null and void.

3.6 Disability Benefit .

- (a) Notwithstanding any other provision hereof, if requested by the Executive and approved by the Board of Directors, the Executive who has not attained his Benefit Eligibility Date shall be entitled to receive the Disability Benefit hereunder, in any case in which it is determined by a duly licensed physician selected by the Association, that the Executive is no longer able, properly and satisfactorily, to perform his regular duties as an Executive on a continuous or sustained basis due to ill health, accident, disability or general inability due to age. If the Executive's employment is terminated pursuant to this paragraph and Board of Executive approval is obtained, the Executive may elect to begin receiving the

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Disability Benefit in lieu of any benefit available under Section 3.3, which is not available prior to the Executive's Benefit Eligibility Date. The Disability Benefit shall equal the annuitized value (using the Interest Factor) of the Executive's Accrued Benefit, which shall be calculated by the Benefits Determiner. The Disability Benefit shall be payable in monthly installments over the Payout Period commencing within thirty (30) days following the later of (i) the above mentioned disability determination and (ii) the approval of the Disability Benefit by the Board of Directors. In the event the Executive dies while receiving payments pursuant to this Subsection, but prior to the completion of all payments due and owing hereunder, the Association shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If the Executive dies after approval of the Disability Benefit by the Board of Directors but before the commencement of such payments, the Executive's Beneficiary shall be entitled to the annuitized value (using the Interest Factor) of the Executive's Accrued Benefit, which shall be calculated by the Benefits Determiner. Such benefit shall be payable to the Beneficiary in monthly installments over the Payout Period commencing within thirty (30) days of the Executive's death.

3.7 Non-Competition During and After Employment with the Association .

- (a) In consideration of the agreements of the Association contained herein and of the payments to be made by the Association pursuant hereto, the Executive hereby agrees that, so long as he remains in the employment of the Association, he will not

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actively engage, either directly or indirectly, in any business or other activity which is or may be deemed to be in any way competitive with or adverse to the best interests of the business of the Association unless the Executives participation therein has been consented to, in writing, by the Board of Directors.

- (b) The Executive expressly agrees that, as consideration for the covenants of the Association contained herein and as a condition to the performance by the Association of its obligations hereunder, from and after any voluntary or involuntary termination of employment, other than a termination of employment in connection with a Change in Control pursuant to Subsection 3.4, and continuing throughout the entire Payout Period, as provided herein, he will not, without the prior written consent of the Association, become associated with, in the capacity of an employee, Executive, officer, principal, agent, trustee or in any other capacity whatsoever, any enterprise conducted in the trading area of the business of the Association which enterprise is, or may be deemed to be, competitive with any business carried on by the Association as of the date of the termination of the Executive's employment.
  - (c) In the event of a termination of the Executive's employment related to a Change in Control pursuant to Subsection 3.4, paragraph (b) of this Subsection 3.7 shall cease to be a condition to the performance by the Association of its obligations under this Plan.
- 3.8 Breach. In the event of any breach by the Executive of the agreements and covenants contained herein, the Board of Directors of the Association shall direct that any unpaid

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balance of any payments to the Executive under this Plan be suspended, and shall thereupon notify the Executive of such suspensions, in writing. Thereupon, if the Board of Directors of the Association shall determine that said breach by the Executive has continued for a period of one (1) month following notification of such suspension, all rights of the Executive and his Beneficiaries under this Plan, including rights to further payments hereunder, shall thereupon terminate.

- 3.9 Additional Death Benefit - Burial Expense. In addition to the above-described benefits, upon the Participant's death, the Participant's Beneficiary shall be entitled to receive a one-time lump sum death benefit in the amount of Ten Thousand (\$10,000.00) Dollars. This benefit shall be provided specifically for the purpose of providing payment for burial and/or funeral expenses of the Participant. Such death benefit shall be payable within thirty (30) days of the Participant's death. The Participant's Beneficiary shall not be entitled to such benefit under this Plan (i) if the Participant is terminated for Cause prior to death or (ii) the Participant's Beneficiary receives a supplemental \$10,000 death benefit under any other non-qualified deferred compensation plan sponsored by the Association.

#### **SECTION IV**

##### **BENEFICIARY DESIGNATION**

The Executive shall make an initial designation of primary and secondary Beneficiaries upon execution of his Joinder Agreement and shall have the right to change such designation, at any subsequent time, by submitting to the Administrator in substantially the form attached as Exhibit A to the Joinder Agreement, a written designation of primary and secondary Beneficiaries. Any Beneficiary designation made subsequent to execution of the Joinder



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Agreement shall become effective only when receipt thereof is acknowledged in writing by the Administrator.

## **SECTION V**

### **EXECUTIVE'S RIGHT TO ASSETS**

The rights of the Executive, any Beneficiary, or any other person claiming through the Executive under this Plan, shall be solely those of an unsecured general creditor of the Association. The Executive, the Beneficiary, or any other person claiming through the Executive, shall only have the right to receive from the Association those payments so specified under this Plan. The Executive agrees that he, his Beneficiary, or any other person claiming through him shall have no rights or interests whatsoever in any asset of the Association, including any insurance policies or contracts which the Association may possess or obtain to informally fund this Plan. Any asset used or acquired by the Association in connection with the liabilities it has assumed under this Plan, unless expressly provided herein, shall not be deemed to be held under any trust for the benefit of the Executive or his Beneficiaries, nor shall any asset be considered security for the performance of the obligations of the Association. Any such asset shall be and remain, a general, unpledged, and unrestricted asset of the Association.

## **SECTION VI**

### **RESTRICTIONS UPON FUNDING**

The Association shall have no obligation to set aside, earmark or entrust any fund or money with which to pay its obligations under this Plan. The Executive, his Beneficiaries or any successor in interest to hire shall be and remain simply a general unsecured creditor of the Association in the same manner as any other creditor having a general claim for matured and unpaid compensation. The Association reserves the absolute right in its sole discretion to either

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purchase assets to meet its obligations undertaken by this Plan or to refrain from the same and to determine the extent, nature, and method of such asset purchases. Should the Association decide to purchase assets such as life insurance, mutual funds, disability policies or annuities, the Association reserves the absolute right, in its sole discretion, to terminate such assets at any time, in whole or in part. At no time shall the Executive be deemed to have any lien, right, title or interest in or to any specific investment or to any assets of the Association. If the Association elects to invest in a life insurance, disability or annuity policy upon the life of the Executive, then the Executive shall assist the Association by freely submitting to a physical examination and by supplying such additional information necessary to obtain such insurance or annuities.

## **SECTION VII**

### **ALIENABILITY AND ASSIGNMENT PROHIBITION**

Neither the Executive nor any Beneficiary under this Plan shall have any power or right to transfer, assign, anticipate, hypothecate, mortgage, commute, modify or otherwise encumber in advance any of the benefits payable hereunder, nor shall any of said benefits be subject to seizure for the payment of any debts, judgments, alimony or separate maintenance owed by the Executive or his Beneficiary, nor be transferable by operation of law in the event of bankruptcy, insolvency or otherwise. In the event the Executive or any Beneficiary attempts assignment, communication, hypothecation, transfer or disposal of the benefits hereunder, the Association's liabilities shall forthwith cease and terminate.

## **SECTION VIII**

### **ADMINISTRATION**

- 8.1 Named Fiduciary and Administrator. The Association shall name a Committee of the Board of Directors as the Named Fiduciary and Administrator of this Plan. The

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Committee shall consist of not less than three persons. The Committee shall have the authority to make, amend, interpret and enforce all appropriate rules and regulations for the administration of this Plan, as may arise in connection with the Plan. A majority vote of the Committee members shall control any decision.

- 8.2 Agents. The Committee may, from time to time, employ other agents and delegate to them such administrative duties as it sees fit, and may from time to time consult with counsel who may be counsel to the Association.
- 8.3 Binding Effect of Decisions. The decision or action of the Committee in respect of any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
- 8.4 Indemnity of Committee. The Association shall indemnify and hold harmless the members of the Committee against any and all claims, loss, damage, expense or liability arising from any action or failure to act with respect to this Plan, except in the case of gross negligence or willful misconduct.

## **SECTION IX**

### **CLAIMS PROCEDURE AND ARBITRATION**

- 9.1 Claims Procedure. In the event that benefits under this Plan are not paid to the Executive (or to his Beneficiary in the case of the Executive's death) and such claimants feel they are entitled to receive such benefits, then a written claim must be made to the Committee within sixty (60) days from the date payments are refused. The Committee shall review the written claim and, if the claim is denied, in whole or in part, it shall provide in writing,

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within ninety (90) days of receipt of such claim, its specific reasons for such denial, reference to the provisions of this Plan or the Joinder Agreement upon which the denial is based, and any additional material or information necessary to perfect the claim. Such writing by Committee shall further indicate the additional steps which must be undertaken by claimants if an additional review of the claim denial is desired.

If claimants desire a second review, they shall notify the Committee in writing within sixty (60) days of the first claim denial. Claimants may review this Plan, the Joinder Agreement or any documents relating thereto and submit any issues and comments, in writing, they may feel appropriate. The Committee shall refer the claim to the Association's full Board of Directors. The Board of Directors of the Association shall then review the second claim and provide a written decision within sixty (60) days of receipt of such claim. The decision shall state the specific reasons for the decision and shall include reference to specific provisions of this Plan or the Joinder Agreement upon which the Association's decision is based.

- 9.2 Arbitration. If claimants continue to dispute the benefit denial based upon completed performance of this Plan and the Joinder Agreement or the meaning and effect of the terms and conditions thereof, then claimants may submit the dispute to mediation, administered by the American Arbitration Association ("AAA") (or a mediator selected by the parties) in accordance with the AAA's Commercial Mediation Rules. If mediation is not successful in resolving the dispute, it shall be settled by arbitration administered by the AAA under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

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## SECTION X

### MISCELLANEOUS

- 10.1 No Effect on Executive's Rights . Nothing contained herein will confer upon the Executive the right to be retained in the employment of the Association nor limit the right of the Association to deal with the Executive without regard to the existence of the Plan.
- 10.2 State Law . The Plan is established under, and will be construed according to, the laws of the State of New York, to the extent such laws are not preempted by the Act and valid regulations published thereunder.
- 10.3 Severability . In the event that any of the provisions of this Plan or portion thereof, are held to be inoperative or invalid by any court of competent jurisdiction, then: (1) insofar as is reasonable, effect will be given to the intent manifested in the provisions held invalid or inoperative, and (2) the validity and enforce ability of the remaining provisions will not be affected thereby.
- 10.4 Incapacity of Recipient . In the event the Executive is declared incompetent and a conservator or other person legally charged with the care of his person or Estate is appointed, any benefits under the Plan to which such Executive is entitled shall be paid to such conservator or other person legally charged with the care of his person or Estate.
- 10.5 Unclaimed Benefit . The Executive shall keep the Association informed of his current address and the current address of his Beneficiaries. The Association shall not be obligated to search for the whereabouts of any person. If the location of the Executive is not made known to the Association as of the date upon which any payment of any benefits may first be made, the Association shall delay payment of the Executive's

benefit payment(s) until the location of the Executive is made known to the Association; however, the Association shall only be obligated to hold such benefit payment(s) for the Executive until the expiration of thirty-six (36) months. Upon expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Executive's Beneficiary. If the location of the Executive's Beneficiary is not made known to the Association by the end of an additional two (2) month period following expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Executive's Estate. If there is no Estate in existence at such time or if such fact cannot be determined by the Association, the Executive and his Beneficiary(ies) shall thereupon forfeit any rights to the balance, if any, of any benefits provided for such Executive and/or Beneficiary under this Plan.

- 10.6 Establishment of Rabbi Trust. The Association intends to establish a rabbi trust into which the Association intends to contribute assets which shall be held therein, subject to the claims of the Association's creditors in the event of the Association's "Insolvency" as defined in the rabbi trust, until the contributed assets are paid to the Executives and their Beneficiaries in such manner and at such times as specified in this Plan. It is the intention of the Association to make contributions to the rabbi trust to provide the Association with a source of funds to assist it in meeting the liabilities of this Plan. The rabbi trust and any assets held therein shall conform to the terms of the rabbi trust agreement which has been established in conjunction with this Plan. To the extent the language in this Plan is modified by the language in the rabbi trust agreement, the rabbi trust agreement shall supersede this Plan. Any contributions to the rabbi trust shall be made during each Plan Year in accordance with the rabbi trust agreement. The amount of such contribution(s)

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shall be equal to the Executive's Accrued Benefit, if any, less: (i) previous contributions made on behalf of the Executive to the rabbi trust, and (ii) earnings to date on all such previous contributions.

- 10.7 Limitations on Liability. Notwithstanding any of the preceding provisions of the Plan, no individual acting as an employee or agent of the Association, or as a member of the Board of Directors shall be personally liable to the Executive or any other person for any claim, loss, liability or expense incurred in connection with the Plan.
- 10.8 Gender. Whenever in this Plan words are used in the masculine or neuter gender, they shall be read and construed as in the masculine, feminine or neuter gender, whenever they should so apply.
- 10.9 Effect on Other Corporate Benefit Plans. Nothing contained in this Plan shall affect the right of the Executive to participate in or be covered by any other corporate benefit available to Executives of the Association constituting a part of the Association's existing or future compensation structure.
- 10.10 Suicide. Notwithstanding anything to the contrary in this Plan, the benefits otherwise provided herein shall not be payable and this Plan shall become null and void with respect to the Executive if the Executive's death results from suicide, whether sane or insane, within twenty-four (24) months after the execution of his Joinder Agreement.
- 10.11 Instrument. This Plan shall be binding upon and shall inure to the benefit of the Association, its successors and assigns, and the Executive, his successors, heirs, executors, administrators, and Beneficiaries.

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- 10.12 Headings. Headings and sub-headings in this Plan are inserted for reference and convenience only and shall not be deemed a part of this Plan.

## **SECTION XI**

### **AMENDMENT/REVOCATION**

- 11.1 Amendment. The Board of Directors may at any time amend the Plan in whole or in part, provided, however, that no amendment shall be effective to decrease or restrict any Participant's Accrued Benefit under the Plan, determined as of the date of Amendment. Any change in the Interest factor shall not become effective until the first day of the calendar year which follows the adoption of the amendment and providing at least thirty (30) days' written notice of the amendment to the Participant. Notwithstanding the above, following a Change in Control, this Plan shall not be amended, modified or revoked at any time, in whole or part, as to any Executive, without the mutual written consent of the Executive and the Association, and such mutual consent shall be required even if the Executive is no longer in the service of the Association.
- 11.2 Termination. The Board of Directors may within the first twelve (12) months after the Plan's Effective Date partially or completely terminate the Plan, if, as a result of changes in the tax laws, the tax, accounting, or other effects of the continuance of the Plan, or potential payments thereunder, would not be in the best interests of the Association.

## **SECTION XII**

### **EXECUTION**

- 12.1 This Plan sets forth the entire understanding of the parties hereto with respect to the transactions contemplated hereby, and any previous agreements or understandings



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between the parties hereto regarding the subject matter hereof are merged into and superseded by this Plan.

12.2 This Plan shall be executed in triplicate, each copy of which, when so executed and delivered, shall be an original, but all three copies shall together constitute one and the same instrument.

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IN WITNESS WHEREOF, the Association has caused this Plan to be executed on the day and date first above written.

ATTEST:

LAKE SHORE SAVINGS AND LOAN ASSOCIATION

/s/ B EVERLY J. M ULKIN

Secretary

By: /s/ D AVID C. M ANCUSO

Title: President/ CEO

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**Exhibit 10.6**

EXECUTIVES  
SUPPLEMENTAL BENEFIT PLAN  
LAKE SHORE SAVINGS AND LOAN ASSOCIATION

October 1, 2001

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## **EXECUTIVES SUPPLEMENTAL BENEFIT PLAN**

This Executive Supplemental Benefit Plan (the "Plan"), executed as of the 1st day of October, 2001, formalizes the understanding by and between LAKE SHORE SAVINGS AND LOAN ASSOCIATION (the "Association"), a mutual savings association, and its Executives, hereinafter referred to as "Executive(s)", who shall be eligible to participate in this Plan by executive of an Executives Supplemental Benefit Plan Joinder Agreement ("Joinder Agreement") in a form provided by the Association.

### **WITNESSETH:**

**WHEREAS** , the Executive are employed by the Association; and

**WHEREAS** , the Association recognizes the valuable services heretofore performed for it by such Executives and wishes to encourage their continued employment and to provide them with additional incentive to achieve corporate objectives; and

**WHEREAS** , the Association wishes to provide the terms and conditions upon which the Association shall pay additional retirement benefits to the Executives; and

**WHEREAS** , the Association intends this Plan to be considered an unfunded arrangement, maintained primarily to provide supplemental retirement income for its Executives, members of a select group of management or highly compensated employees of the Association, for tax purposes and for purposes of the Employee Retirement Income Security Act of 1974, as amended; and

**WHEREAS** , the Association has adopted this Executive Supplemental Benefit Plan which controls all issues relating to Supplemental Benefits as described herein;

**NOW , THEREFORE** , in consideration of the premises and of the mutual promises herein contained, the Association and the Executive agree as follows:

### **SECTION I**

#### **DEFINITIONS**

When used herein, the following words and phrases shall have the meanings below unless the context clearly indicates otherwise:

- 1.1 "Accrued Benefit" means, with respect to any Plan Year, that portion of the Supplemental Benefit which is expensed and accrued as of the Valuation Date of such Plan Year under generally

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accepted accounting principles (GAAP) utilizing the benefits/years-of-service method. The Accrued Benefit for each Plan Year shall be set forth in each Executives' Joinder Agreement.

- 1.2 "Act means the Employee Retirement Income Security Act of 1974, as amended from time to time.
- 1.3 "Actuarial Equivalent" or "Actuarial Equivalency" means the Accrued Benefit payable at the Executive's Benefits Age which differs in time of payment from the specific benefit provided under the Executive's Joinder Agreement but having the same value when computed using pre-retirement and post-retirement interest of 5.75%.
- 1.4 "Administrator" means the Committee.
- 1.5 "Association" means LAKE SHORE SAVINGS AND LOAN ASSOCIATION and any successor thereto.
- 1.6 "Beneficiary" means the person or persons (and their heirs) designated as Beneficiary in the Executive's Joinder Agreement to whom the deceased Executive's benefits are payable. If no Beneficiary is to designated, then the Executive's Spouse, if living, will be deemed the Beneficiary. If the Executive's Spouse is not living, then the Children of the Executive will be deemed the Beneficiaries and will take on a per stirpes basis. If there are no living Children, then the Estate of the Executive will be deemed the Beneficiary.
- 1.7 "Benefit Age" shall be the age at which the Executive becomes eligible to receive the Supplemental Benefit under the Plan. Such age shall be designated in the Executive's Joinder Agreement.
- 1.8 "Benefit Eligibility Date" shall be the date on which an Executive is entitled to receive his Supplemental Benefit. An Executive's "Benefit Eligibility Date" shall occur on the 1<sup>st</sup> day of the month coincident with or next following the month in which the Executive attains his Benefit Age designated in the Joinder Agreement.
- 1.9 "Benefits Determiner" shall mean a third party administrator or agent designated by the Committee.
- 1.10 "Cause" means personal dishonesty, willful misconduct, willful malfeasances breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any

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law, rule, regulation (other than traffic violations or similar offenses), or final cease-and-desist order, material breach of any provision of this Plan, or gross negligence in matters of material importance to the Association.

1.11 "Change in Control" shall mean and include the following with respect to the Association:

- (i) a reorganization, merger, merger conversion, consolidation or sale of all or substantially all of the assets of the Association to another entity which is not controlled by the Association, or a similar transaction occurs in which the Association, is not the resulting entity; or
- (ii) individuals who constitute the Board of Directors of the Association, on the date hereof (the "Incumbent Board") cease for any reason to constitute at least a majority thereof, provided that any person becoming a Director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the Directors comprising the Incumbent Board, shall be, for purposes of this clause (ii) considered as though he were a member of the Incumbent Board.

1.12 "Children" means the Executive's children, or the issue of any deceased child of the Executive, then living at the time payments are due the Children under this Plan. The term "Children" shall include both natural and adopted Children.

1.13 "Committee" means the Committee appointed by the Board of Directors to administer the Plan.

1.14 "Disability Benefit" means the monthly benefit payable to the Executive following a determination, in accordance with Subsection 3.6, that he is no longer able, properly and satisfactorily, to perform his duties as Executive.

1.15 "Effective Date" of the Executives Supplemental Benefit Plan shall be October 1, 2001.

1.16 "Estate" means the estate of the Executive.

1.17 "Executive" means an officer of the Association who is selected to participate in the Plan by the Board of Directors of the Association.

- 1.18 "Payout Period" means the time frame during which certain benefits payable hereunder shall be distributed. Payments shall be made in equal monthly installments commencing within thirty (30) days following the occurrence of the event which triggers distribution and continuing for one Hundred Eighty (180) consecutive months. For purposes of the Survivor's Benefits payable hereunder, the Payout Period shall be One Hundred Eighty (180) consecutive months.
- 1.19 "Plan Year" shall mean each October 1 to September 30, commencing October 1, 2001.
- 1.20 "Spouse" means the individual to whom the Executive is legally married at the time of the Executive's death.
- 1.21 "Supplemental Benefit" means an annual amount payable to the Executive pursuant to the Plan. The Supplemental Benefit to which an Executive will become entitled upon the satisfaction of the applicable conditions shall be equal to the amount set forth in the Executive's Joinder Agreement.
- 1.22 "Survivor's Benefit" means an annual amount payable to the Beneficiary in monthly installments throughout the Payout Period, equal to the amount, if any, designated in the Executive's Joinder Agreement and subject to Subsection 3.4.
- 1.23 "Valuation Date" shall mean the date during the Plan Year on which the Executive's, Accrued Benefit is determined for the Plan Year. The Valuation Date shall be September 30<sup>th</sup> of each Plan Year, and any other date so determined by the Committee.

## **SECTION II**

### **ELIGIBILITY AND PARTICIPATION**

#### **2.1 Eligibility and Participation .**

(a) Eligibility - Eligibility to participate in the Plan shall be limited to those employees of the Association who are designated by the Board of Directors and who are members of a select group of management and highly compensated employees within the meaning of Department of Labor Regulation Section 2520.104-23.

(b) Participation - An Executive's participation in the Plan shall be effective upon notification of the employee of eligibility to participate, completion of a Joinder Agreement by the Executive and acceptance of the binder Agreement by the Committee. Executive's participation in the

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Plan shall continue until such time as the Executive terminates employment with the Association, and as long thereafter as the Executive is eligible to receive benefits under this Plan.

- 2.2 Change in Employment Status . If the Board of directors determines that a Participant's employment performance is no longer at a level which deserves reward through participation in this Plan, but does not terminate the Participant's employment with the Association, participation herein and eligibility to receive benefits hereunder shall be limited to the Participant's Accrued Benefit Account as of the date designated by the Board.

### **SECTION III**

#### **BENEFITS**

- 3.1 Supplemental Benefit . If the Executive is in the employ of the Association until reaching his Benefit Age, the Executive shall be entitled to the Supplement Benefit. Such Supplemental Benefit shall commence on the 1<sup>st</sup> day of the month following the Executive's attainment of his Benefit Age and shall be payable in monthly installments throughout the Payout Period. In the event an Executive dies after commencement of the Supplemental Benefit payments but before completion of all such payments due and owing hereunder, the Association shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
- 3.2 Death Prior to Benefit Age . If the Executive dies prior to attaining his Benefit Age but while employed by the Association, the Executive's Beneficiary shall be entitled to the Actuarial Equivalent of the Executive's Accrued Benefit. Such death benefit shall commence within thirty (30) days of the Executive's death and shall be payable in monthly installments throughout the Payout period.
- 3.3 Voluntary or Involuntary Termination Other than for Cause .
- (a) If the Executive's employment with the Association is voluntarily or involuntarily terminated prior to the attainment of his Benefit Eligibility Date, for any reason other than for Cause, the Executive's death, disability, or following a Change in Control (as defined), the Executive for his Beneficiary) shall be entitled to his Accrued Benefit, if any, as set forth in the Executive's joinder Agreement. Such benefit, if any, shall commence on the Executive's Benefit Eligibility Date and shall be payable in monthly installments throughout the Payout Period. In the event the Executive dies at any time

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after commencement of payments hereunder, but prior to completion of all such payments due and owing hereunder, the Association shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If the Executive dies after his voluntary, or involuntary termination of employment occurring prior to his Benefit Eligibility Date and prior to the commencement of benefits hereunder; the Executive's Beneficiary shall be entitled to the Actuarial Equivalent of his Accrued Benefit, if any, which shall be calculated by the Benefits Determiner. The payment of such benefit, if any, shall commence within thirty (30) days of the Executive's death. The benefit shall be payable in monthly installments over the Payment Period.

3.4 Termination of Employment Related to a Change in Control

- (a) If the Executive's employment with the Association is voluntarily or involuntarily terminated prior to the attainment of his Benefit Eligibility Date, for any reason other than for Cause, the Executive's death, disability, or following a Change in Control (as defined), the Executive (or his Beneficiary) shall be entitled to his Accrued Benefit, if any, as set forth in the Executive's Joinder Agreement. Such benefit, if any, shall commence on the Executive's Benefit Eligibility Date and shall be payable in monthly installments throughout the Payout Period. In the event that the Executive dies at any time after commencement of the payments, but prior to completion of all such payments due and owing hereunder, the Association, or its successor, shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
- (b) If after such termination, the Executive dies prior to commencement of the benefits hereunder, the Executive's Beneficiary shall be entitled to the Survivor's Benefit which shall commence within thirty (30) days of the Executive's death. The Survivor's Benefit shall be payable in monthly installments over the Payout Period.

3.5 Termination for Cause. If the Executive is terminated for Cause, all benefits under the Executive's Joinder Agreement shall be forfeited and the Joinder Agreement shall become null and void.



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### 3.6 Disability Benefit.

- (a) Notwithstanding any other provision hereof, if requested by the Executive and approved by the Board of Directors, the Executive who has not attained his Benefit Eligibility Date shall be entitled to receive the Disability Benefit hereunder, in any case in which it is determined by a duly licensed physician selected by the Association, that the Executive is no longer able, properly and satisfactorily, to perform his regular duties as an Executive on a continuous or sustained basis due to ill health, accident, disability or general inability due to age. If the Executive's employment is terminated pursuant to this paragraph and Board of Director approval is obtained, the Executive may elect to begin receiving the Disability Benefit in lieu of any benefit available under Section 3.3, which is not available prior to the Executive's Benefit Eligibility Date. The Disability Benefit shall equal the Actuarial Equivalent of the Executive's Accrued Benefit, if any, which shall be calculated by the Benefits Determiner. The Disability Benefit, if any, as set forth in the Executive's Joinder Agreement, shall be payable in monthly installments over the Payout Period commencing within thirty (30) days following the later of (i) the above mentioned disability determination and (ii) the approval of the Disability Benefit by the Board of Directors. In the event the Executive dies while receiving payments pursuant to this Subsection, but prior to the completion of all payments due and owing hereunder, the Association shall pay to the Executive's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
- (b) If the Executive dies after approval of the Disability Benefit by the Board of Directors but before the commencement of such payments, the Executive's Beneficiary shall be entitled to the Actuarial Equivalent of the Executive's Accrued Benefit, which shall be calculated by the Benefits Determiner. Such benefit shall be payable to the Beneficiary in monthly installments over the Payout Period commencing within thirty (30) days of the Executive's death.

### 3.7 Non-Competition During and After Employment with the Association.

- (a) In consideration of the agreements of the Association contained herein and of the payments to be made by the Association pursuant hereto, the Executive hereby agrees that, so long as he remains in the employment of the Association, he will not actively engage, either directly or indirectly, in any business or other activity which is or may be

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deemed to be in any way competitive with or adverse to the best interest of the business of the Association unless the executive participation therein has been consented to in writing, by the Board of Directors.

- (b) The Executive expressly agrees that, as consideration for the covenants of the Association contained herein and as a condition to the performance by the Association of its obligations hereunder, from and after any voluntary or involuntary termination of employment, other than a termination of employment in connection with a Change in Control pursuant to Subsection 3.4, and continuing throughout the entire Payout Period, as provided herein, he will not, without the prior written consent of the Association, become associated with, in the capacity of an employee, Executive, officer, principal, agent, trustee or in any other capacity whatsoever, any enterprise conducted in the trading area of the business, of the Association which enterprise is, or may be deemed to be, competitive with any business carried on by the Association as of the date of the termination of the Executive's employment.
  - (c) In the event of a termination of the Executive's employment related to a Change in Control pursuant to Subsection 3.4, paragraph (b) of this Subsection 3.7 shall cease to be a condition to the performance by the Association of its obligations under this Plan.
- 3.8 Breach . In the event of any breach by the Executive of the agreements and covenants contained herein, the Board of Directors of the Association shall direct that any unpaid balance of any payments to the Executive under this Plan be suspended, and shall thereupon notify the Executive of such suspensions, in writing. Thereupon, if the Board of Directors of the Association shall determine that, said breach by the Executive has continued for a period of one (1) month following notification of such suspension, all rights of the Executive, and his Beneficiaries under this Plan, including rights to further payments hereunder, shall thereupon terminate.

#### **SECTION IV**

##### **BENEFICIARY DESIGNATION**

The Executive shall make an initial designation of primary and secondary Beneficiaries upon execution of his Joinder Agreement and shall have the right to change such designation, at any subsequent time, by submitting to the Administrator in substantially the form attached as Exhibit A to the Joinder Agreement, a written designation of primary and secondary Beneficiaries. Any Beneficiary designation

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made subsequent to execution of the Joinder Agreement shall become effective only when receipt thereof is acknowledged in writing by the Administrator.

## **SECTION V**

### **EXECUTIVE'S RIGHT TO ASSETS**

The rights of the Executive, any Beneficiary, or any other person claiming through the Executive under this Plan, shall be solely those of an unsecured general creditor of the Association. The Executive, the Beneficiary, or any other person claiming through the Executive, shall only have the right to receive from the Association those payments so specified under this Plan. The Executive agrees that he, his Beneficiary, or any other person claiming through him shall have no rights or interests whatsoever in any asset of the Association, including any insurance policies or contracts which the Association may possess or obtain to informally fund this Plan. Any asset used or acquired by the Association in connection with the liabilities it has assumed under this Plan, unless expressly provided herein, shall not be deemed to be held under any trust for the benefit of the Executive or his Beneficiaries, nor shall any asset be considered security for the performance of the obligations of the Association. Any such assets shall be and remain, a general, unpledged, and unrestricted asset of the Association.

## **SECTION VI**

### **RESTRICTIONS UPON FUNDING**

The Association shall have no obligation to set aside, earmark or entrust any fund or money with which to pay its obligations under this Plan. The Executive, his Beneficiaries, or any successor in interest to him shall be and remain simply a general unsecured creditor of the Association in the same manner as any other creditor having a general claim for matured and unpaid compensation. The Association reserves the absolute right in its sole discretion to either purchase assets to meet its obligations undertaken by this Plan or to refrain from the same and to determine the extent, nature, and method of such asset purchases. Should the Association decide to purchase assets such as life insurance, mutual funds, disability policies or annuities, the Association reserves the absolute right, in its sole discretion, to terminate such assets at any time, in whole or in part. At no time shall the Executive be deemed to have any lien, right, title or interest in or to any specific investment or to any assets of the Association. If the Association elects to invest in a life insurance, disability or annuity policy upon the life of the Executive, then the Executive shall assist the Association by freely submitting to a physical examination and by supplying such additional information necessary to obtain such insurance or annuities.

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## SECTION VII

### ALIENABILITY AND ASSIGNMENT PROHIBITION

Neither the Executive nor any Beneficiary under this Plan shall have any power or mortgage, to transfer, assign, anticipate, hypothecate, commute, modify or otherwise encumber in advance any of the benefits payable hereunder, nor shall any of said benefits be subject to seizure for the payments of any debts, judgments, alimony or separate maintenance owed by the Executive or his Beneficiary, nor be transferable by operation of law in the event of bankruptcy, insolvency or otherwise. In the event the Executive or any Beneficiary attempts assignment, communication, hypothecation, transfer or disposal of the benefits hereunder, the Association's liabilities shall forthwith cease and terminate.

## SECTION VIII

### ADMINISTRATION

- 8.1 Named Fiduciary and Administrator. The Association shall name a Committee of the Board of Directors as the Named Fiduciary and Administrator of this Plan. The Committee shall consist of not less than three persons. The Committee shall have the authority to make, amend, interpret and enforce all appropriate rules and regulations for the administration of this Plan, as may arise in connection with the Plan. A majority vote of the Committee members shall control any decision.
- 8.2 Agents. The Committee may, from time to time, employ other agents and delegate to them such administrative duties as it sees fit, and may from time to time consult with counsel who may be counsel to the Association.
- 8.3 Binding Effect of Decisions. The decision or action of the Committee in respect of any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
- 8.4 Indemnity of Committee. The Association shall indemnify and hold harmless the members of the Committee against any and all claims, loss, damage, expense or liability arising from any action or failure to act with respect to this Plan, except in the case of gross negligence or willful misconduct.

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## SECTION IX

### CLAIMS PROCEDURE AND ARBITRATION

- 9.1 Claims Procedure. In the event that benefits under this Plan are not paid to the Executive (or to his beneficiary in the case of the Executive's death) and such claimants feel they are entitled to receive such benefits, then a written claim must be made to the Committee within sixty (60) days from the date payments are refused. The Committee shall review the written claims and, if the claim is denied in whole or in part, it shall provide in writing, within ninety (90) days of receipt of such claim, its specific reasons for such denial, reference to the provisions of this Plan or the Joinder Agreement upon which the denial is based, and any additional material or information necessary to perfect the claim. Such writing by Committee shall further indicate the additional steps which must be undertaken by claimants if an additional review of the claim denial is desired.
- If claimants desire a second review, they shall notify the Committee in writing within sixty (60) days of the first claim denial. Claimants may review this Plan, the Joinder Agreement or any documents relating thereto and submit any issues and comments, in writing, they may feel appropriate. The Committee shall refer the claim to the Association's full Board of Directors. The Board of Directors of the Association shall then review the second claim and provide a written decision within sixty (60) days of receipt of such claim. The decision shall state the specific reasons for the decision and shall include reference to specific provisions of this Plan or the Joinder Agreement upon which the Association's decision is based.
- 9.2 Arbitration. If claimants continue to dispute the benefit denial based upon completed performance of this Plan and the Joinder Agreement or the meaning and effect of the terms and conditions thereof, then claimants may submit the dispute to mediation, administered by the American Arbitration Association ("AAA") (or a mediator selected by the parties) in accordance with the: AAA's Commercial Mediation Rules. If mediation is not successful in resolving the dispute, it shall be settled by arbitration administered by the AAA under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

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## SECTION X

### MISCELLANEOUS

- 10.1 No Effect on Executive's Rights . Nothing contained, herein will confer upon the Executive the right to be retained in the employment of the Association nor limit the right of the Association to deal with the Executive without regard to the existence of the Plan.
- 10.2 Statelaw . The Plan is established under, and will be construed according to, the laws of the State of New York, to the extent such laws are not preempted by the Act and valid regulations published thereunder.
- 10.3 Severability . In the event that any of the provisions of this Plan or portion thereof, are held to be inoperative or invalid by any court of competent jurisdiction, then: (1) insofar as is reasonable, effect will be given to the intent manifested in the provisions held invalid or inoperative, and (2) the validity and enforce ability of the remaining provisions will not be affected thereby.
- 10.4 Incapacity of Recipient . In the event the Executive is declared incompetent and a conservator or other person legally charged with the care of his person or Estate is appointed, any benefits under the Plan to which such Executive is entitled shall be paid to such conservator or other person legally charged with the care of his person or Estate.
- 10.5 Unclaimed Benefit . The Executive shall keep the Association informed of his current address and the current address of his Beneficiaries. The Association shall not be obligated to search for the whereabouts of any person. If the location of the Executive is not made known to the Association as of the date upon which any payment of any benefits may first be made, the Association shall delay payment of the Executive's benefit payment(s) until the location of the Executive is made known to the Association; however, the Association shall only be obligated to hold such benefit payments) for the Executive until the expiration of thirty-six (36) months. Upon expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Executive's Beneficiary. If the location of the Executive's Beneficiary is not made known to the Association by the end of an additional two (2) month period following expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Executive's Estate. If there is no Estate in existence at such time or if such, fact cannot be determined by the Association, the Executive and his Beneficiary(ies) shall thereupon forfeit any rights to the balance, if any, of any benefits provided for such Executive and/or Beneficiary under this Plan.

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- 10.6 Establishment of Rabbi Trust. The Association may establish a rabbi trust into which the Association may contribute assets, subject to the claims of the Association's creditors in the event of the Association's "Insolvency", until the contributed assets are paid to the Executives and their Beneficiaries in such manner and at such times as specified in this Plan. Such rabbi trust and any assets held therein shall conform to the terms of the rabbi trust agreement. To the extent the language in this Plan is modified by the language of a rabbi trust agreement, the rabbi trust agreement shall supersede this Plan. Any contributions to a rabbi trust shall be made during each Plan Year in accordance with the rabbi trust agreement.
- 10.7 Limitations on Liability. Notwithstanding any of the preceding provisions of the plan, no individual acting as an employee or agent of the Association, or as a member of the Board of Directors shall be personally liable to the Executive or any other person for any claim, loss, liability or expense incurred in connection with the Plan.
- 10.8 Gender. Whenever in this Plan words are used in the masculine or neuter gender, they shall be read and construed as in the masculine, feminine or neuter gender, whenever they should so apply.
- 10.9 Effect on Other Corporate Benefit Plans. Nothing contained in this Plan shall affect the right of the Executive to participate in or be covered by any other corporate benefit available to Executives of the Association constituting a part of the Association's existing or future compensation structure.
- 10.10 Suicide. Notwithstanding anything to the contrary in this Plan, the benefits otherwise provided herein shall not be payable and this Plan shall become null and void with respect to the Executive if the Executive's death results from suicide, whether sane or insane, within twenty-four (24) months after the execution of his Joinder Agreement.
- 10.11 Inurement. This Plan shall be binding upon and shall inure to the benefit of the Association, its successors and assigns, and the Executive, his successors, heirs, executors, administrators, and Beneficiaries.
- 10.12 Headings. Headings and sub-headings in this Plan are inserted for reference and convenience only and shall not be deemed a part of this Plan.

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## **SECTION XI**

### **AMENDMENT/REVOCATION**

- 11.1 Amendment. The Board of Directors may at any time amend the Plan in whole or in part, provided, however, that no amendment shall be effective to decrease or restrict any Participant's Accrued Benefit under the Plan, determined as of the date of Amendment. Any change in the Actuarial Equivalency factors shall not become effective until the first day of the calendar year which follows the adoption of the amendment and providing at least thirty (30) days' written notice of the amendment to the Participant. Notwithstanding the above, following a Change in Control, this Plan shall not be amended, modified or revoked at any time, in whole or part, as to any Executive, without the mutual written consent of the Executive and the Association, and such mutual consent shall be, required even if the Executive is no longer in the service of the Association.
- 11.2 Termination. The Board of Directors may within the first twelve (12) months after the Plan's Effective Date partially or completely terminate the Plan, if, as a result of changes in the tax laws, the tax, accounting, or other effects of the continuance of the Plan, or potential payments thereunder, would not be in the best interests of the Association.

## **SECTION XII**

### **EXECUTION**

- 12.1 This Plan and any and all properly executed Joinder Agreements set forth the entire understanding of the parties hereto with respect to the transactions contemplated hereby.
- 12.2 This Plan shall be executed in triplicate, each copy of which, when so executed and delivered, shall be an original, but all three copies shall together constitute one and the same instrument.



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IN WITNESS WHEREOF, the Association has caused this Plan to be executed on the day and date first above written.

ATTEST:

LAKE SHORE SAVINGS AND LOAN  
ASSOCIATION

\_\_\_\_\_  
/s/ B EVERLY J. M ULKIN  
Secretary

By: \_\_\_\_\_ /s/ D AVID C. M ANCUSO  
Title: President/ CEO

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**Exhibit 10.7**

DIRECTORS  
SUPPLEMENTAL BENEFIT PLAN  
LAKE SHORE SAVINGS AND LOAN ASSOCIATION

October 1, 1999

Financial Institution Consulting Corporation  
700 Colonial Road, Suite 260  
Memphis, Tennessee 38117  
WATS: 1-800-873-0089  
FAX: (901) 684-7411  
(901) 684-7400

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## DIRECTORS SUPPLEMENTAL BENEFIT PLAN

This Directors Supplemental Benefit Plan (the "Plan"), executed as of the - day of 1999, formalizes the understanding by and between LAKE SHORE SAVINGS AND LOAN ASSOCIATION (the "Association"), a mutual savings association, and its Directors, hereinafter referred to as "Director(s)", who shall be eligible to participate in this Plan by execution of a Directors Supplemental. Benefit Plan Joinder Agreement ("Joinder Agreement") in a form provided by the Association.

### WITNESSETH:

**WHEREAS** , the Directors serve the Association as members of the Board of Directors; and

**WHEREAS** , the Association desires to honor, reward and recognize the Directors who have provided long and faithful service to the Association and to ensure the continued service on the Board by such Directors until retirement age; and

**WHEREAS** , the Directors wish to be assured that they will be entitled to a certain amount of additional compensation for some definite period of time from and after retirement from active service with the Association or other termination of service and wish to provide their beneficiaries with benefits from and after death; and

**WHEREAS** , the Association and the Directors wish to provide the terms and conditions upon which the Association shall pay such additional compensation to the Directors after retirement or other termination of service and/or death benefits to their beneficiaries after death; and

**WHEREAS** , the Association and the Directors intend this Plan to be considered an unfunded arrangement, maintained primarily to provide supplemental retirement income for such Directors; and

**WHEREAS** , the Association has adopted this Directors Supplemental Benefit Plan which controls all issues relating to Supplemental Benefits as described herein;

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**NOW, THEREFORE,** in consideration of the premises and of the mutual promises herein contained, the Association and the Directors agree as follows:

## **SECTION I**

### **DEFINITIONS**

When used herein, the following words and phrases shall have the meanings below unless the context clearly indicates otherwise:

- 1.1 “Accrued Benefit” means with respect to any Plan Year, that portion of the Supplemental Benefit which is expensed and accrued as of the Valuation Date of such Plan Year under generally accepted accounting principles (GAAP) utilizing the benefits/years-of service method. The Accrued Benefit for each Plan Year shall be set forth in each Directors Joinder Agreement.
- 1.2 “Act” means the Employee Retirement Income Security Act of 1974, as amended from time to time.
- 1.3 “Administrator” means the Committee.
- 1.4 “Annuitized Value” means the value of the Participant’s Accrued Benefit increased by monthly compounding using the Interest factor and expressed as a stream of annual benefit payments.
- 1.5 “Association” means LAKE SHORE SAVINGS AND LOAN ASSOCIATION and any successor thereto.
- 1.6 “Beneficiary” means the person or persons (and their heirs) designated as Beneficiary in the Director’s Joinder Agreement to whom the deceased Director’s benefits are payable. If no Beneficiary is so designated, then the Director’s Spouse, if living, will, be deemed the Beneficiary. If the Director’s Spouse is not living, then the Children of the Director will be deemed the Beneficiaries and will take on a per stirpes basis. If there are no living Children, then the Estate of the Director will be deemed the Beneficiary.

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- 1.7 “Benefit Age” shall be the age at which the Director becomes eligible to receive the Supplemental Benefit under the Plan. Such age shall be designated in the Director’s Joinder Agreement.
- 1.8 “Benefit Eligibility Date” shall be the date on which a Director is entitled to receive his Supplemental Benefit. A Director’s “Benefit Eligibility Date” shall occur on the 1st day of the month coincident with or next following the month in which the Director attains his Benefit Age designated in the Joinder Agreement.
- 1.9 “Benefits Determiner” shall mean Financial Institutions Consulting Corporation, or its successors or assigns.
- 1.10 “Cause” means personal dishonesty, willful misconduct, willful malfeasance, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, regulation (other than traffic violations or similar offenses), or final cease-and-desist order, material breach of any provision of this Plan, or gross negligence in matters of material importance to the Association.
- 1.11 For these purposes, a “Change in Control” shall mean and include the following with respect to the Association:
- (i) a reorganization, merger, merger conversion, consolidation or sale of all or substantially all of the assets of the Association to another entity which is not controlled by the Association, or a similar transaction occurs in which the Association, is not the resulting entity; or
  - (ii) individuals who constitute the Board of Directors of the Association, on the date hereof (the “Incumbent Board”) cease for any reason to constitute at least a majority thereof, provided that any person becoming a Director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the Directors comprising the Incumbent Board, shall be, for purposes of this clause (ii) considered as though he were a member of the Incumbent Board.

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- 1.12 "Children" means the Director's children, or the issue of any deceased child, then living at the time payments are due the Children under this Plan. The term "Children" shall include both natural and adopted Children.
- 1.13 "Committee" means the Committee appointed by the Board of Directors to administer the Plan.
- 1.14 "Director" means a Director of the Association.
- 1.15 "Disability Benefit" means the monthly benefit payable to the Director following a determination, in accordance with Subsection 3.6, that he is no longer able, properly and satisfactorily, to perform his duties as Director.
- 1.16 "Effective Date" of the Directors Supplemental Benefit shall be October 1, 1999.
- 1.17 "Estate" means the estate of the Director.
- 1.18 "Interest Factor" means monthly compounding or discounting, as applicable, at seven percent (7%) per annum.
- 1.19 "Payout Period" means the time frame during which certain benefits payable hereunder shall be distributed. Payments shall be made in equal monthly installments commencing within thirty (30) days following the occurrence of the event which triggers distribution and continuing for One Hundred Eighty (180) consecutive months. For purposes of the Survivor's Benefits payable hereunder, the Payout Period shall be One Hundred Eighty (180) consecutive months.
- 1.20 "Plan Year" shall mean each October 1 to September 30, commencing October 1, 1999.
- 1.21 "Spouse" means the individual to whom the Director is legally married at the time of the Director's death.
- 1.22 "Supplemental Benefit" means an annual amount payable to the Director pursuant to the Plan. The Supplemental Benefit to which a Director will become entitled upon the

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satisfaction of the applicable conditions shall be equal to the amount set forth in the Director's Joinder Agreement.

- 1.23 "Survivor's Benefit" means an annual amount payable to the Beneficiary in monthly installments throughout the Payout Period, equal to the amount designated in the Director's Joinder Agreement and subject to Subsection 3.2.
- 1.24 "Valuation Date" shall mean the date during the Plan Year on which the Executive's Accrued Benefit is determined for the Plan Year. The Valuation Date shall be September 30' of each Plan Year, and any other date so determined by the Committee.

## **SECTION II**

### **ELIGIBILITY AND PARTICIPATION**

- 2.1 Eligibility - Eligibility to participate in the Plan shall be limited to those Directors of the Association who are not also employees of the Association.
- 2.2 Participation - A Directors participation in the Plan shall be effective upon completion of a Joinder Agreement by the Director and acceptance of the Joinder Agreement by the Committee. Participation in the Plan shall continue until such time as the Director terminates service with the Association, and as long thereafter as the Director is eligible to receive benefits under this Plan.

## **SECTION III**

### **BENEFITS**

- 3.1 Supplemental Benefit. If the Director is in the service of the Association until reaching his Benefit Age, the Director shall be entitled to the Supplemental Benefit. Such Supplemental Benefit shall commence on the 1st day of the month following the Director's attainment of his Benefit Age and shall be payable in monthly installments throughout the Payout Period. In the event a Director dies after commencement of the Supplemental Benefit payments but before completion of all such payments due and owing hereunder, the Association shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

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- 3.2 Death Prior to Benefit Age . If the Director dies prior to attaining his Benefit Age but while in the service of the Association, the Director's Beneficiary shall be entitled to the Survivor's Benefit. The Survivor's Benefit shall commence within thirty (30) days of the Director's death and shall be payable in monthly installments throughout the Payout Period.
- 3.3 Voluntary or Involuntary Termination Other Than for Cause .
- (a) If the Director's service with the Association is voluntarily or involuntarily terminated prior to the attainment of his Benefit Eligibility Date, for any reason other than for Cause, the Director's death, disability, or following a Change in Control (as defined), the Director (or his Beneficiary) shall be entitled to the Annuitized Value of his Accrued Benefit, as set forth in the Executive's Joinder Agreement. Such benefit shall commence on the Director's Benefit Eligibility Date and shall be payable in monthly installments throughout the Payout Period. In the event the Director dies at any time after commencement of payments hereunder, but prior to completion of all such payments due and owing hereunder, the Association shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
  - (b) If the Director dies after his voluntary or involuntary termination of service occurring prior to his Benefit Eligibility Date, and prior to the commencement of benefits hereunder, the Director's Beneficiary shall be entitled to the Annuitized Value of his Accrued Benefit, which shall be calculated by the Benefits Determiner. The payment of such benefit shall commence within thirty (30) days of the Director's death. The benefit shall be payable in monthly installments over the Payout Period.
- 3.4 Termination of Service Related to a Change in Control .
- (a) If the Director's service is terminated (either voluntarily or involuntarily) following or coincident with a Change in Control, the Director shall be entitled to his full Supplemental Benefit (as if he had remained in service until his Benefit

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Age). Such benefit shall commence on the 1st day of the month following his termination of service and shall be payable in monthly installments throughout the Payout Period. In the event that the Director dies at any time after commencement of the payments, but prior to completion of all such payments due and owing hereunder, the Association, or its successor, shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If, after such termination, the Director dies prior to commencement of the benefits hereunder, the Director's Beneficiary shall be entitled to the Survivor's Benefit which shall commence within thirty (30) days of the Director's death. The Survivor's Benefit shall be payable in monthly installments over the Payout Period.

3.5 Termination for Cause. If the Director is terminated for Cause, all benefits under the Director's Joinder Agreement shall be forfeited and the Joinder Agreement shall become null and void.

3.6 Disability Benefit.

- (a) Notwithstanding any other provision hereof, if requested by the Director and approved by the Board of Directors, the Director who has not attained his Benefit Eligibility Date shall be entitled to receive the Disability Benefit hereunder, in any case in which it is determined by a duly licensed physician selected by the Association, that the Director is no longer able, properly and satisfactorily, to perform his regular duties as a Director on a continuous or sustained basis due to ill health, accident, disability or general inability due to age. If the Director's service is terminated pursuant to this paragraph and Board of Director approval is obtained, the Director may elect to begin receiving the Disability Benefit in lieu of any benefit available under Section 3.3, which is not available prior to the Director's Benefit Eligibility Date. The Disability Benefit shall equal the Annuitized Value of the Director's Accrued Benefit which shall be calculated by the Benefits Determiner. The Disability Benefit shall be payable in monthly installments over



the Payout Period commencing within thirty (30) days following the later of (i) the above mentioned disability determination and (ii) the approval of the Disability Benefit by the Board of Directors. In the event the Director dies while receiving payments pursuant to this Subsection, but prior to the completion of all payments due and owing hereunder, the Association shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If the Director dies after approval of the Disability Benefit by the Board of Directors but before the commencement of such payments, the Director's Beneficiary shall be entitled to the Annuitized Value of the Director's Accrued Benefit which shall be calculated by the Benefits Determiner. Such benefit shall be payable to the Beneficiary in monthly installments over the Payout Period commencing within thirty (30) days of the Director's death.

3.7 Non-Competition During and After Service on the Board.

- (a) In consideration of the agreements of the Association contained herein and of the payments to be made by the Association pursuant hereto, the Director hereby agrees that, so long as he remains in the service of the Association, he will not actively engage, either directly or indirectly, in any business or other activity which is or maybe deemed to be in any way competitive with or adverse to the best interests of the business of the Association unless the Directors participation therein has been consented to, in writing, by the Board of Directors.
- (b) The Director expressly agrees that, as consideration for the covenants of the Association contained herein and as a condition to the performance by the Association of its obligations hereunder, from and after any voluntary or involuntary termination of service, other than a termination of service in connection with a Change in Control pursuant to Subsection 3.4, and continuing throughout the entire Payout Period, as provided herein, he will not, without the prior written consent of the Association, become associated with, in the capacity of an employee, director, or officer, any bank holding company, bank, savings association or mortgage company with offices in Chautauqua County, New York,

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and/or any other counties in which the Association has offices, and which offers products and services competing with those offered by the Association.

- (c) In the event of a termination of the Director's service related to a Change in Control pursuant to Subsection 3.4, paragraph (b) of this Subsection 3.7 shall cease to be a condition to the performance by the Association of its obligations under this Plan.

3.8 Breach. In the event of any breach by the Director of the agreements and covenants contained herein, the Board of Directors of the Association shall direct that any unpaid balance of any payments to the Director under this Plan be suspended, and shall thereupon notify the Director of such suspensions, in writing. Thereupon, if the Board of Directors of the Association shall determine that said breach by the Director has continued for a period of one (1) month following notification of such suspension, all rights of the Director and his Beneficiaries under this Plan, including rights to further payments hereunder, shall thereupon terminate.

3.9 Additional Death Benefit - Burial Expense. In addition to the above-described benefits, upon the Participant's death, the Participant's Beneficiary shall be entitled to receive a one-time lump sum death benefit in the amount of Ten Thousand (\$10,000.00) Dollars. This benefit shall be provided specifically for the purpose of providing payment for burial and/or funeral expenses of the Participant. Such death benefit shall be payable within thirty (30) days of the Participant's death. The Participant's Beneficiary shall not be entitled to such benefit under this Plan (i) if the Participant is terminated for Cause prior to death or (ii) the Participant's Beneficiary receives a supplemental \$10,000 death benefit under any other non-qualified deferred compensation plan sponsored by the Association.

## **SECTION IV**

### **BENEFICIARY DESIGNATION**

The Director shall make an initial designation of primary and secondary Beneficiaries upon execution of his Joinder Agreement and shall have the right to change such designation, at

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any subsequent time, by submitting to the Administrator in substantially the form attached as Exhibit A to the Joinder Agreement, a written designation of primary and secondary Beneficiaries. Any Beneficiary designation made subsequent to execution of the Joinder Agreement shall become effective only when receipt thereof is acknowledged in writing by the Administrator.

## **SECTION V**

### **DIRECTOR'S RIGHT TO ASSETS**

The rights of the Director, any Beneficiary, or any other person claiming through the Director under this Plan, shall be solely those of an unsecured general creditor of the Association. The Director, the Beneficiary, or any other person claiming through the Director, shall only have the right to receive from the Association those payments so specified under this Plan. The Director agrees that he, his Beneficiary, or any other person claiming through him shall have no rights or interests whatsoever in any asset of the Association, including any insurance policies or contracts which the Association may possess or obtain to informally fund this Plan. Any asset used or acquired by the Association in connection with the liabilities it has assumed under this Plan, unless expressly provided herein, shall not be deemed to be held under any trust for the benefit of the Director or his Beneficiaries, nor shall any asset be considered security for the performance of the obligations of the Association. Any such asset shall be and remain, a general, unpledged, and unrestricted asset of the Association.

## **SECTION VI**

### **RESTRICTIONS UPON FUNDING**

The Association shall have no obligation to set aside, earmark or entrust any fund or money with which to pay its obligations under this Plan. The Director, his Beneficiaries or any successor in interest to hire shall be and remain simply a general unsecured creditor of the Association in the same manner as any other creditor having a general claim for matured and unpaid compensation. The Association reserves the absolute right in its sole discretion to either purchase assets to meet its obligations undertaken by this plan or to refrain from the same and to determine the extent, nature, and method of such asset purchases. Should the Association decide to purchase assets such as life insurance, mutual funds, disability policies or annuities, the

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Association reserve's the absolute right, in its sole discretion, to terminate such, assets at any time, in whole or in part. At no time shall the Director be deemed to have any lien, right, title or interest in or to any specific investment or to any assets of the Association. If the Association elects to invest in a life insurance, disability or annuity policy upon the life of the Director, then the Director shall assist the Association by freely submitting to a physical examination and by supplying such additional information necessary to obtain such insurance or annuities.

## **SECTION VII**

### **ALIENABILITY AND ASSIGNMENT PROHIBITION**

Neither the Director nor any Beneficiary under this Plan shall have any power or right to transfer, assign, anticipate, hypothecate, mortgage, commute, modify or otherwise encumber in advance any of the benefits payable hereunder, nor shall any of said benefits be subject to seizure for the payment of any debts, judgments, alimony or separate maintenance owed by the Director or his Beneficiary, nor be transferable by operation of law in the event of bankruptcy, insolvency or otherwise. In the event the Director or any Beneficiary attempts assignment, communication, hypothecation, transfer or disposal of the benefits hereunder, the Association's liabilities shall forthwith cease and terminate.

## **SECTION VIII**

### **ADMINISTRATION**

- 8.1 Named Fiduciary and Administrator . The Association shall name a Committee of the Board of Directors as the Named Fiduciary and Administrator of this Plan. The Committee shall consist of not less than three persons. The Committee shall have the authority to make, amend, interpret and enforce all appropriate rules and regulations for the administration of this Plan, as may arise in connection with the Plan. A majority vote of the Committee members shall control any decision.
- 8.2 Agents . The Committee may, from time to time, employ other agents and delegate to them such administrative duties as it sees fit, and may from time to time consult with counsel who may be counsel to the Association.

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- 8.3 Binding Effect of Decisions . The decision or action of the Committee in respect of any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
- 8.4 Indemnity of Committee . The Association shall indemnify and hold harmless the members of the Committee against any and all claims, loss, damage, expense or liability arising from any action or failure to act with respect to this Plan, except in the case of gross negligence or willful misconduct.

## **SECTION IX**

### **CLAIMS PROCEDURE AND ARBITRATION**

- 9.1 Claims Procedure . In the event that benefits under this Plan are not paid to the Director (or to his Beneficiary in the case of the Director's death) and such claimants feel they are entitled to receive such benefits, then a written claim must be made to the Committee within sixty (60) days from the date payments are refused. The Committee shall review the written claim and, if the claim is denied, in whole or in part, it shall provide in writing, within ninety (90) days of receipt of such claim, its specific reasons for such denial, reference to the provisions of this Plan or the Joinder Agreement upon which the denial is based, and any additional material or information necessary to perfect the claim. Such writing by the Committee shall further indicate the additional steps which must be undertaken by claimants if an additional review of the claim denial is desired.

If claimants desire a second review, they shall notify the Committee in writing within sixty (60) days of the first claim denial. Claimants may review this plan, the Joinder Agreement or any documents relating thereto and submit any issues and comments, in writing, they may feel appropriate. The Committee shall refer the claim to the Association's full Board of Directors. The Board of Directors of the Association shall then review the second claim and provide a written decision within sixty (60) days of receipt of such claim. The decision shall state the specific reasons for the decision and shall include reference to specific provisions of this Plan or the Joinder Agreement upon which the Association's decision is based.

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- 9.2 Arbitration. If claimants continue to dispute the benefit denial based upon completed performance of this Plan and the Joinder Agreement or the meaning and effect of the terms and conditions thereof, then claimants may submit the dispute to mediation, administered by the American Arbitration Association (“AAA”) (or a mediator selected by the parties) in accordance with the AAA’s Commercial Mediation Rules. If mediation is not successful in resolving the dispute, it shall be settled by arbitration administered by the AAA under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

## **SECTION X**

### **MISCELLANEOUS**

- 10.1 No Effect on Director’s Rights. Nothing contained herein will confer upon the Director the right to be retained in the service of the Association nor limit the right of the Association to deal with the Director without regard to the existence of the Plan.
- 10.2 State Law. The Plan is established under, and will be construed according to, the laws of the State of New York, to the extent such laws are not preempted by the Act and valid regulations published thereunder.
- 10.3 Severability. In the event that any of the provisions of this Plan or portion thereof, are held to be inoperative or invalid by any court of competent jurisdiction, then: (1) insofar as is reasonable, effect will be given to the intent manifested in the provisions held invalid or inoperative, and (2) the validity and enforce ability of the remaining provisions will not be affected thereby.
- 10.4 Incapacity of Recipient. In the event the Director is declared incompetent and a conservator or other person legally charged with the care of his person or Estate is appointed, any benefits under the Plan to which such Director is entitled shall be paid to such conservator or other person legally charged with the care of his person or Estate.
- 10.5 Unclaimed Benefit. The Director shall keep the Association informed of his current address and the current address of his Beneficiaries. The Association shall not be obligated to search for the whereabouts of any person. If the location of the Director is

not made known. to the Association as of the date upon which any payment of any benefits may first be made, the Association shall delay payment of the Director's benefit payment(s) until the location of the Director is made known to the Association; however, the Association shall only be obligated to hold such benefit payment(s) for the Director until the expiration of thirty-six (36) months. Upon expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Director's Beneficiary. If the location of the Director's Beneficiary is not made known to the Association by the end of an additional two (2) month period following expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Director's Estate. If there is no Estate in existence at such time or if such fact cannot be determined by the Association, the Director and his Beneficiary(ies) shall thereupon forfeit any rights to the balance, if any, of any benefits provided for such Director and/or Beneficiary under this Plan.

- 10.6 Establishment of Rabbi Trust . The Association intends to establish a rabbi trust into which the Association intends to contribute assets which shall be held therein, subject to the claims of the Association's creditors in the event of the Association's "Insolvency" as defined in the rabbi trust, until the contributed assets are paid to the, Directors and their Beneficiaries in such manner and at such times as specified in this Plan. It is the intention of the Association to make contributions to the rabbi trust to provide the Association with a source of funds to assist it in meeting the liabilities of this Plan. The rabbi trust and any assets held therein shall conform to the terms of the rabbi trust agreement which has been established in conjunction with this Plan. To the extent the language in this Plan is modified by the language in the rabbi trust agreement, the rabbi trust agreement shall supersede this Plan. Any contributions to the rabbi trust shall be made during each Plan Year in accordance with the rabbi trust agreement. The amount of such contributions shall be equal to the Director's Accrued Benefit, if any, less: (i) previous contributions made on behalf of the Director to the rabbi trust, and (ii) earnings to date on all such previous contributions.
- 10.7 Limitations on Liability . Notwithstanding any of the preceding provisions of the Plan, no individual acting as an employee or agent of the Association, or as a member of the

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Board of Directors shall be personally liable to the Director or any other person for any claim, loss, liability or expense incurred in connection with the Plan.

- 10.8 Gender. Whenever in this Plan words are used in the masculine or neuter gender, they shall be read and construed as in the masculine, feminine or neuter gender, whenever they should so apply.
- 10.9 Effect on Other Corporate Benefit Plans. Nothing contained in this Plan shall affect the right of the Director to participate in or be covered by any other corporate benefit available to Directors of the Association constituting a part of the Association's existing or future compensation structure.
- 10.10 Suicide. Notwithstanding anything to the contrary in this Plan, the benefits otherwise provided herein shall not be payable and this Plan, shall become null and void with respect to the Director if the Director's death results from suicide, whether sane or insane, within twenty-four (24) months after the execution of his Joinder Agreement.
- 10.11 Increment. This Plan shall be binding upon and shall inure to the benefit of the Association, its successors and assigns, and the Director, his successors, heirs, executors, administrators, and Beneficiaries.
- 10.12 Headings. Headings and sub-headings in this Plan are inserted for reference and convenience only and shall not be deemed a part of this Plan.

## **SECTION XI**

### **AMENDMENT/REVOCATION**

- 11.1 Amendment. The Board of Directors may at any time amend the Plan in whole or in part, provided, however, that no amendment shall be effective to decrease or restrict any Participant's Accrued Benefit under the Plan, determined as of the date of the Amendment. Any change in the Interest Factor shall not become effective until the first day of the calendar year which follows the adoption of the amendment and providing at least thirty (30) days' written notice of the amendment to the Participant. Notwithstanding the above, following a Change in Control, this Plan shall not be



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amended, modified or revoked at any time, in whole or part, as to any Executive, without the mutual written consent of the Executive and the Association, and such mutual consent shall be required even if the Executive is no longer in the service of the Association.

- 11.2 Termination . The Board of Directors may within the first twelve (12) months after the Plan's Effective Date partially or completely terminate the Plan, if, as a result of changes in the tax laws, the tax, accounting, or other effects of the continuance of the Plan, or potential payments thereunder, would not be in the best interests of the Association.

## **SECTION XII**

### **EXECUTION**

- 12.1 This Plan sets forth the entire understanding of the parties hereto with respect to the transactions contemplated hereby, and any previous agreements or understandings between the parties hereto regarding the subject matter hereof are merged into and superseded by this Plan.
- 12.2 This Plan shall be executed in triplicate, each copy of which, when so executed and delivered, shall be an original, but all three copies shall together constitute one and the same instrument.

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IN WITNESS WHEREOF, the Association has caused this Plan to be executed on the day and date first above written.

ATTEST:

LAKE SHORE SAVINGS AND LOAN  
ASSOCIATION

\_\_\_\_\_  
/s/ B EVERLY J. M ULKIN  
Secretary

By: \_\_\_\_\_ /s/ D AVID C. M ANCUSO

Title: President/ CEO

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**Exhibit 10.8**

DIRECTORS  
SUPPLEMENTAL BENEFIT PLAN  
LAKE SHORE SAVINGS AND LOAN ASSOCIATION  
OCTOBER 1, 2001

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## **DIRECTORS SUPPLEMENTAL BENEFIT PLAN**

This Directors Supplemental Benefit Plan (the “Plan”), executed as of the 1<sup>st</sup> day of October, 2001, formalizes the understanding by and between LAKE SHORE SAVINGS AND LOAN ASSOCIATION (the “Association”), a mutual savings association, and its Directors, hereinafter referred to as “Director(s)”, who shall be eligible to participate in this Plan by execution of a Directors Supplemental Benefit Plan Joinder Agreement (“Joinder Agreement”) in a form provided by the Association.

### **WITNESSETH:**

**WHEREAS** , the Directors serve the Association as members of the Board of Directors; and

**WHEREAS** , the Association desires to honor, reward and recognize the Directors who have provided long and faithful service to the Association and to ensure the continued service on the Board by such Directors until retirement age; and

**WHEREAS** , the Directors wish to be assured that they will be entitled to a certain amount of additional compensation for some definite period of time from and after retirement from active service with the Association or other termination of service and wish to provide their beneficiaries with benefits from and after death; and

**WHEREAS** , the Association and the Directors wish to provide the terms and conditions upon which the Association shall pay such additional compensation to the Directors after retirement or other termination of service and/or death benefits to their beneficiaries after death; and

**WHEREAS** , the Association and the Directors intend this Plan to be considered an unfunded arrangement, maintained primarily to provide supplemental retirement income from such Directors; and

**WHEREAS** , the Association has adopted this Directors Supplemental Benefit Plan which controls all issues relating to Supplemental Benefits as described herein;

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**NOW, THEREFORE**, in consideration of the premises and of the mutual promises herein contained, the Association and the Directors agree as follows:

## **SECTION I**

### **DEFINITIONS**

When used herein, the following words and phrases shall have the meanings below unless the context clearly indicates otherwise.

- 1.1 “Accrued Benefit” means, with respect to any Plan Year, that portion of the Supplemental Benefit which is expensed and accrued as of the Valuation Date of such Plan Year under generally accepted accounting principles (GAAP), utilizing the benefits/years of service method. The Accrued Benefit for each Plan Year shall be set forth in each Director’s Joinder Agreement.
- 1.2 “Act” means the Employee Retirement Income Security Act of 1974, as amended from time to time.
- 1.3 “Actuarial Equivalent” or “Actuarial Equivalency” means the Accrued Benefit payable at the Director’s Benefits Age which differs in time of payment from the specific benefit provided under the Director’s Joinder Agreement but having the same value when computed using pre-retirement and post-retirement interest of 5.75%.
- 1.4 “Administrator” means the Committee.
- 1.5 “Association” means LAKE SHORE SAVINGS AND LOAN ASSOCIATION and any successor thereto.
- 1.6 “Beneficiary” means the person or persons (and their heirs) designated as Beneficiary in the Director’s Joinder Agreement to whom the deceased Director’s benefits are payable. If no Beneficiary is so designated, then the Director’s Spouse, if living, will be deemed the Beneficiary. If the Director’s Spouse is not living, then the Children of the Director will be deemed the Beneficiaries and will take on a per stirpes basis. If there are no living Children, then the Estate of the Director will be deemed the Beneficiary.

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- 1.7 “Benefit Age” shall be the age at which the Director becomes eligible to receive the Supplemental Benefit under the Plan. Such age shall be designated in the Director’s Joinder Agreement.
- 1.8 “Benefit Eligibility Date” shall be the date on which a Director is entitled to receive his Supplemental Benefit. A Director’s “Benefit Eligibility Date” shall occur on the 1<sup>st</sup> day of the month coincident with or next following the month in which the Director attains his Benefit Age designated in the Joinder Agreement.
- 1.9 “Benefits Determiner” shall mean a third party administrator or agent designated by the Committee.
- 1.10 “Cause” means personal dishonesty, willful misconduct, willful malfeasance, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, regulation (other than traffic violations or similar offenses), or final cease-and-desist order material breach of any provision of this Plan, or gross negligence in matters of material importance to the Association.
- 1.11 For these purposes, a “Change in Control” shall mean and include the following with respect to the Association:
- (i) a reorganization, merger, merger conversion, consolidation or sale of all or substantially all of the assets of the Association to another entity which is not controlled by the Association, or a similar transaction occurs in which the Association, is not the resulting entity; or
  - (ii) individuals who constitute the Board of Directors of the Association, on the date hereof (the “Incumbent Board”) cease for any reason to constitute at least a majority thereof, provided that any person becoming a Director subsequent to the date hereof whose election was approved by a vote of at least three-quarters of the Directors comprising the Incumbent Board, shall be, for purposes of this clause (ii) considered as though he were a member of the Incumbent Board.

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- 1.12 "Children" means the Director's children, or the issue of any deceased child, then living at the time payments are due the Children under this Plan. The term "Children" shall include both natural and adopted Children.
- 1.13 "Committee" means the Committee appointed by the Board of Directors to administer the Plan.
- 1.14 "Director" means a Director of the Association.
- 1.15 "Disability Benefit" means the monthly benefit payable to the Director following a determination, in accordance with Subsection 3.6, that he is no longer able, properly and satisfactorily, to perform his duties as Director.
- 1.16 "Effective Date" of the Directors Supplemental Benefit Plan shall be October 1, 2001.
- 1.17 "Estate" means the estate of the Director.
- 1.18 "Payout Period" means the time frame during which certain benefits payable hereunder shall be distributed. Payments shall be made in equal monthly installments commencing within thirty (30) days following the occurrence of the event which triggers distribution and continuing for One Hundred Eighty (180) consecutive months. For purposes of the Survivor's Benefits payable hereunder, the Payout Period shall be One Hundred Eighty (180) consecutive months.
- 1.19 "Plan Year" shall mean each October 1 to September 30, commencing on October 1, 2001.
- 1.20 "Spouse" means the individual to whom the Director is legally married at the time of the Director's death.
- 1.21 "Supplemental Benefit" means an annual amount payable to the Director pursuant to the Plan. The Supplemental Benefit to which an Director will become entitled upon the satisfaction of the applicable conditions shall be equal to the amount set forth in the Director's Joinder Agreement.

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- 1.22 “Survivor’s Benefit” means an annual amount payable to the Beneficiary in monthly installments throughout the Payout Period, equal to the amount designated in the Director’s Joinder Agreement and subject to Subsection 3.4.
- 1.23 “Valuation Date” shall mean the date during the Plan Year on which the Director’s Accrued Benefit is determined for the Plan Year. The Valuation Date shall be September 30<sup>th</sup> of each Plan Year, and any other date so determined by the Committee.

## **SECTION II**

### **ELIGIBILITY AND PARTICIPATION**

- 2.1 Eligibility. Eligibility to participate in the Plan shall be limited to those Directors of the Association who are not also employees of the Association.
- 2.2 Participation. A Director’s participation in the Plan shall be effective upon completion of a Joinder Agreement by the Director and acceptance of the Joinder Agreement by the Committee. Participation in the Plan shall continue until such time as the Director terminates service with the Association, and as long thereafter as the Director is eligible to receive benefits under this Plan.

## **SECTION III**

### **BENEFITS**

- 3.1 Supplemental Benefit. If the Director is in the service of the Association until reaching his Benefit Age, the Director shall be entitled to the Supplement Benefit. Such Supplemental Benefit shall commence on the 1<sup>st</sup> day of the month following the Director’s attainment of his Benefit Age and shall be payable in monthly installments throughout the Payout Period. In the event a Director dies after commencement of the Supplemental Benefit payments but before completion of all such payments due and owing hereunder, the Association shall pay to the Director’s Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
- 3.2 Death Prior to Benefit Age. If the Director dies prior to attaining his Benefit Age but while employed by the Association, the Director’s Beneficiary shall be entitled to the

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Actuarial Equivalent of the Director's Accrued Benefit. Such death benefit shall commence within thirty (30) days of the Director's death and shall be payable in monthly installments throughout the Payout Period.

3.3 Voluntary or Involuntary Termination Other Than for Cause .

- (a) If the Director's service with the Association is voluntarily or involuntarily terminated prior to the attainment of his Benefit Eligibility Date, for any reason other than for Cause, the Director's death, disability, or following a Change in Control (as defined), the Director (or his Beneficiary) shall be entitled to his Accrued Benefit, as set forth in the Director's Joinder Agreement. Such benefit shall commence on the Director's Benefit Eligibility Date and shall be payable in monthly installments throughout the Payout Period. In the event the Director dies at any time after commencement of payments hereunder, but prior to completion of all such payments due and owing hereunder, the Association shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.
- (b) If the Director dies after his voluntary or involuntary termination of service occurring prior to his Benefit Eligibility Date, and prior to the commencement of benefits hereunder, but prior to completion of all such payments due and owing hereunder, the Association shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

3.4 Termination of Service Related to a Change in Control .

- (a) If the Director's employment is terminated (either voluntarily or involuntarily) following or coincident with a Change in Control, the Director shall be entitled to his full Supplemental Benefit (as if he had remained in service until his Benefit Age). Such benefit shall commence on the 1<sup>st</sup> day of the month following his termination of service and shall be payable in monthly installments throughout the Payout Period. In the event that the Director dies at any time after commencement of the payments, but prior to completion of all such payments due



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and owing hereunder, the Association, or its successor, shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If, after such termination, the Director dies prior to commencement of the benefits hereunder, the Director's Beneficiary shall be entitled to the Survivor's Benefit which shall commence within thirty (30) days of the Director's death. The Survivor's Benefit shall be payable in monthly installments over the Payout Period.

3.5 Termination for Cause . If the Director is terminated for Cause, all benefits under the Director's Joinder Agreement shall be forfeited and the Joinder Agreement shall become null and void.

3.6 Disability Benefit .

- (a) Notwithstanding any other provision hereof, if requested by the Director and approved by the Board of Directors, the Director who has not attained his Benefit Eligibility Date shall be entitled to receive the Disability Benefit hereunder, in any case in which it is determined by a duly licensed physician selected by the Association, that the Director is no longer able, properly and satisfactorily, to perform his regular duties as a Director on a continuous or sustained basis due to ill health, accident, disability or general inability due to age. If the Director's service is terminated pursuant to this paragraph and Board of Director approval is obtained, the Director may elect to begin receiving the Disability Benefit in lieu of any benefit available under Section 3.3, which is not available prior to the Director's Benefit Eligibility Date. The Disability Benefit shall equal the Actuarial Equivalent of the Director's Accrued Benefit, which shall be calculated by the Benefits Determiner. The Disability Benefit shall be payable in monthly installments over the Payout Period commencing within thirty (30) days following the later of (i) the above mentioned disability determination and (ii) the approval of the Disability Benefit by the Board of Directors. In the event the Director dies while receiving payments pursuant to this Subsection, but prior to the completion

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of all payments due and owing hereunder, the Association shall pay to the Director's Beneficiary a continuation of the monthly installments for the remainder of the Payout Period.

- (b) If the Director dies after approval of the Disability Benefit by the Board of Directors but before the commencement of such payments, the Director's Beneficiary shall be entitled to the Actuarial Equivalent of the Director's Accrued Benefit, which shall be calculated by the Benefits Determiner. Such benefit shall be payable to the Beneficiary in monthly installments over the Payout Period commencing within thirty (30) days of the Director's death.

3.7 Non-Competition During and After Service on the Board .

- (a) In consideration of the agreements of the Association contained herein and of the payments to be made by the Association pursuant hereto, the Director hereby agrees that, so long as he remains in the service of the Association, he will not actively engage, either directly or indirectly, in any business or other activity which is or may be deemed to be in any way competitive with or adverse to the best interests of the business of the Association unless the Directors participation therein has been consented to, in writing, by the Board of Directors.
- (b) The Director expressly agrees that, as consideration for the covenants of the Association contained herein and as a condition to the performance by the Association of its obligations hereunder, from and after any voluntary or involuntary termination of service, other than a termination of service in connection with a Change in Control pursuant to Subsection 3.4 and continuing throughout the entire Payout Period, as provided herein, he will not, without the prior written consent of the Association, become associated with, in the capacity of an employee, director, or officer, any bank holding company, bank, savings association or mortgage company with offices in Chautauqua County, New York, and/or any other counties in which the Association has offices, and which offers products and services competing with those offered by the Association.

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- (c) In the event of a termination of the Director's service related to a Change in Control pursuant to Subsection 3.4, paragraph (b) of this Subsection 3.7 shall cease to be a condition to the performance by the Association of its obligations under this Plan.
- 3.8 Breach . In the event of any breach by the Director of the agreements and covenants contained herein, the Board of Directors of the Association shall direct that any unpaid balance of any payments to the Director under this Plan be suspended, and shall thereupon notify the Director of such suspensions, in writing. Thereupon, if the Board of Directors of the Association shall determine that said breach by the Director has continued for a period of one (1) month following notification of such suspension, all rights of the Director and his Beneficiaries under this Plan, including rights to further payments hereunder, shall thereupon terminate.

#### **SECTION IV**

##### **BENEFICIARY DESIGNATION**

The Director shall make an initial designation of primary and secondary Beneficiaries upon execution of his Joinder Agreement and shall have the right to change such designation, at any subsequent time, by submitting to the Administrator in substantially the form attached as Exhibit A to the Joinder Agreement, a written designation of primary and secondary Beneficiaries. Any Beneficiary designation made subsequent to execution of the Joinder Agreement shall become effective only when receipt thereof is acknowledged in writing by the Administrator.

#### **SECTION V**

##### **DIRECTOR'S RIGHT TO ASSETS**

The rights of the Director, any Beneficiary, or any other person claiming through the Director under this Plan, shall be solely those of an unsecured general creditor of the Association. The Director, the Beneficiary, or any other person claiming through the Director, shall only have the right to receive from the Association those payments so specified under this Plan. The Director agrees that he, his Beneficiary, or any other person claiming through him

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shall have no rights or interests whatsoever in any asset of the Association including any insurance policies or contracts which the Association may possess or obtain to informally fund this Plan. Any asset used or acquired by the Association in connection with the liabilities it has assumed under this Plan, unless expressly provided herein, shall not be deemed to be held under any trust for the benefit of the Director or his Beneficiaries, nor shall any asset be considered security for the performance of the obligations of the Association. Any such assets shall be and remain, a general, unpledged, and unrestricted asset of the Association.

## **SECTION VI**

### **RESTRICTIONS UPON FUNDING**

The Association shall have no obligation to set aside, earmark or entrust any fund or money with which to pay its obligations under this Plan. The Director, his Beneficiaries, or any successor in interest to him shall be and remain simply a general unsecured creditor of the Association in the same manner as any other creditor having a general claims for matured and unpaid compensation. The Association reserves the absolute right in its sole discretion to either purchase assets to meet its obligations undertaken by this plan or to refrain from the same and to determine the extent, nature, and method of such asset purchases. Should the Association decide to purchase assets such as life insurance, mutual funds, disability policies or annuities, the Association reserves the absolute right in its sole discretion, to terminate such assets at any time, in whole or in part. At no time shall the Director be deemed to have any lien, right, title or interest in or to any specific investment or to any assets of the Association. If the Association elects to invest in a life insurance, disability or annuity policy upon the life of the Director, then the Director shall assist the Association by freely submitting to a physical examination and by supplying such additional information necessary to obtain such insurance or annuities.

## **SECTION VII**

### **ALIENABILITY AND ASSIGNMENT PROHIBITION**

Neither the Director nor any Beneficiary under this Plan shall have any power or right to transfer, assign, anticipate, hypothecate, mortgage, commute, modify or otherwise encumber in advance any of the benefits payable hereunder, nor shall any of said benefits be subject to seizure for the payments of any debts, judgments, alimony or separate maintenance owed by the Director

or his Beneficiary, nor be transferable by operation of law in the event of bankruptcy, insolvency or otherwise. In the event the Director or any Beneficiary attempts assignment, communication, hypothecation, transfer or disposal of the benefits hereunder, the Association's liabilities shall forthwith cease and terminate.

## **SECTION VIII**

### **ADMINISTRATION**

- 8.1 Named Fiduciary and Administrator . The Association shall name a Committee of the Board of Directors as the Named Fiduciary and Administrator of this Plan. The Committee shall consist of not less than three persons. The Committee shall have the authority to make, amend, interpret and enforce all appropriate rules and regulations for the administration of this Plan, as may arise in connection with the Plan. A majority vote of the Committee members shall control any decision.
- 8.2 Agents . The Committee may, from time to time, employ other agents and delegate to them such administrative as it sees fit and may from time to time consult with counsel who may be counsel to the Association.
- 8.3 Binding Effect of Decisions . The decision or action of the Committee in respect of any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
- 8.4 Indemnity of Committee . The Association shall indemnify and hold harmless the members of the Committee against any and all claims, loss, damage, expense or liability arising from any action or failure to act with respect to this Plan, except in the case of gross negligence or willful misconduct.

## **SECTION IX**

### **CLAIMS PROCEDURE AND ARBITRATION**

- 9.1 Claims Procedure . In the event that benefits under this Plan are not paid to the Director (or to his beneficiary in the case of the Director's death) and such claimants feel they are

entitled to receive such benefits, then a written claim must be made to the Committee within sixty (60) days from the date payments are refused. The Committee shall review the written claim and, if the claim is denied, in whole or in part, it shall provide in writing, within ninety (90) days of receipt of such claim, its specific reasons for such denial is based, reference to the provisions of this Plan or the Joinder Agreement upon which the denial is based, and any additional material or information necessary to perfect the claim. Such writing by Committee shall further indicate the additional steps which must be undertaken by claimants if an additional review of the claim denial is desired.

If claimants desire a second review, they shall notify the Committee in writing within sixty (60) days of the first claim denial. Claimants may review this Plan, the Joinder Agreement or any documents relating thereto and submit any issues and comments, in writing, they may feel appropriate. The Committee shall refer the claim to the Association's full Board of Directors. The Board of Directors of the Association shall then review the second claim and provide a written decision within sixty (60) days of receipt of such claim. The decision shall state the specific reasons for the decision and shall include reference to specific provisions of this Plan or the Joinder Agreement upon which the Association's decision is based.

- 9.2 Arbitration . If claimants continue to dispute the benefit denial based upon completed performance of this Plan and the Joinder Agreement or the meaning and effect of the terms and conditions thereof, then claimants may submit the dispute to mediation, administered by the American Arbitration Association ("AAA") (or a mediator selected by the parties) in accordance with the AAA's Commercial Mediation Rules. If mediation is not successful in resolving the dispute, it shall be settled by arbitration administered by the AAA under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

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## SECTION X

### MISCELLANEOUS

- 10.1 No Effect on Director's Rights. Nothing contained herein will confer upon the Director the right to be retained in the service of the Association nor limit the right of the Association to deal with the Director without regard to the existence of the Plan.
- 10.2 State Law. The Plan is established under, and will be construed according to, the laws of the State of New York, to the extent such laws are not preempted by the Act and valid regulations published thereunder.
- 10.3 Severability. In the event that any of the provisions of this Plan or portion thereof, are held to be inoperative or invalid by any court of competent jurisdiction, then: (1) insofar as is reasonable effect will be given to the intent manifested in the provisions held invalid or inoperative, and (2) the validity and enforce ability of the remaining provisions will not be affected thereby.
- 10.4 Incapacity of Recipient. In the event the Director is declared incompetent and a conservator or other person legally charged with the care of his person, or Estate is appointed, any benefits under the Plan to which such Director is entitled shall be paid to such conservator or other person legally charged with the care of his person or Estate.
- 10.5 Unclaimed Benefit. The Director shall keep the Association informed of his current address and the current address of his Beneficiaries. The Association shall not be obligated to search for the whereabouts of any person. If the location of the Director is not made known to the Association as of the date upon which any payment of any benefits may first be made, the Association shall delay payment of the Director's benefit payment(s) until the location of the Director is made known to the Association; however, the Association shall only be obligated to hold such benefit payment(s) for the Director until the expiration of thirty-six (36) months. Upon expiration of the thirty-six (36) month period, the Association may discharge its obligation by payment to the Director's Beneficiary. If the location of the Director's Beneficiary is not made known to the Association by the end of an additional two (2) month period following expiration of the

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thirty-six (36) month period, the Association may discharge its obligation by payment to the Director's Estate. If there is no Estate in existence at such time or if such fact cannot be determined by the Association, the Director and his Beneficiary(ies) shall thereupon forfeit any rights to the balance, if any, of any benefits provided for such Director and/or Beneficiary under this Plan.

- 10.6 Establishment of Rabbi Trust. The Association may establish a rabbi trust into which the Association may contribute assets, subject to the claims of the Association's creditors in the event of the Association's "Insolvency", until the contributed assets are paid to the directors and their Beneficiaries in such manner and at such times as specified in this Plan. Such rabbi trust and any assets held therein shall conform to the terms of the rabbi trust agreement. To the extent the language in this Plan is modified by the language in the rabbi trust agreement, the rabbi trust agreement shall supersede this Plan. Any contributions to a rabbi trust shall be made during each Plan Year in accordance with the rabbi trust agreement.
- 10.7 Limitations on Liability. Notwithstanding any of the preceding provisions of the Plan, no individual acting as an employee or agent of the Association, or as a member of the Board of Directors shall be personally liable to the Director or any other person for any claim, loss, liability or expense incurred in connection with the Plan.
- 10.8 Gender. Whenever in this Plan words are used in the masculine or neuter gender, they shall be read and construed as in the masculine, feminine or neuter gender, whenever they should so apply.
- 10.9 Effect on Other Corporate Benefit Plans. Nothing contained in this Plan shall affect the right of the Director to participate in or be covered by any other corporate benefit available to the Directors of the Association constituting a part of the Association's existing or future compensation structure.
- 10.10 Suicide. Notwithstanding anything to the contrary in this Plan, the benefits otherwise provided herein shall not be payable and this Plan shall become null and void with



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respect to the Director if the Director's death results from suicide, whether sane or insane, within twenty-four (24) months after the execution of his Joinder Agreement.

- 10.11 Inurement. This Plan shall be binding upon and shall inure to the benefit of the Association, its successors and assigns, and the Director, his successors, heirs, executors, administrators, and Beneficiaries.
- 10.12 Headings. Headings and sub-headings in this Plan are inserted for reference and convenience only and shall not be deemed a part of this Plan.

## **SECTION XI**

### **AMENDMENT/REVOCATION**

- 11.1 Amendment. The Board of Directors may at any time amend the Plan in whole or in part, provided, however, that no amendment shall be effective to decrease or restrict any Participant's Accrued Benefit under the Plan, determined as of the date of Amendment. Any change in the Actuarial Equivalency factors shall not become effective until the first day of the calendar year which follows the adoption of the amendment and providing at least thirty (30) days' written notice of the amendment to the Participant. Notwithstanding the above, following a Change in Control, this Plan shall not be amended, modified or revoked at any time, in whole or part, as to any Director, without the mutual written consent of the Director and the Association, and such mutual consent shall be required even if the Director is no longer in the service of the Association.
- 11.2 Termination. The Board of Directors may within the first twelve (12) months after the Plan's Effective Date partially or completely terminate the Plan, if, as a result of changes in the tax laws, the tax, accounting, or other effects of the continuance of the Plan, or potential payments thereunder, would not be in the best interests of the Association.

## **SECTION XII**

### **EXECUTION**

- 12.1 This Plan and any and all properly executed Joinder Agreements set forth the entire understanding of the parties hereto with respect to the transactions contemplated hereby.

12.2 This Plan shall be executed in triplicate, each copy of which, when so executed and delivered, shall be an original, but all three copies shall together constitute one and the same instrument.

IN WITNESS WHEREOF, the Association has caused this Plan to be executed on the day and date first above written.

ATTEST:

LAKESHORE SAVINGS AND LOAN  
ASSOCIATION

/s/ B EVERLY J. M ULKIN  
Secretary

By: /s/ D AVID C. M ANCUSO  
Title: President/ CEO

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**Exhibit 16.1**

November 3, 2005

Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Commissioners:

We have read the statements made by Lake Shore Savings and Loan Association (copy attached), which we understand will be filed with the United States Securities and Exchange Commission, pursuant to Item 304 of Regulation S-K, as part of the Registration Statement on Form S-1 of Lake Shore Savings and Loan Association to be filed on or about November 3, 2005. We agree with the statements concerning our Firm in such Form S-1.

Very truly yours,

/s/ PricewaterhouseCoopers LLP

**Exhibit 16.2**

October 31, 2005

Securities and Exchange Commission  
450 Fifth Street, N. W.  
Washington, D.C. 20549

Ladies and Gentlemen:

We have read the statements made by Lake Shore Savings and Loan Association (copy attached), which we understand will be filed with the United States Securities and Exchange Commission, pursuant to Item 304 of Regulation S-K, as part of Lake Shore Savings and Loan Association's Registration Statement on Form S-1 to be filed on or about November 2, 2005. We agree with the statements concerning our Firm in such Form S-1.

Very truly yours,

/s/ Fagliarone Group CPAs, PC  
D/b/a TFG CPAs

Lake Shore Savings and Loan Association  
Statement Concerning Change in Accountants  
Attachment to Letter of Fagliarone Group CPAs, PC dated October 31, 2005

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 accountants' 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.

**Exhibit 23.2**

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 Registration Statement (Form S-1) and Form 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  
October 28, 2005

**Exhibit 23.3**

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the use in this 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 Registration Statement. We also consent to the reference to us under the heading "Experts" in such Registration Statement.

/s/ PricewaterhouseCoopers LLP  
Buffalo, New York  
November 3, 2005

**Exhibit 23.4**

November 1, 2005

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-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.

**Exhibit 99.1**

**PRO FORMA VALUATION REPORT**

***MUTUAL HOLDING COMPANY  
STOCK OFFERING***

***LAKE SHORE SAVINGS AND LOAN  
ASSOCIATION  
Dunkirk, New York***

***Dated As Of:  
September 30, 2005***

***Prepared By:***

***RP® Financial, LC.  
1700 North Moore Street  
Suite 2210  
Arlington, Virginia 22209***

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**RP® FINANCIAL, LC.**

Financial Services Industry Consultants

September 30, 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).

**Washington Headquarters**

Rosslyn Center  
1700 North Moore Street, Suite 2210  
Arlington, VA 22209  
www.rpfinancial.com

Telephone: (703) 528-1700  
Fax No.: (703) 528-1788  
Toll-Free No.: (866) 723-0594  
E-Mail: mail@rpfinancial.com

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 September 30, 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 June 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.

/s/ W ILLIAM E. P OMMERING

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**William E. Pommerening**  
**Chief Executive Officer and**  
**Managing Director**

/s/ G REGORY E. D UNN

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**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 six branch offices. The administrative facilities, main office and four branches are located in Chautauqua County, which is south of Buffalo, and two branches are located in the Buffalo metropolitan area in Erie County. The Association is planning to open a third branch office in Erie County in 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 June 30, 2005, Lake Shore Savings had \$332.0 million in assets, \$247.4 million in deposits and total equity of \$27.8 million equal to 8.4% 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 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, consumer, home equity, 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, corporate bonds 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, which have fixed rate terms with laddered maturities.

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 to 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 2001.

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 one-half years. From December 31, 2000 through June 30, 2005, Lake Shore Savings' assets increased at an 11.7% 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 one-half years is presented in Exhibit I-3.

Lake Shore Savings' loans receivable portfolio increased at a 10.2% annual rate from year end 2000 through June 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 60.2% at June 30, 2005. Lake Shore Savings' historical emphasis on 1-4 family lending is reflected in its loan portfolio composition, as 71.8% of total loans receivable consisted of 1-4 family permanent mortgage loans at June 30, 2005. Trends in the Association's loan portfolio composition over the past five

and one-half 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 one-half

[Table 1.1 is omitted. It has been filed as a paper filing.]

years lending diversification by the Association has been mostly in the areas of home equity lines of credit, which equaled 14.6% of total loans at June 30, 2005, and commercial real estate loans, which equaled 7.3% of total loans at June 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 one-half years. Construction loans have been a limited area of lending diversification for the Association, with such loans equaling 1.1% of total loans at June 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 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 June 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 1.3% of total loans at June 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 one-half 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 35.3% of assets at June 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 \$2.9 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 June 30, 2005, the mortgage-backed securities portfolio consisted of \$48.2 million of CMOs and \$25.8 million of pass-through securities. With the exception of \$259,000 of pass-through certificates, the entire mortgage-backed securities portfolio was classified as available for sale. As of June 30, 2005, the net unrealized loss on the available for sale mortgage-backed securities portfolio equaled \$850,000.

Beyond the Association's investment in mortgage-backed securities, investment securities held by the Association at June 30, 2005 consisted of asset-backed securities that are substantially secured by home equity loans (\$17.5 million), U.S. Government and agency securities (\$4.4 million), municipal bonds (\$1.5 million) and equity securities (\$1.5 million). The Association also held \$2.6 million of FHLB stock at June 30, 2005. Available for sale investments and held to maturity investments totaled \$21.3 million and \$2.1 million, respectively, at June 30, 2005. Investments maintained as held to maturity consisted of U.S. Government securities. As of June 30, 2005, the net unrealized gain on the available for sale investment portfolio equaled \$1.6 million. The Association also maintained cash and cash equivalents of \$16.0 million at June 30, 2005, which equaled 4.8% 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 June 30, 2005, the cash surrender value of the Association's BOLI equaled \$5.6 million.

Over the past five and one-half 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 June 30, 2005, the Association's deposits increased at an annual rate of 8.4%. 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 74.5% at June 30, 2005. Transaction and savings accounts equaled 45.0% of the Association's total deposits at June 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 one-half years, increasing from \$100.5 million or 51.5% of total deposits at year end 2002 to \$136.0 million or 55.0% of total deposits at June 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 2005. The Association maintained total borrowings of \$51.4 million at June 30, 2005 or 15.5% of assets. Borrowings held by the Association consist of 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 8.3% for the Association. Asset growth was slightly 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 8.4% at June 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 June 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 June 30, 2005. The Association reported positive earnings over the past five and one-half 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 June 30, 2005, the Association's reported net income of \$2.3 million or 0.72% 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 positive trend in the Association's return on average assets ratio since 2003 has primarily been realized through leveraging of the operating expense ratio, while the net interest margin has stabilized. Non-interest operating income has been a fairly stable, but somewhat limited contributor to the Association's earnings. Loan loss provisions have had a varied impact on the Association's earnings over the past five and one-half years, but typically have been a fairly limited. Likewise, gains and losses realized from the sale

[Table 1.2 is omitted. It has been filed as a paper filing.]

of investments and loans have not been a significant factor in the Association's earnings over the past five and one-half years.

Over the past five and one-half years, the Association's net interest income to average assets ratio ranged from a low high of 3.68% during 2002 to a low of 2.94% during 2004. For the twelve months ended June 30, 2005, the Association's net interest income to average assets ratio equaled 2.97%. 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 2.98% during the six months ended June 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 one-half 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 June 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 2.48% of average assets during 2004 and for the twelve months ended June 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 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 1.20 times during the twelve months ended June 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 70.1% efficiency ratio maintained for the twelve months ended June 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 one-half 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 0.04% of average assets during the twelve months ended June 30, 2005. As of June 30, 2005, the Association maintained valuation allowances of \$1.3 million, equal to 0.64% of net loans receivable and 121.5% 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 one-half 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 one-half 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 June 30, 2005, the Association's effective tax rate equaled 30.0%, which was less than the 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 June 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 26% 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 45.0% of the Association's deposits at June 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 one-half years and Exhibit I-10 provides the contractual maturity of the Association's loan portfolio by loan type as of June 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 June 30, 2005, the Association's outstanding balance of 1-4 family permanent mortgage loans equaled \$143.7 million or 71.8% 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 June 30, 2005, the Association's outstanding balance of home equity loans equaled \$29.3 million or 14.6% 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 June 30, 2005, the Association's outstanding balance of commercial real estate loans equaled \$14.6 million or 7.3% 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 June 30, 2005, Lake Shore Savings' outstanding balance of construction loans equaled \$2.2 million or 1.1% 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 June 30, 2005, Lake Shore Savings' outstanding balance of commercial business loans equaled \$8.0 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 June 30, 2005, the Association's outstanding balance of consumer loans equaled \$2.5 million or 1.3% of total loans outstanding.

Exhibit I-11 provides a summary of the Association's lending activities over the past five and one-half 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

\$17.5 million for the six months of 2005 compared to \$24.3 million for the first six 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 since 2001, although only nominal loan growth was recorded for the first six 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 six 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 one-half 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 \$1.3 million of non-performing assets at June 30, 2005, equal to 0.38% of assets. As shown in Exhibit I-12, the Association's balance of non-performing assets at June 30, 2005 consisted of \$429,000 of non-accruing loans, \$619,000 of accruing loans past due 90 days or more and \$211,000 of other 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 June 30, 2005, the Association maintained valuation allowances of \$1.3 million, equal to 0.64% of net loans receivable and 121.5% percent 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 June 30, 2005 deposits equaled 82.7% of Lake Shore Savings' interest-bearing funding composition. Exhibit I-13 sets forth the Association's deposit composition for the past three and one-half years and Exhibit I-14 provides the interest rate and maturity composition of the CD portfolio at June 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 June 30, 2005, the CD portfolio totaled \$136.0 million or 55.0% of total deposits and 57.0% of the CDs were scheduled to mature in one year or less. As of June 30, 2005, jumbo CDs (CD accounts with balances of \$100,000 or more) amounted to \$30.2 million or 22.2% of total CDs. Lake Shore Savings does not maintain any brokered CDs.

Lower cost savings and transaction accounts comprise the balance of the Association's deposit composition, with such deposits amounting to \$111.4 million or 45.0% of total deposits at June 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 June 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 \$51.4 million of FHLB advances at June 30, 2005, which were utilized to fund fixed rate residential loans. The FHLB advances have fixed rate terms with laddered maturities. 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 six branch offices located in the towns of Fredonia, Westfield, Jamestown (two locations), East Amherst and Orchard Park. Dunkirk, Fredonia, Westfield and Jamestown are part of Chautauqua County, which is south of Buffalo. East Amherst and Orchard Park are located in the Buffalo metropolitan area in Erie County. The Association's 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 geographic expansion into markets with more favorable demographic characteristics.

[Table 2.1 is omitted. It has been filed as a paper filing.]

### 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, higher oil prices showed signs of constraining the economy at the beginning of the fourth quarter of 2004, as U.S. manufacturing activity fell to a thirteen month low in October 2004. Consumer confidence also fell in October reflecting concerns over sluggish job growth. However, job growth was strong in October as 337,000 jobs were added, although the national unemployment rate for October ticked up to 5.5% as more people started to look for jobs. Helped by the strong job growth and lower oil prices, consumer confidence rose in November. Notwithstanding the employment gains, the leading economic indicators fell for a fifth straight month in October. Low mortgage rates continued to support strong home sales for October. U.S. job growth for November slowed sharply, although the U.S. unemployment rate for November declined to 5.4%. Economic data at the close of the year generally reflected signs of an improving economy, which 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, it 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 last July. 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. First quarter GDP growth was revised upward from 3.1% to 3.5%, while an accompanying inflation measure remained unrevised. 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 upward revisions in first quarter GDP growth 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. However, despite Katrina and higher energy prices, manufacturing activity picked up in September. Comparatively, business activity in the service sector dropped sharply in September.

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 bond 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 U.S. 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. As of September 30, 2005, one- and 10-year U.S. government bonds were yielding 4.01% and 4.34%, respectively, versus comparable year ago yields of 2.21% and 4.14%. Exhibit II-2 provides historical interest rate trends from 1995 through September 30, 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 represent 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. July 2005 unemployment rates for Chautauqua County and Erie County equaled 4.6% and 5.6%, respectively, versus a comparable unemployment rate of 5.2% for both New York and the U.S. Similar to the U.S. and New York, the July 2005 unemployment rates for the counties of Chautauqua and Erie were lower compared to a year ago. The reduction in unemployment rates for the primary market area counties suggest that the regional economy participated in the national economic recovery over the past year, notwithstanding the unfavorable demographic trends that have been occurring in the regional market area.



Table 2.3  
Unemployment Trends(1)

Region	July 2004 Unemployment	July 2005 Unemployment
United States	5.7%	5.2%
New York	5.9	5.2
Chautauqua County	5.0	4.6
Erie County	5.8	5.6

(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' seven offices. Table 2.4 displays deposit market trends from June 30, 2001 through June 30, 2004 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 a decline 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 \$200.8 million of deposits at the Chautauqua County branches represented a 16.0% market share of thrift and bank deposits at June 30, 2004. Comparatively, the two branches that were opened in Erie County during 2003 had total deposits of \$39.7 million at June 30, 2004, 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

[Table 2.4 is omitted. It has been filed as a paper filing.]

primarily in the Buffalo MSA. During the three year period covered in Table 2.4, a 4.0% annual deposit growth rate in Chautauqua County served to increase the Association’s deposit market share from 15.2% at June 30, 2001 to 16.0% at June 30, 2004.

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 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, independent mortgage brokers, and credit unions 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

Location	Name
Chautauqua County	HSBC Bank USA (18.9%)
	Manufacturers & Traders Trust (16.7%)
	Community Bank NA (15.5%)
	Lake Shore Sav. (16.0%) - Rank of 3
Erie County	HSBC Bank USA (37.9%)
	Manufacturers & Traders Trust (29.0%)
	KeyBank NA (7.9%)
	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 32 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 Company. 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 \$439 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 (15.03% of assets versus 11.19% for the all public average), generate comparable earnings on a return on average assets basis (0.66% ROAA versus 0.73% for the all public average), and generate a lower return on equity (4.66% ROE versus 7.55% 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)	2,678	287	322
Equity/Assets (%)	11.19%	15.03%	24.16
Return on Assets (%)	0.73	0.66	0.71
Return on Equity (%)	7.55	4.66	3.00

[Table 3.1 is omitted. It has been filed as a paper filing.]



	<i>All Publicly-Traded</i>	<i>Peer Group Reported Basis</i>	<i>Fully Converted Basis (Pro Forma)</i>
Pricing Ratios (Averages)(1)			
Price/Earnings (x)	19.16x	28.17x	26.01x
Price/Book (%)	151.29%	169.69%	89.10%
Price/Assets (%)	16.81	24.44	21.58

(1) Based on market prices as of September 30, 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 June 30, 2005, unless otherwise indicated for the Peer Group companies. Lake Shore Savings' net worth base of 8.4% was below the Peer Group's average net worth ratio of 15.0%. 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 8.4% and 14.5%, 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 60.2% was slightly lower than the comparable Peer Group ratio of 63.6%. Comparatively, the Association's cash and investments-to-assets ratio of 35.3% was slightly above the comparable ratio for the Peer Group of 31.3%. Overall, Lake Shore Savings' interest-earning assets amounted to 95.5% of assets, which approximated the comparable Peer Group ratio of 94.9%.

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 74.5% of assets, which was similar to the comparable Peer Group ratio of 72.0%. Borrowings also accounted for a slightly higher portion of the Association's interest-bearing funding composition, as indicated by borrowings-to-assets ratios of 15.5% and 11.9% 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 90.0% and 83.9%, 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 likely 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 is stronger than the Association's ratio, based on IEA/IBL ratios of 113.1% and 106.1%, respectively. 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 18-month period ended June 30, 2005, while the Peer Group's growth rates are based on annual growth for the twelve months ended June 30, 2005 or the most recent period available. Lake Shore Savings' assets increased at a 6.2% annualized rate, which was slightly below the Peer Group's asset

growth rate of 7.2%. Asset growth for the Association consisted of a mix of loans and cash and investments, with a higher growth rate indicated for cash and investments. Asset growth for the Peer Group was realized through loan growth, which was partially funded with cash and investments.

A combination of deposits and borrowings funded the Association's asset growth, reflecting annualized growth rates of 4.8% and 12.0%, respectively. Comparatively, the Peer Group had a slightly lower deposit growth rate of 2.4% and a slightly higher borrowings growth rate of 13.4%. Capital growth rates posted by the Association and the Peer Group equaled 7.5% and 4.8%. 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 capital realized from 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 June 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 0.72% and 0.66%, respectively. The Peer Group maintained comparative earnings advantages with respect to net interest income and non-interest operating income, while lower operating expenses and slightly lower 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 on interest-earning assets (5.22% versus 5.02% for the Association), which was supported by the Peer Group's interest-earning asset composition that reflected a higher concentration of loans

[Table 3.3 is omitted. It has been filed as a paper filing.]

and a 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 and the Peer Group both reported cost of funds equal to 2.02%. Overall, Lake Shore Savings and the Peer Group reported net interest income to average assets ratios of 2.97% and 3.28%, 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 2.48% and 2.83%, 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 1.20x and 1.16x, 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 0.77% 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 70.1% was comparable to the Peer Group's efficiency ratio of 69.6%.

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 0.04% 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 0.09% 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 one time expenses recorded by two of the Peer Group companies pursuant to funding charitable funds at the time of their minority stock offerings.

Taxes had a comparable impact on the Association's and the Peer Group's earnings, as Lake Shore Savings and the Peer Group posted effective tax rates of 29.97% and 29.41%, 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 (65.6% of assets versus 53.9% for the Peer Group). The Association's higher ratio was attributable to maintaining a higher concentration of mortgage-backed securities relative to the Peer Group, as the Association and the Peer Group

[Table 3.4 is omitted. It has been filed as a paper filing.]



maintained comparable ratios of 1-4 family loans as a percent of assets. Loans serviced for others equaled 5.0% and 11.0% 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 more significant 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 (9.8% of assets), while other areas of lending diversification for the Peer Group were fairly balanced between construction and land loans (2.46% of assets), commercial business loans (2.53% of assets) and consumer loans (3.0% 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 (4.4% of assets), commercial business loans (2.4% of assets) and construction and land loans (0.7% of assets). Overall, the Peer Group's higher ratio of loans-to-assets and greater degree of lending diversification into higher risk types of lending translated into a slightly higher risk weighted assets-to-assets ratio of 56.9%, versus a comparable Peer Group ratio of 52.8%.

#### 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 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 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.

[Table 3.5 is omitted. It has been filed as a paper filing.]

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 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 (0.38% versus 0.35% 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 (0.21% 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 (297.0% versus 323.3% for the Peer Group), while loss reserves maintained as percent of loans were slightly higher for the Peer Group (0.84% versus 0.64% for the Association). Net loan charge-offs were slightly higher for the Association, as net loan charge-offs posted by the Association and the Peer Group equaled 0.11% and 0.07% of their respective loan balances.

#### 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

[Table 3.6 is omitted. It has been filed as a paper filing.]

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 higher risk weighted assets-to-assets ratio than maintained by the Association. Lake Shore Savings' funding composition reflected a comparable level of deposits and a higher level of borrowings than 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. 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 (35.3% of assets versus 31.3% 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 a comparable concentration of deposits and a slightly higher concentration of 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, Lake Shore Savings' balance sheet strength was considered to be slightly more favorable than Peer Group's, as implied by the upward adjustment applied for the Association's balance sheet liquidity. Accordingly, a slight upward adjustment was applied for the Association's financial condition.

## 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 (0.72% of average assets versus 0.66% for the Peer Group). The Association maintained a lower level of operating expenses than the Peer Group, which was largely offset by the Peer Group's higher net interest margin and higher level of non-interest operating income. 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 (1.20x versus 1.16x for the Peer Group). Similarly, the Association's efficiency ratio of 70.1% approximated the Peer Group's efficiency ratio of 69.6%, 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 and the Peer Group had similar effective tax rates. 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 was 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 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 comparable to the Peer Group's. 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 Company'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 lower 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 loan growth made to the Peer Group's asset growth (11.4% loan growth rate compared to a 4.5% 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 no 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 lower than 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, July 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	July 2005 Unemployment
Lake Shore Savings - NY	Chautauqua	4.6%
<u>The Peer Group</u>		
Alliance Bank MHC – PA	Delaware	4.9%
Cheviot Financial Corp. MHC - OH	Hamilton	5.4

Table 4.1 (continued)  
Market Area Unemployment Rates  
Lake Shore Savings and the Peer Group Companies(1)

First Federal Fin. Services MHC – IL	Madison	5.8
Gouverneur Bancorp MHC – NY	St. Lawrence	5.9
Greene Co. Bancorp MHC - NY	Greene	4.8
Jacksonville Bancorp MHC – IL	Morgan	5.1
Naug. Valley Finan. Corp. MHC – CT	New Haven	5.9
Oneida Financial MHC – NY	Madison	5.0
PSB Holdings, Inc. MHC – CT	Windham	5.6
Pathfinder Bancorp MHC - NY	Oswego	6.4

(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 1.33% to 3.87%. The average dividend yield on the stocks of the Peer Group institutions equaled 2.38% as of September 30, 2005. As of September 30, 2005, approximately 88% of all publicly-traded thrifts had adopted cash dividend policies (see Exhibit IV-1), exhibiting an average yield of 2.22%. 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 \$11.6 million to \$49.6 million as of September 30, 2005, with average and median market values of \$27.7 million and \$28.6 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. Higher oil prices and allegations of improprieties in the insurance industry pressured the Dow Jones Industrial Average ("DJIA") to its lowest level of the year in late-October 2004. Lower oil prices reversed the downward trend in stocks at the close of October. The election outcome, a rise in consumer confidence and a strong jobs report for October extended the stock market rally into mid-November, as the DJIA hit a seven month high. Concerns about the falling dollar and a sharp rise in October producer prices temporarily dampened the stock market rally in late-November, but then stocks recovered in early-December on a sharp decline on oil prices. Some favorable economic data, including a strong report on December consumer confidence and a five-month low in new unemployment claims, helped to extend the rally through the end of the year as the DJIA move 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 going 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 23<sup>rd</sup>. Stocks rebounded mildly at the close of the third quarter, which helped the DJIA to a 2.9% gain for the third quarter. As an indication of the general trends in the nation's stock markets over the past year, as of September 30, 2005, the DJIA closed at 10568.70 an increase of 3.7% from one year ago and a decline of 2.0% year-to-date, and the NASDAQ closed at 2151.69 an increase of 10.8% from one year ago and a decline of 1.1% year-to-date. The Standard & Poors 500 Index closed at 1228.81 on September 30, 2005 an increase of 8.6% from one year ago and an increase of 1.4% 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 stocks followed the broader stock market lower at the close of the third quarter of 2004 and then rebounded in conjunction with the broader stock market rally at the start of the fourth quarter. After trading in a narrow range into mid-October, thrift stocks moved lower on some disappointing third quarter earnings and lower guidance on future earnings due to margin compression resulting from a flatter yield curve. The rally in the boarder stock market and the Federal Reserve's indication that inflation risks were well contained fueled gains in the thrift sector during the first half of November. Trading activity in thrift stocks was mixed during late-November, as the rally lost steam on some profit taking and higher than expected inflation data for October. Thrift issues followed the broader market higher in early-December 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 weighted heavily on the thrift sector. On September 30, 2005, the SNL Index for all publicly-traded thrifts closed at 1,527.2, an increase of 0.7% from one year ago and a decline of 4.9% year-to-date. The SNL MHC Index closed at 2,864.2 on September 30, 2005, an increase of 4.6% from one year ago and a decline of 2.2% 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 in recent months. As shown in Table 4.2, four mutual holding company offerings were completed during the past three months, while no standard or second-step conversions were completed during the past three months. Two of the

[Table 4.2 is omitted. It has been filed as a paper filing.]

mutual holding company offerings were closed at the top of their superranges, one was closed between the maximum and supermaximum of its offering range and one was closed at slightly above the minimum of its offering range. On a fully-converted basis, the average closing pro forma price/tangible book ratio of the recent MHC offerings equaled 80.8%. On average, the four recent MHC offerings reflected price appreciation of 9.6% after the first week of trading and price appreciation of 10.2% after the first month of trading.

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 no acquisitions pending for a New York savings institution. 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	Slight Upward
Profitability, Growth and Viability of Earnings	No Adjustment
Asset Growth	No Adjustment
Primary Market Area	Slight Downward
Dividends	No Adjustment
Liquidity of the Shares	No Adjustment



Key Valuation Parameters:	Valuation 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 4.3 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.

[Table 4.3 is omitted. It has been filed as a paper filing.]

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 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 September 30, 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 \$2.327 million for the twelve months ended June 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 June 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 \$2.326 million for the twelve months ended June 30, 2005. (Note: see Exhibit IV-9 for the adjustments applied to the Peer Group's earnings in the calculation of core earnings).

	Amount
	( <b>\$000</b> )
Net income	\$2,327
Less: Gain on sale of investments(1)	(1)
Core earnings estimate	\$2,326

(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 equaled 19.65 times and 19.66 times, respectively, which provided for discounts of 24.5% and 29.4% relative to the Peer Group's average reported and core P/E multiples (fully-converted basis) of 26.01 times and 27.83 times, respectively (see Table 4.4). At the top of the superrange, the Association's reported and core P/E multiples equaled 25.29 times and 25.30 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 2.8% and 9.1%, respectively.

On an MHC reported basis, the Association's reported and core P/E multiples at the midpoint value of \$50.0 million equaled 20.89 times and 20.90 times, respectively. The Association's reported and core P/E multiples provided for discounts of 25.8% and 27.4% relative to the Peer Group's average reported and core P/E multiples of 28.17 times and 28.77 times, respectively. The Association's implied MHC pricing ratios relative to the MHC pricing ratios for the Peer Group are shown in Table 4.5, 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 71.91%. In comparison to the average P/B and P/TB ratios for the Peer Group of 89.10% and 92.39%, the Association's ratios reflected a discount of 19.3% on a P/B basis and a discount of 22.2% 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 79.67%. 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 10.6% and 13.8%, 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 107.99%. In comparison to the average P/B and P/TB ratios

[Table 4.4 is omitted. It has been filed as a paper filing.]

[Table 4.5 is omitted. It has been filed as a paper filing.]



indicated for the Peer Group of 169.69% and 180.77%, respectively, Lake Shore Savings' ratios were discounted by 36.4% on a P/B basis and 40.3% 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 13.38% of pro forma assets. Comparatively, the Peer Group companies exhibited an average P/A ratio (fully-converted basis) of 21.58%, which implies a discount of 38.0% 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 14.26%. In comparison to the Peer Group's average P/A ratio of 24.44%, Lake Shore Savings' P/A ratio indicated a discount of 41.7%.

#### 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 four recently completed MHC offerings closed at an average price/tangible book ratio of 80.8% (fully-converted basis) and, on average, appreciated 9.6% and 10.2% during the first week and first month of trading, respectively. In comparison, the Association's P/TB ratio of 71.9% at the midpoint value reflects an implied discount of 11.0% 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 1.4% relative to the average closing P/TB ratio of the recent MHC offerings. The current average fully-converted P/TB ratio of the three recent MHC offerings that are traded

on NASDAQ equaled 85.6%, based on closing market prices as of September 30, 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 16.0% and at the top of the superrange the discount narrows to 6.9%.

#### Valuation Conclusion

Based on the foregoing, it is our opinion that, as of September 30, 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 4.4 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 4.5 and are detailed in Exhibits IV-10 and IV-11.

[IN ACCORDANCE WITH RULE 202 OF REGULATION S-T, THE EXHIBITS TO THIS VALUATION REPORT HAVE BEEN FILED IN PAPER PURSUANT TO A CONTINUING HARDSHIP EXEMPTION.]

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