

BERKSHIRE HILLS BANCORP INC
Form 10-Q
May 10, 2013
Table of Contents

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: March 31, 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: 000-51584

BERKSHIRE HILLS BANCORP, INC.

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(Exact name of registrant as specified in its charter)

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 25,078,040 shares of common stock, par value \$0.01 per share, outstanding as of May 7, 2013.

Table of Contents

BERKSHIRE HILLS BANCORP, INC.

FORM 10-Q

INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Consolidated Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012</u>	4
<u>Consolidated Statements of Income for the Three Months Ended March 31, 2013 and 2012</u>	5
<u>Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2013 and 2012</u>	6
<u>Consolidated Statements of Changes in Stockholders' Equity for the Three Months Ended March 31, 2013 and 2012</u>	7
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2013 and 2012</u>	8
Notes to Consolidated Financial Statements	10
<u>Note 1</u> <u>Basis of Presentation</u>	10
<u>Note 2</u> <u>Recent Accounting Pronouncements</u>	10
<u>Note 3</u> <u>Trading Account Security</u>	11
<u>Note 4</u> <u>Securities Available for Sale and Held to Maturity</u>	12
<u>Note 5</u> <u>Loans</u>	16
<u>Note 6</u> <u>Deposits</u>	31
<u>Note 7</u> <u>Borrowed Funds</u>	32
<u>Note 8</u> <u>Stockholders' Equity</u>	34
<u>Note 9</u> <u>Earnings per Share</u>	36
<u>Note 10</u> <u>Stock-Based Compensation Plans</u>	37
<u>Note 11</u> <u>Operating Segments</u>	37
<u>Note 12</u> <u>Derivative Financial Instruments and Hedging Activities</u>	38
<u>Note 13</u> <u>Fair Value Measurements</u>	46
<u>Note 14</u> <u>Net Interest Income after Provision for Loan Losses</u>	54
<u>Note 15</u> <u>Subsequent Events</u>	54
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	54
<u>Selected Financial Data</u>	58
<u>Average Balances and Average Yields/Rates</u>	59
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	67
<u>Item 4. Controls and Procedures</u>	68
<u>PART II. OTHER INFORMATION</u>	

Table of Contents

<u>Item 1A.</u>	<u>Risk Factors</u>	70
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	70
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	71
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	71
<u>Item 5.</u>	<u>Other Information</u>	71
<u>Item 6.</u>	<u>Exhibits</u>	72
<u>Signatures</u>		73

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

(In thousands, except share data)	March 31, 2013	December 31, 2012
Assets		
Cash and due from banks	\$ 53,683	\$ 63,382
Short-term investments	20,648	34,862
Total cash and cash equivalents	74,331	98,244
Trading security	16,485	16,893
Securities available for sale, at fair value	558,875	466,169
Securities held to maturity (fair values of \$51,634 and \$52,490)	50,472	51,024
Federal Home Loan Bank stock and other restricted securities	37,870	39,785
Total securities	663,702	573,871
Loans held for sale	72,348	85,368
Residential mortgages	1,234,616	1,324,251
Commercial mortgages	1,397,142	1,413,544
Commercial business loans	618,342	600,126
Consumer loans	638,972	650,733
Total loans	3,889,072	3,988,654
Less: Allowance for loan losses	(33,263)	(33,208)
Net loans	3,855,809	3,955,446
Premises and equipment, net	88,181	86,461
Other real estate owned	2,513	1,929
Goodwill	255,529	255,199
Other intangible assets	17,682	19,059
Cash surrender value of bank-owned life insurance policies	88,893	88,198
Deferred tax assets, net	56,581	57,729
Other assets	69,765	75,305
Total assets	\$ 5,245,334	\$ 5,296,809
Liabilities		
Demand deposits	\$ 656,706	\$ 673,921
NOW deposits	374,721	379,880
Money market deposits	1,504,092	1,439,632
Savings deposits	451,959	436,387
Time deposits	1,113,113	1,170,589
Total deposits	4,100,591	4,100,409
Short-term debt	114,390	163,150
Long-term Federal Home Loan Bank advances	195,208	195,321
Subordinated notes	89,632	89,617
Total borrowings	399,230	448,088

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Other liabilities	71,631	81,047
Total liabilities	4,571,452	4,629,544

Stockholders' equity

Common stock (\$.01 par value; 50,000,000 shares authorized and 26,525,466 shares issued and 25,254,448 shares outstanding in 2013; 26,525,466 shares issued and 25,148,522 shares outstanding in 2012)	265	265
Additional paid-in capital	585,452	585,360
Unearned compensation	(5,845)	(3,035)
Retained earnings	126,430	122,014
Accumulated other comprehensive loss	(1,671)	(2,979)
Treasury stock, at cost (1,271,018 shares in 2013 and 1,376,944 shares in 2012)	(30,749)	(34,360)
Total stockholders' equity	673,882	667,265
Total liabilities and stockholders' equity	\$ 5,245,334	\$ 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	
	2013	March 31, 2012
Interest and dividend income		
Loans	\$ 47,081	\$ 35,051
Securities and other	3,800	3,621
Total interest and dividend income	50,881	38,672
Interest expense		
Deposits	5,363	5,502
Borrowings and junior subordinated notes	3,581	2,025
Total interest expense	8,944	7,527
Net interest income	41,937	31,145
Non-interest income		
Loan related fees	2,717	1,171
Deposit related fees	4,259	3,500
Mortgage banking fees	2,217	202
Insurance commissions and fees	2,997	2,746
Wealth management fees	2,264	1,900
Total fee income	14,454	9,519
Non-recurring gain		42
Other	344	241
Total non-interest income	14,798	9,802
Total net revenue	56,735	40,947
Provision for loan losses	2,400	2,000
Non-interest expense		
Compensation and benefits	17,741	13,589
Occupancy and equipment	5,768	4,395
Technology and communications	2,991	1,958
Marketing and promotion	638	351
Professional services	1,490	1,365
FDIC premiums and assessments	828	681
Other real estate owned and foreclosures	23	179
Amortization of intangible assets	1,377	1,311
Merger and conversion related expenses	5,064	4,223
Other	3,563	2,142
Total non-interest expense	39,483	30,194
Income from continuing operations before income taxes	14,852	8,753
Income tax expense	4,387	2,272
Net income from continuing operations	10,465	6,481
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	\$ 10,465	\$ 5,844
Basic and diluted earnings per share:		
Continuing operations	\$ 0.42	\$ 0.31
Discontinued operations		(0.03)
Total basic and diluted earnings per share	\$ 0.42	\$ 0.28

Weighted average common shares outstanding:

Basic	24,948	20,955
Diluted	25,143	21,062

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	
	2013	March 31, 2012
Net income	\$ 10,465	\$ 5,844
Other comprehensive income, before tax:		
Changes in unrealized gains and losses on securities available-for-sale	733	1,293
Changes in unrealized gains and losses on derivative hedges	1,442	284
Changes in unrealized gains and losses on terminated swaps	236	235
Income taxes related to other comprehensive income:		
Changes in unrealized gains and losses on securities available-for-sale	(320)	(515)
Changes in unrealized gains and losses on derivative hedges	(575)	(206)
Changes in unrealized gains and losses on terminated swaps	(208)	(98)
Total other comprehensive income	1,308	993
Total comprehensive income	\$ 11,773	\$ 6,837

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

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

(In thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Unearned compen- sation	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					5,844			5,844
Other comprehensive income						993		993
Total comprehensive income								6,837
Cash dividends declared (\$0.17 per share)					(3,603)			(3,603)
Forfeited shares	(6)		11	119			(130)	
Exercise of stock options	1				(6)		22	16
Restricted stock grants	60		(134)	(1,380)			1,514	
Stock-based compensation				466				466
Net tax benefit related to stock-based compensation			18					18
Other, net	(11)						(265)	(265)
Balance at March 31, 2012	21,192	\$ 229	\$ 494,199	\$ (3,585)	\$ 111,712	\$ (3,892)	\$ (41,829)	\$ 556,834
Balance at December 31, 2012	25,148	\$ 265	\$ 585,360	\$ (3,035)	\$ 122,014	\$ (2,979)	\$ (34,360)	\$ 667,265
Comprehensive income:								
Net income					10,465			10,465
Other comprehensive income						1,308		1,308
Total comprehensive income								11,773
Cash dividends declared (\$0.18 per share)					(4,561)			(4,561)
Treasury stock purchased	(98)						(2,434)	(2,434)
Forfeited shares	(4)		8	90			(98)	
Exercise of stock options	118				(1,488)		3,315	1,827
Restricted stock grants	146		(691)	(3,485)			4,176	
Stock-based compensation			296	585				881
Net tax benefit related to stock-based compensation			479					479
Other, net	(56)						(1,348)	(1,348)

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Balance at March 31, 2013	25,254	\$	265	\$	585,452	\$	(5,845)	\$	126,430	\$	(1,671)	\$	(30,749)	\$	673,882
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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)	Three months ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	\$ 10,465	\$ 5,844
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,400	2,000
Net amortization of securities	354	488
Change in unamortized net loan costs and premiums	(511)	(135)
Premises and equipment depreciation and amortization expense	1,725	1,441
Stock-based compensation expense	881	466
Accretion of purchase accounting entries	(4,659)	(1,248)
Amortization of other intangibles	1,377	1,311
Excess tax loss from stock-based payment arrangements	(479)	(18)
Income from cash surrender value of bank-owned life insurance policies	(695)	(643)
Gain on sales of securities, net	(1)	(41)
Net (increase) decrease in loans held for sale	13,020	1,455
Loss on disposition of assets	1,596	1,527
(Gain) loss on sale of real estate	(115)	40
Net change in other	(3,072)	792
Net cash provided by operating activities	22,286	13,279
Cash flows from investing activities:		
Net decrease in trading security	128	120
Proceeds from sales of securities available for sale		3,040
Proceeds from maturities, calls and prepayments of securities available for sale	37,481	23,190
Purchases of securities available for sale	(129,806)	(29,208)
Proceeds from maturities, calls and prepayments of securities held to maturity	882	1,436
Purchases of securities held to maturity	(329)	(2,057)
Net change in loans	100,676	(83,636)
Net cash used for Divestiture		(48,890)
Proceeds from sale of Federal Home Loan Bank stock	1,915	1,836
Purchase of premises and equipment, net	(5,094)	(4,468)
Proceeds from sale of other real estate	449	1,671
Net cash provided by (used in) investing activities	6,302	(136,966)

*(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)	Three months ended March 31,	
	2013	2012
Cash flows from financing activities:		
Net increase in deposits	1,049	82,475
Proceeds from Federal Home Loan Bank advances and other borrowings	90,015	44,360
Repayments of Federal Home Loan Bank advances and other borrowings	(138,873)	(30,058)
Net proceeds from reissuance of treasury stock		16
Purchase of treasury stock	(2,434)	
Exercise of stock options	1,827	
Excess tax loss from stock-based payment arrangements	479	18
Common stock cash dividends paid	(4,564)	(3,603)
Net cash (used in) provided by financing activities	(52,501)	93,208
Net change in cash and cash equivalents	(23,913)	(30,479)
Cash and cash equivalents at beginning of year	98,244	75,782
Cash and cash equivalents at end of year	\$ 74,331	\$ 45,303
Supplemental cash flow information:		
Interest paid on deposits	\$ 5,330	\$ 5,539
Interest paid on borrowed funds	3,440	2,025
Income taxes paid, net	638	1,233
Acquisition of non-cash assets and liabilities:		
Liabilities assumed	(330)	
Other non-cash changes:		
Other net comprehensive income	1,308	993
Real estate owned acquired in settlement of loans	918	250

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

Table of Contents

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 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.

Out of Period Adjustment

During the three months ended March 31, 2013, the Company recorded a correction of an immaterial error that increased net income by \$0.4 million. The amount represents a correction to tax-related over-accruals that occurred in the fourth quarter of 2012. After evaluating the quantitative and qualitative aspects of these adjustments, the Company concluded that its prior year financial statements were not materially misstated and, therefore, no restatement was required.

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 limits 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 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.

Table of Contents

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 \$13.5 million and \$13.6 million, and a fair value of \$16.5 million and \$16.9 million, at March 31, 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 March 31, 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
March 31, 2013				
Securities available for sale				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 80,897	\$ 4,784	\$ (222)	\$ 85,459
Government guaranteed residential mortgage-backed securities	42,968	707	(35)	43,640
Government-sponsored residential mortgage-backed securities	336,894	2,666	(255)	339,305
Corporate bonds	36,042	248	(74)	36,216
Trust preferred securities	18,713	1,537	(1,873)	18,377
Other bonds and obligations	3,374	9	(1)	3,382
Total debt securities	518,888	9,951	(2,460)	526,379
<i>Equity securities:</i>				
Marketable equity securities	28,536	4,120	(160)	32,496
Total securities available for sale	547,424	14,071	(2,620)	558,875
Securities held to maturity				
Municipal bonds and obligations	8,289			8,289
Government-sponsored residential mortgage-backed securities	75	7		82
Tax advantaged economic development bonds	41,331	1,615	(460)	42,486
Other bonds and obligations	777			777
Total securities held to maturity	50,472	1,622	(460)	51,634
Total	\$ 597,896	\$ 15,693	\$ (3,080)	\$ 610,509
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

Table of Contents

The amortized cost and estimated fair value of available for sale (AFS) and held to maturity (HTM) securities, segregated by contractual maturity at March 31, 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	\$ 100	\$ 100	\$ 4,500	\$ 4,500
Over 1 year to 5 years	9,922	10,048	4,208	4,259
Over 5 years to 10 years	46,876	47,729	25,382	26,252
Over 10 years	82,128	85,557	16,307	16,541
Total bonds and obligations	139,026	143,434	50,397	51,552
Marketable equity securities	28,536	32,496		
Residential mortgage-backed securities	379,862	382,945	75	82
Total	\$ 547,424	\$ 558,875	\$ 50,472	\$ 51,634

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Table of Contents

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
March 31, 2013						
Securities available for sale						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 222	\$ 9,308	\$	\$	\$ 222	\$ 9,308
Government-guaranteed residential mortgage-backed securities	35	5,355			35	5,355
Government-sponsored residential mortgage-backed securities	255	91,375			255	91,375
Corporate bonds	73	15,859	1	5,000	74	20,859
Trust preferred securities	1	1,545	1,872	1,728	1,873	3,273
Other bonds and obligations	1	1,986			1	1,986
Total debt securities	587	125,428	1,873	6,728	2,460	132,156
Marketable equity securities	18	1,713	142	1,858	160	3,571
Total securities available for sale	605	127,141	2,015	8,586	2,620	135,727
Securities held to maturity						
Tax advantaged economic development bonds	460	7,987			460	7,987
Total securities held to maturity	460	7,987			460	7,987
Total	\$ 1,065	\$ 135,128	\$ 2,015	\$ 8,586	\$ 3,080	\$ 143,714
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 March 31, 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 March 31, 2013:

Table of Contents

AFS municipal bonds and obligations

At March 31, 2013, 12 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 2.3% 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 we are appropriately compensated for that risk. There were no material underlying credit downgrades during the first quarter of 2013. All securities are performing.

AFS residential mortgage-backed securities

At March 31, 2013, 18 out of the total 186 securities in the Company's portfolios of AFS residential mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented less than 1% 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 considered performing.

AFS corporate bonds

At March 31, 2013, 5 out of the total 8 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represented less than 1% of the amortized cost of the securities. All 5 securities remain investment grade rated and the market value of the securities supports the Company's amortized value. The securities are considered performing.

AFS trust preferred securities

At March 31, 2013, 3 out of the total 7 securities in the Company's portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 36.4% 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. 5 of the 7 securities contain at least one below investment grade ratings. 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 considered performing.

At March 31, 2013, \$1.7 million of the total unrealized losses was attributable to a \$2.6 million investment in a Mezzanine Class B tranche of a \$360 million pooled trust preferred security issued by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of \$0.9 million, for potential other-than-temporary-impairment (OTTI) at March 31, 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 \$51 million in excess subordination above current and projected losses. The security is considered performing.

HTM tax advantaged economic development bonds

At March 31, 2013, 1 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 5.5% of the amortized cost of securities in unrealized loss positions. The Company has the intent of maintaining these bonds to recovery. All securities are considered performing.

AFS other bonds and obligations

At March 31, 2013, 1 of the total 10 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented less than 1% of the amortized cost of securities

Table of Contents

in unrealized loss positions. The securities are investment grade rated and there were no material underlying credit downgrades during the first quarter of 2013. 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 March 31, 2013, 3 out of the total 26 securities in the Company's portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 4.3% 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 March 31, 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 includes residential mortgage, commercial mortgage, commercial business, and consumer loan segments to customers. 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 and other commercial business loan classes. Consumer loans include home equity, direct and indirect auto and other. 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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Table of Contents

(In thousands)	March 31, 2013		Total
	Business Loans	Acquired Loans	
Residential mortgages			
1-4 family	\$ 813,150	\$ 396,899	\$ 1,210,049
Construction	18,516	6,051	24,567
Total residential mortgages	831,666	402,950	1,234,616
Commercial mortgages:			
Construction	149,599	19,461	169,060
Single and multi-family	65,203	78,003	143,206
Commercial real estate	754,411	330,465	1,084,876
Total commercial mortgages	969,213	427,929	1,397,142
Commercial business loans:			
Asset based lending	274,632	3,978	278,610
Other commercial business loans	243,057	96,675	339,732
Total commercial business loans	517,689	100,653	618,342
Total commercial loans	1,486,902	528,582	2,015,484
Consumer loans:			
Home equity	199,101	118,062	317,163
Other	98,489	223,320	321,809
Total consumer loans	297,590	341,382	638,972
Total loans	\$ 2,616,158	\$ 1,272,914	\$ 3,889,072

(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

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Total loans	\$	2,625,636	\$	1,363,018	\$	3,988,654
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Table of Contents

The carrying amount of the acquired loans at March 31, 2013 totaled \$1.27 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 \$69.8 million and loans that were considered not impaired at the acquisition date with a carrying amount of \$1.20 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 March 31,			
	2013		2012	
Balance at beginning of period	\$	8,247	\$	1,277
Acquisitions				
Sales				
Reclassification from nonaccretable difference for loans with improved cash flows				
Changes in expected cash flows that do not affect nonaccretable difference				
Accretion		(2,581)		(609)
Balance at end of period	\$	5,666	\$	668

Table of Contents

The following is a summary of past due loans at March 31, 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
March 31, 2013							
Residential mortgages:							
1-4 family	\$ 3,633	\$ 996	\$ 8,738	\$ 13,367	\$ 799,783	\$ 813,150	\$ 1,896
Construction	553	111	89	753	17,763	18,516	89
Total	4,186	1,107	8,827	14,120	817,546	831,666	1,985
Commercial mortgages:							
Construction		225	4,318	4,543	145,056	149,599	
Single and multi-family	214	140	474	828	64,375	65,203	330
Commercial real estate	3,962	548	6,248	10,758	743,653	754,411	
Total	4,176	913	11,040	16,129	953,084	969,213	330
Commercial business loans:							
Asset based lending					274,632	274,632	
Other commercial business loans	396	124	2,885	3,405	239,652	243,057	230
Total	396	124	2,885	3,405	514,284	517,689	230
Consumer loans:							
Home equity	1,663	186	2,553	4,402	194,699	199,101	1,001
Other	361	118	362	841	97,648	98,489	142
Total	2,024	304	2,915	5,243	292,347	297,590	1,143
Total	\$ 10,782	\$ 2,448	\$ 25,667	\$ 38,897	\$ 2,577,261	\$ 2,616,158	\$ 3,688

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							
Asset based lending					255,265	255,265	

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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
March 31, 2013							
Residential mortgages:							
1-4 family	\$ 862	\$ 648	\$ 2,819	\$ 4,329	\$ 392,570	\$ 396,899	\$ 843
Construction					6,051	6,051	
Total	862	648	2,819	4,329	398,621	402,950	843
Commercial mortgages:							
Construction			1,080	1,080	18,381	19,461	1,080
Single and multi-family	230	3,424	1,243	4,897	73,106	78,003	1,165
Commercial real estate	284		11,576	11,860	318,605	330,465	9,968
Total	514	3,424	13,899	17,837	410,092	427,929	12,213
Commercial business loans:							
Asset based lending					3,978	3,978	
Other commercial business loans	320	187	2,286	2,793	93,882	96,675	1,422
Total	320	187	2,286	2,793	97,860	100,653	1,422
Consumer loans:							
Home equity	544	495	279	1,318	116,744	118,062	64
Other	3,037	450	383	3,870	219,450	223,320	45
Total	3,581	945	662	5,188	336,194	341,382	109
Total	\$ 5,277	\$ 5,204	\$ 19,666	\$ 30,147	\$ 1,242,767	\$ 1,272,914	\$ 14,587

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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Table of Contents

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

(In thousands)	Business Loans		March 31, 2013 Acquired Loans		Total
Residential mortgages:					
1-4 family	\$	6,842	\$	1,976	\$ 8,818
Total		6,842		1,976	8,818
Commercial mortgages:					
Construction		4,318			4,318
Single and multi-family		144	78		222
Other		6,248	1,608		7,856
Total		10,710	1,686		12,396
Commercial business loans:					
Other commercial business loans		2,655	864		3,519
Total		2,655	864		3,519
Consumer loans:					
Home equity		1,552	215		1,767
Other		220	338		558
Total		1,772	553		2,325
Total non-accrual loans	\$	21,979	\$	5,079	\$ 27,058

(In thousands)	Business Loans		December 31, 2012 Acquired Loans		Total
Residential mortgages:					
1-4 family	\$	6,498	\$	968	\$ 7,466
Construction					
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

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

Table of Contents**Business Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
March 31, 2013						
Balance at beginning of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Charged-off loans	190	720	679	250		1,839
Recoveries on charged-off loans	16	3	71	36		126
Provision for loan losses	244	402	194	874	148	1,862
Balance at end of period	\$ 5,998	\$ 18,548	\$ 5,191	\$ 2,126	\$ 177	\$ 32,040
Individually evaluated for impairment	765	1,374	824	272		3,235
Collectively evaluated	5,233	17,174	4,367	1,854	177	28,805
Total	\$ 5,998	\$ 18,548	\$ 5,191	\$ 2,126	\$ 177	\$ 32,040

Loans receivable:

Balance at end of period						
Individually evaluated for impairment	7,625	30,024	1,900	1,510		41,059
Collectively evaluated	824,041	939,189	515,789	296,080		2,575,099
Total	\$ 831,666	\$ 969,213	\$ 517,689	\$ 297,590		\$ 2,616,158

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
March 31, 2013						
Balance at beginning of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Charged-off loans	86	235	25	316		662
Recoveries on charged-off loans			2	28		30
Provision for loan losses	95	265	27	307	(156)	538
Balance at end of period	\$ 518	\$ 420	\$ 100	\$ 333	\$ (148)	\$ 1,223
Individually evaluated for impairment	113					113
Collectively evaluated	405	420	100	333	(148)	1,110
Total	\$ 518	\$ 420	\$ 100	\$ 333	\$ (148)	\$ 1,223

Loans receivable:

Balance at end of Period						
Individually evaluated for impairment	954	2,374	181			3,509
Collectively evaluated	401,996	425,555	100,472	341,382		1,269,405
Total	\$ 402,950	\$ 427,929	\$ 100,653	\$ 341,382		\$ 1,272,914

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

Table of Contents

The following is a summary of impaired loans at March 31, 2013:

Business Loans

(In thousands)	Recorded Investment	At March 31, 2013 Unpaid Principal Balance		Related Allowance
With no related allowance:				
Residential mortgages - 1-4 family	\$ 2,476	\$ 2,476		\$
Commercial mortgages - single and multifamily	2,380	2,380		
Commercial mortgages - real estate	3,289	3,289		
Other commercial business loans	70	70		
Consumer - home equity	556	556		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 1,933	\$ 2,698		\$ 765
Commercial mortgages - construction	1,408	1,938		530
Commercial mortgages - real estate	1,755	2,599		844
Other commercial business loans	565	1,389		824
Consumer - home equity	456	728		272
Total				
Residential mortgages	\$ 4,409	\$ 5,174		\$ 765
Commercial mortgages	8,832	10,206		1,374
Commercial business	635	1,459		824
Consumer	1,012	1,284		272
Total impaired loans	\$ 14,888	\$ 18,123		\$ 3,235

Acquired Loans

(In thousands)	Recorded Investment	At March 31, 2013 Unpaid Principal Balance		Related Allowance
With no related allowance:				
Commercial mortgages - real estate	\$ 1,608	\$ 1,608		\$
Other commercial business loans	180	180		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 747	\$ 860		\$ 113
Total				
Residential mortgages	\$ 747	\$ 860		\$ 113
Commercial mortgages	1,608	1,608		
Commercial business	180	180		
Total impaired loans	\$ 2,535	\$ 2,648		\$ 113

Table of Contents

The following is a summary of impaired loans at December 31, 2012:

Business Loans

(In thousands)	Recorded Investment	At December 31, 2012		Related Allowance
		Unpaid Principal		
		Balance		
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		Related Allowance
		Unpaid Principal		
		Balance		
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

Table of Contents

The following is a summary of the average recorded investment and interest income recognized on impaired loans as of March 31, 2013 and March 31, 2012:

Business Loans

(in thousands)	Three Months Ended March 31, 2013		Three Months Ended March 31, 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	\$ 2,141	\$ 20	\$ 583	\$ 15
Commercial-construction	2,380			
Commercial mortgages - single and multifamily			81	
Commercial mortgages - real estate	3,295	10	677	15
Commercial business loans	70			
Consumer-home equity	455	4	35	1
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 2,234	\$ 1	\$ 914	\$ 14
Commercial-construction	1,938		34	2
Commercial mortgages - single and multifamily			1,926	
Commercial mortgages - real estate	2,765		6	
Commercial business loans	1,721	14	526	9
Consumer-home equity	558		211	
Total				
Residential mortgages	\$ 4,375	\$ 21	\$ 1,497	\$ 29
Commercial mortgages	10,378	10	3,216	24
Commercial business loans	1,791	14	34	2
Consumer loans	1,013	4	246	1
Total impaired loans	\$ 17,557	\$ 49	\$ 4,993	\$ 56

Acquired Loans

(in thousands)	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Commercial mortgages - real estate	\$ 803	\$ 2	\$	\$
Commercial business loans	181			
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 861	\$	\$	\$
Total				
Residential mortgages	\$ 861	\$	\$	\$
Commercial mortgages	803	2		
Commercial business loans	181			

Total impaired loans	\$	1,845	\$	2	\$	\$
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Table of Contents

Credit Quality Information

The Bank utilizes an eleven grade internal loan rating system for each of its commercial real estate, construction and commercial 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**

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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.

Table of Contents

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 undertakes the same process of assigning risk ratings as historical loans, which 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.

Table of Contents

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 March 31, 2013, there had not been such a decrease and therefore there was no allowance for losses on acquired loans under Subtopic ASC 310-30.

The Company presented several tables within this footnote of historical 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 March 31, 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	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 803,416	\$ 860,970	\$ 18,316	\$ 20,085	\$ 821,732	\$ 881,055
Special mention	996	1,291	111	210	1,107	1,501
Substandard	8,738	8,061	89	49	8,827	8,110
Total	\$ 813,150	\$ 870,322	\$ 18,516	\$ 20,344	\$ 831,666	\$ 890,666

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:								

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Pass	\$	141,218	\$	142,946	\$	61,679	\$	40,690	\$	693,588	\$	707,867	\$	896,485	\$	891,503
Special mention						88	\$	420		7,958		5,965		8,046		6,385
Substandard		8,381		7,748		3,436		2,222		52,865		54,930		64,682		64,900
Doubtful												105				105
Total	\$	149,599	\$	150,694	\$	65,203	\$	43,332	\$	754,411	\$	768,867	\$	969,213	\$	962,893

Commercial Business Loans

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending		Other		Total commercial business loans	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:						
Pass	\$	274,632	\$	255,265		