

BERKSHIRE HILLS BANCORP INC
Form 10-Q
August 09, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: June 30, 2013

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

For the transition period from to

Commission File Number: 001-15781

BERKSHIRE HILLS BANCORP, INC.

(Exact name of registrant as specified in its charter)

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Delaware

(State or other jurisdiction of incorporation or organization)

04-3510455

(I.R.S. Employer Identification No.)

24 North Street, Pittsfield, Massachusetts

(Address of principal executive offices)

01201

(Zip Code)

Registrant's telephone number, including area code: **(413) 443-5601**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

The Registrant had 25,037,291 shares of common stock, par value \$0.01 per share, outstanding as of August 5, 2013.

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Table of Contents**PART I****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)	June 30, 2013	December 31, 2012
Assets		
Cash and due from banks	\$ 56,623	\$ 63,382
Short-term investments	23,482	34,862
Total cash and cash equivalents	80,105	98,244
Trading security	15,566	16,893
Securities available for sale, at fair value	568,268	466,169
Securities held to maturity (fair values of \$50,056 and \$52,490)	49,604	51,024
Federal Home Loan Bank stock and other restricted securities	37,667	39,785
Total securities	671,105	573,871
Loans held for sale, at fair value	64,101	85,368
Residential mortgages	1,232,488	1,324,251
Commercial mortgages	1,352,913	1,413,544
Commercial business loans	643,924	600,126
Consumer loans	641,350	650,733
Total loans	3,870,675	3,988,654
Less: Allowance for loan losses	(33,248)	(33,208)
Net loans	3,837,427	3,955,446
Premises and equipment, net	88,644	86,461
Other real estate owned	2,713	1,929
Goodwill	256,118	255,199
Other intangible assets	16,337	19,059
Cash surrender value of bank-owned life insurance policies	89,592	88,198
Deferred tax assets, net	60,410	57,729
Other assets	57,579	75,305
Total assets	\$ 5,224,131	\$ 5,296,809
Liabilities		
Demand deposits	\$ 644,059	\$ 673,921
NOW deposits	356,695	379,880
Money market deposits	1,295,771	1,439,632
Savings deposits	444,586	436,387
Time deposits	1,074,112	1,170,589
Total deposits	3,815,223	4,100,409
Short-term debt	415,720	163,150
Long-term Federal Home Loan Bank advances	175,106	195,321

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Subordinated notes	89,647	89,617
Total borrowings	680,473	448,088
Other liabilities	55,465	81,047
Total liabilities	4,551,161	4,629,544

Stockholders equity

Common stock (\$.01 par value; 50,000,000 shares authorized and 26,525,466 shares issued and 25,095,578 shares outstanding in 2013; 26,525,466 shares issued and 25,148,522 shares outstanding in 2012)	265	265
Additional paid-in capital	586,401	585,360
Unearned compensation	(5,385)	(3,035)
Retained earnings	132,930	122,014
Accumulated other comprehensive loss	(6,210)	(2,979)
Treasury stock, at cost (1,429,888 shares in 2013 and 1,376,944 shares in 2012)	(35,031)	(34,360)
Total stockholders equity	672,970	667,265
Total liabilities and stockholders equity	\$ 5,224,131	\$ 5,296,809

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest and dividend income				
Loans	\$ 45,443	\$ 38,787	\$ 92,524	\$ 73,838
Securities and other	4,254	3,869	8,054	7,490
Total interest and dividend income	49,697	42,656	100,578	81,328
Interest expense				
Deposits	5,052	5,482	10,415	10,984
Borrowings and junior subordinated notes	3,541	2,121	7,122	4,146
Total interest expense	8,593	7,603	17,537	15,130
Net interest income	41,104	35,053	83,041	66,198
Non-interest income				
Loan related income	2,644	1,479	5,361	2,650
Mortgage banking income	2,129	2,045	4,346	2,247
Deposit related fees	4,805	3,963	9,064	7,463
Insurance commissions and fees	2,407	2,768	5,404	5,514
Wealth management fees	2,070	1,757	4,334	3,657
Total fee income	14,055	12,012	28,509	21,531
Other	546	269	890	510
Gain on sale of securities, net	1,005	7	1,005	7
Non-recurring gain				42
Total non-interest income	15,606	12,288	30,404	22,090
Total net revenue	56,710	47,341	113,445	88,288
Provision for loan losses	2,700	2,250	5,100	4,250
Non-interest expense				
Compensation and benefits	18,151	15,638	35,892	29,227
Occupancy and equipment	5,737	4,490	11,505	8,885
Technology and communications	3,480	2,258	6,471	4,216
Marketing and promotion	603	778	1,241	1,129
Professional services	1,764	1,493	3,254	2,858
FDIC premiums and assessments	890	870	1,718	1,551
Other real estate owned and foreclosures	284	(6)	307	173
Amortization of intangible assets	1,345	1,357	2,722	2,668
Merger and conversion related expenses	775	4,085	5,839	8,308
Other	4,906	3,221	8,469	5,363
Total non-interest expense	37,935	34,184	77,418	64,378
Income from continuing operations before income taxes	16,075	10,907	30,927	19,660
Income tax expense	4,038	2,921	8,425	5,193
Net income from continuing operations	12,037	7,986	22,502	14,467
Loss from discontinued operations before income taxes (including gain on disposal of \$63 in 2012)				(261)
Income tax expense				376
Net loss from discontinued operations				(637)
Net income	\$ 12,037	\$ 7,986	\$ 22,502	\$ 13,830
Basic earnings per share:				
Continuing operations	\$ 0.49	\$ 0.37	\$ 0.91	\$ 0.68

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Discontinued operations					(0.03)
Total basic earnings per share	\$	0.49	\$	0.37	\$ 0.91 \$ 0.65
Diluted earnings per share:					
Continuing operations	\$	0.48	\$	0.37	\$ 0.90 \$ 0.68
Discontinued operations					(0.03)
Total diluted earnings per share	\$	0.48	\$	0.37	\$ 0.90 \$ 0.65
Weighted average common shares outstanding:					
Basic		24,779		21,742	24,863 21,349
Diluted		24,956		21,806	25,049 21,434

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	\$ 12,037	\$ 7,986	\$ 22,502	\$ 13,830
Other comprehensive income, before tax:				
Changes in unrealized gains and losses on securities available-for-sale	(13,431)	1,394	(12,698)	2,687
Changes in unrealized gains and losses on derivative hedges	6,155	(2,488)	7,598	(2,204)
Changes in unrealized gains and losses on terminated swaps	236	235	471	471
Changes in unrealized gains and losses on pension		(256)		(256)
Income taxes related to other comprehensive income:				
Changes in unrealized gains and losses on securities available-for-sale	5,077	(450)	4,758	(964)
Changes in unrealized gains and losses on derivative hedges	(2,481)	1,152	(3,057)	946
Changes in unrealized gains and losses on terminated swaps	(95)	(31)	(303)	(131)
Total other comprehensive (loss) income	(4,539)	(444)	(3,231)	549
Total comprehensive income	\$ 7,498	\$ 7,542	\$ 19,271	\$ 14,379

The accompanying notes are an integral part of these consolidated financial statements.

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(In thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Unearned compensation	Retained earnings	Accumulated other comprehensive loss	Treasury stock	Total
Balance at December 31, 2011	21,148	\$ 229	\$ 494,304	\$ (2,790)	\$ 109,477	\$ (4,885)	\$ (42,970)	\$ 553,365
Comprehensive income:								
Net income					13,830			13,830
Other comprehensive income						549		549
Total comprehensive income								14,379
Acquisition of The Connecticut Bank and Trust Company	965	9	21,981					21,990
Cash dividends declared (\$0.34 per share)					(7,372)			(7,372)
Forfeited shares	(8)		11	169			(180)	
Exercise of stock options	13				(64)		335	271
Restricted stock grants	64		(148)	(1,476)			1,624	
Stock-based compensation				897				897
Net tax benefit related to stock-based compensation			35					35
Other, net	(13)						(295)	(295)
Balance at June 30, 2012	22,169	\$ 238	\$ 516,183	\$ (3,200)	\$ 115,871	\$ (4,336)	\$ (41,486)	\$ 583,270
Balance at December 31, 2012	25,148	\$ 265	\$ 585,360	\$ (3,035)	\$ 122,014	\$ (2,979)	\$ (34,360)	\$ 667,265
Comprehensive income:								
Net income					22,502			22,502
Other comprehensive loss						(3,231)		(3,231)
Total comprehensive income								19,271
Cash dividends declared (\$0.36 per share)					(9,068)			(9,068)
Treasury stock purchased	(348)						(8,868)	(8,868)
Forfeited shares	(6)		10	140			(150)	
Exercise of stock options	195				(2,518)		5,100	2,582
Restricted stock grants	155		(690)	(3,717)			4,407	
Stock-based compensation			585	1,227				1,812
Net tax benefit related to stock-based compensation			1,150					1,150
Other, net	(48)		(14)				(1,160)	(1,174)
Balance at June 30, 2013	25,096	\$ 265	\$ 586,401	\$ (5,385)	\$ 132,930	\$ (6,210)	\$ (35,031)	\$ 672,970

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)	Six months ended June 30,	
	2013	2012
Cash flows from operating activities:		
Net income	\$ 22,502	\$ 13,830
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	5,100	4,250
Net amortization of securities	739	986
Change in unamortized net loan costs and premiums	(2,890)	(461)
Premises and equipment depreciation and amortization expense	3,610	2,921
Stock-based compensation expense	1,812	895
Accretion of purchase accounting entries, net	(8,884)	(3,541)
Amortization of other intangibles	2,722	2,668
Excess tax loss from stock-based payment arrangements	(1,150)	(35)
Income from cash surrender value of bank-owned life insurance policies	(1,394)	(1,281)
Gain on sales of securities, net	(1,005)	(48)
Net decrease (increase) in loans held for sale	21,267	(9,561)
Loss on disposition of assets	1,596	1,527
(Gain) loss on sale of real estate	(67)	28
Net change in other	(938)	3,925
Net cash provided by operating activities	43,020	16,103
Cash flows from investing activities:		
Net decrease in trading security	253	240
Proceeds from sales of securities available for sale	4,591	32,440
Proceeds from maturities, calls and prepayments of securities available for sale	66,176	47,006
Purchases of securities available for sale	(185,300)	(89,843)
Proceeds from maturities, calls and prepayments of securities held to maturity	2,493	25,775
Purchases of securities held to maturity	(1,073)	(8,685)
Net decrease (increase) in loans	120,860	(200,668)
Net cash used for Divestiture		(48,890)
Proceeds from sale of Federal Home Loan Bank stock	2,118	1,861
Purchase of premises and equipment, net	1,472	1,872
Acquisitions, net of cash paid		(58,150)
Proceeds from sale of other real estate	(7,280)	(11,604)
Net cash provided by (used in) investing activities	4,310	(308,646)

(continued)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONCLUDED)**

(In thousands)	Six months ended June 30,	
	2013	2012
Cash flows from financing activities:		
Net (decrease) increase in deposits	(283,650)	98,609
Proceeds from Federal Home Loan Bank advances and other borrowings	491,360	231,595
Repayments of Federal Home Loan Bank advances and other borrowings	(258,975)	(39,891)
Net proceeds from reissuance of treasury stock		271
Purchase of treasury stock	(8,868)	
Exercise of stock options	2,582	
Excess tax loss from stock-based payment arrangements	1,150	35
Common stock cash dividends paid	(9,068)	(7,372)
Net cash (used in) provided by financing activities	(65,469)	283,247
Net change in cash and cash equivalents	(18,139)	(9,296)
Cash and cash equivalents at beginning of year	98,244	75,782
Cash and cash equivalents at end of year	\$ 80,105	\$ 66,486
Supplemental cash flow information:		
Interest paid on deposits	\$ 10,411	\$ 10,984
Interest paid on borrowed funds	7,018	4,146
Income taxes paid (refunded), net	978	(965)
Acquisition of non-cash assets and liabilities:		
Assets acquired		342,786
Liabilities assumed	(919)	(253,155)
Other non-cash changes:		
Other net comprehensive income	(3,231)	549
Real estate owned acquired in settlement of loans	2,189	320

The accompanying notes are an integral part of these consolidated financial statements.

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NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and contain all adjustments, consisting solely of normal, recurring adjustments, necessary for a fair presentation of results for such periods.

In addition, these interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures normally included in financial statements prepared according to U.S. GAAP have been omitted.

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures for Berkshire Hills Bancorp, Inc. (the Company) previously filed with the Securities and Exchange Commission in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

Reclassifications

Certain items in prior financial statements have been reclassified to conform to the current presentation.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2011-11, Disclosures About Offsetting Assets and Liabilities. This project began as an attempt to converge the offsetting requirements under U.S. GAAP and International Financial Reporting Standards (IFRS). However, as the FASB and International Accounting Standards Board were not able to reach a converged solution with regards to offsetting requirements, they each developed convergent disclosure requirements to assist in reconciling differences in the offsetting requirements under U.S. GAAP and IFRS. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. ASU No. 2011-11 also requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The provisions of ASU No. 2013-01 limit the scope of the new balance sheet offsetting disclosures to the following financial instruments, to the extent they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the statement of financial position: (1) derivative financial instruments; (2) repurchase agreements and reverse repurchase agreements; and (3) securities borrowing and securities lending transactions. The Company adopted the provisions of ASU No. 2011-11 and ASU No. 2013-01 effective January 1, 2013. As the provisions of ASU No. 2011-11 and ASU No. 2013-01 only impacted the disclosure requirements related to the offsetting of assets and liabilities and information about instruments and transactions eligible for offset in the statement of financial position, the adoption had no impact

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on the Company's consolidated statements of income and condition. See Note 12 to the Consolidated Financial Statements for the disclosures required by ASU No. 2011-11 and ASU No. 2013-01.

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Reclassifications Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income, to improve the transparency of reporting these reclassifications. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also require that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line item affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, entities would instead cross reference to the related note to the financial statements for additional information. The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the Consolidated Financial Statements, the adoption of ASU No. 2013-02 had no impact on the Company's consolidated statements of income and condition. See Note 8 to the Consolidated Financial Statements for the disclosures required by ASU No. 2013-02.

NOTE 3. TRADING ACCOUNT SECURITY

The Company holds a tax advantaged economic development bond that is being accounted for at fair value. The security had an amortized cost of \$13.4 million and \$13.6 million, and a fair value of \$15.6 million and \$16.9 million, at June 30, 2013 and December 31, 2012, respectively. As discussed further in Note 12 - Derivative Financial Instruments and Hedging Activities, the Company has entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there are no other securities in the trading portfolio at June 30, 2013.

Table of Contents**NOTE 4. SECURITIES AVAILABLE FOR SALE AND HELD TO MATURITY**

The following is a summary of securities available for sale and held to maturity:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2013				
Securities available for sale				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 81,855	\$ 2,908	\$ (1,732)	\$ 83,031
Government guaranteed residential mortgage-backed securities	38,473	395	(216)	38,652
Government-sponsored residential mortgage-backed securities	358,175	2,049	(5,495)	354,729
Corporate bonds	41,001	55	(1,821)	39,235
Trust preferred securities	16,990	1,533	(1,766)	16,757
Other bonds and obligations	3,364	1	(139)	3,226
Total debt securities	539,858	6,941	(11,169)	535,630
<i>Equity securities:</i>				
Marketable equity securities	30,390	2,763	(515)	32,638
Total securities available for sale	570,248	9,704	(11,684)	568,268
Securities held to maturity				
Municipal bonds and obligations	7,779			7,779
Government-sponsored residential mortgage-backed securities	75	4		79
Tax advantaged economic development bonds	40,974	1,123	(675)	41,422
Other bonds and obligations	776			776
Total securities held to maturity	49,604	1,127	(675)	50,056
Total	\$ 619,852	\$ 10,831	\$ (12,359)	\$ 618,324
December 31, 2012				
Securities available for sale				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 79,498	\$ 5,359	\$ (100)	\$ 84,757
Government guaranteed residential mortgage-backed securities	42,305	805	(18)	43,092
Government-sponsored residential mortgage-backed securities	275,940	2,732	(79)	278,593
Corporate bonds	9,998	117	(108)	10,007
Trust preferred securities	21,784	1,089	(1,916)	20,957
Other bonds and obligations	3,459	17	(4)	3,472
Total debt securities	432,984	10,119	(2,225)	440,878
Marketable equity securities	22,467	3,187	(363)	25,291
Total securities available for sale	455,451	13,306	(2,588)	466,169
Securities held to maturity				
Municipal bonds and obligations	8,295			8,295
	76	7		83

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Government-sponsored residential
mortgage-backed securities

Tax advantaged economic development bonds	41,678	1,837	(378)	43,137
Other bonds and obligations	975			975
Total securities held to maturity	51,024	1,844	(378)	52,490
Total	\$ 506,475	\$ 15,150	\$ (2,966)	\$ 518,659

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The amortized cost and estimated fair value of available for sale (AFS) and held to maturity (HTM) securities, segregated by contractual maturity at June 30, 2013 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable. Equity securities have no maturity and are also shown in total.

(In thousands)	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	\$ 3,099	\$ 3,153	\$ 4,718	\$ 4,718
Over 1 year to 5 years	7,180	7,224	3,703	3,749
Over 5 years to 10 years	53,538	52,174	27,441	27,821
Over 10 years	79,393	79,698	13,667	13,689
Total bonds and obligations	143,210	142,249	49,529	49,977
Marketable equity securities	30,390	32,638		
Residential mortgage-backed securities	396,648	393,381	75	79
Total	\$ 570,248	\$ 568,268	\$ 49,604	\$ 50,056

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Securities with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

(In thousands)	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
June 30, 2013						
Securities available for sale						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 1,732	\$ 15,261	\$	\$	\$ 1,732	\$ 15,261
Government-guaranteed residential mortgage-backed securities	216	8,932			216	8,932
Government-sponsored residential mortgage-backed securities	5,495	234,176			5,495	234,176
Corporate bonds	1,776	29,227	45	6,955	1,821	36,182
Trust preferred securities	36	1,506	1,730	1,872	1,766	3,378
Other bonds and obligations	139	2,871			139	2,871
Total debt securities	9,394	291,973	1,775	8,827	11,169	300,800
Marketable equity securities	187	6,312	328	1,672	515	7,984
Total securities available for sale	9,581	298,285	2,103	10,499	11,684	308,784
Securities held to maturity						
Tax advantaged economic development bonds	675	8,825			675	8,825
Total securities held to maturity	675	8,825			675	8,825
Total	\$ 10,256	\$ 307,110	\$ 2,103	\$ 10,499	\$ 12,359	\$ 317,609
December 31, 2012						
Securities available for sale						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 100	\$ 4,140	\$	\$	\$ 100	\$ 4,140
Government guaranteed residential mortgage-backed securities	18	5,108			18	5,108
Government-sponsored residential mortgage-backed securities	69	31,433	10	5,366	79	36,799
Corporate bonds			108	6,892	108	6,892
Trust preferred securities	1	2,754	1,915	1,686	1,916	4,440
Other bonds and obligations	4	2,055			4	2,055
Total debt securities	192	45,490	2,033	13,944	2,225	59,434
Marketable equity securities	90	1,410	273	1,727	363	3,137
Total securities available for sale	\$ 282	\$ 46,900	\$ 2,306	\$ 15,671	\$ 2,588	\$ 62,571

Securities held to maturity												
Tax advantaged economic development bonds		378		8,129				378		8,129		
Total securities held to maturity		378		8,129				378		8,129		
Total	\$	660	\$	55,029	\$	2,306	\$	15,671	\$	2,966	\$	70,700

Debt Securities

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of June 30, 2013, prior to this recovery. The Company's ability and intent to hold these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historically low portfolio turnover. The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's AFS and HTM portfolios were not other-than-temporarily impaired at June 30, 2013:

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AFS municipal bonds and obligations

At June 30, 2013, 24 of the total 140 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 10.2% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the second quarter of 2013. All securities are performing.

AFS residential mortgage-backed securities

At June 30, 2013, 59 out of the total 191 securities in the Company's portfolios of AFS residential mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 2.3% of the amortized cost of securities in unrealized loss positions within the AFS portfolio. The Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) guarantee the contractual cash flows of all of the Company's residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the past quarter. All securities are performing.

AFS corporate bonds

At June 30, 2013, 8 out of the total 9 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represented 4.8% of the amortized cost of the securities. All 8 securities remain investment grade rated and the market value of the securities supports the Company's amortized value. All securities are performing.

AFS trust preferred securities

At June 30, 2013, 3 out of the total 6 securities in the Company's portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 34.3% of the amortized cost of securities in unrealized loss positions. The Company's evaluation of the present value of expected cash flows on these securities supports its conclusions about the recoverability of the securities' amortized cost basis. 4 of the 6 securities contain at least one below investment grade ratings by the three major rating agencies. The Company reviews the financial strength of all of the single issue trust issuers and has concluded that the amortized cost remains supported by the market value of these securities and they are performing.

At June 30, 2013, \$1.6 million of the total unrealized losses was attributable to a \$2.8 million investment in a Mezzanine Class B tranche of a \$360 million pooled trust preferred security collateralized by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of \$1 million, for potential other-than-temporary-impairment (OTTI) at June 30, 2013 and determined that OTTI was not evident based on both the Company's ability and intent to hold the security until the recovery of its remaining amortized cost and the protection from credit loss afforded by \$46 million in excess subordination above current and projected losses. The security is performing.

AFS other bonds and obligations

At June 30, 2013, 2 of the total 9 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 4.6% of the amortized cost of securities in unrealized loss positions. The securities are investment grade rated and there were no material underlying credit downgrades during the second quarter of 2013. All securities are performing.

HTM tax advantaged economic development bonds

At June 30, 2013, 2 of the total 8 securities in the Company's portfolio of tax advantaged economic development bonds were in an unrealized loss position. Aggregate unrealized losses represented 7.1% of the amortized cost of

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securities in unrealized loss positions. The Company has the intent of maintaining these bonds to recovery. All securities are performing.

Marketable Equity Securities

In evaluating its marketable equity securities portfolio for OTTI, the Company considers its ability to more likely than not hold an equity security to recovery. The Company additionally considers other various factors including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI is recognized immediately through earnings.

At June 30, 2013, 5 out of the total 23 securities in the Company's portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 6.1% of the amortized cost of the securities. The Company has the ability and intent to hold the securities until a recovery of their cost basis and does not consider the securities other-than-temporarily impaired at June 30, 2013. As new information becomes available in future periods, changes to the Company's assumptions may be warranted and could lead to a different conclusion regarding the OTTI of these securities.

NOTE 5. LOANS

The Company's loan portfolio is segregated into the following segments: residential mortgage, commercial mortgage, commercial business, and consumer. Residential mortgage loans include classes for 1-4 family owner occupied and construction loans. Commercial mortgage loans include construction, single and multi-family, and commercial real estate classes. Commercial business loans include asset based lending loans, lease financing and other commercial business loan classes. Consumer loans include home equity, direct and indirect auto and other. These portfolio segments each have unique risk characteristics that are considered when determining the appropriate level for the allowance for loan losses.

A substantial portion of the loan portfolio is secured by real estate in western Massachusetts, southern Vermont, northeastern New York, and in the Bank's New England lending areas. The ability of many of the Bank's debtors to honor their contracts is dependent, among other things, on the economies and real estate markets in these areas.

Total loans include business loans and acquired loans. Acquired loans are those loans acquired from the acquisitions of Beacon Federal Bancorp, Inc., The Connecticut Bank and Trust Company, Legacy Bancorp, Inc., and Rome Bancorp, Inc. The following is a summary of total loans:

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(In thousands)	June 30, 2013		Total
	Business Loans	Acquired Loans	
Residential mortgages			
1-4 family	\$ 836,575	\$ 369,946	\$ 1,206,521
Construction	20,268	5,699	25,967
Total residential mortgages	856,843	375,645	1,232,488
Commercial mortgages:			
Construction	110,609	17,750	128,359
Single and multi-family	57,520	71,318	128,838
Commercial real estate	785,828	309,888	1,095,716
Total commercial mortgages	953,957	398,956	1,352,913
Commercial business loans:			
Asset based lending	263,132	3,935	267,067
Other commercial business loans	292,746	84,111	376,857
Total commercial business loans	555,878	88,046	643,924
Total commercial loans	1,509,835	487,002	1,996,837
Consumer loans:			
Home equity	230,121	80,163	310,284
Other	105,109	225,957	331,066
Total consumer loans	335,230	306,120	641,350
Total loans	\$ 2,701,908	\$ 1,168,767	\$ 3,870,675

(In thousands)	December 31, 2012		Total
	Business Loans	Acquired Loans	
Residential mortgages:			
1-4 family	\$ 870,322	\$ 427,210	\$ 1,297,532
Construction	20,344	6,375	26,719
Total residential mortgages	890,666	433,585	1,324,251
Commercial mortgages:			
Construction	150,694	17,131	167,825
Single and multi-family	43,332	80,488	123,820
Commercial real estate	768,867	353,032	1,121,899
Total commercial mortgages	962,893	450,651	1,413,544
Commercial business loans:			
Asset based lending	255,265	2,830	258,095
Other commercial business loans	234,662	107,369	342,031
Total commercial business loans	489,927	110,199	600,126
Total commercial loans	1,452,820	560,850	2,013,670
Consumer loans:			
Home equity	205,892	119,509	325,401
Other	76,258	249,074	325,332
Total consumer loans	282,150	368,583	650,733
Total loans	\$ 2,625,636	\$ 1,363,018	\$ 3,988,654

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The carrying amount of the acquired loans at June 30, 2013 totaled \$1.17 billion. These loans consisted of loans determined to be impaired at the time of acquisition, which are accounted for in accordance with ASC Topic 310-30, with a carrying amount of \$42.7 million and loans that were considered not impaired at the acquisition date with a carrying amount of \$1.13 billion.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*.

(In thousands)	Three months ended June 30,	
	2013	2012
Balance at beginning of period	\$ 5,666	\$ 668
Acquisitions		2,816
Sales	(301)	
Reclassification from nonaccretable difference for loans with improved cash flows		
Changes in expected cash flows that do not affect nonaccretable difference		
Accretion	(2,037)	(930)
Balance at end of period	\$ 3,328	\$ 2,554

(In thousands)	Six months ended June 30,	
	2013	2012
Balance at beginning of period	\$ 8,247	\$ 1,277
Acquisitions		2,816
Sales	(301)	
Reclassification from nonaccretable difference for loans with improved cash flows		
Changes in expected cash flows that do not affect nonaccretable difference		
Accretion	(4,618)	(1,539)
Balance at end of period	\$ 3,328	\$ 2,554

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The following is a summary of past due loans at June 30, 2013 and December 31, 2012:

Business Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
June 30, 2013							
Residential mortgages:							
1-4 family	\$ 3,491	\$ 594	\$ 7,827	\$ 11,912	\$ 824,663	\$ 836,575	\$ 3,100
Construction			152	152	20,116	20,268	111
Total	3,491	594	7,979	12,064	844,779	856,843	3,211
Commercial mortgages:							
Construction	412		4,318	4,730	105,879	110,609	
Single and multi-family	237		343	580	56,940	57,520	
Commercial real estate	6,872	2,062	7,216	16,150	769,678	785,828	602
Total	7,521	2,062	11,877	21,460	932,497	953,957	602
Commercial business loans:							
Asset based lending					263,132	263,132	
Other commercial business loans	300	274	2,638	3,212	289,534	292,746	92
Total	300	274	2,638	3,212	552,666	555,878	92
Consumer loans:							
Home equity	766	207	1,828	2,801	227,320	230,121	530
Other	479	94	251	824	104,285	105,109	144
Total	1,245	301	2,079	3,625	331,605	335,230	674
Total	\$ 12,557	\$ 3,231	\$ 24,573	\$ 40,361	\$ 2,661,547	\$ 2,701,908	\$ 4,579

Business Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2012							
Residential mortgages:							
1-4 family	\$ 4,105	\$ 1,291	\$ 8,061	\$ 13,457	\$ 856,865	\$ 870,322	\$ 1,563
Construction		210	48	258	20,086	20,344	48
Total	4,105	1,501	8,109	13,715	876,951	890,666	1,611
Commercial mortgages:							
Construction			4,668	4,668	146,026	150,694	
Single and multi-family	616		27	643	42,689	43,332	
Commercial real estate	1,183	1,727	8,231	11,141	757,726	768,867	1,195
Total	1,799	1,727	12,926	16,452	946,441	962,893	1,195
Commercial business loans:							

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Asset based lending					255,265	255,265	
Other commercial							
business loans	745	372	3,427	4,544	230,118	234,662	159
Total	745	372	3,427	4,544	485,383	489,927	159
Consumer loans:							
Home equity	828	300	1,856	2,984	202,908	205,892	424
Other	546	55	248	849	75,409	76,258	69
Total	1,374	355	2,104	3,833	278,317	282,150	493
Total	\$ 8,023	\$ 3,955	\$ 26,566	\$ 38,544	\$ 2,587,092	\$ 2,625,636	\$ 3,458

Table of Contents**Acquired Loans**

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
June 30, 2013							
Residential mortgages:							
1-4 family	\$ 2,697	\$ 595	\$ 2,871	\$ 6,163	\$ 363,783	\$ 369,946	\$ 1,694
Construction					5,699	5,699	
Total	2,697	595	2,871	6,163	369,482	375,645	1,694
Commercial mortgages:							
Construction		1,136	1,232	2,368	15,382	17,750	1,232
Single and multi-family	345		1,897	2,242	69,076	71,318	1,094
Commercial real estate	1,232		8,432	9,664	300,224	309,888	5,562
Total	1,577	1,136	11,561	14,274	384,682	398,956	7,888
Commercial business loans:							
Asset based lending					3,935	3,935	
Other commercial business loans	383	247	2,032	2,662	81,449	84,111	1,096
Total	383	247	2,032	2,662	85,384	88,046	1,096
Consumer loans:							
Home equity	703	360	336	1,399	78,764	80,163	171
Other	2,948	453	935	4,336	221,621	225,957	100
Total	3,651	813	1,271	5,735	300,385	306,120	271
Total	\$ 8,308	\$ 2,791	\$ 17,735	\$ 28,834	\$ 1,139,933	\$ 1,168,767	\$ 10,949

Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2012							
Residential mortgages:							
1-4 family	\$ 1,817	\$ 585	\$ 2,523	\$ 4,925	\$ 422,285	\$ 427,210	\$ 1,555
Construction					6,375	6,375	
Total	1,817	585	2,523	4,925	428,660	433,585	1,555
Commercial mortgages:							
Construction			1,056	1,056	16,075	17,131	1,056
Single and multi-family	194	1,328	746	2,268	78,220	80,488	746
Commercial real estate	1,532	2,024	11,062	14,618	338,414	353,032	10,176
Total	1,726	3,352	12,864	17,942	432,709	450,651	11,978
Commercial business loans:							
Asset based lending					2,830	2,830	
Other commercial business loans	422	577	2,177	3,176	104,193	107,369	1,764

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Total	422	577	2,177	3,176	107,023	110,199	1,764
Consumer loans:							
Home equity	1,689	169	89	1,947	117,562	119,509	52
Other	2,624	365	271	3,260	245,814	249,074	171
Total	4,313	534	360	5,207	363,376	368,583	223
Total	\$ 8,278	\$ 5,048	\$ 17,924	\$ 31,250	\$ 1,331,768	\$ 1,363,018	\$ 15,520

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The following is summary information pertaining to non-accrual loans at June 30, 2013 and December 31, 2012:

(In thousands)	June 30, 2013		Total
	Business Loans	Acquired Loans	
Residential mortgages:			
1-4 family	\$ 4,768	\$ 1,177	\$ 5,945
Total	4,768	1,177	5,945
Commercial mortgages:			
Construction	4,318		4,318
Single and multi-family	343	803	1,146
Other	6,614	2,870	9,484
Total	11,275	3,673	14,948
Commercial business loans:			
Other commercial business loans	2,545	936	3,481
Total	2,545	936	3,481
Consumer loans:			
Home equity	1,298	165	1,463
Other	107	835	942
Total	1,405	1,000	2,405
Total non-accrual loans	\$ 19,993	\$ 6,786	\$ 26,779

(In thousands)	December 31, 2012		Total
	Business Loans	Acquired Loans	
Residential mortgages:			
1-4 family	\$ 6,498	\$ 968	\$ 7,466
Total	6,498	968	7,466
Commercial mortgages:			
Construction	4,668		4,668
Single and multi-family	27		27
Other	7,036	886	7,922
Total	11,731	886	12,617
Commercial business loans:			
Other commercial business loans	3,268	413	3,681
Total	3,268	413	3,681
Consumer loans:			
Home equity	1,432	37	1,469
Other	179	100	279
Total	1,611	137	1,748
Total non-accrual loans	\$ 23,108	\$ 2,404	\$ 25,512

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Activity in the allowance for loan losses for the six months ended June 30, 2013 and the period ended December 31, 2012 was as follows:

Business Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
June 30, 2013						
Balance at beginning of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Charged-off loans	836	2,015	694	600		4,145
Recoveries on charged-off loans	150	451	81	113		795
Provision for loan losses	389	777	376	1,919	117	3,578
Balance at end of period	\$ 5,631	\$ 18,076	\$ 5,368	\$ 2,898	\$ 146	\$ 32,119
Individually evaluated for impairment	302	1,812	903	295		3,312
Collectively evaluated	5,329	16,264	4,465	2,603	146	28,807
Total	\$ 5,631	\$ 18,076	\$ 5,368	\$ 2,898	\$ 146	\$ 32,119

Loans receivable:

Balance at end of period						
Individually evaluated for impairment	5,398	26,184	1,982	1,334		34,898
Collectively evaluated	851,445	927,773	553,896	333,896		2,667,010
Total	\$ 856,843	\$ 953,957	\$ 555,878	\$ 335,230		\$ 2,701,908

Business Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
December 31, 2012						
Balance at beginning of year	\$ 3,150	\$ 22,095	\$ 4,540	\$ 2,203	\$ (90)	\$ 31,898
Charged-off loans	2,604	4,229	697	1,537		9,067
Recoveries on charged-off loans	103	52	96	165		416
Provision for loan losses	5,279	945	1,666	635	119	8,644
Balance at end of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Individually evaluated for impairment	342	1,444	1,205	273		3,264
Collectively evaluated for impairment	5,586	17,419	4,400	1,193	29	28,627
Total	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891

Loans receivable:

Balance at end of year						
Individually evaluated for impairment	6,362	30,287	2,821	1,218		40,688
Collectively evaluated for impairment	884,304	932,606	487,106	280,932		2,584,948
Total	\$ 890,666	\$ 962,893	\$ 489,927	\$ 282,150		\$ 2,625,636

Table of Contents**Acquired Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
June 30, 2013						
Balance at beginning of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Charged-off loans	422	682	134	574		1,812
Recoveries on charged-off loans	(4)	11	23	72		102
Provision for loan losses	435	706	112	519	(250)	1,522
Balance at end of period	\$ 518	\$ 425	\$ 97	\$ 331	\$ (242)	\$ 1,129
Individually evaluated for impairment	70	29				99
Collectively evaluated	448	396	97	331	(242)	1,030
Total	\$ 518	\$ 425	\$ 97	\$ 331	\$ (242)	\$ 1,129

Loans receivable:

Balance at end of Period						
Individually evaluated for impairment	1,026	6,731	183			7,940
Collectively evaluated	374,619	392,225	87,863	306,120		1,160,827
Total	\$ 375,645	\$ 398,956	\$ 88,046	\$ 306,120		\$ 1,168,767

Acquired Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
December 31, 2012						
Balance at beginning of year	\$ 281	\$ 158	\$ 38	\$ 87	\$ (18)	\$ 546
Charged-off loans	43			340		383
Recoveries on charged-off loans				208		208
Provision for loan losses	271	232	58	359	26	946
Balance at end of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Individually evaluated for impairment	55					55
Collectively evaluated for impairment	454	390	96	314	8	1,262
Total	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317

Loans receivable:

Balance at end of year						
Individually evaluated for impairment	371	886				1,257
Collectively evaluated for impairment	433,214	449,765	110,199	368,583		1,361,761
Total	\$ 433,585	\$ 450,651	\$ 110,199	\$ 368,583		\$ 1,363,018

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The following is a summary of impaired loans on non-accrual status at June 30, 2013:

Business Loans

(In thousands)	Recorded Investment	At June 30, 2013 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	\$ 1,310	\$ 1,310	\$
Commercial mortgages - single and multifamily	2,380	2,380	
Commercial mortgages - real estate	3,464	3,464	
Other commercial business loans	63	63	
Consumer - home equity	200	200	
With an allowance recorded:			
Residential mortgages - 1-4 family	\$ 1,346	\$ 1,648	\$ 302
Commercial mortgages - construction	1,408	1,938	530
Commercial mortgages - real estate	1,650	2,932	1,282
Other commercial business loans	483	1,386	903
Consumer - home equity	615	910	295
Total			
Residential mortgages	\$ 2,656	\$ 2,958	\$ 302
Commercial mortgages	8,902	10,714	1,812
Commercial business	546	1,449	903
Consumer	815	1,110	295
Total impaired loans	\$ 12,919	\$ 16,231	\$ 3,312

Acquired Loans

(In thousands)	Recorded Investment	At June 30, 2013 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	\$ 87	\$ 87	\$
Commercial mortgages - real estate	3,413	3,413	
Other commercial business loans	183	183	
With an allowance recorded:			
Residential mortgages - 1-4 family	\$ 456	\$ 526	\$ 70
Commercial mortgages - real estate	154	183	29
Total			
Residential mortgages	\$ 543	\$ 613	\$ 70
Commercial mortgages	3,567	3,596	29
Commercial business	183	183	
Total impaired loans	\$ 4,293	\$ 4,392	\$ 99

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The following is a summary of impaired loans on non-accrual status at December 31, 2012:

Business Loans

(In thousands)	Recorded Investment	At December 31, 2012 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	\$ 3,408	\$ 3,408	\$
Commercial mortgages - construction	2,730	2,730	
Commercial mortgages - single and multifamily			
Commercial mortgages - real estate	3,450	3,450	
Other commercial business loans	31	31	
Consumer - home equity	602	602	
With an allowance recorded:			
Residential mortgages - 1-4 family	\$ 1,056	\$ 1,343	\$ 287
Commercial mortgages - construction	1,584	1,938	354
Commercial mortgages - single and multifamily			
Commercial mortgages - real estate	2,019	3,109	1,090
Other commercial business loans	1,135	2,340	1,205
Consumer - home equity	209	482	273
Total			
Residential mortgages	\$ 4,464	\$ 4,751	\$ 287
Commercial mortgages	9,783	11,227	1,444
Commercial business	1,166	2,371	1,205
Consumer	811	1,084	273
Total impaired loans	\$ 16,224	\$ 19,433	\$ 3,209

Acquired Loans

(In thousands)	Recorded Investment	At December 31, 2012 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	\$ 215	\$ 215	
Commercial mortgages - real estate	886	886	
With an allowance recorded:			
Residential mortgages - 1-4 family	\$ 101	\$ 156	\$ 55
Total			
Residential mortgages	\$ 316	\$ 371	\$ 55
Residential mortgages - 1-4 family	886	886	
Total impaired loans	\$ 1,202	\$ 1,257	\$ 55

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The following is a summary of the average recorded investment and interest income recognized on impaired loans as of June 30, 2013 and June 30, 2012:

Business Loans

(in thousands)	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	\$ 2,504	\$ 45	\$ 2,098	\$ 21
Commercial-construction	2,378	1		
Commercial mortgages - single and multifamily			299	
Commercial mortgages - real estate	3,477	30	3,022	26
Commercial business loans	67			
Consumer-home equity	245	9	166	1
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 1,466	\$ 4	\$ 3,569	\$ 22
Commercial-construction	1,938		6,757	
Commercial mortgages - single and multifamily			73	
Commercial mortgages - real estate	2,931	1	2,381	22
Commercial business loans	1,554	31	145	3
Consumer-home equity	825	1	704	
Total				
Residential mortgages	\$ 3,970	\$ 49	\$ 5,667	\$ 43
Commercial mortgages	10,724	32	12,532	48
Commercial business loans	1,621	31	145	3
Consumer loans	1,070	10	870	1
Total impaired loans	\$ 17,385	\$ 122	\$ 19,214	\$ 95

Acquired Loans

(in thousands)	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	\$ 328	\$ 1	\$ 526	\$
Commercial mortgages - real estate	2,006	20	274	10
Commercial business loans	182			
Consumer-home equity			38	
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 505	\$ 1	\$	\$

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Commercial mortgages - real estate		186		2			
Total							
Residential mortgages	\$	833	\$	2	\$	526	\$
Commercial mortgages		2,192		22		274	10
Commercial business loans		182					
Consumer loans						38	
Total impaired loans	\$	3,207	\$	24	\$	838	\$

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Credit Quality Information

For the purpose of estimating the allowance for loan losses the Bank utilizes an eleven grade internal loan rating system for each of its commercial mortgage and commercial business loans as follows:

1 **Substantially Risk Free**

Borrowers in this category are of unquestioned credit standing and are at the pinnacle of credit quality. Credits in this category are generally cash secured with strong management depth and experience and exhibit a superior track record.

2 **Minimal Risk**

A relationship which provides an adequate return on investment to the Company, has been stable during the last three years and has a superior financial condition as determined by a comparison with the industry. In addition, management must be of unquestionable character and have strong abilities as measured by its long-term financial performance.

3 **Moderate Risk**

A relationship which does not appear to possess more than the normal degree of credit risk. Overall, the borrower's financial statements compare favorably with the industry. A strong secondary repayment source exists and the loan is performing as agreed.

4 **Better than Average Risk**

A relationship which possesses most of the characteristics found in the Moderate Risk category and ranges from definitely sound to those with minor risk characteristics. Operates in a reasonably stable industry that may be moderately affected by the business cycle and moderately open to changes. Has a satisfactory track record and the loan is performing as agreed.

5 **Average Risk**

A relationship which possesses most of the characteristics found in the Better than Average Risk category but may have recently experienced a loss year often as a result of its operation in a cyclical industry. The relationship has smaller margins of debt service coverage with some elements of reduced strength. Good secondary repayment source exists and the loan is performing as agreed. Start-up businesses and construction loans will generally be assigned to this category as well.

6 **Acceptable Risk**

Borrowers in this category may be more highly leveraged than their industry peers and experience moderate losses relative to net worth. Trends and performance, e.g. sales and earnings, leverage, among other factors may be negative. Management's ability may be questionable, or perhaps untested. The industry may be experiencing either temporary or long term pressures. Collateral values are seen as more important in assessing risk than in higher quality loans. Failure to meet required line clean-up periods or other terms and conditions, including some slow payments may also predicate this grade.

7 **Special Mention**

A classification assigned to all relationships for credits with potential weaknesses which present a higher than normal credit risk, but not to the point of requiring a Substandard loan classification. No loss of principal or interest is anticipated. However, these credits are followed closely, and if necessary, remedial plans to reduce the Company's risk exposure are established.

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8 Substandard Performing

A classification assigned to a credit that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans will be evaluated on at least a quarterly basis to determine if an additional allocation of the Company's allowance for loan loss is warranted.

9 Substandard Non-Performing

A classification given to Substandard credits which have deteriorated to the point that management has placed the accounts on non-accrual status due to delinquency exceeding 90 days or where the Company has determined that collection of principal and interest in full is unlikely.

10 Doubtful

Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, highly questionable and improbable. Collection in excess of 50% of the balance owed is not expected.

11 Loss

Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be possible in the future.

The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Loans that are current within 59 days are rated Pass. Residential mortgages that are 60-89 days delinquent are rated Special Mention. Loans delinquent for 90 days or greater are rated Substandard and generally placed on non-accrual status. Home equity loans are risk rated based on the same rating system as the Company's residential mortgages.

Ratings for other consumer loans, including auto loans, are rated based on a two rating system. Loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Other consumer loans are placed on non-accrual at such time as they become Non-performing.

Acquired Loans Credit Quality Analysis

Upon acquiring a loan portfolio, our Internal Loan Review function assigns risk ratings to the acquired loans, utilizing the same methodology as it does with historical loans. This may differ from the risk rating policy of the predecessor company. Loans which are rated Substandard or worse according to the rating process outlined below are deemed to be credit impaired loans accounted for under ASC 310-30, regardless of whether they are classified as performing or non-performing.

The Bank utilizes an eleven grade internal loan rating system for each of its acquired commercial real estate, construction and commercial loans as outlined in the Credit Quality Information section of this Note. The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Residential mortgages that are current within 59 days are rated Pass. Residential mortgages that are 60 - 89 days delinquent are rated Special Mention. Residential mortgages delinquent for 90 days or greater are rated Substandard. Home equity loans are risk rated based on the same rating system as the Company's residential mortgages. Other consumer loans are rated based on a two rating system. Other consumer loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Non-performing other consumer loans are deemed to be credit impaired loans accounted for under ASC 310-30.

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The Company subjects loans that do not meet the ASC 310-30 criteria to ASC 450-20 by collectively evaluating these loans for an allowance for loan loss. The Company applies a methodology similar to the methodology prescribed for originated loans, which includes the application of environmental factors to each category of loans. The methodology to collectively evaluate the acquired loans outside the scope of ASC 310-30 includes the application of a number of environmental factors that reflect management's best estimate of the level of incremental credit losses that might be recognized given current conditions. This is reviewed as part of the allowance for loan loss adequacy analysis. As the loan portfolio matures and environmental factors change, the loan portfolio will be reassessed each quarter to determine an appropriate reserve allowance.

A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At June 30, 2013, the allowance for loan losses related to acquired loans was \$1.1 million using the above mentioned criteria.

The Company presented several tables within this footnote separately for business loans and acquired loans in order to distinguish the credit performance of the acquired loans.

The following table presents the Company's loans by risk rating at June 30, 2013 and December 31, 2012:

Business Loans**Residential Mortgages**

Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 828,154	\$ 860,970	\$ 20,116	\$ 20,085	\$ 848,270	\$ 881,055
Special mention	594	1,291		210	594	1,501
Substandard	7,827	8,061	152	49	7,979	8,110
Total	\$ 836,575	\$ 870,322	\$ 20,268	\$ 20,344	\$ 856,843	\$ 890,666

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

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(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012
Grade:								
Pass	\$ 103,053	\$ 142,946	\$ 53,711	\$ 40,690	\$ 714,543	\$ 707,867	\$ 871,307	\$ 891,503
Special mention			231	\$ 420	6,979	5,965	7,210	6,385
Substandard	7,556	7,748	3,578	2,222	64,306	54,930	75,440	64,900
Doubtful						105		105
Total	\$ 110,609	\$ 150,694	\$ 57,520	\$ 43,332	\$ 785,828	\$ 768,867	\$ 953,957	\$ 962,893

Commercial Business Loans

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending		Other		Total commercial business loans	
	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 263,132	\$ 255,265	\$ 281,332	\$ 219,172	\$ 544,464	\$ 474,437
Special mention			1,425	5,857	1,425	5,857
Substandard			9,417	9,541	9,417	9,541
Doubtful			572	92	572	92
Total	\$ 263,132	\$ 255,265	\$ 292,746	\$ 234,662	\$ 555,878	\$ 489,927

Consumer Loans

Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Other		Total consumer loans	
	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012
Performing	\$ 228,823	\$ 204,460	\$ 105,002	\$ 76,079	\$ 333,825	\$ 280,539
Nonperforming	1,298	1,432	107	179	1,405	1,611
Total	\$ 230,121	\$ 205,892	\$ 105,109	\$ 76,258	\$ 335,230	\$ 282,150

Table of Contents**Acquired Loans****Residential Mortgages**

Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 361,524	\$ 424,102	\$ 5,699	\$ 6,375	\$ 367,223	\$ 430,477
Special mention	595	585			595	585
Substandard	7,827	2,523			7,827	2,523
Total	\$ 369,946	\$ 427,210	\$ 5,699	\$ 6,375	\$ 375,645	\$ 433,585

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012	Jun. 30, 2013	Dec. 31, 2012
Grade:								
Pass	\$ 9,954	\$ 10,142	\$ 51,861	\$ 57,305	\$ 285,025	\$ 318,809	\$ 346,840	\$ 386,256
Special mention	1,056	1,057	6,146	10,383	3,821	6,790	11,023	18,230
Substandard	6,740	5,932	13,311	12,800	21,042	27,433	41,093	46,165
Total	\$ 17,750	\$ 17,131	\$					