BERKSHIRE HILLS BANCORP INC
Form 10-K
March 16, 2007

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

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

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: 0-58514

BERKSHIRE HILLS BANCORP, INC.
(Exact name of registrant as specified in its charter)

Delaware	**04-3510455**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
24 North Street, Pittsfield, Massachusetts	**01201**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (413) 443-5601
Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $0.01 per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "large accelerated filer and accelerated filer" in rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated filer o Accelerated filer x   Non-accelerated filer o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $255 million, based upon the closing price of $35.48 as quoted on the NASDAQ Global Select Market as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares outstanding of the registrant's common stock as of March 7, 2007 was 8,760,526.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2007 Annual Meeting of Shareholders are incorporated by reference in Part III of this Form 10-K.

INDEX

Index

PART I

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of Berkshire Hills Bancorp, Inc. and Berkshire Bank. This document may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company, are generally identified by use of the words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “project,” “seek,” “strive,” “try,” or future or conditional verbs “would,” “should,” “could,” “may,” or similar expressions. Although we believe that our plans, intentions and expectations, as reflected in these forward-looking statements are reasonable, we can give no assurance that these plans, intentions or expectations will be achieved or realized. Our ability to predict results or the actual effects of our plans and strategies are inherently uncertain. Actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained in this Form 10-K. Important factors that could cause actual results to differ materially from our forward-looking statements are set forth under Item 1A. - “Risk Factors” in this Form 10-K, and in other reports filed with the Securities and Exchange Commission. There are a number of factors, many of which are beyond our control, that could cause actual conditions, events, or results to differ significantly from those described in the forward-looking statements. These factors include, but are not limited to: general economic conditions, either nationally or locally in some or all of the areas in which we conduct our business; conditions in the securities markets or the banking industry; changes in interest rates and energy prices, which may affect our net income or future cash flows; changes in deposit flows, and in demand for deposit, loan, and investment products and other financial services in our local markets; changes in real estate values, which could impact the quality of the assets securing our loans; changes in the quality or composition of the loan or investment portfolios; changes in competitive pressures among financial institutions or from non-financial institutions; the ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames; our timely development of new and competitive products or services in a changing environment, and the acceptance of such products or services by our customers; the outcome of pending or threatened litigation or of other matters before regulatory agencies, whether currently existing or commencing in the future; changes in accounting principles, policies, practices, or guidelines; changes in legislation and regulation; operational issues and/or capital spending necessitated by the potential need to adapt to industry changes in information technology systems on which we are highly dependent; changes in the monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; war or terrorist activities; and other economic, competitive, governmental, regulatory, and geopolitical factors affecting the Company’s operations, pricing, and services. Additionally, the timing and occurrence or non-occurrence of events may be subject to circumstances beyond our control. You should not place undue reliance on these forward-looking statements, which reflect our expectations only as of the date of this report. We do not assume any obligation to revise forward-looking statements except as may be required by law.

GENERAL

Berkshire Hills Bancorp, Inc. is a Delaware corporation and the holding company for Berkshire Bank. Established in 1846, Berkshire Bank is one of Massachusetts' oldest and largest independent banks and is the largest banking institution based in Western Massachusetts. The Bank is headquartered in Pittsfield, Massachusetts and operates 27 full-service banking offices serving communities throughout Western Massachusetts and in Northeastern New York. The Bank operates in three regions:

- The Berkshire County Region, with eleven offices in Berkshire County.

- The Pioneer Valley Region with ten offices along the Connecticut River valley north and west of Springfield in Massachusetts. The Company entered this region through the acquisition of Woronoco Bancorp Inc. in June 2005.

-3-

Index

- The New York Region serving Albany and the surrounding area in Northeastern New York. This region represents a de novo expansion by the Bank. At year end 2006, it had six offices, with another four offices scheduled to open in the first half of 2007.

These three regions are viewed as having favorable demographics and provide an attractive regional niche for the Bank to distinguish itself as the preferred choice compared to larger super-regional banks and smaller community banks. The Company is pursuing growth through acquisitions, de novo branching, product development, and organic growth. The Company is considering possible expansion into Southern Vermont and Northern Connecticut. The Bank entered the Pioneer Valley area of Massachusetts in 2005 with the acquisition of Woronoco Bancorp, Inc. The Company made acquisitions of insurance and financial planning providers in 2004 and 2005, followed by the acquisition of five affiliated insurance agencies in the fourth quarter of 2006. These insurance acquisitions were merged and integrated into the Berkshire Insurance Group, which was made a subsidiary of the Company. The Company aspires to be “America’s Most Exciting Bank”. It has set out to change the financial service experience, and its vision is to establish itself as a world-class financial services company through an engaging and exciting environment where customers want to do business and employees want to work.

The Bank is a full-scale provider of deposit, lending, investment, and insurance products by a team of employees with extensive experience in banking, insurance, and investment management. The Company stresses quality control, including using Six Sigma tools to improve operational effectiveness and efficiency. It is enhancing its credit and risk management functions to maintain strong asset quality and careful interest rate management. It stresses a culture of teamwork and performance excellence to produce customer satisfaction to support its strategic growth and profitability.

COMPANY WEBSITE AND AVAILABILITY OF SECURITIES AND EXCHANGE COMMISSION FILINGS

The Company’s Internet website is www.berkshirebank.com. The Company makes available free of charge on or through its website, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after the Company electronically files such material with the Securities and Exchange Commission. Information on the website is not incorporated by reference and is not a part of this annual report on Form 10-K.

COMPETITION

The Company is subject to strong competition from banks and other financial institutions and financial service providers. Its competition includes national and super-regional banks such as Bank of America, TD Banknorth, and Citizens Bank, which have substantially greater resources and lending limits. Non-bank competitors include credit unions, brokerage firms, insurance providers, financial planners, and the mutual fund industry. New technology is reshaping customer interaction with financial service providers and the increase of Internet-accessible financial institutions increases competition for the Company’s customers. The Company generally competes on the basis of customer service, relationship management, and the pricing of loan and deposit products and wealth management services. The location and convenience of branch offices is also a significant competitive factor, particularly regarding new offices. The Bank has recently designated regional headquarters led by regional presidents as an important component of its market management. The Company has recently revised its vision - to establish itself as a world-class financial services company through an engaging and exciting environment where customers want to do business and employees want to work. This brand and culture statement is expected to drive customer emotional engagement, loyalty, market share and profitability.

LENDING ACTIVITIES

General. The Bank originates loans in the four basic portfolio categories discussed below. Lending activities are limited by federal and state laws and regulations. Loan interest rates and other key loan terms are affected principally by the Bank's asset/liability strategy, loan demand, competition, and the supply of money available for lending purposes. These factors, in turn, are affected by general and economic conditions, monetary policies of the federal government, including the Federal Reserve Board, legislative tax policies and governmental budgetary matters. The majority of the Bank's loans are made in its market areas and are secured by real estate in its primary markets. Lending activities are therefore affected by activity in these real estate markets. The Bank does not engage in subprime lending activities targeted towards borrowers in high risk categories. The Bank monitors and limits the amount of long-term fixed-rate lending volume. Adjustable-rate loan products generally reduce interest rate risk but may produce higher loan losses in

Index

the event of sustained rate increases. Despite the 4.25% increase in the prime interest rate over the two years ending in June 2006, such higher losses have not yet been recorded but were determined to be inherent in the portfolio, which resulted in an increase in the loan loss allowance in 2006.

Loan Portfolio Analysis. The following table sets forth the year-end composition of the Bank's loan portfolio in dollar amounts and as a percentage of the portfolio at the dates indicated.

	2006		2005		2004		2003		2002	
(Dollars in millions)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Residential mortgages	$ 599.2	36%	$ 549.8	39%	$ 235.2	28%	$ 265.5	34%	$ 241.6	33%
Commercial mortgages	567.1	33	410.7	29	260.5	32	206.4	26	157.1	22
Commercial business	189.8	11	158.7	11	150.9	18	166.3	21	165.3	23
Total commercial loans	756.9	44	569.4	40	411.4	50	372.7	47	322.4	45
Consumer	342.9	20	301.0	21	181.5	22	154.0	19	159.0	22
Total loans	1,699.0	100%	1,420.2	100%	828.1	100%	792.2	100%	723.0	100%
Allowance for loan losses	(19.4)		(13.0)		(9.3)		(9.0)		(10.3)	
Net loans	$ 1,679.6		$ 1,407.2		$ 818.8		$ 783.2		$ 712.7	

Residential mortgages. The Bank originates first mortgage loans to individuals, secured by one-to-four family residences in its markets. The Bank originates both fixed-rate and adjustable-rate mortgages to finance primary and secondary residences, as well as non-owner occupied properties. The Bank also provides construction and land development first mortgage loans to individuals. The Bank also offers jumbo loan products and FHA/VA related products. Berkshire Bank generally underwrites, processes, and closes its residential mortgages following conforming secondary market guidelines.

The Bank originates loans to individuals for the construction and acquisition of personal residences. These loans generally provide fifteen-month construction periods followed by a permanent mortgage loan, and follow the Bank's normal mortgage underwriting guidelines. Residential construction loans totaled $32 million at year-end 2006.

The Bank normally holds most adjustable-rate mortgages for its own portfolio. It generally sells most 15 and 30 year fixed-rate mortgages on a servicing released flow basis, although some are retained in portfolio. Forward sale commitments are made when customers rate-lock their applications. Sometimes the Bank also sells or securitizes some existing residential mortgages to adjust interest rate risk or to provide liquidity. Residential mortgages are viewed as having the least credit risk and the narrowest lending margins among the Bank's lending products.

Commercial Mortgages. The Bank originates commercial mortgages on properties used for business purposes such as small office buildings, industrial, healthcare, lodging, recreation, or retail facilities. This portfolio also includes commercial 1-4 family and multifamily properties. Loans may generally be made with terms of up to 25 years and with interest rates that adjust periodically (primarily from floating to five years).

Berkshire Bank generally requires that borrowers have debt service coverage ratios (the ratio of available cash flows before debt service to debt service) of at least 1.25 times. Loans may be made up to 80% of appraised value. Generally, commercial mortgages require personal guarantees by the principals. Credit enhancements in the form of additional collateral or guarantees are normally considered for start-up businesses without a qualifying cash flow history.

The Bank also originates commercial construction loans for residential and commercial properties. These loans generally have an interest-only phase during construction and then convert to permanent financing. Berkshire Bank also originates land loans for the purpose of holding or developing the land for sale. Land loans are normally three year notes with principal due at maturity. Commercial construction loans totaled $130 million at year-end 2006.

Commercial mortgages generally involve larger principal amounts and a greater degree of risk than residential mortgages. They also often provide higher lending spreads. Because repayment is often dependent on the successful

Index

operation or management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy. Additionally, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than on established cash flows. If the Bank is forced to foreclose on a construction project before or at completion, there is a higher risk of credit loss. Berkshire Bank seeks to minimize these risks through strict adherence to its underwriting standards and portfolio management processes.

Commercial Business Loans. The Bank offers secured commercial term loans with repayment terms which are normally limited to the lesser of the expected useful life of the asset being financed, generally not exceeding seven years. Berkshire Bank also offers revolving loans, lines of credit, letters of credit, time notes and Small Business Administration guaranteed loans. Business lines of credit have adjustable rates of interest and are payable on demand, subject to annual review and renewal.

Commercial lending policies regarding debt-service coverage ability and guarantees are similar to those which govern commercial real estate lending. Commercial business loans are generally secured by a variety of collateral such as accounts receivable, inventory and equipment, and are generally supported by personal guarantees. Loan to value ratios depend on the collateral type and generally do not exceed 95% of the liquidation value of the collateral. Some commercial loans may also be secured by liens on real estate. Berkshire Bank generally does not make unsecured commercial loans.

Commercial loans are of higher risk and are made primarily on the basis of the borrower's ability to make repayment from the cash flows of its business. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value. The Bank gives additional consideration to the borrower's credit history and capacity to help mitigate these risks. Commercial loans are often a central component of a total commercial banking relationship, and are therefore an important component of the Bank's lending activities.

Consumer Loans. Berkshire Bank's consumer lending strategy is focused on indirect automobile loans and home equity loans. The Bank offers fixed-rate automobile loans with terms of up to 72 months for new and recent model used cars and up to 66 months for older model used cars. The Bank generally makes such loans up to 100% of the retail value shown in the *NADA Used Car Guide*. This program is targeted towards prime grade credits. The Bank does not offer subprime lending programs. The automobile loans have produced a higher loan charge-off rate than the Bank's residential mortgage and home equity loans. Collections are more sensitive to changes in borrower financial circumstances, and the collateral can be depreciated or damaged prior to repossession. Additionally, collections are more subject to the limitations of federal and state laws. Automobile loans outstanding totaled $196 million at year-end 2006. The Bank originates indirect loans through a network of automobile dealers in its market, as well as through a conduit sales finance company sourced from franchised automobile dealerships.

The Bank's home equity lines of credit are typically secured by second mortgages on borrowers' residences. Home equity lines have an initial revolving period up to ten years, followed by an amortizing term up to fifteen years. These loans are normally indexed to the prime rate. Home equity loans also include amortizing fixed-rate second mortgages with terms up to fifteen years. Lending policies for combined debt service and collateral coverage are similar to those used for residential first mortgages, although underwriting verifications are more streamlined. Home equity line credit risks are similar to those of adjustable-rate first mortgages, although these loans may be more sensitive to losses when interest rates are rising due to more sensitivity to rate changes and more possible compression of collateral coverage on second liens. The Bank also includes all other consumer loans in this portfolio total, including personal secured and unsecured loans and overdraft protection facilities. Home equity and other loans outstanding at year-end 2006 totaled $147 million.

Index

Maturity and Sensitivity of Loan Portfolio. The following table shows contractual final maturities of selected loan categories at year-end 2006. The contractual maturities do not reflect premiums, discounts, and deferred costs, and do not reflect prepayments.

Contractual Maturity *(In thousands)*	One Year or Less	More than One to Five Years	More Than Five Years	Total
Construction mortgage loans:				
Residential	$ 1,669	$ 30,653	$ -	$ 32,322
Commercial	23,293	106,505	-	129,798
Commercial business loans	92,771	46,053	50,934	189,758
Total	$ 117,733	$ 183,211	$ 50,934	$ 351,878

For the $234 million total of loans above which mature in more than one year, $40 million of these loans are fixed-rate and $194 million are adjustable rate.

Loan Administration. Lending activities are governed by a loan policy approved by the Board of Directors. Internal staff perform post-closing loan documentation review, quality control and ongoing loan review. The Bank assigns a risk rating to all commercial loans, and loan review staff perform an ongoing program of loan and risk rating reviews. Management also employs an independent third party for loan reviews, as discussed in “Allowance for Loan Losses.”

The Bank’s lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by Berkshire Bank’s Board of Directors and management. The Board of Directors has approved individual and combined lending approval authorities up to specified limits. Above those limits, the Board of Directors established Regional Loan Committees with commercial approval authority generally up to $5 million. Management’s Executive Loan Committee is responsible for commercial loan approval above $5 million and residential mortgage approval above $2 million. The Bank’s lending activities are conducted by its salaried and commissioned loan personnel and through its relationships with automobile dealers. From time to time, the Bank will purchase whole loans or participations in loans. These loans are underwritten according to Berkshire Bank’s underwriting criteria and procedures and are generally serviced by the originating lender under terms of the applicable participation agreement. The Bank from time to time will sell or securitize residential mortgages in the secondary market based on prevailing market interest rate conditions and an analysis of the composition and risk of the loan portfolio, the Bank’s interest rate risk profile and liquidity needs. The Bank sells a limited number of commercial loan participations on a non-recourse basis. The Bank issues loan commitments to its prospective borrowers conditioned on the occurrence of certain events. Loan origination commitments are made in writing on specified terms and conditions and are generally honored for up to ninety days from approval; some commercial commitments are made for longer terms. Total lending commitments, including lines and letters of credit, were $456 million at year-end 2006.

The loan policy sets certain limits on concentrations of credit and requires periodic reporting of concentrations to the Bank’s Board. Loans outstanding to the ten largest relationships totaled $155 million at year-end 2006. All of these relationships were rated in the three lowest risk commercial risk rating categories used by the Bank. Total year-end commercial construction loans outstanding were 74% of the Bank’s risk based capital at year-end, and total commercial mortgage outstandings (excluding certain owner-occupied loans) were estimated at 265% of risk based capital. The FDIC has recently established monitoring guidelines of 100% and 300% for these ratios, respectively. Above these guidelines, additional monitoring and risk management controls are required. Based on commitments outstanding at year-end 2006, the Bank may exceed these monitoring guidelines for one or both of these ratios in 2007, and the Bank is proactively establishing additional monitoring and risk management controls as set forth by the FDIC. The commercial construction and development loans primarily involve lodging, leisure, and retail properties. For the majority of these loans, the Bank provides permanent or semi-permanent financing after the construction period. The Bank also finances residential and condominium construction and development projects. The total number of units without committed end sales does not exceed sixty units.

Problem Assets. While Berkshire Bank generally prefers to work with borrowers to resolve problems, Berkshire Bank generally will initiate foreclosure or other proceedings no later than the 90^{th} day of a delinquency, as necessary, to

Index

minimize any potential loss. Management reports to the Board of Directors monthly delinquent loans and nonperforming assets. Loans are generally removed from accruing status when they reach 90 days delinquent, except for certain loans which are well secured and in the process of collection. Delinquent auto loans are maintained on accrual until they reach 120 days delinquent, and then they are generally charged-off.

Real estate acquired by Berkshire Bank as a result of loan collections is classified as real estate owned until sold. When property is acquired it is recorded at fair market value less estimated selling costs at the date of foreclosure, establishing a new cost basis. Holding costs and decreases in fair value after acquisition are expensed. At year-end 2006, Berkshire Bank had no foreclosed real estate.

The following table sets forth additional information on year-end problem assets.

(Dollars in thousands)	2006	2005	2004	2003	2002
Nonaccruing loans:					
Residential mortgages	$ 15	$ 261	$ 327	$ 348	$ 230
Commercial mortgages	308	271	147	496	-
Commercial business	7,203	553	523	1,887	2,850
Consumer	66	101	155	468	661
Total nonperforming loans	7,592	1,186	1,152	3,199	3,741
Real estate owned	-	-	-	-	1,500
Total nonperforming assets	$ 7,592	$ 1,186	$ 1,152	$ 3,199	$ 5,241
Troubled debt restructurings	$ 5,268	$ 1,234	$ 510	$ 214	$ -
Accruing loans 90+ days past due	281	110	65	306	590
Total nonperforming loans/total loans	0.45%	0.08%	0.14%	0.40%	0.52%
Total nonperforming assets/total assets	0.35%	0.06%	0.09%	0.26%	0.36%

Asset Classification and Delinquencies. The Bank performs an internal analysis of its loan portfolio and assets to classify such loans and assets similar to the manner in which such loans and assets are classified by the federal banking regulators. There are four classifications for problem assets: loss, doubtful, substandard and special mention. An asset classified as "Loss" is normally fully charged-off. "Substandard" assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Nonaccruing loans are normally classified as substandard. "Doubtful" assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated "Special Mention."

At year-end 2006, there were no loan balances classified as loss. The balance of loans classified as doubtful was $228 thousand. Loans classified as substandard totaled $23.7 million. The largest three substandard commercial relationships totaled $10.6 million and were in the process of collection. The largest substandard loan totaled $6.0 million and was in collection through bankruptcy proceedings. This loan is secured by business assets and had a $0.5 million impaired loan reserve at year-end. Loans classified as substandard are collectively regarded as having the potential to be nonperforming in the future. Loans rated special mention totaled $34.4 million at year end 2006. Loans delinquent 30 - 90 days totaled $4.1 million at year-end 2006. Troubled debt restructurings totaled $5.3 million at year-end 2006, which was increased from $1.2 million at the prior year-end due primarily to restructurings related to certain substandard loans.

Allowance for Loan Losses. Berkshire Bank maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance represents management's estimate of inherent losses that are probable and estimable as of the date of the financial statements. The allowance includes a specific component for impaired loans and an unallocated component for estimated model imprecision.

Index

The loan portfolio and other credit exposures are regularly reviewed by management to evaluate the adequacy of the allowance for loan losses. The methodology for assessing the appropriateness of the allowance includes comparison to actual losses, peer group comparisons, industry data and economic conditions. In addition, management employs an independent third party to perform an annual review of all of Berkshire Bank's commercial loan relationships exceeding $1 million, all material credits on Berkshire Bank's watch list or classified as substandard, and a random sampling of new loans. The regulatory agencies, as an integral part of their examination process, also periodically review Berkshire Bank's allowance for loan losses. Such agencies may require Berkshire Bank to make additional provisions for estimated losses based upon judgments different from those of management.

In assessing the allowance for loan losses, loss factors are applied to various pools of outstanding loans. Loss factors are based on management's judgment of losses inherent in the portfolio, including past loan loss experience, known and inherent risks in the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values and economic conditions. The loss factors may be adjusted for significant factors that, in management's judgment, affect the losses inherent in the portfolio as of the evaluation date. Generally, nonaccruing commercial loans are deemed impaired and evaluated for specific valuation allowances. Berkshire Bank primarily segregates the loan portfolio according to the primary loan types: residential mortgages, commercial mortgages, commercial business loans and consumer loans, and also evaluates commercial construction loans as a pool. Reserves are assigned to impaired loans, and this is normally based on the fair value of collateral since most impaired loans are deemed to be collateral dependent. In 2006, the Company adjusted its loan loss allowance based on new loss factors which emerged during the year, as is further described in Item 7 of this Form 10-K.

In addition, management assesses the allowance using factors that cannot be associated with specific credit or loan categories. These factors include management's subjective evaluation of local and national economic and business conditions, portfolio concentration and changes in the character and size of the loan portfolio. The allowance methodology reflects management's objective that the overall allowance appropriately reflects a margin for the imprecision necessarily inherent in estimates of expected credit losses.

Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making its determinations. Because the estimation of inherent losses cannot be made with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loan deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect Berkshire Bank's financial condition and results of operations. In 2006, the allowance was reduced by $425 thousand representing the transfer to liabilities of reserves for losses on unfunded credit commitments.

Index

The following table presents an analysis of the allowance for loan losses for the years indicated.

(Dollars in thousands)	2006	2005	2004	2003	2002