

BERKSHIRE HILLS BANCORP INC
Form 10-Q
November 10, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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 0-51584

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

Delaware 04-3510455
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

24 North Street, Pittsfield, 01201
Massachusetts
(Address of principal executive (Zip Code)
offices)

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

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

(Do not check if a 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 12,223,599 shares of common stock, par value \$0.01 per share, outstanding as of November 7, 2008.

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 September 30, 2008 and December 31, 2007</u> | 3 |
| <u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2008 and 2007</u> | 4 |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2008 and 2007</u> | 5 |
| <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2008 and 2007</u> | 6 |
| <u>Notes to Consolidated Financial Statements</u> | 7 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 21 |
| <u>Selected Financial Data</u> | 24 |
| <u>Average Balances and Average Yields/Rate</u> | 25 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 32 |
| <u>Item 4. Controls and Procedures</u> | 32 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 33 |
| <u>Item 1A. Risk Factors</u> | 33 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 33 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 34 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 34 |
| <u>Item 5. Other Information</u> | 34 |
| <u>Item 6. Exhibits</u> | 34 |

Signatures

PART I

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED BALANCE SHEETS

| (In thousands, except share data) | September 30, 2008 | December 31, 2007 |
|---|-----------------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 26,445 | \$ 33,259 |
| Federal funds sold and short-term investments | 8,124 | 7,883 |
| Total cash and cash equivalents | 34,569 | 41,142 |
| Trading securities, at fair value | 15,267 | - |
| Securities available for sale, at fair value | 205,554 | 197,964 |
| Securities held to maturity | 25,923 | 39,456 |
| Federal Home Loan Bank stock | 21,077 | 21,077 |
| Loans held for sale | 5,401 | 3,445 |
| Residential mortgages | 672,004 | 657,045 |
| Commercial mortgages | 794,780 | 704,764 |
| Commercial business loans | 181,224 | 203,564 |
| Consumer loans | 344,359 | 378,643 |
| Total loans | 1,992,367 | 1,944,016 |
| Less: Allowance for loan losses | (22,886) | (22,116) |
| Net loans | 1,969,481 | 1,921,900 |
| Premises and equipment, net | 37,902 | 38,806 |
| Goodwill | 161,178 | 161,632 |
| Other intangible assets | 18,490 | 20,820 |
| Cash surrender value of life insurance policies | 35,331 | 35,316 |
| Other assets | 35,526 | 31,874 |
| Total assets | \$ 2,565,699 | \$ 2,513,432 |
| Liabilities and Stockholders' Equity | | |
| Liabilities | | |
| Demand deposits | \$ 227,271 | \$ 231,994 |
| NOW deposits | 196,217 | 213,150 |
| Money market deposits | 450,818 | 439,341 |
| Savings deposits | 220,800 | 210,186 |
| Total non-maturity deposits | 1,095,106 | 1,094,671 |
| Brokered time deposits | 3,008 | 21,497 |
| Other time deposits | 739,090 | 706,395 |
| Total time deposits | 742,098 | 727,892 |
| Total deposits | 1,837,204 | 1,822,563 |
| Borrowings | 366,092 | 334,474 |
| Junior subordinated debentures | 15,464 | 15,464 |
| Other liabilities | 14,257 | 14,094 |
| Total liabilities | 2,233,017 | 2,186,595 |

| | | |
|---|--------------|--------------|
| Stockholders' equity | | |
| Preferred stock (\$.01 par value; 1,000,000 shares authorized; none issued) | - | - |
| Common stock (\$.01 par value; 26,000,000 shares authorized; 12,513,825 shares issued) | 125 | 125 |
| Additional paid-in capital | 265,897 | 266,134 |
| Unearned compensation | (2,205) | (2,009) |
| Retained earnings | 125,125 | 113,387 |
| Accumulated other comprehensive income (loss) | (4,273) | 1,217 |
| Treasury stock, at cost (2,020,671 shares at September 30, 2008 and 2,021,120 at December 31, 2007) | (51,987) | (52,017) |
| Total stockholders' equity | 332,682 | 326,837 |
| Total liabilities and stockholders' equity | \$ 2,565,699 | \$ 2,513,432 |

See accompanying notes to consolidated financial statements.

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

| (In thousands, except per share data) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------------|------------------------------------|------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Interest and dividend income | | | | |
| Loans | \$ 30,078 | \$ 29,719 | \$ 91,224 | \$ 87,393 |
| Securities and other | 3,014 | 2,912 | 9,225 | 8,702 |
| Total interest and dividend income | 33,092 | 32,631 | 100,449 | 96,095 |
| Interest expense | | | | |
| Deposits | 9,676 | 12,581 | 32,485 | 36,849 |
| Borrowings and junior subordinated debentures | 4,087 | 4,571 | 11,694 | 13,539 |
| Total interest expense | 13,763 | 17,152 | 44,179 | 50,388 |
| Net interest income | 19,329 | 15,479 | 56,270 | 45,707 |
| Non-interest income | | | | |
| Insurance commissions and fees | 2,640 | 2,661 | 11,480 | 11,438 |
| Deposit service fees | 2,518 | 1,825 | 7,159 | 5,127 |
| Wealth management fees | 1,338 | 1,044 | 4,533 | 2,931 |
| Loan service and interest rate swap fees | 561 | 324 | 1,026 | 681 |
| Total fee income | 7,057 | 5,854 | 24,198 | 20,177 |
| Other | 174 | 433 | 1,042 | 1,160 |
| Gain (loss) on sale of securities, net | 4 | (672) | (22) | (591) |
| Loss on prepayment of borrowings, net | - | (1,180) | - | (1,180) |
| Loss on sale of loans, net | - | (1,991) | - | (1,991) |
| Total non-interest income | 7,235 | 2,444 | 25,218 | 17,575 |
| Total net revenue | 26,564 | 17,923 | 81,488 | 63,282 |
| Provision for loan losses | 1,250 | 390 | 3,180 | 1,240 |
| Non-interest expense | | | | |
| Salaries and employee benefits | 9,796 | 7,891 | 29,294 | 24,632 |
| Occupancy and equipment | 2,760 | 2,418 | 8,502 | 7,289 |
| Marketing, data processing, and professional services | 2,121 | 2,260 | 6,423 | 6,323 |
| Non-recurring expense | - | 1,606 | 683 | 1,758 |
| Amortization of intangible assets | 889 | 684 | 2,992 | 2,008 |
| Other | 2,171 | 1,730 | 6,549 | 5,092 |
| Total non-interest expense | 17,737 | 16,589 | 54,443 | 47,102 |
| Income before income taxes | 7,577 | 944 | 23,865 | 14,940 |
| Income tax expense | 2,301 | - | 6,827 | 4,478 |
| Net income | \$ 5,276 | \$ 944 | \$ 17,038 | \$ 10,462 |
| Basic earnings per share | \$ 0.51 | \$ 0.11 | \$ 1.65 | \$ 1.19 |
| Diluted earnings per share | \$ 0.51 | \$ 0.10 | \$ 1.64 | \$ 1.17 |
| Weighted average shares outstanding | | | | |
| Basic | 10,303 | 8,922 | 10,330 | 8,774 |
| Diluted | 10,400 | 9,045 | 10,421 | 8,921 |

See accompanying notes to consolidated financial statements.

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

| (In thousands except per share data) | Nine Months Ended September | |
|---|-----------------------------|-------------|
| | 2008 | 30, 2007 |
| Total stockholders' equity at beginning of period | \$ 326,837 | \$ 258,161 |
| Comprehensive income: | | |
| Net income | 17,038 | 10,462 |
| Net unrealized (loss) gain on securities available-for-sale, net of reclassification adjustments and tax effects | (4,531) | 92 |
| Net (loss) gain on derivative instruments | (958) | 71 |
| Total comprehensive income | 11,549 | 10,625 |
| Factory Point Bancorp, Inc. acquisition | - | 63,423 |
| Cash dividends declared (\$0.47 per share in 2008 and \$0.43 per share in 2007) | (4,917) | (3,783) |
| Treasury stock purchased | (4,883) | (554) |
| Forfeited shares | - | (995) |
| Exercise of stock options | 2,927 | 1,623 |
| Reissuance of treasury stock-other | 1,435 | 1,722 |
| Stock-based compensation | 1,208 | 1,184 |
| Tax benefit (loss) from stock compensation | (69) | 615 |
| Other equity changes, net | (1,405) | (1,375) |
| Total stockholders' equity at end of period | \$ 332,682 | \$ 330,646 |

See accompanying notes to consolidated financial statements.

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands) | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 17,038 | \$ 10,462 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 3,180 | 1,240 |
| Depreciation, amortization, and deferrals, net | 5,872 | 4,754 |
| Stock-based compensation | 1,208 | 1,184 |
| Excess tax effects from stock-based payment arrangements | 69 | (615) |
| Increase in cash surrender value of bank-owned life insurance policies | (1,125) | (789) |
| Net loss on sales of securities, net | 22 | 591 |
| Net change in loans held for sale | (1,956) | - |
| Loss on prepayment of borrowings | - | 1,180 |
| Net loss on sales of loans | - | 1,991 |
| Loss from sale of premises | 35 | - |
| Writedowns of other real estate owned | 136 | - |
| Net change in all other assets | (2,739) | 175 |
| Net change in other liabilities | 1,054 | (1,015) |
| Net cash provided by operating activities | 22,794 | 19,158 |
| Cash flows from investing activities: | | |
| Acquisition of Factory Point Bancorp, Inc. | - | (7,641) |
| Sales of securities available for sale | 9,167 | 59,141 |
| Proceeds from maturities, calls and prepayments - securities available for sale | 21,256 | 25,227 |
| Purchases of securities available for sale | (44,953) | (16,778) |
| Proceeds from maturities, calls and prepayments - securities held to maturity | 27,653 | 8,144 |
| Purchases of securities held to maturity | (14,391) | (10,159) |
| Purchase of trading security | (15,000) | - |
| Increase in loans, net | (51,520) | (8,534) |
| Capital expenditures | (2,090) | (4,449) |
| Proceeds from surrender of life insurance | 1,103 | - |
| Payment for acquisition | (1,030) | - |
| Proceeds from sale of other real estate owned | 547 | - |
| Proceeds from sale of premises and equipment | 74 | - |
| Total net cash (used) provided by investing activities | (69,184) | 44,951 |
| Cash flows from financing activities: | | |
| Net (decrease) increase in deposits | 14,642 | 5,179 |
| Proceeds from Federal Home Loan Bank ("FHLB") advances | 194,835 | 93,293 |
| Repayments of Federal Home Loan Bank advances and other borrowings | (162,718) | (167,585) |
| Proceeds from bank note | - | 25,000 |
| Repayment of bank note | - | (15,000) |
| Treasury stock purchased | (4,883) | (554) |
| Proceeds from reissuance of treasury stock | 2,927 | 1,623 |

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

| | | |
|--|-----------|-----------|
| Excess tax effects from stock-based payment arrangements | (69) | 615 |
| Cash dividends paid | (4,917) | (3,783) |
| Net cash provided (used) by financing activities | 39,817 | (61,212) |
| Net change in cash and cash equivalents | (6,573) | 2,897 |
| Cash and cash equivalents at beginning of period | 41,142 | 30,985 |
| Cash and cash equivalents at end of period | \$ 34,569 | \$ 33,882 |
| Supplemental cash flow information: | | |
| Interest paid on deposits | \$ 32,241 | \$ 36,416 |
| Interest paid on borrowed funds | 11,827 | 13,722 |
| Income taxes paid, net | 5,265 | 5,492 |

See accompanying notes to consolidated financial statements.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

Basis of Presentation and Consolidation, and Use of Estimates

The consolidated financial statements include the accounts of Berkshire Hills Bancorp, Inc. ("Berkshire" or the "Company") and its wholly-owned subsidiaries: Berkshire Bank (the "Bank") and Berkshire Insurance Group, but exclude its wholly-owned subsidiary Berkshire Hills Capital Trust I, which is accounted for using the equity method. The consolidated financial statements and notes thereto have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated in consolidation. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results which may be expected for the year.

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, as of the date of the consolidated financial statements, and the reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are susceptible to near-term changes include the determination of the allowance for loan losses, tax related assets and liabilities, and the carrying value of goodwill and other intangible assets. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Berkshire's Annual Report on Form 10-K for the year ended December 31, 2007.

Business

Through its wholly-owned subsidiaries, the Company provides a variety of financial services to individuals, municipalities and businesses through its offices in Western Massachusetts, Vermont and Northeastern New York. Its primary deposit products are checking, NOW, money market, savings, and time deposit accounts. Its primary lending products are residential mortgage, commercial mortgage, commercial business loans and consumer loans. The Company offers electronic banking, cash management, and other transaction and reporting services. The Company offers wealth management services including trust, financial planning, and investment services. The Company is the agent for complete lines of property and casualty, life, disability, and health insurance.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Acquisitions

In January 2008, the Company acquired the Center for Financial Planning (“CFP”) in Albany, New York. This acquisition provides a foundation for the Bank’s New York region wealth management and investment services. The acquisition was accounted for as a purchase transaction with all cash consideration funded through internal sources. The operating results of CFP are included with the Company's results of operations since the date of acquisition. The purchase of CFP did not significantly impact the Company's consolidated financial statements.

On September 21, 2007, the Company completed its acquisition of Factory Point Bancorp, Inc. and its subsidiary, Factory Point National Bank of Manchester Center, Vermont (collectively “Factory Point”) for \$79.4 million, including the assumption of Factory Point stock options. Under the terms of the agreement, the Company issued 1,913,353 shares of the Company’s common stock and paid \$16.0 million in cash in exchange for all outstanding Factory Point shares and also assumed all outstanding Factory Point stock options. Concurrent with the merger of Berkshire Hills Bancorp and Factory Point Bancorp, the Bank and Factory Point National Bank merged with the Bank as the surviving entity. The operating results of Factory Point are included with the Company's results of operations since the date of acquisition. See footnote 2 in Berkshire’s Annual Report on Form 10-K for the year ended December 31, 2007 for additional information for this acquisition.

Earnings Per Common Share

Earnings per common share have been computed based on the following (average diluted shares outstanding are calculated using the treasury stock method):

| (In thousands, except per share data) | Three Months Ended Sept. | | Nine Months Ended Sept. | |
|--|--------------------------|---------|-------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income applicable to common stock | \$ 5,276 | \$ 944 | \$ 17,038 | \$ 10,462 |
| Average number of common shares outstanding | 10,425 | 9,023 | 10,452 | 8,869 |
| Less: average number of unvested stock award shares | (122) | (101) | (122) | (95) |
| Average number of basic shares outstanding | 10,303 | 8,922 | 10,330 | 8,774 |
| Plus: average number of dilutive unvested stock award shares | 17 | 101 | 17 | 95 |
| Plus: average number of dilutive shares based on stock options | 80 | 22 | 74 | 52 |
| Average number of diluted shares outstanding | 10,400 | 9,045 | 10,421 | 8,921 |
| Basic earnings per share | \$ 0.51 | \$ 0.11 | \$ 1.65 | \$ 1.19 |
| Diluted earnings per share | \$ 0.51 | \$ 0.10 | \$ 1.64 | \$ 1.17 |

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Statements of Financial Accounting Standards

SFAS No. 141, "Business Combinations (Revised 2007)." SFAS 141R replaces SFAS 141, "Business Combinations," and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, "Accounting for Contingencies." The allowance for loan losses related to loans acquired will not be included in the Company's allowance for loan losses, but will be reflected in the fair value of loans acquired. SFAS 141R is expected to have a significant impact on the Company's accounting for business combinations closing on or after January 1, 2009.

SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements (see Note 10 - Fair Value Measurements).

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115." SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates (see Note 2 – Securities and Note 10 - Fair Value Measurements).

SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51." SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133." SFAS 161 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," to amend and expand the disclosure requirements of SFAS 133 to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for the Company on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

On October 10, 2008 the FASB issued FASB Staff Position ("FSP") 157-3, "Determining the Fair Value of a Financial Assets When the Market for that Asset is Not Active", which provides an example that illustrates key considerations in determining the fair value of a financial asset when the market for that asset is not active. The FSP does not change existing generally accepted accounting principles. The FSP provides clarification for how to consider various inputs in determining fair value under current market conditions consistent with the principles of SFAS 157. This FSP is effective upon issuance, including prior periods for which financial statement have not been issued. The impact of adoption did not have a material impact on the Company's consolidated financial position or results of operations.

SEC Staff Accounting Bulletins

Staff Accounting Bulletin (SAB) No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings." SAB No. 109 supersedes SAB 105, "Application of Accounting Principles to Loan Commitments," and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The guidance in SAB 109 became effective on January 1, 2008 and did not have a material impact on the Company's financial statements.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SECURITIES

A summary of securities follows:

| (In thousands) | Amortized Cost | Fair Value |
|--------------------------------------|-------------------|---------------|
| September 30, 2008 | | |
| Trading - Municipal obligation | \$ 15,000 | \$ 15,267 |
| Securities Available for Sale | | |
| Debt securities: | | |
| Municipal bonds and obligations | \$ 73,385 | \$ 70,965 |
| Mortgage-backed securities, other | 119,093 | 120,046 |
| Other bonds and obligations | 15,587 | 12,050 |
| Total debt securities | 208,065 | 203,061 |
| Total equity securities | 2,384 | 2,493 |
| Total securities available for sale | 210,449 | 205,554 |
| Securities Held to Maturity | | |
| Municipal bonds and obligations | 25,039 | 25,488 |
| Mortgage-backed securities | 884 | 881 |
| Total securities held to maturity | 25,923 | 26,369 |
| Total securities | \$ 251,372 | \$ 247,190 |
| | | |
| December 31, 2007 | | |
| Securities Available for Sale | | |
| Debt securities: | | |
| Municipal bonds and obligations | \$ 74,223 | \$ 75,186 |
| Mortgage-backed securities | 103,387 | 104,518 |
| Other bonds and obligations | 15,601 | 15,265 |
| Total debt securities | 193,211 | 194,969 |
| Total equity securities | 2,836 | 2,995 |
| Total securities available for sale | 196,047 | 197,964 |
| Securities Held to Maturity | | |
| Municipal bonds and obligations | 36,981 | 37,233 |
| Mortgage-backed securities | 2,475 | 2,456 |
| Total securities held to maturity | 39,456 | 39,689 |
| Total securities | \$ 235,503 | \$ 237,653 |

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 159, "The Fair Value Option for

Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." SFAS 159 permits the Company to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, thus the Company may record identical financial assets and liabilities at fair value or by another measurement basis permitted under generally accepted accounting principles, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

portions of instruments. Adoption of SFAS 159 on January 1, 2008 did not have a significant impact on the Company's financial statements.

The Company elected to account for one security at fair value under SFAS No. 159 acquired during the second quarter of 2008. This security is classified as trading on the consolidated balance sheet. The Company has the intent and ability to hold this security to maturity and will report the purchase of this security in the investing section on the consolidated statement of cash flows. The investment security accounted for at fair value has an amortized cost of \$15.0 million and a fair value of \$15.3 million at September 30, 2008. See note 9 – Derivative Financial Instruments for additional information related to this investment security and the related interest rate swap.

The unrealized losses on the other bonds and obligations available for sale increased to \$3.5 million at September 30, 2008. This portfolio consists of investment grade corporate trust preferred securities and corporate debt. The unrealized losses on the portfolio are due to an increase in credit spreads and liquidity issues in the marketplace. The Company has concluded these unrealized losses are temporary in nature since they are not related to the underlying credit quality of the issuers, and the Company has the intent and ability to hold these investments for a time necessary to recover its cost or stated maturity (at which time, full payment is expected).

3. LOANS

Loans consist of the following:

| (Dollars in millions) | September 30, 2008 | December 31, 2007 |
|------------------------------------|-----------------------|----------------------|
| Residential mortgages: | | |
| 1 - 4 Family | \$ 636 | \$ 610 |
| Construction | 36 | 47 |
| Total residential mortgages | 672 | 657 |
| Commercial mortgages: | | |
| Construction | 134 | 125 |
| Single and multi-family | 70 | 69 |
| Other commercial mortgages | 591 | 510 |
| Total commercial mortgages | 795 | 704 |
| Commercial business loans | 181 | 204 |
| Total commercial loans | 976 | 908 |
| Consumer loans: | | |
| Auto and other | 157 | 211 |
| Home equity | 187 | 168 |
| Total consumer loans | 344 | 379 |
| Total loans | \$ 1,992 | \$ 1,944 |

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. LOAN LOSS ALLOWANCE

Activity in the allowance for loan losses is as follows:

| (In thousands) | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2008 | 2007 |
| Balance at beginning of period | \$ 22,116 | \$ 19,370 |
| Provision for loan losses | 3,180 | 1,240 |
| Allowance attributed to acquired loans | - | 4,453 |
| Loans charged-off | (2,968) | (3,259) |
| Recoveries | 558 | 304 |
| Balance at end of period | \$ 22,886 | \$ 22,108 |

5. DEPOSITS

A summary of time deposits is as follows:

| (Dollars in millions) | September 30, 2008 | December 31, 2007 |
|--------------------------|-----------------------|----------------------|
| Time less than \$100,000 | \$ 394 | \$ 409 |
| Time \$100,000 or more | 345 | 298 |
| Brokered time | 3 | 21 |
| Total time deposits | \$ 742 | \$ 728 |

6. REGULATORY CAPITAL

The Bank's actual and required capital ratios are as follows:

| | September 30, 2008 | December 31, 2007 | FDIC Minimum to be Well Capitalized |
|--|--------------------|-------------------|--|
| Total capital to risk weighted assets | 10.5% | 10.4% | 10.0 % |
| Tier 1 capital to risk weighted assets | 9.4 | 9.3 | 6.0 |
| Tier 1 capital to average assets | 7.9 | 8.0 | 5.0 |

At each date shown, Berkshire Bank met the conditions to be classified as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table above.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. STOCK-BASED COMPENSATION PLANS

A combined summary of activity in the Company's stock award and stock option plans for the nine months ended September 30, 2008 is presented in the following table:

| (Shares in thousands) | Non-vested Stock Awards Outstanding | | Stock Options Outstanding | |
|-----------------------------|--|--|------------------------------|---|
| | Number of Shares | Weighted- Average Grant Date Fair Value | Number of Shares | Weighted- Average Exercise Price |
| Balance, December 31, 2007 | 105 | \$ 31.88 | 644 | \$ 21.90 |
| Granted | 64 | 22.38 | - | - |
| Stock options exercised | - | - | (153) | 19.51 |
| Stock awards vested | (45) | 29.97 | - | - |
| Forfeited | (2) | 27.67 | (6) | 33.46 |
| Balance, September 30, 2008 | 122 | \$ 27.39 | 485 | \$ 22.52 |

During the nine months ended September 30, 2008 and 2007, proceeds from stock option exercises totaled \$2.9 million and \$1.6 million, respectively. During the nine months ended September 30, 2008, there were 217,000 shares issued in connection with stock option exercises and non-vested stock awards. All of these shares were issued from available treasury stock. Stock-based compensation expense totaled \$1.2 million during the nine months ended September 30, 2008 and 2007. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

8. OPERATING SEGMENTS

The Company has two reportable operating segments, Banking and Insurance, which are delineated by the consolidated subsidiaries of Berkshire Hills Bancorp. Banking includes the activities of Berkshire Bank and its subsidiaries, which provide commercial and consumer banking services. Insurance includes the activities of Berkshire Insurance Group, which provides commercial and consumer insurance services. The only other consolidated financial activity of the Company is the Parent, which consists of the transactions of Berkshire Hills Bancorp. Management fees for corporate services provided by the Bank to Berkshire Insurance Group and the Parent are eliminated.

The accounting policies of each reportable segment are the same as those of the Company. The Insurance segment and the Parent reimburse the Bank for administrative services provided to them. Income tax expense for the individual segments is calculated based on the activity of the segments, and the Parent records the tax expense or benefit necessary to reconcile to the consolidated total. The Parent does not allocate capital costs. Average assets include securities available-for-sale based on amortized cost.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the Company's operating segments was as follows:

| (In thousands) | Banking | Insurance | Parent | Eliminations | Total Consolidated |
|---|-----------|-----------|----------|--------------|--------------------|
| Three months ended September 30, 2008 | | | | | |
| Net interest income | \$ 19,736 | \$ - | \$ 2,593 | \$ (3,000) | \$ 19,329 |
| Provision for loan losses | 1,250 | - | - | - | 1,250 |
| Net interest income after provision for loan losses | 18,486 | - | 2,593 | (3,000) | 18,079 |
| Non-interest income | 4,576 | 2,659 | 2,392 | (2,392) | 7,235 |
| Non-interest expense | 15,179 | 2,742 | (184) | - | 17,737 |
| Income (loss) before income taxes | 7,883 | (83) | 5,169 | (5,392) | 7,577 |
| Income tax expense (benefit) | 2,472 | (64) | (107) | - | 2,301 |
| Net income (loss) | \$ 5,411 | \$ (19) | \$ 5,276 | \$ (5,392) | \$ 5,276 |
| | | | | | |
| Average assets (in millions) | \$ 2,520 | \$ 31 | \$ 361 | \$ (357) | \$ 2,555 |

| (In thousands) | Banking | Insurance | Parent | Eliminations | Total Consolidated |
|---|-----------|-----------|----------|--------------|--------------------|
| Three months ended September 30, 2007 | | | | | |
| Net interest income (loss) | \$ 15,972 | \$ - | \$ (493) | \$ - | \$ 15,479 |
| Provision for loan losses | 390 | - | - | - | 390 |
| Net interest income after provision for loan losses | 15,582 | - | (493) | - | 15,089 |
| Non-interest income (loss) | (263) | 2,707 | 1,405 | (1,405) | 2,444 |
| Non-interest expense | 13,773 | 2,600 | 216 | - | 16,589 |
| Income before income taxes | 1,546 | 107 | 696 | (1,405) | 944 |
| Income tax expense (benefit) | 204 | 44 | (248) | - | - |
| Net income | \$ 1,342 | \$ 63 | \$ 944 | \$ (1,405) | \$ 944 |
| | | | | | |
| Average assets (in millions) | \$ 2,171 | \$ 32 | \$ 298 | \$ (288) | \$ 2,213 |

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. OPERATING SEGMENTS (continued)

| (In thousands) | Banking | Insurance | Parent | Eliminations | Total Consolidated |
|---|-----------|-----------|-----------|--------------|--------------------|
| Nine months ended September 30, 2008 | | | | | |
| Net interest income | \$ 57,645 | \$ - | \$ 19,125 | \$ (20,500) | \$ 56,270 |
| Provision for loan losses | 3,180 | - | - | - | 3,180 |
| Net interest income after provision for loan losses | 54,465 | - | 19,125 | (20,500) | 53,090 |
| Non-interest income | 13,697 | 11,519 | (2,411) | 2,413 | 25,218 |
| Non-interest expense | 46,260 | 7,691 | 492 | - | 54,443 |
| Income before income taxes | 21,902 | 3,828 | 16,222 | (18,087) | 23,865 |
| Income tax expense (benefit) | 6,160 | 1,483 | (816) | - | 6,827 |
| Net income | \$ 15,742 | \$ 2,345 | \$ 17,038 | \$ (18,087) | \$ 17,038 |
| Average assets (in millions) | \$ 2,487 | \$ 32 | \$ 350 | \$ (343) | \$ 2,526 |

| (In thousands) | Banking | Insurance | Parent | Eliminations | Total Consolidated |
|---|-----------|-----------|-----------|--------------|--------------------|
| Nine months ended September 30, 2007 | | | | | |
| Net interest income | \$ 47,197 | \$ - | \$ 2,010 | \$ (3,500) | \$ 45,707 |
| Provision for loan losses | 1,240 | - | - | - | 1,240 |
| Net interest income after provision for loan losses | 45,957 | - | 2,010 | (3,500) | 44,467 |
| Non-interest income | 5,938 | 11,561 | 8,337 | (8,261) | 17,575 |
| Non-interest expense | 38,836 | 7,681 | 585 | - | 47,102 |
| Income before income taxes | 13,059 | 3,880 | 9,762 | (11,761) | 14,940 |
| Income tax expense (benefit) | 3,587 | 1,591 | (700) | - | 4,478 |
| Net income | \$ 9,472 | \$ 2,289 | \$ 10,462 | \$ (11,761) | \$ 10,462 |
| Average assets (in millions) | \$ 2,148 | \$ 32 | \$ 277 | \$ (272) | \$ 2,185 |

9. DERIVATIVE FINANCIAL INSTRUMENTS

The fair value of derivative positions outstanding is included in other assets, accrued interest payable and other liabilities in the accompanying consolidated balance sheets. At September 30, 2008, the Company had outstanding interest rate swaps with a total notional amount of \$150.0 million that are designated as hedges of FHLB advances and junior subordinated debentures. The swaps effectively convert the debt from floating rate to fixed rate and qualify for cash flow hedge accounting under SFAS No. 133 with the objective of protecting the overall cash flows from the Company's monthly interest payments for the \$150.0 million in floating rate FHLB advances and junior subordinated debentures.

During the second quarter of 2008, the Company initiated a program to provide derivative financial instruments to certain customers, acting as an intermediary in the transaction. All of these customer derivatives, however, are immediately hedged upon issuance by executing a mirror image derivative with a dealer counterparty such that the Company has no net interest rate risk exposure resulting from the transactions. Exposure with respect to these

derivatives is largely limited to nonperformance by either the customer or the other counterparty. The notional amount of customer derivatives and the related counterparty derivatives each totaled \$28.9

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

million at September 30, 2008. The customer derivatives and the related counterparty derivatives are marked to market and any difference is reflected in non-interest income.

The Company executed an economic hedge in the second quarter and entered into a transaction whereby the Company elected to account for a \$15.0 million fixed-rate municipal obligation at fair value under FAS 159 and entered into a \$15.0 million pay-fixed and receive-floating interest rate swap with a counterparty and has accounted for the derivative at fair value under SFAS No. 133. The changes in the fair value of the investment security and interest rate swap are expected to offset each other with any differences reflected in non-interest income. The Company elected the fair value option for this municipal obligation security due to several factors such as the large dollar amount of the obligation in relation to other municipal obligation securities in the Company's held-to-maturity portfolio as well as the term of the obligation which was 21.5 years at origination. The intent of the economic hedge was to improve the Company's asset sensitivity to changing interest rates.

Interest Rate Derivatives. The notional amounts and estimated fair values of interest rate derivative positions outstanding at September 30, 2008 are presented in the following table (amounts in thousands). The Company utilizes independent third party valuation models with observable market data inputs to estimate fair values of interest rate swaps. The Company also obtains dealer quotations for these derivatives for comparative purposes to assess the reasonableness of the model valuations.

| | Notional A mount | Estimated Fair Value - Asset (Liability) |
|---|---------------------|---|
| A summary of interest rate derivatives at September 30, 2008, follows: | | |
| Interest rate swaps on variable-rate borrowings | \$ 150,000 | \$ (1,544) |
| Customer related interest rate swaps | | |
| Receive floating/pay fixed | 28,948 | (468) |
| Receive fixed/pay floating | 28,948 | 477 |
| Receive floating/pay fixed interest rate swap related to to the IRB security | 15,000 | (407) |

The weighted average rate paid and received for cash flow interest rate swaps outstanding as of September 30, 2008 were as follows:

| | Fixed Interest Rate Paid | Floating Interest Rate Received |
|---|--------------------------------|---------------------------------------|
| Cash flow hedge interest rate swaps on variable-rate borrowings | 4.37% | 2.96% |

Interest rate contracts involve the risk of dealing with institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have an investment grade credit rating and be approved by the Company's Risk Management Committee. The Company's credit exposure, net of collateral pledged, relating to interest rate swaps with upstream financial institution counterparties was not material at September 30, 2008. Collateral levels for upstream financial institution counterparties are monitored and adjusted on a regular basis for changes in interest rate swap values.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, "Fair Value Measurements," for financial assets and financial liabilities. In accordance with Financial Accounting Standards Board Staff Position (FSP) No. 157-2, "Effective Date of FASB Statement No. 157," the Company will delay application of SFAS 157 for non-financial assets and non-financial liabilities, until January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

- Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value effective January 1, 2008.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available for Sale. Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Trading Securities at Fair Value. Securities accounted for at fair value are reported utilizing Level 2 inputs obtained from third parties.

Derivatives. Currently, the Company uses swaps to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, foreign exchange rates, and implied volatilities.

To comply with the provisions of SFAS No. 157, the Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2008, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
|-------------------------------|-------------------|-------------------|-------------------|---------------------|
| Securities available for sale | \$ - | \$ 205,554 | \$ - | \$ 205,554 |
| Trading securities | - | 15,267 | - | 15,267 |
| Net derivative liability | - | 1,942 | - | 1,942 |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis were not significant at September 30, 2008.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets and liabilities measured at fair value on a non-recurring basis include those measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. As stated above, SFAS 157 will be applicable to these fair value measurements beginning January 1, 2009.

BERKSHIRE HILLS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. SUBSEQUENT EVENT

On October 6, 2008, the Company announced that it planned to raise approximately \$30 million through the sale of shares of Berkshire Hills Bancorp common stock in an underwritten public offering. The Company also announced that it granted the underwriters an option to purchase additional shares of common stock representing 15% of the gross offering proceeds to cover over-allotments, if any.

On October 8, 2008, the Company announced the pricing of the public offering of Berkshire Hills Bancorp common stock at a price of \$24.00 per share. The total issuance, including the over-allotment was 1.725 million shares and the proceeds, net of the underwriting discount and issuance costs, were \$38.8 million. The offering closed on October 14, 2008. The Company intends to utilize the net proceeds from the offering to strengthen its capital base and to provide growth capital for its affiliates and for general corporate purposes.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the notes thereto appearing in Part I, Item 1 of this document and with Management's Discussion and Analysis included in the 2007 Annual Report on Form 10-K. In the following discussion, income statement comparisons are against the same period of the previous year and balance sheet comparisons are against the previous fiscal year-end, unless otherwise noted. Operating results discussed herein are not necessarily indicative of the results for the year ending December 31, 2008 or any future period. In management's discussion and analysis of financial condition and results of operations, certain reclassifications have been made to make prior periods comparable. Tax-equivalent adjustments are the result of increasing income from tax-advantaged securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 35% federal income tax rate.

Berkshire Hills Bancorp, Inc. is the holding company for Berkshire Bank. Established in 1846, Berkshire Bank is one of Massachusetts' oldest and largest independent banks and the largest banking institution based in Western Massachusetts. The Bank is headquartered in Pittsfield, Massachusetts with branches serving communities throughout Western Massachusetts, Northeastern New York and Southern Vermont. The Bank is transitioning into a regional financial services company and is positioning itself as the financial institution of choice in its retail and commercial markets, delivering exceptional customer service and a broad array of competitively priced deposit, loan, insurance, wealth management and trust services, and investment products. Berkshire Hills Bancorp is also the holding company for Berkshire Insurance Group, which sells all lines of insurance (personal, commercial, employee benefits, and life insurance) in ten locations in Massachusetts and in affiliation with the branch offices of Berkshire Bank.

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 subsidiaries. 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 such as “will,” “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-Q. Important factors that could cause actual results to differ materially from our forward-looking statements are set forth under Item 1A. - “Risk Factors” in our annual report on Form 10-K for the year ended December 31, 2007 and in Form 10-Q, 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.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES, AND NEW ACCOUNTING PRONOUNCEMENTS

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements in the 2007 Form 10-K. Please see those policies in conjunction with this discussion. The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Company considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Company's financial statements.

Accounting policies related to the allowance for loan losses, income taxes, and goodwill and identifiable intangible assets are considered to be critical, as these policies involve considerable subjective judgment and estimation by management. For additional information regarding critical accounting policies, refer to Note 1 - Summary of Significant Accounting Policies in the notes to consolidated financial statements and the sections captioned "Critical Accounting Policies" and "Loan Loss Allowance" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2007 Form 10-K. There have been no significant changes in the Company's application of critical accounting policies since year-end 2007. Please refer to the note on Recent Accounting Pronouncements in Note 1 to the financial statements of this report for a detailed discussion of new accounting pronouncements. The Company performs an annual impairment test of goodwill in the fourth quarter of its fiscal year-end. As of September 30, 2008, there have been no events requiring the Company to perform an interim impairment test of goodwill.

Selected Financial Data

The following summary data is based in part on the consolidated financial statements and accompanying notes, and other information appearing elsewhere in this Form 10-Q.

| | At or for the Three Months Ended September 30, | | At or for the Nine Months Ended September 30, | |
|--|--|-----------|---|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Performance Ratios: | | | | |
| Return on average assets | 0.82% | 0.18% | 0.90% | 0.64% |
| Return on average equity | 6.26 | 1.44 | 6.84 | 5.18 |
| Net interest margin | 3.48 | 3.20 | 3.45 | 3.20 |
| Stockholders' equity/total assets | 12.97 | 13.38 | 12.97 | 13.38 |
| Financial Data: (In millions) | | | | |
| Total assets | \$ 2,566 | \$ 2,472 | \$ 2,566 | \$ 2,472 |
| Total loans | 1,992 | 1,939 | 1,992 | 1,939 |
| Other earning assets | 273 | 236 | 273 | 236 |
| Total intangible assets | 180 | 183 | 180 | 183 |
| Deposits | 1,837 | 1,796 | 1,837 | 1,796 |
| Borrowings and debentures | 382 | 332 | 382 | 332 |
| Stockholders' equity | 333 | 331 | 333 | 331 |
| Asset Quality Ratios: | | | | |
| Net charge-offs annualized/average loans | 0.19% | 0.23% | 0.16% | 0.23% |
| Loan loss allowance/total loans | 1.15 | 1.14 | 1.15 | 1.14 |
| Nonperforming assets/total assets | 0.44 | 0.48 | 0.44 | 0.48 |
| Per Share Data: | | | | |
| Earnings - diluted | \$ 0.51 | \$ 0.10 | \$ 1.64 | \$ 1.17 |
| Dividends declared | 0.16 | 0.15 | 0.47 | 0.43 |
| Book value | 31.71 | 30.82 | 31.71 | 30.82 |
| Common stock price: | | | | |
| High | 32.00 | 33.00 | 32.00 | 34.82 |
| Low | 20.68 | 25.21 | 20.61 | 25.21 |
| Close | 32.00 | 30.23 | 32.00 | 30.23 |
| For the Period: (In thousands) | | | | |
| Net interest income | \$ 19,329 | \$ 15,479 | \$ 56,270 | \$ 45,707 |
| Provision for loan losses | 1,250 | 390 | 3,180 | 1,240 |
| Non-interest income | 7,235 | 2,444 | 25,218 | 17,575 |
| Non-interest expense | 17,737 | 16,589 | 54,443 | 47,102 |
| Net income | 5,276 | 944 | 17,038 | 10,462 |

(1) All performance ratios are annualized and based on average balance sheet amounts where applicable.

Average Balances and Average Yields/Rate

The following table presents average balances and an analysis of average rates and yields on an annualized fully taxable equivalent basis for the periods included.

| (Dollars in millions) | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|----------------------------------|-----------------|----------------------------|-----------------|---------------------------------|-----------------|----------------------------|-----------------|
| | 2008 Average Balance | Yield / Rate | 2007 Average Balance | Yield / Rate | 2008 Average Balance | Yield / Rate | 2007 Average Balance | Yield / Rate |
| Assets | | | | | | | | |
| Loans | | | | | | | | |
| Residential mortgages | \$ 672 | 5.65% | \$ 635 | 5.35% | \$ 665 | 5.67% | \$ 617 | 5.35% |
| Commercial mortgages | 788 | 6.24 | 609 | 7.49 | 749 | 6.51 | 593 | 7.52 |
| Commercial business | | | | | | | | |
| loans | 192 | 6.41 | 171 | 8.06 | 197 | 6.80 | 184 | 8.01 |
| Consumer loans | 346 | 5.86 | 349 | 7.03 | 357 | 6.16 | 345 | 7.01 |
| Total loans | 1,998 | 5.99 | 1,764 | 6.68 | 1,968 | 6.19 | 1,739 | 6.70 |
| Securities and other | 272 | 5.27 | 229 | 6.15 | 273 | 5.30 | 232 | 6.04 |
| Total earning assets | 2,270 | 5.89 | 1,993 | 6.70 | 2,241 | 6.08 | 1,971 | 6.60 |
| Other assets | 285 | | 220 | | 285 | | 215 | |
| Total assets | \$ 2,555 | | \$ 2,213 | | \$ 2,526 | | \$ 2,186 | |
| Liabilities and stockholders' equity | | | | | | | | |
| Deposits | | | | | | | | |
| NOW deposits | \$ 193 | 0.64% | \$ 142 | 1.40% | \$ 201 | 0.82% | \$ 141 | 1.49% |
| Money market deposits | 447 | 1.86 | 330 | 3.67 | 469 | 2.30 | 311 | 3.69 |
| Savings deposits | 222 | 0.61 | 198 | 1.17 | 215 | 0.76 | 198 | 1.11 |
| Time deposits | 734 | 3.76 | 701 | 4.69 | 718 | 4.08 | 702 | 4.75 |
| Total interest-bearing deposits | 1,596 | 2.41 | 1,371 | 3.64 | 1,603 | 2.71 | 1,352 | 3.63 |
| Borrowings and debentures | | | | | | | | |
| | 380 | 4.27 | 375 | 4.84 | 358 | 4.37 | 379 | 4.76 |
| Total interest-bearing liabilities | 1,976 | 2.77 | 1,746 | 3.90 | 1,961 | 3.01 | 1,731 | 3.88 |
| Non-interest-bearing demand deposits | | | | | | | | |
| | 233 | | 187 | | 224 | | 179 | |
| Other liabilities | 11 | | 4 | | 9 | | 7 | |
| Total liabilities | 2,220 | | 1,937 | | 2,194 | | 1,917 | |
| Stockholders' equity | 335 | | 276 | | 332 | | 269 | |
| Total liabilities and stockholders' equity | \$ 2,555 | | \$ 2,213 | | \$ 2,526 | | \$ 2,186 | |
| Interest rate spread | | 3.12% | | 2.80% | | 3.07% | | 2.72% |
| Net interest margin | | 3.48% | | 3.20% | | 3.45% | | 3.20% |

Supplementary Data

| | | | | |
|---------------------------------|----------|----------|----------|----------|
| Total deposits (in millions) | \$ 1,829 | \$ 1,558 | \$ 1,827 | \$ 1,531 |
| Fully taxable equivalent income | | | | |
| adjustment (in thousands) | 532 | 533 | 1,556 | 1,626 |

(1) The average balances of loans include nonaccrual loans, loans held for sale, and deferred fees and costs.

(2) The average balance of investment securities is based on amortized cost.

SUMMARY

Berkshire's third quarter 2008 net income was \$5.3 million (\$0.51 per diluted share), compared to \$0.9 million (\$0.10 per diluted share) in the third quarter 2007. For the first nine months of the year, Berkshire reported 2008 net income of \$17.0 million (\$1.64 per diluted share) compared to \$10.5 million (\$1.17 per diluted share) for the same period in 2007. 2007 results include charges related to the acquisition of Factory Point Bancorp, Inc. and balance sheet and expense restructurings.

Earnings for 2008 included the benefit of Berkshire's Vermont region, which was formed with the acquisition of Factory Point Bancorp in September 2007. Most major categories of revenue and expense increased due to this acquisition, and earnings per share included the impact of additional shares issued in the acquisition. First half earnings also included the seasonal benefit of insurance contingency revenue.

Berkshire produced a 48% increase in third quarter net revenues, which contributed to a \$4.3 million increase in net income and higher earnings per share, which totaled \$0.51 for the quarter. Net interest income increased \$3.9 million or 25% in the third quarter mainly from an increase in earning assets from the Factory Point Bancorp acquisition, modest organic loan growth (up 2% from December 31, 2007) and a 28 basis point "bp" improvement in the net interest margin. Non-interest income increased 196% in the third quarter from \$3.8 million in balance sheet restructuring charges in 2007. Excluding the impact of these balance sheet restructuring charges, non-interest income increased 15% or \$0.9 million from increases in deposit service fees, wealth management fees, and loan services fees benefiting from the Factory Point acquisition and solid growth in commercial products and demand deposit accounts. Noninterest expenses increased \$1.1 million in the third quarter of 2008 primarily from the Factory Point acquisition.

Net interest income increased \$10.6 million or 23% for the first nine months of 2008, mainly from an increase in earning assets from the Factory Point Bancorp acquisition and a 25 bp improvement in the net interest margin. Non-interest income increased 43% for the first nine months of 2008 from \$3.9 million in balance sheet restructuring charges in 2007. Excluding the impact of these balance sheet restructuring charges, non-interest income increased 18% or \$3.8 million from increases in deposit service fees, wealth management fees, and loan services fees benefiting from the Factory Point acquisition and growth in commercial products and demand deposit accounts. Non-interest expenses increased \$7.3 million in 2008 primarily from the Factory Point acquisition.

The Company's loan performance remained well controlled in 2008. Berkshire does not offer subprime lending programs and does not purchase investment securities backed by subprime mortgages. The third quarter loan loss provision was \$1.3 million compared to \$0.4 million in 2007. The Company's provision exceeded net charge-offs by \$0.3 million in the third quarter of 2008 mainly to provide for loan growth during the quarter. Net charge-offs totaled \$1.9 million for the third quarter of 2007 which exceeded the provision for loan losses. This was due to several factors. The allowance to total loans increased from 1.11% in the linked quarter in 2007 to 1.14% at September 30, 2007, and was driven by the \$4.5 million added to the provision in connection with the Factory Point acquisition and the sale of \$50 million in residential mortgages in connection with the deleveraging program in 2007. Additionally, of the \$1.9 million in net

charge-offs in 2007, \$1.5 million was related to the Company's largest nonperforming loan which had a previously established \$1.0 million reserve assigned to it.

COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2008 AND DECEMBER 31, 2007

Balance Sheet Summary. Total assets grew at a 3% annualized rate to \$2.57 billion from \$2.51 billion during the first nine months of 2008. Asset growth resulted primarily from loans which grew at a 3% annualized rate to \$1.99 billion from \$1.94 billion. Total deposits increased by \$15 million to \$1.84 billion from \$1.82 billion primarily from increases in money market accounts and time deposits. Stockholders' equity grew at a 2% annualized rate to \$333 million from \$327 million.

Assets. The \$52 million increase in assets was primarily due to a \$48 million increase in loans. Investment securities available for sale totaled \$205.6 million at September 30, 2008 compared to 198.0 million at December 31, 2007. There was a \$4.9 million unrealized loss on investment securities available for sale at September 30, 2008, compared to an unrealized gain of \$1.9 million at December 31, 2007. The unrealized loss was driven mainly by unrealized losses on the other bonds and obligations available for sale which totaled \$3.5 million at September 30, 2008. This portfolio consists of investment grade corporate trust preferred securities and corporate debt. The unrealized losses on the portfolio are due to an increase in credit spreads and liquidity issues in the marketplace. The Company has concluded these unrealized losses are temporary in nature since they are not related to the underlying credit quality of the issuers, and the Company has the intent and ability to hold these investments for a time necessary to recover its cost or stated maturity (at which time, full payment is expected). The Company does not hold any preferred stock or equity investments of Fannie Mae or Freddie Mac.

Total loans increased by \$48 million in the first nine months of 2008 due to commercial loan growth of \$68 million. Commercial loans grew at a 10% annualized rate for the first nine months of 2008 due to commercial real estate loans in and around Berkshire's markets, representing increased market share as local business borrowers have relied more on regional lenders and less on national lenders. Permanent residential mortgages and home equity loans increased by \$45 million at an 8% annualized rate in 2008. Auto loans decreased by \$54 million due to a planned reduction related to pricing and underwriting conditions in that market. Residential construction loans decreased by \$11 million due to slower residential construction.

Loan performance remained well-controlled in 2008. The Company does not offer subprime lending programs or Alt A mortgage programs. The annualized rate of net loan charge-offs was 0.16% during the year. Total nonperforming assets decreased slightly during the year to 0.44% of total assets from 0.46% at year-end 2007. Nonperforming assets totaled \$11.3 million at September 30, 2008, and included two commercial relationships with balances over \$1.0 million totaling \$3.8 million at September 30, 2008. The decrease in nonperforming assets was due mainly to pay downs of a few small commercial mortgages and charge-offs during the year. Total accruing delinquent loans were 0.48% of total loans at the end of the third quarter, compared to 0.43% at year-end 2007. The loan loss allowance increased to 1.15% of total loans at the end of the third quarter of 2008 from 1.14% at December 31, 2007. Impaired loans totaled \$14.6 million at the end of the third quarter with a specific valuation allowance of \$1.1 million. Based on management's assessment of national economic trends and trends in the Company's commercial

loan risk ratings, the Company recognizes that the level of problem assets and loan charge-offs may be higher in future periods.

In addition to the nonperforming assets discussed above, the Company has identified approximately \$52.8 million in potential problem loans at the end of the third quarter 2008, as compared to \$23.0 million at year-end 2007. Potential problem loans are loans that are currently performing, but where known information about possible credit problems of the related borrowers cause management to have doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. Potential problem loans are typically loans that are performing but are classified by the Company's loan rating system as "substandard." At quarter-end 2008 and year-end 2007, potential problem loans primarily consisted of commercial business loans and commercial mortgages. At the end of the third quarter 2008, there were ten potential problem loans that exceeded \$1.0 million, totaling \$44.8 million in aggregate, compared to six potential problem loans exceeding \$1.0 million, totaling \$14.2 million at year-end 2007. The increase in potential problem loans was due mainly to three large commercial mortgage credit relationships totaling \$27.8 million down graded in the third quarter. In light of current economic events, Management has increased its risk management resources and has been more focused on identifying potential problem loans early to achieve resolutions before loans become impaired or nonperforming. The three large credits are currently not delinquent or impaired and Management is working with the borrowers to achieve favorable resolutions. Management cannot predict the extent to which economic conditions may worsen or other factors may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses.

Liabilities. For the first nine months of 2008, non-maturity deposit balances remained relatively unchanged as higher cost municipal accounts were replaced with retail accounts. This was primarily due to money market account promotions and steady growth in relationships, as reflected by growth in personal demand deposit balances and savings accounts. Most of Berkshire's retail deposit and loan promotions are linked to companion checking accounts. Consumer deposit growth was offset by lower commercial and municipal balances and the planned pay down of \$18 million in higher cost brokered time deposits. The number of commercial checking accounts increased in 2008, and commercial deposits (including municipalities) reflected targeted run-off of higher cost accounts. Excluding brokered deposits, total deposits increased by \$33 million during the first nine months of the year.

Berkshire also entered into \$150 million in interest rate swaps in 2008 to fix the rate on variable rate borrowings, thereby reducing risk related to rising interest rates. Berkshire increased borrowings by \$32 million during 2008 to fund loan growth and brokered time deposit payoffs.

Equity. Stockholders' equity increased by \$6 million (2% annualized) to \$333 million due primarily to the benefit of retained earnings. Book value per share increased to \$31.71 at the end of the third quarter from \$31.15 at year-end 2007. The ratio of total equity to assets decreased to 12.97% at September 30, 2008 from 13.00% at December 31, 2007. The Company repurchased 200,000 shares of common stock during the first half of 2008 at an average cost of \$24.41 per share under its announced repurchase plan. The Company did not repurchase any shares under

the plan in the third quarter of 2008. The Company increased its quarterly dividend to \$0.16 in the third quarter of 2008, an increase of 7% compared to the same period in 2007.

In the fourth quarter of 2008, the Company issued 1.725 million shares of common stock in a public offering and raised approximately \$38.8 million, net of the underwriting discount. The purpose of this additional equity was primarily to strengthen the Company's capital base, and to provide growth capital for its affiliates and for general corporate purposes.

COMPARISON OF OPERATING RESULTS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

Net Income. Net income increased for both the three and nine months ended September 30, 2008 compared to the same periods in 2007. Net income increased by \$4.3 million (459%) and \$6.6 million (63%) for these periods, respectively. Net income increased from the acquisition of Factory Point, stronger net interest margin, an increase in fee income and merger and balance sheet restructuring charges in the third quarter of 2007. Diluted earnings per share were \$0.51 and \$1.64 for the three and nine months ended September 30, 2008 compared to \$0.10 and \$1.17 for the same periods in 2007. The year-to-date return on assets was 0.90% and return on equity was 6.8% in 2008, compared to 0.64% and 5.2% in 2007.

Total Net Revenue. Net revenue increased by \$8.6 million (48%) and \$18.2 million (29%) in the third quarter and first nine months of 2008 compared to the same periods in 2007. These increases were primarily due to higher net interest income, fee income and balance sheet restructuring charges in the third quarter of 2007. Year-to-date net revenue per diluted share increased by 10% to \$7.82 in 2008 from \$7.09 in 2007, excluding the impact of the balance sheet restructuring charges in 2007, net revenue per diluted share was \$7.52 for 2007.

Net Interest Income. Net interest income increased by \$3.9 million (25%) and \$10.6 million (23%) in the third quarter and first nine months of 2008, compared to the same periods in 2007. The increase reflected an improvement in the net interest margin and the benefit of growth in average earning assets which was due to the Factory Point acquisition and commercial loan growth. Average earning assets increased by \$277 million (14%) and \$270 million (14%) in the third quarter and first nine months of 2008, compared to 2007.

The net interest margin increased to 3.48% from 3.20% for the third quarter of 2008 compared to 2007, and increased to 3.45% from 3.20% for the first nine months of 2008 compared to 2007, due primarily to a balance sheet restructuring in the third quarter of 2007, the Factory Point acquisition, favorable deposit pricing strategies, rate reductions by the Federal Reserve in the first quarter of 2008 and an increase in non-interest bearing demand deposit accounts. The yield on earning assets declined 81 bp from 6.70% for the third quarter of 2007 to 5.89% in 2008. The rate paid on interest-bearing liabilities decreased 113 bp from 3.90% for the third quarter of 2007 to 2.77% in 2008. These declines were driven by several interest rate reductions in the Federal Funds rate during the first quarter of 2008 and initiatives to lower deposit costs by allowing high cost large dollar amounts deposit accounts to run-off. The Company anticipates the benefit from Federal Reserve interest rate reductions that resulted subsequent to the third quarter of 2008 will be limited for interest-bearing deposits due to the inability to further lower deposit rates at these low levels.

Non-Interest Income. Total third quarter fee income increased by \$1.2 million (21%) in 2008 compared to 2007, and fee income for the first nine months of 2008 increased by \$4.0 million (20%) compared to 2007. These increases were due mainly to an increase in deposit service fees, loan service and interest rate swap fees and wealth management fees. For the first nine months of the year, deposit fee income increased by \$2.0 million due primarily to the Factory Point acquisition and growth in transaction accounts. For the first nine months of the year, wealth management fees grew by \$1.6 million, reflecting growth in total assets under management from the Factory Point and Center for Financial Planning acquisitions and organic growth. Loan service and interest rate swap fees increased \$0.3 million for the first nine months of 2008 mainly from the Company's back-to-back interest rate swap program offered to customers in 2008. The decrease in other income of \$0.3 million in the third quarter of 2008 compared to the same period in 2007 was primarily due to a net \$0.2 million fair value loss on a hedged transaction accounted for under FAS 159. Third quarter 2007 results reflect a \$3.8 million loss in connection with the deleveraging program mentioned previously. The Company sold \$32 million in investment securities for a \$0.7 million loss, \$50 million in residential mortgages for a \$2.0 million loss and paid down \$48 million in callable and term borrowings at a cost of \$1.2 million.

Provision for Loan Losses. The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company. The level of the allowance is a critical accounting estimate which is subject to uncertainty. The level of the allowance was included in the discussion of financial condition. The third quarter provision for loan losses was \$1.3 million in 2008, compared to \$0.4 million in 2007. For the first nine months, the provision was \$3.2 million in 2008, compared to \$1.2 million in 2007. The increase in the provision for loan losses in 2008 reflects commercial loan growth and several events which impacted the 2007 provision. The 2007 provision was impacted by the second quarter provision which was unusually low due to the impact of the outplacement of certain large commercial loan balances during that quarter. The third quarter 2007 provision was impacted by the \$4.5 million added to the allowance in connection with the Factory Point acquisition, and the sale of \$50 million in residential mortgages in connection with the deleveraging program which increased the allowance to total loans from 1.11% in the 2007 linked quarter to 1.14% at September 30, 2007. Additionally, of the \$1.9 million in net charge-offs for the third quarter of 2007, \$1.5 million was related to the Company's largest nonperforming loan at that time which had a previously established \$1.0 million reserve assigned to it.

Non-Interest Expense and Income Tax Expense. Non-interest expense increased by \$1.1 million (7%) in the third quarter and by \$7.3 million (16%) for the first nine months of 2008 compared to 2007. The increases in non-interest expense resulted mainly from the additional expenses associated with the Factory Point acquisition. Other expense increased \$1.5 million for the first nine months of 2008 compared to 2007, and includes \$0.3 million in additional expenses associated with loan collection and other real estate owned costs and expenses associated with the Factory Point acquisition. Second quarter 2008 expense included \$0.7 million in non-core charges related to a severance charge and charge-offs of certain deferred loan costs and late fees receivable while third quarter 2007 expenses included merger, integration and restructuring expenses of \$1.6 million mainly from the Factory Point acquisition.

The effective tax rate in the third quarter and first nine months of 2008 was 30% and 29%, compared to no expense for the third quarter of 2007 and 30% for the first nine months of 2007. No income tax was recorded in the third quarter of 2007, as tax-exempt municipal bond and life insurance income exceeded pre-tax income due to the deleveraging and merger charges.

Results of Segment Operations. The Company has designated two operating segments for financial statement disclosure: banking and insurance. Additional information about the Company's accounting for segment operations is contained in Note 8 to the financial statements.

One of the Company's strategies is to emphasize fee income growth to diversify revenues, and reduce reliance on net interest income where margins are under pressure. The Company's acquisition of insurance agencies in the fourth quarter of 2006 was a significant step in implementing this strategy. The third quarter results for the insurance segment was a slight loss compared to \$0.1 million in net income for the third quarter of 2007 and \$2.3 million in net income for the first nine months of 2008 and 2007. The acquired agencies have a significant seasonality to revenues and earnings due to the impact of annual contingency revenues which are received in the first half of the year. The first quarter income of the insurance segment is expected to be the highest quarterly income of this segment due to this seasonality. Net profit from the banking segment totaled \$5.4 million and \$15.8 million for the third quarter and first nine months of 2008, compared to \$1.3 million and \$9.5 million in 2007. The increase in net profit from the banking segment is primarily from the acquisition of Factory Point, the improvement in net interest margin and increased fee income.

Comprehensive Income. Accumulated other comprehensive income is a component of total stockholders' equity on the balance sheet. Comprehensive income includes changes in accumulated other comprehensive income (loss), which consists principally of changes (after-tax) in the unrealized market gains and losses of investment securities available for sale and the change in fair value of cash flow hedges. The change in accumulated other comprehensive income (loss) was a loss of \$5.5 million in the first nine months of 2008, compared to a gain of \$0.2 million in the first nine months of 2007, primarily due to changes in bond prices and the value of interest rate swaps as a result of interest rate changes. The Company recorded total comprehensive income of \$11.5 million in 2008, compared to \$10.6 million in 2007.

Liquidity and Cash Flows. The Company's primary sources of funds were deposit growth and borrowings in the first nine months of 2008. The primary use of funds was loan growth. Net deposit and loan growth are expected to continue to be significant sources and uses of funds. Borrowings from the Federal Home Loan Bank are a significant source of liquidity for daily operations and for borrowings targeted for specific asset/liability purposes. Berkshire Hills Bancorp's primary routine sources of funds are expected to be dividends from Berkshire Bank and Berkshire Insurance Group. The holding company also receives cash from the exercise of stock options and uses cash for dividends, stock repurchases and debt service. Additional discussion about the Company's liquidity and cash flows is contained in the Company's 2007 Form 10-K in Item 7.

Capital Resources. Please see the "Equity" section of the Comparison of Financial Condition for a discussion of stockholders' equity. At September 30, 2008, Berkshire Bank continued to be classified as "well capitalized." Additional information about regulatory capital is contained in the notes to the consolidated financial statements and in the 2007 Form 10-K.

Off-Balance Sheet Arrangements and Contractual Obligations. In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in the Company's financial instruments. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. A further presentation of the Company's off-balance sheet arrangements is presented in the Company's 2007 Form 10-K. For the nine months ended September 30, 2008, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material effect on the Company's financial condition, results of operations or cash flows. Information relating to payments due under contractual obligations is presented in the 2007 Form 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For the quarter ended September 30, 2008, the Bank showed a neutral to slightly asset sensitive position to parallel interest rates changes over the course of the next twelve months. These results are in contrast to the results reported at fiscal year end 2007 in which the company exhibited a more liability sensitive profile to changes in general market rates. The primary reasons for this change are several strategic actions that the company took in the first half of 2008 in order to better position itself for a potential increase in market rates. As previously discussed, the Company entered into cash flow derivative hedges in order to transition some of its short term floating rate liability costs into long term fixed rate products while we felt that these rates were at advantageous levels. Berkshire has also tried to extend liabilities by offering our customers competitively priced 2-5 year Certificates of Deposit. Finally, during the first half of the year Berkshire began a back-to-back interest rate swap program with selected, high credit quality commercial customers in which it was ultimately able to grow the short term adjustable rate portion of its commercial portfolio. The Company anticipates the benefit from Federal Reserve interest rate reductions that resulted subsequent to the third quarter of 2008 will be limited for interest-bearing deposits due to the inability to further lower deposit rates at these low levels.

There have been no material changes to the way that the Company measures market risk during the first nine months of 2008. For further discussion about the Company's Quantitative and Qualitative Aspects of Market Risk, please review Item 7A of the Report 10-K filed for the fiscal year ended December 31, 2007.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report. No change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the last fiscal quarter that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

The Company is not involved in any legal proceedings other than routine legal proceedings occurring in the normal course of business. Such routine proceedings, in the aggregate, are believed by management to be immaterial to the Company's financial condition or results of operations.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) No Company unregistered securities were sold by the Company during the quarter ended September 30, 2008.

(b) Not applicable.

(c) The following table provides certain information with regard to shares repurchased by the Company in the third quarter of 2008.

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|----------------------|--|------------------------------------|--|---|
| July 1-31, 2008 | - | \$ - | - | 97,993 |
| August 1-31, 2008 | - | - | - | 97,993 |
| September 1-30, 2008 | - | - | - | 97,993 |
| Total | - | \$ - | - | 97,993 |

On December 14, 2007, the Company authorized the purchase of up to 300,000 additional shares, from time to time, subject to market conditions. The repurchase plan will continue until it is completed or terminated by the Board of Directors. The Company has no plans that it has elected to terminate prior to expiration or under which it does not intend to make further purchases. During the quarter, 588 shares were repurchased by the Company to fund tax withholdings for vested stock awards and cashless stock option exercises during the period. These shares are not included in the total number of shares purchased as part of publicly announced plans.

ITEM 3.DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4.SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5.OTHER INFORMATION

None.

ITEM 6.EXHIBITS

| | |
|-------------|--|
| 3.1 | Certificate of Incorporation of Berkshire Hills Bancorp, Inc.(1) |
| 3.2 | Amended and restated Bylaws of Berkshire Hills Bancorp, Inc.(2) |
| 4.1 | Draft Stock Certificate of Berkshire Hills Bancorp, Inc.(1) |
| <u>31.1</u> | Rule 13a-14(a) Certification of Chief Executive Officer |
| <u>31.2</u> | Rule 13a-14(a) Certification of Chief Financial Officer |
| <u>32.1</u> | Section 1350 Certification of Chief Executive Officer |
| <u>32.2</u> | Section 1350 Certification of Chief Financial Officer |

- (1) Incorporated herein by reference from the Exhibits to Form S-1, Registration Statement and amendments thereto, initially filed on March 10, 2000, Registration No. 333-32146.
- (2) Incorporated herein by reference from the Exhibits to the Form 8-K as filed on February 29, 2008.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BERKSHIRE HILLS BANCORP, INC.

Dated: November 7, 2008

By: /s/ Michael P. Daly
Michael P. Daly
President, Chief Executive Officer
and Director

Dated: November 7, 2008

By: /s/ Kevin P. Riley
Kevin P. Riley
Executive Vice President, Chief Financial
Officer and Treasurer