

BERKSHIRE HILLS BANCORP INC

Form 10-Q

August 09, 2018

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: June 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-15781

BERKSHIRE HILLS BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

04-3510455

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

60 State Street, Boston, Massachusetts

(Address of principal executive offices)

02109

(Zip Code)

Registrant's telephone number, including area code: (800) 773-5601, ext. 133773

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filers," "accelerated filers," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

Table of Contents

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 45,423,719 shares of common stock, par value \$0.01 per share, outstanding as of August 7, 2018.

---

Table of ContentsBERKSHIRE 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 June 30, 2018 and December 31, 2017</u>	<u>4</u>
<u>Consolidated Statements of Income for the Three and Six Months Ended June 30, 2018 and 2017</u>	<u>5</u>
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017</u>	<u>6</u>
<u>Consolidated Statements of Changes in Shareholders' Equity for the Six Months Ended June 30, 2018 and 2017</u>	<u>7</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017</u>	<u>8</u>
Notes to Consolidated Financial Statements	
<u>Note 1 Basis of Presentation</u>	<u>10</u>
<u>Note 2 Trading Security</u>	<u>13</u>
<u>Note 3 Securities Available for Sale, Held to Maturity, and Marketable Equity Securities</u>	<u>14</u>
<u>Note 4 Loans</u>	<u>19</u>
<u>Note 5 Loan Loss Allowance</u>	<u>34</u>
<u>Note 6 Deposits</u>	<u>41</u>
<u>Note 7 Borrowed Funds</u>	<u>41</u>
<u>Note 8 Capital Ratios and Shareholders' Equity</u>	<u>43</u>
<u>Note 9 Earnings per Share</u>	<u>48</u>
<u>Note 10 Stock-Based Compensation Plans</u>	<u>49</u>
<u>Note 11 Derivative Financial Instruments and Hedging Activities</u>	<u>50</u>
<u>Note 12 Fair Value Measurements</u>	<u>57</u>
<u>Note 13 Net Interest Income after Provision for Loan Losses</u>	<u>66</u>
<u>Note 14 Revenue</u>	<u>67</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>69</u>
<u>Selected Financial Data</u>	<u>69</u>
<u>Average Balances and Average Yields/Rates</u>	<u>71</u>
<u>Non-GAAP Financial Measures</u>	<u>73</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>84</u>

Item 4. Controls and Procedures

85

2

---

Table of Contents

PART II. OTHER INFORMATION

<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>86</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>87</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>88</u>
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	<u>88</u>
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	<u>88</u>
<u>Item 5.</u>	<u>Other Information</u>	<u>88</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>89</u>
	<u>Signatures</u>	<u>90</u>

Table of Contents

## PART I

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BERKSHIRE HILLS BANCORP, INC.  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks	\$90,964	\$91,122
Short-term investments	48,093	157,641
Total cash and cash equivalents	139,057	248,763
Trading security, at fair value	11,483	12,277
Marketable equity securities, at fair value	59,726	45,185
Securities available for sale, at fair value	1,393,250	1,380,914
Securities held to maturity (fair values of \$377,486 and \$405,276)	379,905	397,103
Federal Home Loan Bank stock and other restricted securities	75,530	63,085
Total securities	1,919,894	1,898,564
Loans held for sale, at fair value	149,182	153,620
Commercial real estate loans	3,319,323	3,264,742
Commercial and industrial loans	1,875,118	1,803,939
Residential mortgages	2,397,192	2,102,807
Consumer loans	1,118,333	1,127,850
Total loans	8,709,966	8,299,338
Less: Allowance for loan losses	(55,925)	(51,834)
Net loans	8,654,041	8,247,504
Premises and equipment, net	112,217	109,352
Goodwill	519,128	519,287
Other intangible assets	35,838	38,296
Cash surrender value of bank-owned life insurance policies	193,121	191,221
Deferred tax assets, net	53,679	47,061
Other assets	125,806	117,083
Total assets	\$11,901,963	\$11,570,751
Liabilities		
Demand deposits	\$1,553,039	\$1,606,656
NOW and other deposits	858,014	734,558
Money market deposits	2,619,943	2,776,157
Savings deposits	747,722	741,954
Time deposits	3,060,034	2,890,205
Total deposits	8,838,752	8,749,530
Short-term debt	1,002,000	667,300
Long-term Federal Home Loan Bank advances	272,342	380,436
Subordinated borrowings	89,429	89,339
Total borrowings	1,363,771	1,137,075
Other liabilities	183,199	187,882
Total liabilities	\$10,385,722	\$10,074,487
(continued)		

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

	June 30, 2018	December 31, 2017
Shareholders' equity		
Preferred Stock (Series B non-voting convertible preferred stock - \$0.01 par value; 2,000,000 shares authorized, 521,607 shares issued and outstanding in 2018; 1,000,000 shares authorized, 521,607 shares issued and outstanding in 2017)	40,633	40,633
Common stock (\$.01 par value; 100,000,000 shares authorized and 46,211,894 shares issued and 45,420,276 shares outstanding in 2018; 50,000,000 shares authorized, 46,211,894 shares issued and 45,290,433 shares outstanding in 2017)	460	460
Additional paid-in capital - common stock	1,244,691	1,242,487
Unearned compensation	(10,096	) (6,531 )
Retained earnings	283,256	239,179
Accumulated other comprehensive (loss) income	(21,266	) 4,161
Treasury stock, at cost (791,618 shares in 2018 and 921,461 shares in 2017)	(21,437	) (24,125 )
Total shareholders' equity	1,516,241	1,496,264
Total liabilities and shareholders' equity	\$11,901,963	\$11,570,751
The accompanying notes are an integral part of these consolidated financial statements.		

Table of ContentsBERKSHIRE HILLS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Interest and dividend income				
Loans	\$101,649	\$71,983	\$194,484	\$140,926
Securities and other	15,230	12,683	29,635	24,449
Total interest and dividend income	116,879	84,666	224,119	165,375
Interest expense				
Deposits	17,768	9,971	33,093	19,069
Borrowings	7,990	5,150	14,435	9,875
Total interest expense	25,758	15,121	47,528	28,944
Net interest income	91,121	69,545	176,591	136,431
Non-interest income				
Mortgage banking originations	10,195	16,281	20,342	28,959
Loan related income	6,549	5,275	11,987	9,454
Deposit related fees	7,605	6,645	15,671	12,849
Insurance commissions and fees	2,549	2,588	5,574	5,724
Wealth management fees	2,280	2,286	4,877	4,812
Total fee income	29,178	33,075	58,451	61,798
Other, net	155	(276 )	1,423	(183 )
(Loss)/gain on securities, net	718	(1 )	(784 )	12,569
(Loss)/gain on sale of business operations and other assets, net	(21 )	—	460	—
Loss on termination of hedges	—	—	—	(6,629 )
Total non-interest income	30,030	32,798	59,550	67,555
Total net revenue	121,151	102,343	236,141	203,986
Provision for loan losses	6,532	4,889	12,107	9,984
Non-interest expense				
Compensation and benefits	41,134	36,997	83,318	73,116
Occupancy and equipment	10,230	8,678	20,312	17,704
Technology and communications	7,359	6,883	14,189	12,970
Marketing and promotion	2,369	3,177	4,981	5,176
Professional services	1,139	2,190	3,192	4,641
FDIC premiums and assessments	1,411	1,588	2,606	2,886
Other real estate owned and foreclosures	1	30	68	58
Amortization of intangible assets	1,246	770	2,514	1,571
Acquisition, restructuring, and other expenses	847	2,903	5,940	14,585
Other	6,601	6,307	12,086	11,142
Total non-interest expense	72,337	69,523	149,206	143,849
Income before income taxes	42,282	27,931	74,828	50,153
Income tax expense	8,251	8,237	15,549	14,999
Net income	\$34,031	\$19,694	\$59,279	\$35,154
Preferred stock dividend	229	—	459	—
Income available to common shareholders	33,802	19,694	58,820	35,154
Earnings per common share:				
Basic	\$0.74	\$0.53	\$1.29	\$0.97



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

Diluted	\$0.74	\$0.53	\$1.28	\$0.96
Weighted average shares outstanding:				
Basic	46,032	37,324	45,999	36,305
Diluted	46,215	37,474	46,206	36,466

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

5

---

Table of ContentsBERKSHIRE HILLS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$34,031	\$19,694	\$59,279	\$35,154
Other comprehensive income, before tax:				
Changes in unrealized loss on debt securities available-for-sale	(7,840 )	3,927	(27,002 )	(5,505 )
Changes in unrealized loss on derivative hedges	—	—	—	6,573
Income taxes related to other comprehensive income:				
Changes in unrealized loss on debt securities available-for-sale	2,001	(1,455 )	6,932	2,086
Changes in unrealized gains on derivative hedges	—	—	—	(2,589 )
Total other comprehensive (loss)/income	(5,839 )	2,472	(20,070 )	565
Total comprehensive income	\$28,192	\$22,166	\$39,209	\$35,719

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

Table of Contents

## BERKSHIRE HILLS BANCORP, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Preferred stock	Common stock	Additional	Unearned	Retained	Accumulated	Treasury			
(In thousands)	Shares	Shares	paid-in	compensation	earnings	other	stock	Total		
	Amount	Amount	capital			comprehensive				
	Share	Share	capital			income/(loss)				
Balance at December 31, 2016	—	35,673	\$366	\$898,989	\$(6,374)	\$217,494	\$9,766	\$(26,943)	\$1,093,298	
Comprehensive income:										
Net income	—	—	—	—	—	35,154	—	—	35,154	
Other comprehensive loss	—	—	—	—	—	—	565	—	565	
Total comprehensive income	—	—	—	—	—	35,154	565	—	35,719	
Common stock issued	—	4,638	46	152,879	—	—	—	—	152,925	
Cash dividends declared (\$0.42 per share)	—	—	—	—	—	(15,024)	—	—	(15,024)	
Forfeited shares	—	(10)	—	63	304	—	—	(367)	—	
Exercise of stock options	—	7	—	—	—	(85)	—	196	111	
Restricted stock grants	—	154	—	1,566	(5,505)	—	—	3,939	—	
Stock-based compensation	—	—	—	—	2,524	—	—	—	2,524	
Other, net	—	(34)	—	(4)	—	(69)	—	(1,286)	(1,359)	
Balance at June 30, 2017	—	40,428	\$412	\$1,053,493	\$(9,051)	\$237,470	\$10,331	\$(24,461)	\$1,268,194	
Balance at December 31, 2017	522	\$40,633	45,290	\$460	\$1,242,487	\$(6,531)	\$239,179	\$4,161	\$(24,125)	\$1,496,264
Comprehensive income:										
Net income	—	—	—	—	—	59,279	—	—	59,279	
Other comprehensive loss	—	—	—	—	—	—	(20,070)	—	(20,070)	
Total comprehensive income	—	—	—	—	—	59,279	(20,070)	—	39,209	

Adoption of ASU No 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Liabilities	—	—	—	—	—	—	6,253	(6,253 )	—	—
Adoption of ASU No 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	—	—	—	—	—	—	(896 )	896	—	—
Cash dividends declared on common shares (\$0.44 per share)	—	—	—	—	—	—	(19,977 )	—	—	(19,977 )
Cash dividends declared on preferred shares (\$0.88 per share)	—	—	—	—	—	—	(459 )	—	—	(459 )
Forfeited shares	—	—	(15 )	—	88	478	—	—	(566 )	—
Exercise of stock options	—	—	8	—	—	—	(123 )	—	224	101
Restricted stock grants	—	—	181	—	2,100	(6,841 )	—	—	4,741	—
Stock-based compensation	—	—	—	—	—	2,798	—	—	—	2,798
Other, net	—	—	(44 )	—	16	—	—	—	(1,711 )	(1,695 )
Balance at June 30, 2018	522	\$40,633	45,420	\$460	\$1,244,691	\$(10,096)	\$283,256	\$(21,266)	\$(21,437)	\$1,516,241

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



Table of ContentsBERKSHIRE HILLS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income	\$ 59,279	\$ 35,154
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	12,107	9,984
Net amortization of securities	1,460	1,332
Change in unamortized net loan costs and premiums	(1,520 )	(158 )
Premises and equipment depreciation and amortization expense	5,215	4,961
Stock-based compensation expense	2,798	2,524
Accretion of purchase accounting entries, net	(11,114 )	(7,971 )
Amortization of other intangibles	2,514	1,571
Income from cash surrender value of bank-owned life insurance policies	(2,359 )	(1,188 )
Securities losses (gains), net	784	(12,571 )
Originations of loans held for sale	(1,106,100 )	(1,105,114 )
Proceeds from sale of loans held for sale	1,130,880	1,108,264
Net gain on sale of loans and other mortgage banking income	(20,342 )	(28,959 )
Loss on disposition of assets	—	912
Loss on sale of real estate	—	(12 )
	2,100	2,782

Amortization of interest in tax-advantaged projects			
Net change in other	(9,748	)	4,374
Net cash provided by operating activities	65,954		15,885
Cash flows from investing activities:			
Net decrease in trading security	329		311
Proceeds from sales of securities available for sale	—		3,444
Proceeds from maturities, calls, and prepayments of securities available for sale	93,049		88,821
Purchases of securities available for sale	(165,312	)	(227,484
Proceeds from sales of marketable equity securities	26,096		38,575
Purchases of marketable equity securities	(12,688	)	(14,230
Proceeds from maturities, calls, and prepayments of securities held to maturity	23,981		6,076
Purchases of securities held to maturity	(7,781	)	(23,582
Net change in loans	(413,717	)	(279,723
Proceeds from surrender of bank-owned life insurance	459		310
Proceeds from sale of Federal Home Loan Bank stock	28,673		68,672
Purchase of Federal Home Loan Bank stock	(41,118	)	(76,433
Net investment in limited partnership tax credits	2,464		(756
Purchase of premises and equipment, net	(7,958	)	(6,921

Payment to terminate cash flow hedges	—		6,573	
Proceeds from sale of other real estate	1,600		274	
Net cash (used) by investing activities (continued)	(471,923	)	(416,073	)

8

---



Table of Contents

(In thousands)	Six Months Ended	
	June 30, 2018	2017
Cash flows from financing activities:		
Net increase in deposits	90,009	94,324
Proceeds from Federal Home Loan Bank advances and other borrowings	2,287,896	3,841,600
Repayments of Federal Home Loan Bank advances and other borrowings	(2,061,307)	(3,683,292)
Exercise of stock options	101	111
Common and preferred stock cash dividends paid	(20,436 )	(15,023 )
Common stock issued, net	—	152,925
Acquisition contingent consideration paid	—	(1,700 )
Net cash provided by financing activities	296,263	388,945
Net change in cash and cash equivalents	(109,706 )	(11,243 )
Cash and cash equivalents at beginning of period	248,763	113,075
Cash and cash equivalents at end of period	\$ 139,057	\$ 101,832
Supplemental cash flow information:		
Interest paid on deposits	\$32,160	\$19,398
Interest paid on borrowed funds	14,202	10,021
Income taxes paid (refund), net	(2,446 )	6,339
Other non-cash changes:		
Other net comprehensive income	(20,070 )	565
Real estate owned acquired in settlement of loans	(1,600 )	390

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1. BASIS OF PRESENTATION

The consolidated financial statements (the “financial statements”) of Berkshire Hills Bancorp, Inc. and its subsidiaries (the “Company” or “Berkshire”) have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The Company is a Delaware corporation and the holding company for Berkshire Bank (the “Bank”), a Massachusetts-chartered trust company headquartered in Boston, Massachusetts, and Berkshire Insurance Group, Inc. These financial statements include the accounts of the Company, its wholly-owned subsidiaries and the Bank’s consolidated subsidiaries. In consolidation, all significant intercompany accounts and transactions are eliminated. All material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise.

The Company has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

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

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures Berkshire Hills Bancorp, Inc. previously filed with the Securities and Exchange Commission in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In management’s opinion, all adjustments necessary for a fair statement are reflected in the interim periods presented.

#### Reclassifications

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

#### Prior Period Acquisition

The Company completed the acquisition of Commerce Bancshares Corp. (“Commerce”), the parent company of Commerce Bank & Trust Company (“Commerce Bank”), at the close of business on October 13, 2017. With this acquisition, the Company established a market position in Worcester, New England’s second largest city. Additionally, this acquisition was a catalyst for the Company’s decision to relocate its corporate headquarters to Boston and to expand its Greater Boston market initiatives. This acquisition also increased the Company’s total assets over the \$10 billion Dodd Frank Act threshold for additional regulatory requirements.

The acquisition was accounted for under the acquisition method of accounting in accordance with ASC Topic 805, Business Combinations. Due to the complexity in valuing the acquired loans and the significant amount of data inputs required, the valuation of the loans is not yet final. Fair value estimates are based on the information available, and are subject to change up to one year after the closing date of the acquisition as additional information relative to the closing date fair values become available. In the second quarter of 2018 the Company did not recognize a material measurement period adjustment. Management continues to review initial estimates on certain areas such as loan valuations and the deferred tax asset and the review will be completed in the third quarter of 2018.

#### Recently Adopted Accounting Principles

Effective January 1, 2018, the following new accounting guidance was adopted by the Company:

ASU No. 2014-09, Revenue from Contracts with Customers (additional information is disclosed in Note 14 - Revenue of the Consolidated Financial Statements);

ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities

The adoption of these accounting standards did not have a material impact on the Company's financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In February 2018, the FASB issued ASU No. 2018-02, "Income statement - Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" which will allow a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. These amendments are effective for all entities for fiscal years beginning after December 15, 2018. For interim periods within those fiscal years, early adoption of the amendment is permitted including public business entities for reporting periods for which financial statements have not yet been issued. The Company elected to early adopt ASU 2018-02 during the first quarter of 2018, and elected to reclassify the income tax effects of the Tax Cuts and Jobs Act of 2017 from AOCI to retained earnings. The immaterial reclassification increased AOCI and decreased retained earnings by \$896 thousand, with no net effect on total shareholders' equity.

### Future Application of Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases". The new pronouncement improves the transparency and comparability of financial reporting around leasing transactions and more closely aligns accounting for leases with the recently issued International Financial Reporting Standard. The pronouncement affects all entities that are participants to leasing agreements. From a lessee accounting perspective, the ASU requires a lessee to recognize assets and liabilities on the balance sheet for operating leases and changes many key definitions, including the definition of a lease. The ASU includes a short-term lease exception for leases with a term of twelve months or less, in which a lessee can make an accounting policy election not to recognize lease assets and lease liabilities. Lessees will continue to differentiate between finance leases (previously referred to as capital leases) and operating leases, using classification criteria that are substantially similar to the previous guidance. For lessees, the recognition, measurement, and presentation of expenses and cash flows arising from a lease have not significantly changed from previous GAAP. From a lessor accounting perspective, the guidance is largely unchanged, except for targeted improvements to align with new terminology under lessee accounting and with the updated revenue recognition guidance in Topic 606. For sale-leaseback transactions, for a sale to occur the transfer must meet the sale criteria under the new revenue standard, ASC 606. Entities will not be required to reassess transactions previously accounted under then existing guidance.

Additionally, the ASU includes additional quantitative and qualitative disclosures required by lessees and lessors to help users better understand the amount, timing, and uncertainty of cash flows arising from leases. ASU No. 2016-02 is effective for fiscal years beginning after December 31, 2018, and interim periods within those fiscal years. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply as well as transition guidance specific to nonstandard leasing transactions. The Company is currently evaluating the provisions of ASU No. 2016-02 to determine the potential impact the new standard will have on the Company's consolidated financial statements. It is expected that assets and liabilities will increase based on the present value of remaining lease payments for leases in place at the adoption date; however, this is not expected to be material to the Company's results of operations or financial position. The Company continues to identify a complete inventory of arrangements containing a lease and accumulating the lease data necessary to apply the guidance. We will continue to review contracts up through the effective date and may identify additional leases or leases embedded in arrangements that will be within the scope of the new guidance.

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments." This ASU improves financial reporting by requiring timelier recording of credit losses on loans and other financial instruments. The ASU requires companies to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Forward-looking information will now be used in credit loss estimates. The ASU requires enhanced disclosures to provide better understanding surrounding significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company's portfolio. These disclosures include qualitative and quantitative requirements

that provide additional information about the amounts recorded in the financial statements. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. Most debt instruments will require a cumulative-effect adjustment to retained earnings on the statement of financial position as of the beginning of the first reporting

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

period in which the guidance is adopted (modified retrospective approach). However, there is instrument-specific transition guidance. ASU No. 2016-13 is effective for interim and annual periods beginning after December 15, 2019. Early application will be permitted for interim and annual periods beginning after December 15, 2018. The Company is evaluating the provisions of ASU No. 2016-13, and will closely monitor developments and additional guidance to determine the potential impact on the Company's consolidated financial statements. The Company expects the primary changes to be the application of the expected credit loss model to the financial statements. In addition, the Company expects the guidance to change the presentation of credit losses within the available-for-sale fixed maturities portfolio through an allowance method rather than as a direct write-down. The expected credit loss model will require a financial asset to be presented at the net amount expected to be collected. The allowance method for available-for-sale debt securities will allow the Company to record reversals of credit losses if the estimate of credit losses declines. The Company is in the process of identifying and implementing required changes to loan loss estimation models and processes and evaluating the impact of this new accounting guidance, which at the date of adoption is expected to increase the allowance for credit losses with a resulting negative adjustment to retained earnings.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles: Goodwill and Other: Simplifying the Test for Goodwill Impairment." The ASU simplifies the test for goodwill impairment by eliminating the second step of the current two-step method. Under the new accounting guidance, entities will compare the fair value of a reporting unit with its carrying amount. If the carrying amount exceeds the reporting unit's fair value, the entity is required to recognize an impairment charge for this amount. Current guidance requires an entity to proceed to a second step, whereby the entity would determine the fair value of its assets and liabilities. The new method applies to all reporting units. The performance of a qualitative assessment is still allowable. This accounting guidance is effective prospectively for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect adoption to have a material effect on our consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities." The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. ASU No. 2017-12 is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption, including adoption in an interim period, permitted. ASU 2017-12 requires a modified retrospective transition method in which the Company will recognize the cumulative effect of the change on the opening balance of each affected component of equity in the consolidated balance sheet as of the date of adoption. While the Company continues to assess all potential impacts of the standard, we currently do not expect adoption to have a material impact on our consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. TRADING SECURITY

The Company holds a tax advantaged economic development bond accounted for at fair value. The security had an amortized cost of \$10.4 million and \$10.8 million, and a fair value of \$11.5 million and \$12.3 million, at June 30, 2018 and December 31, 2017, respectively. As discussed further in Note 11 - Derivative Financial Instruments and Hedging Activities, the Company entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there were no other securities in the trading portfolio at June 30, 2018.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 3. SECURITIES AVAILABLE FOR SALE, HELD TO MATURITY, AND MARKETABLE EQUITY SECURITIES

The Company adopted ASU-2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" in the first quarter of 2018. All changes in the fair value of marketable equity securities, including other-than-temporary impairment, are immediately recognized in earnings.

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

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	\$ 110,381	\$ 2,475	\$(719 )	\$ 112,137
Agency collateralized mortgage obligations	940,130	10	(24,923 )	915,217
Agency mortgage-backed securities	190,872	45	(6,247 )	184,670
Agency commercial mortgage-backed securities	62,930	—	(3,417 )	59,513
Corporate bonds	100,985	534	(457 )	101,062
Trust preferred securities	11,266	348	—	11,614
Other bonds and obligations	9,042	44	(49 )	9,037
Total securities available for sale	1,425,606	3,456	(35,812 )	1,393,250
Securities held to maturity				
Municipal bonds and obligations	268,529	3,928	(3,066 )	269,391
Agency collateralized mortgage obligations	72,754	169	(1,392 )	71,531
Agency mortgage-backed securities	7,457	—	(351 )	7,106
Agency commercial mortgage-backed securities	10,449	—	(532 )	9,917
Tax advantaged economic development bonds	20,395	19	(1,194 )	19,220
Other bonds and obligations	321	—	—	321
Total securities held to maturity	379,905	4,116	(6,535 )	377,486
Marketable equity securities	55,618	6,024	(1,916 )	59,726
Total	\$ 1,861,129	\$ 13,596	\$(44,263 )	\$ 1,830,462



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	\$ 113,427	\$ 5,012	\$(206)	\$ 118,233
Agency collateralized mortgage obligations	859,705	397	(8,944)	851,158
Agency mortgage-backed securities	218,926	279	(2,265)	216,940
Agency commercial mortgage-backed securities	64,025	41	(1,761)	62,305
Corporate bonds	110,076	882	(237)	110,721
Trust preferred securities	11,334	343	—	11,677
Other bonds and obligations	9,757	154	(31)	9,880
Total securities available for sale	1,387,250	7,108	(13,444)	1,380,914
Securities held to maturity				
Municipal bonds and obligations	270,310	8,675	(90)	278,895
Agency collateralized mortgage obligations	73,742	1,045	(486)	74,301
Agency mortgage-backed securities	7,892	—	(164)	7,728
Agency commercial mortgage-backed securities	10,481	—	(268)	10,213
Tax advantaged economic development bonds	34,357	596	(1,135)	33,818
Other bonds and obligations	321	—	—	321
Total securities held to maturity	397,103	10,316	(2,143)	405,276
Marketable equity securities	36,483	9,211	(509)	45,185
Total	\$ 1,820,836	\$ 26,635	\$(16,096)	\$ 1,831,375

The amortized cost and estimated fair value of available for sale (“AFS”) and held to maturity (“HTM”) securities segregated by contractual maturity at June 30, 2018 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable.

(In thousands)	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	\$265	\$266	\$2,251	\$2,251
Over 1 year to 5 years	32,662	32,794	14,496	14,425
Over 5 years to 10 years	76,018	76,647	6,701	6,780
Over 10 years	122,729	124,143	265,797	265,476
Total bonds and obligations	231,674	233,850	289,245	288,932
Mortgage-backed securities	1,193,932	1,159,400	90,660	88,554
Total	\$ 1,425,606	\$ 1,393,250	\$ 379,905	\$ 377,486

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(In thousands)	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
June 30, 2018						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	\$ 162	\$ 5,805	\$ 557	\$ 8,600	\$ 719	\$ 14,405
Agency collateralized mortgage obligations	20,590	800,936	4,333	97,803	24,923	898,739
Agency mortgage-backed securities	3,074	119,032	3,173	62,416	6,247	181,448
Agency commercial mortgage-backed securities	351	13,421	3,066	46,092	3,417	59,513
Corporate bonds	457	61,521	—	—	457	61,521
Other bonds and obligations	20	987	29	2,085	49	3,072
Total securities available for sale	24,654	1,001,702	11,158	216,996	35,812	1,218,698
Securities held to maturity						
Municipal bonds and obligations	2,885	117,250	181	1,936	3,066	119,186
Agency collateralized mortgage obligations	720	31,773	672	11,882	1,392	43,655
Agency mortgage-backed securities	—	—	351	7,106	351	7,106
Agency commercial mortgage-backed securities	—	—	532	9,917	532	9,917
Tax advantaged economic development bonds	1,194	15,514	—	—	1,194	15,514
Total securities held to maturity	4,799	164,537	1,736	30,841	6,535	195,378
Total	\$ 29,453	\$ 1,166,239	\$ 12,894	\$ 247,837	\$ 42,347	\$ 1,414,076
December 31, 2017						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	\$ —	\$ —	\$ 206	\$ 8,985	\$ 206	\$ 8,985
Agency collateralized mortgage obligations	6,849	655,479	2,095	80,401	8,944	735,880
Agency mortgage-backed securities	765	95,800	1,500	65,323	2,265	161,123
Agency commercial mortgage-backed securities	334	17,379	1,427	39,268	1,761	56,647
Corporate bonds	1	328	236	15,769	237	16,097
Other bonds and obligations	11	1,096	20	2,004	31	3,100
Total securities available for sale	7,960	770,082	5,484	211,750	13,444	981,832
Securities held to maturity						
Municipal bonds and obligations	35	10,213	55	2,059	90	12,272
Agency collateralized mortgage obligations	—	—	486	12,946	486	12,946
Agency mortgage-backed securities	—	—	164	7,728	164	7,728
Agency commercial mortgage-backed securities	—	—	268	10,213	268	10,213
Tax advantaged economic development bonds	1,135	7,305	—	—	1,135	7,305
Total securities held to maturity	1,170	17,518	973	32,946	2,143	50,464

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

Total	\$ 9,130	\$ 787,600	\$ 6,457	\$ 244,696	\$ 15,587	\$ 1,032,296
-------	----------	------------	----------	------------	-----------	--------------

16

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Debt Securities

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of June 30, 2018, prior to this recovery. The Company's ability and intent to hold these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historically low portfolio turnover.

The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's AFS and HTM portfolios were not other-than-temporarily impaired at June 30, 2018:

#### AFS municipal bonds and obligations

At June 30, 2018, 17 of the total 251 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 4.8% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the quarter. All securities are performing.

#### AFS collateralized mortgage obligations

At June 30, 2018, 237 out of the total 245 securities in the Company's portfolio of AFS collateralized mortgage obligations were in unrealized loss positions. Aggregate unrealized losses represented 2.7% of the amortized cost of securities in unrealized loss positions. The Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), and Government National Mortgage Association ("GNMA") guarantee the contractual cash flows of all of the Company's collateralized mortgage obligations. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

#### AFS commercial and residential mortgage-backed securities

At June 30, 2018, 73 out of the total 100 securities in the Company's portfolio of AFS mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 3.9% of the amortized cost of securities in unrealized loss positions. The FNMA, FHLMC, and GNMA guarantee the contractual cash flows of all of the Company's mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

#### AFS corporate bonds

At June 30, 2018, 12 out of the total 20 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represents 0.7% of the amortized cost of bonds in unrealized loss positions. The Company reviews the financial strength of all of these bonds and has concluded that the amortized cost remains supported by the expected future cash flows of these securities.

#### AFS other bonds and obligations

At June 30, 2018, 6 out of the total 8 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 1.6% of the amortized cost of securities in unrealized loss positions. The securities are all investment grade rated, and there were no material underlying credit downgrades during the quarter. All securities are performing.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### HTM Municipal bonds and obligations

At June 30, 2018, 78 of the 227 securities in the Company's portfolio of municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 2.5% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the quarter. All securities are performing.

### HTM collateralized mortgage obligations

At June 30, 2018, 4 of the 9 securities in the Company's portfolio of HTM collateralized mortgage obligations were in unrealized loss positions. Aggregate unrealized losses represented 4.7% of the amortized cost of securities in unrealized loss positions. The FNMA, FHLMC, and GNMA guarantee the contractual cash flows of all of the Company's collateralized residential mortgage obligations. The securities are investment grade rated, and there were no material underlying credit downgrades during the quarter. All securities are performing.

### HTM commercial and residential mortgage-backed securities

At June 30, 2018, 2 out of a total of 2 securities in the Company's portfolio of HTM mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 4.9% of the amortized cost of securities in unrealized loss positions. The FNMA, FHLMC, and GNMA guarantee the contractual cash flows of the Company's residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the quarter. All securities are performing.

### HTM tax-advantaged economic development bonds

At June 30, 2018, 3 out of the total 6 securities in the Company's portfolio of tax advantaged economic development bonds were in unrealized loss positions. Aggregate unrealized losses represented 7.2% of the amortized cost of the securities in unrealized loss positions. One of the above mentioned tax advantaged economic bonds was downgraded to special mention during 2017. The Company believes that more likely than not all the principal outstanding will be collected. All securities are performing.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 4. LOANS

The Company's loan portfolio is segregated into the following segments: commercial real estate, commercial and industrial, residential mortgage, and consumer. Commercial real estate loans include construction, single and multi-family, and other commercial real estate classes. Residential mortgage loans include classes for 1-4 family owner occupied and construction loans. Consumer loans include home equity, direct and indirect auto, and other. These portfolio segments each have unique risk characteristics that are considered when determining the appropriate level for the allowance for loan losses. A substantial portion of the loan portfolio is secured by real estate in Massachusetts, southern Vermont, northeastern New York, New Jersey and in the Bank's other New England lending areas. The ability of many of the Bank's borrowers to honor their contracts is dependent, among other things, on the specific economy and real estate markets of these areas.

Total loans include business activity loans and acquired loans. Acquired loans are those loans acquired from Commerce Bank and Trust Company, First Choice Bank, Parke Bank, Firestone Financial Corp., Hampden Bancorp, Inc., the New York branch acquisition, Beacon Federal Bancorp, Inc., The Connecticut Bank and Trust Company, Legacy Bancorp, Inc., and Rome Bancorp, Inc. Acquired loans that are refinanced are transferred to business activity loans. Business activity and acquired loans are serviced, managed, and accounted for under the Company's same control environment. The following is a summary of total loans:

(In thousands)	June 30, 2018			December 31, 2017		
	Business Activities	Acquired Loans	Total	Business Activities	Acquired Loans	Total
Commercial real estate:						
Construction	\$345,896	\$59,268	\$405,164	\$269,206	\$84,965	\$354,171
Single and multi-family	378,434	195,865	574,299	217,083	206,082	423,165
Other commercial real estate	1,644,666	695,194	2,339,860	1,731,418	755,988	2,487,406
Total commercial real estate	2,368,996	950,327	3,319,323	2,217,707	1,047,035	3,264,742
Commercial and industrial loans:	1,355,864	519,254	1,875,118	1,182,569	621,370	1,803,939
Total commercial loans	3,724,860	1,469,581	5,194,441	3,400,276	1,668,405	5,068,681
Residential mortgages:						
1-4 family	2,129,976	259,734	2,389,710	1,808,024	289,373	2,097,397
Construction	7,289	193	7,482	5,177	233	5,410
Total residential mortgages	2,137,265	259,927	2,397,192	1,813,201	289,606	2,102,807
Consumer loans:						
Home equity	293,450	99,380	392,830	294,954	115,227	410,181
Auto and other	634,804	90,699	725,503	603,767	113,902	717,669
Total consumer loans	928,254	190,079	1,118,333	898,721	229,129	1,127,850
Total loans	\$6,790,379	\$1,919,587	\$8,709,966	\$6,112,198	\$2,187,140	\$8,299,338

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The carrying amount of the acquired loans at June 30, 2018 totaled \$1.9 billion. A subset of these loans was determined to have evidence of credit deterioration at acquisition date, which is accounted for in accordance with ASC 310-30. These purchased credit-impaired loans presently maintain a carrying value of \$70.8 million (and a note balance of \$171.7 million). These loans are evaluated for impairment through the periodic reforecasting of expected cash flows. Loans considered not credit-impaired at acquisition date had a carrying amount of \$1.8 billion.

At December 31, 2017, acquired loans maintained a carrying value of \$2.2 billion and purchased credit-impaired loans totaled \$97.3 million (note balance of \$208.7 million). Loans considered not credit-impaired at acquisition date had a carrying amount of \$2.1 billion.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality:

	Three Months Ended June 30,	
(In thousands)	2018	2017
Balance at beginning of period	\$10,392	\$7,363
Accretion	(2,195 )	(1,005 )
Net reclassifications from (to) nonaccretable difference	(169 )	(85 )
Payments received, net	(1,724 )	(506 )
Disposals	—	—
Balance at end of period	\$6,304	\$5,767

  

	Six Months Ended June 30,	
(In thousands)	2018	2017
Balance at beginning of period	\$11,561	\$8,738
Accretion	(4,918 )	(2,051 )
Net reclassifications from (to) nonaccretable difference	1,654	333
Payments received, net	(1,912 )	(1,253 )
Disposals	(81 )	—
Balance at end of period	\$6,304	\$5,767

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of past due loans at June 30, 2018 and December 31, 2017:

## Business Activities Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
June 30, 2018							
Commercial real estate:							
Construction	\$ —	\$ —	\$—	\$ —	\$345,896	\$345,896	\$ —
Single and multi-family	314	—	433	747	377,687	378,434	9
Other commercial real estate	1,163	262	21,993	23,418	1,621,248	1,644,666	16,706
Total	1,477	262	22,426	24,165	2,344,831	2,368,996	16,715
Commercial and industrial loans:							
Total	2,272	114	2,528	4,914	1,350,950	1,355,864	42
Residential mortgages:							
1-4 family	817	445	2,798	4,060	2,125,916	2,129,976	879
Construction	—	—	—	—	7,289	7,289	—
Total	817	445	2,798	4,060	2,133,205	2,137,265	879
Consumer loans:							
Home equity	72	—	2,462	2,534	290,916	293,450	—
Auto and other	2,766	478	1,667	4,911	629,893	634,804	49
Total	2,838	478	4,129	7,445	920,809	928,254	49
Total	\$ 7,404	\$ 1,299	\$31,881	\$ 40,584	\$6,749,795	\$6,790,379	\$ 17,685

## Business Activities Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2017							
Commercial real estate:							
Construction	\$ —	\$ —	\$—	\$ —	\$269,206	\$269,206	\$ —
Single and multi-family	—	—	451	451	216,632	217,083	—
Other commercial real estate	1,925	48	5,023	6,996	1,724,422	1,731,418	457
Total	1,925	48	5,474	7,447	2,210,260	2,217,707	457
Commercial and industrial loans:							
Total	4,031	1,912	6,023	11,966	1,170,603	1,182,569	128
Residential mortgages:							
1-4 family	2,412	242	2,186	4,840	1,803,184	1,808,024	520
Construction	—	—	—	—	5,177	5,177	—
Total	2,412	242	2,186	4,840	1,808,361	1,813,201	520
Consumer loans:							
Home equity	444	1,235	1,747	3,426	291,528	294,954	120
Auto and other	3,389	599	1,597	5,585	598,182	603,767	143
Total	3,833	1,834	3,344	9,011	889,710	898,721	263



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

Total	\$ 12,201	\$ 4,036	\$ 17,027	\$ 33,264	\$ 6,078,934	\$ 6,112,198	\$ 1,368
-------	-----------	----------	-----------	-----------	--------------	--------------	----------

21

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Acquired Credit Impaired	Total Loans	Past Due > 90 days and Accruing
June 30, 2018							
Commercial real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ 7,633	\$ 59,268	\$ —
Single and multi-family	337	100	270	707	2,074	195,865	—
Other commercial real estate	417	1,248	4,680	6,345	21,308	695,194	323
Total	754	1,348	4,950	7,052	31,015	950,327	323
Commercial and industrial loans:							
Total	446	260	1,543	2,249	32,297	519,254	—
Residential mortgages:							
1-4 family	1,318	241	1,494	3,053	5,054	259,734	216
Construction	—	—	—	—	—	193	—
Total	1,318	241	1,494	3,053	5,054	259,927	216
Consumer loans:							
Home equity	183	119	998	1,300	2,004	99,380	81
Auto and other	150	8	483	641	396	90,699	14
Total	333	127	1,481	1,941	2,400	190,079	95
Total	\$ 2,851	\$ 1,976	\$ 9,468	\$ 14,295	\$ 70,766	\$ 1,919,587	\$ 634

## Acquired Loans

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Acquired Credit Impaired	Total Loans	Past Due > 90 days and Accruing
December 31, 2017							
Commercial real estate:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ 7,655	\$ 84,965	\$ —
Single and multi-family	671	—	203	874	2,846	206,082	—
Other commercial real estate	816	1,875	2,156	4,847	42,801	755,988	109
Total	1,487	1,875	2,359	5,721	53,302	1,047,035	109
Commercial and industrial loans:							
Total	1,252	268	1,439	2,959	34,629	621,370	23
Residential mortgages:							
1-4 family	957	2,581	1,247	4,785	6,974	289,373	30
Construction	—	—	—	—	—	233	—
Total	957	2,581	1,247	4,785	6,974	289,606	30
Consumer loans:							
Home equity	286	40	1,965	2,291	1,956	115,227	—
Auto and other	346	135	430	911	483	113,902	38
Total	632	175	2,395	3,202	2,439	229,129	38
Total	\$ 4,328	\$ 4,899	\$ 7,440	\$ 16,667	\$ 97,344	\$ 2,187,140	\$ 200



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is summary information pertaining to non-accrual loans at June 30, 2018 and December 31, 2017:

(In thousands)	June 30, 2018			December 31, 2017		
	Business Acquired Activities <del>Loans</del> (1)	Loans(1)	Total	Business Acquired Activities <del>Loans</del> (2)	Loans(2)	Total
Commercial real estate:						
Construction	\$—	\$—	\$—	\$—	\$—	\$—
Single and multi-family	424	206	630	451	203	654
Other commercial real estate	5,287	3,493	8,780	4,566	2,047	6,613
Total	5,711	3,699	9,410	5,017	2,250	7,267
Commercial and industrial loans:						
Total	2,486	1,543	4,029	5,895	1,333	7,228
Residential mortgages:						
1-4 family	1,919	1,278	3,197	1,666	1,217	2,883
Construction	—	—	—	—	—	—
Total	1,919	1,278	3,197	1,666	1,217	2,883
Consumer loans:						
Home equity	2,462	917	3,379	1,627	1,965	3,592
Auto and other	1,618	469	2,087	1,454	392	1,846
Total	4,080	1,386	5,466	3,081	2,357	5,438
Total non-accrual loans	\$14,196	\$ 7,906	\$22,102	\$15,659	\$ 7,157	\$22,816

(1) At quarter end June 30, 2018, acquired credit impaired loans accounted for \$927 thousand of loans greater than 90 days past due that are not presented in the above table.

(2) At December 31, 2017, acquired credit impaired loans accounted for \$83 thousand of loans greater than 90 days past due that are not presented in the above table.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Loans evaluated for impairment as of June 30, 2018 and December 31, 2017 were as follows:

## Business Activities Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
June 30, 2018					
Loans receivable:					
Balance at end of period					
Individually evaluated for impairment	\$ 27,806	\$ 2,340	\$ 2,280	\$ 1,835	\$ 34,261
Collectively evaluated for impairment	2,341,190	1,353,524	2,134,985	926,419	6,756,118
Total	\$ 2,368,996	\$ 1,355,864	\$ 2,137,265	\$ 928,254	\$ 6,790,379

## Business Activities Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
December 31, 2017					
Loans receivable:					
Balance at end of year					
Individually evaluated for impairment	\$ 33,732	\$ 5,761	\$ 3,872	\$ —	\$ 43,365
Collectively evaluated for impairment	2,183,975	1,176,808	1,809,329	898,721	6,068,833
Total	\$ 2,217,707	\$ 1,182,569	\$ 1,813,201	\$ 898,721	\$ 6,112,198

## Acquired Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
June 30, 2018					
Loans receivable:					
Balance at end of Period					
Individually evaluated for impairment	\$ 5,601	\$ 864	\$ 765	\$ 815	\$ 8,045
Purchased credit-impaired loans	31,015	32,297	5,054	2,400	70,766
Collectively evaluated for impairment	913,711	486,093	254,108	186,864	1,840,776
Total	\$ 950,327	\$ 519,254	\$ 259,927	\$ 190,079	\$ 1,919,587

## Acquired Loans

(In thousands)	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
December 31, 2017					
Loans receivable:					
Balance at end of year					
Individually evaluated for impairment	\$ 4,244	\$ 421	\$ 2,617	\$ 27	\$ 7,309
Purchased credit-impaired loans	53,302	34,629	6,974	2,439	97,344
Collectively evaluated for impairment	989,489	586,320	280,015	226,663	2,082,487
Total	\$ 1,047,035	\$ 621,370	\$ 289,606	\$ 229,129	\$ 2,187,140

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of impaired loans at June 30, 2018 and December 31, 2017:

## Business Activities Loans

(In thousands)	June 30, 2018		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Commercial real estate - single and multifamily	\$—	\$ —	\$ —
Other commercial real estate loans	26,609	32,123	—
Commercial and industrial loans	908	2,180	—
Residential mortgages - 1-4 family	904	1,541	—
Consumer - home equity	1,776	2,410	—
Consumer - other	—	—	—
With an allowance recorded:			
Commercial real estate - single and multifamily	\$306	\$ 323	\$ 1
Other commercial real estate loans	1,430	1,423	14
Commercial and industrial loans	1,453	1,434	70
Residential mortgages - 1-4 family	1,395	1,440	109
Consumer - home equity	43	52	—
Consumer - other	15	15	1
Total			
Commercial real estate	\$28,345	\$ 33,869	\$ 15
Commercial and industrial loans	2,361	3,614	70
Residential mortgages	2,299	2,981	109
Consumer	1,834	2,477	1
Total impaired loans	\$34,839	\$ 42,941	\$ 195

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. These amounts are components of total loans and other assets on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Business Activities Loans

(In thousands)	December 31, 2017		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Commercial real estate - single and multifamily	\$1,077	\$ 3,607	\$ —
Other commercial real estate loans	18,285	18,611	—
Commercial and industrial loans	2,060	2,629	—
Residential mortgages - 1-4 family	660	1,075	—
Consumer - home equity	867	1,504	—
With an allowance recorded:			
Commercial real estate - construction	\$159	\$ 159	\$ 1
Commercial real estate - single and multifamily	159	171	1
Other commercial real estate loans	14,321	15,235	227
Commercial and industrial loans	3,716	4,249	66
Residential mortgages - 1-4 family	1,344	1,446	130
Consumer - home equity	1,014	999	34
Consumer - other	17	17	1
Total			
Commercial real estate	\$34,001	\$ 37,783	\$ 229
Commercial and industrial loans	5,776	6,878	66
Residential mortgages	2,004	2,521	130
Consumer	1,898	2,520	35
Total impaired loans	\$43,679	\$ 49,702	\$ 460

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. This amount is a component of total loans on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	June 30, 2018		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Commercial real estate - single and multifamily	\$ 167	\$ 261	\$ —
Other commercial real estate loans	2,501	5,556	—
Commercial and industrial loans	521	597	—
Residential mortgages - 1-4 family	696	707	—
Consumer - home equity	501	959	—
Consumer - other	13	15	—
With an allowance recorded:			
Commercial real estate - single and multifamily	\$ 759	\$ 756	\$ 10
Other commercial real estate loans	2,201	2,211	22
Commercial and industrial loans	348	347	9
Residential mortgages - 1-4 family	76	76	6
Consumer - home equity	301	360	11
Total			
Commercial real estate	\$ 5,628	\$ 8,784	\$ 32
Commercial and industrial loans	869	944	9
Residential mortgages	772	783	6
Consumer	815	1,334	11
Total impaired loans	\$ 8,084	\$ 11,845	\$ 58

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. This amount is a component of total loans on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	December 31, 2017		Related Allowance
	Recorded Investment (1)	Unpaid Principal Balance (2)	
With no related allowance:			
Commercial real estate - single and multifamily	\$204	\$ 290	\$ —
Other commercial real estate loans	1,123	2,794	—
Other commercial and industrial loans	255	310	—
Residential mortgages - 1-4 family	658	671	—
Consumer - home equity	1,374	1,654	—
Consumer - other	27	27	—
With an allowance recorded:			
Commercial real estate - single and multifamily	\$887	\$ 880	\$ 18
Other commercial real estate loans	2,043	1,661	38
Commercial and industrial loans	165	166	1
Residential mortgages - 1-4 family	166	185	9
Consumer - home equity	433	540	45
Total			
Commercial real estate	\$4,257	\$ 5,625	\$ 56
Commercial and industrial loans	420	476	1
Residential mortgages	824	856	9
Consumer	1,834	2,221	45
Total impaired loans	\$7,335	\$ 9,178	\$ 111

(1) The Recorded Investment represents the face amount of the loan increased or decreased by applicable accrued interest, net deferred loan fees and costs, and unamortized premium or discount, and reflects direct charge-offs. This amount is a component of total loans on the Consolidated Balance Sheet.

(2) The Unpaid Principal Balance represents the customer's legal obligation to the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of the average recorded investment and interest income recognized on impaired loans as of June 30, 2018 and 2017:

## Business Activities Loans

(In thousands)	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Commercial real estate - single and multifamily	\$—	\$ —	\$99	\$ —
Other commercial real estate loans	29,092	326	22,362	473
Commercial and industrial loans	4,467	201	1,251	16
Residential mortgages - 1-4 family	942	26	1,870	11
Consumer - home equity	1,754	4	90	—
Consumer - other	—	—	—	—
With an allowance recorded:				
Commercial real estate - single and multifamily	\$310	\$ 8	\$171	\$ 8
Other commercial real estate loans	1,476	39	10,056	119
Commercial and industrial loans	1,279	83	6,902	131
Residential mortgages - 1-4 family	1,409	32	636	7
Consumer - home equity	45	1	2,371	17
Consumer - other	16	—	—	—
Total				
Commercial real estate	\$30,878	\$ 373	\$32,688	\$ 600
Commercial and industrial loans	5,746	284	8,153	147
Residential mortgages	2,351	58	2,506	18
Consumer loans	1,815	5	2,461	17
Total impaired loans	\$40,790	\$ 720	\$45,808	\$ 782

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

(In thousands)	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Commercial real estate - single and multifamily	\$ 182	\$ 9	\$ 396	\$ 43
Other commercial real estate loans	2,124	102	269	49
Commercial and industrial loans	349	27	298	1
Residential mortgages - 1-4 family	1,505	6	393	6
Consumer - home equity	760	—	771	—
Consumer - other	17	1	—	—
With an allowance recorded:				
Commercial real estate - single and multifamily	\$ 765	\$ 20	\$ 905	\$ 12
Other commercial real estate loans	2,255	69	1,482	19
Commercial and industrial loans	287	17	328	8
Residential mortgages - 1-4 family	77	2	94	1
Consumer - home equity	320	5	390	5
Consumer - other	—	—	—	—
Total				
Other commercial real estate loans	\$ 5,326	\$ 200	\$ 3,052	\$ 123
Commercial and industrial loans	636	44	626	9
Residential mortgages	1,582	8	487	7
Consumer loans	1,097	6	1,161	5
Total impaired loans	\$ 8,641	\$ 258	\$ 5,326	\$ 144

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Troubled Debt Restructuring Loans

The Company's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. TDRs are evaluated individually for impairment and may result in a specific allowance amount allocated to an individual loan.

The following tables include the recorded investment and number of modifications identified during the three and six months ended June 30, 2018 and June 30, 2017. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. There were no modifications made during the three months ended June 30, 2018. The modifications for the six months ended June 30, 2018 were attributable to interest rate concessions, principal concessions, maturity date extensions, modified payment terms, reamortization, and accelerated maturity. The modifications for the three and six months ended June 30, 2017 were attributable to interest rate concessions, principal concessions, maturity date extensions, modified payment terms, reamortization, and accelerated maturity.

(Dollars in thousands)	Three Months Ended June 30, 2018			
	Pre-Modification		Post-Modification	
	Number of	Outstanding Recorded	Outstanding Recorded	Investment
	Modifications	Investment	Investment	
Troubled Debt Restructurings				
Commercial and industrial	—	\$ —	\$ —	—
Residential - 1-4 Family	—	—	—	—
Total	—	\$ —	\$ —	—
	Six Months Ended June 30, 2018			
(Dollars in thousands)	Pre-Modification		Post-Modification	
	Number of	Outstanding Recorded	Outstanding Recorded	Investment
	Modifications	Investment	Investment	
Troubled Debt Restructurings				
Commercial and industrial	4	\$ 1,995	\$ 1,924	
Residential - 1-4 Family	1	118	118	
Total	5	\$ 2,113	\$ 2,042	
	Three Months Ended June 30, 2017			
(Dollars in thousands)	Pre-Modification		Post-Modification	
	Number of	Outstanding Recorded	Outstanding Recorded	Investment
	Modifications	Investment	Investment	
Troubled Debt Restructurings				
Commercial - Other	9	\$ 10,613	\$ 9,385	
Commercial and industrial - Other	4	1,793	1,793	
Residential - 1-4 Family	—	—	—	
Consumer Home Equity	—	—	—	
Total	13	\$ 12,406	\$ 11,178	

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands)	Six Months Ended June 30, 2017	
	Pre-Modification Number of Outstanding Modifications Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings		
Commercial - Other	15 \$ 13,445	\$ 11,718
Commercial and industrial - Other	5 1,817	1,817
Residential - 1-4 Family	2 205	188
Consumer Home Equity	1 53	53
Total	23 \$ 15,520	\$ 13,776

The following table discloses the recorded investments and numbers of modifications for TDRs where a concession has been made within the previous 12 months, that then defaulted in the respective reporting period. For the three and six months ended June 30, 2018, there were two loans that were restructured that had subsequently defaulted during the period.

(Dollars in thousands)	Modifications that Subsequently Defaulted Three Months Ended June 30, 2018	
	Number of Contracts	Investment
Troubled Debt Restructurings		
Commercial - Other	1 \$ 5,992	
Commercial and industrial - Other	1 \$ 1,065	

(Dollars in thousands)	Modifications that Subsequently Defaulted Six Months Ended June 30, 2018	
	Number of Contracts	Investment
Troubled Debt Restructurings		
Commercial - Other	1 \$ 5,992	
Commercial and industrial - Other	1 \$ 1,065	

(Dollars in thousands)	Modifications that Subsequently Defaulted Three Months Ended June 30, 2017	
	Number of Contracts	Investment
Troubled Debt Restructurings		
Commercial - Other	— \$ —	—
Commercial and industrial - Other	— \$ —	—

(Dollars in thousands)	Modifications that Subsequently Defaulted Six Months Ended June 30, 2017	
	Number of Contracts	Investment
Troubled Debt Restructurings		
Commercial - Other	1 \$ 113	
Commercial and industrial - Other	1 \$ 101	

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the Company's TDR activity for the three and six months ended June 30, 2018 and 2017:

(In thousands)	Three Months Ended June 30,	
	2018	2017
Balance at beginning of the period	\$43,105	\$34,699
Principal payments	(2,511 )	(266 )
TDR status change (1)	—	—
Other reductions/increases (2)	(7,088 )	(1,055 )
Newly identified TDRs	—	11,178
Balance at end of the period	\$33,506	\$44,556
	Six Months Ended June 30,	
	2018	2017
Balance at beginning of the period	\$41,990	\$33,829
Principal payments	(3,150 )	(1,154 )
TDR status change (1)	—	—
Other reductions/increases (2)	(7,376 )	(1,895 )
Newly identified TDRs	2,042	13,776
Balance at end of the period	\$33,506	\$44,556

- (1) TDR status change classification represents TDR loans with a specified interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk and the loan was on current payment status and not impaired based on the terms specified by the restructuring agreement.
- (2) Other reductions classification consists of transfer to other real estate owned and charge-offs and advances to loans.

The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.

As of June 30, 2018, the Company maintained no foreclosed residential real estate property. Additionally, residential mortgage loans collateralized by real estate property that are in the process of foreclosure as of June 30, 2018 and December 31, 2017 totaled \$3.8 million and \$4.9 million, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 5. LOAN LOSS ALLOWANCE

Activity in the allowance for loan losses for the three and six months ended June 30, 2018 and 2017 was as follows:

Business Activities Loans (In thousands)	At or for the three months ended June 30, 2018				Total
	Commercial and real estate	Commercial and industrial loans	Residential mortgages	Consumer	
Balance at beginning of period	\$17,841	\$ 13,229	\$ 8,598	\$ 7,609	\$47,277
Charged-off loans	1,392	1,706	27	837	3,962
Recoveries on charged-off loans	26	447	6	135	614
Provision/(releases) for loan losses	2,676	2,685	853	171	6,385
Balance at end of period	\$19,151	\$ 14,655	\$ 9,430	\$ 7,078	\$50,314

Business Activities Loans (In thousands)	At or for the six months ended June 30, 2018				Total
	Commercial and real estate	Commercial and industrial loans	Residential mortgages	Consumer	
Balance at beginning of period	\$16,843	\$ 13,850	\$ 9,420	\$ 5,807	\$45,920
Charged-off loans	1,498	2,596	27	1,777	5,898
Recoveries on charged-off loans	49	491	6	209	755
Provision/(releases) for loan losses	3,757	2,910	31	2,839	9,537
Balance at end of period	\$19,151	\$ 14,655	\$ 9,430	\$ 7,078	\$50,314

Business Activities Loans (In thousands)	At or for the three months ended June 30, 2017				Total
	Commercial and real estate	Commercial and industrial loans	Residential mortgages	Consumer	
Balance at beginning of period	\$16,280	\$ 11,850	\$ 7,863	\$ 5,470	\$41,463
Charged-off loans	1,393	581	278	631	2,883
Recoveries on charged-off loans	—	55	14	87	156
Provision/(releases) for loan losses	1,046	1,306	512	1,295	4,159
Balance at end of period	\$15,933	\$ 12,630	\$ 8,111	\$ 6,221	\$42,895

Business Activities Loans (In thousands)	At or for the six months ended June 30, 2017				Total
	Commercial and real estate	Commercial and industrial loans	Residential mortgages	Consumer	
Balance at beginning of period	\$16,498	\$ 9,447	\$ 7,805	\$ 5,479	\$39,229
Charged-off loans	1,516	1,851	513	1,317	5,197
Recoveries on charged-off loans	57	71	29	172	329
Provision/(releases) for loan losses	894	4,963	790	1,887	8,534
Balance at end of period	\$15,933	\$ 12,630	\$ 8,111	\$ 6,221	\$42,895

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Acquired Loans (In thousands)	At or for the three months ended June 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$3,995	\$ 1,243	\$ 1,046	\$ 298	\$6,582
Charged-off loans	972	—	622	164	1,758
Recoveries on charged-off loans	259	66	11	304	640
Provision/(releases) for loan losses	100	(182 )	183	46	147
Balance at end of period	\$3,382	\$ 1,127	\$ 618	\$ 484	\$5,611
Acquired Loans (In thousands)	At or for the six months ended June 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$3,856	\$ 1,125	\$ 598	\$ 335	\$5,914
Charged-off loans	1,712	155	1,053	693	3,613
Recoveries on charged-off loans	265	95	36	344	740
Provision/(releases) for loan losses	973	62	1,037	498	2,570
Balance at end of period	\$3,382	\$ 1,127	\$ 618	\$ 484	\$5,611
Acquired Loans (In thousands)	At or for the three months ended June 30, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$2,128	\$ 1,054	\$ 706	\$ 453	\$4,341
Charged-off loans	94	43	71	340	548
Recoveries on charged-off loans	13	(56 )	(2 )	(14 )	(59 )
Provision/(releases) for loan losses	309	59	57	305	730
Balance at end of period	\$2,356	\$ 1,014	\$ 690	\$ 404	\$4,464
Acquired Loans (In thousands)	At or for the six months ended June 30, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Balance at beginning of period	\$2,303	\$ 1,164	\$ 766	\$ 536	\$4,769
Charged-off loans	670	481	215	491	1,857
Recoveries on charged-off loans	22	1	38	41	102
Provision/(releases) for loan losses	701	330	101	318	1,450
Balance at end of period	\$2,356	\$ 1,014	\$ 690	\$ 404	\$4,464





## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present a summary of the allowance for loan losses as of June 30, 2018 and December 31, 2017:

Business Activities Loans (In thousands)	At June 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	15	70	109	1	195
Collectively evaluated for impairment	19,136	14,585	9,321	7,077	50,119
Total	\$ 19,151	\$ 14,655	\$ 9,430	\$ 7,078	\$ 50,314

Business Activities Loans (In thousands)	At December 31, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	229	66	130	35	460
Collectively evaluated for impairment	16,614	13,784	9,290	5,772	45,460
Total	16,843	13,850	9,420	5,807	45,920

Acquired Loans (In thousands)	At June 30, 2018				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	32	9	6	11	58
Purchased credit-impaired loans	—	—	—	—	—
Collectively evaluated for impairment	3,350	1,118	612	473	5,553
Total	\$ 3,382	\$ 1,127	\$ 618	\$ 484	\$ 5,611

Acquired Loans (In thousands)	At December 31, 2017				
	Commercial real estate	Commercial and industrial loans	Residential mortgages	Consumer	Total
Individually evaluated for impairment	56	1	9	45	111
Collectively evaluated for impairment	3,800	1,124	589	290	5,803
Total	3,856	1,125	598	335	5,914

## Credit Quality Information

## Business Activities Loans Credit Quality Analysis

The Company monitors the credit quality of its portfolio by using internal risk ratings that are based on regulatory guidance. Loans that are given a Pass rating are not considered a problem credit. Loans that are classified as Special Mention loans are considered to have potential credit problems and are evaluated closely by management.

Substandard and non-accruing loans are loans for which a definitive weakness has been identified and which may make full collection of contractual cash flows questionable. Doubtful loans are those with identified weaknesses that make full collection of contractual cash flows, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

For commercial credits, the Company assigns an internal risk rating at origination and reviews the rating annually, semiannually or quarterly depending on the risk rating. The rating is also reassessed at any point in time when management becomes aware of information that may affect the borrower's ability to fulfill their obligations.

The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Loans that are current within 59 days are rated Pass. Residential mortgages that are 60-89 days delinquent are rated Special Mention. Loans delinquent for 90 days

36

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

or greater are rated Substandard and generally placed on non-accrual status. Home equity loans are risk rated based on the same rating system as the Company's residential mortgages.

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

### Acquired Loans Credit Quality Analysis

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

The Bank utilizes an eleven grade internal loan rating system for each of its acquired commercial real estate, construction and commercial loans as outlined in the Credit Quality Information section of this Note. The ratings system is similar to loans originated through business activities.

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

Additionally, the Company considers the need for a reserve for acquired loans accounted for outside of the scope of ASC 310-30 under ASC 310-20. At acquisition date, the Bank determined a fair value mark with credit and interest rate components. Under the Company's model, the impairment evaluation process involves comparing the carrying value of acquired loans, including the entire unamortized premium or discount, to the calculated reserve allowance. If necessary, the Company books a reserve to account for shortfalls identified through this calculation. Fair value marks are not bifurcated when evaluating for impairment.

A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At June 30, 2018, the allowance for loan losses related to acquired loans under ASC 310-30 and ASC 310-20 was \$5.6 million using the above mentioned criteria.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present the Company's loans by risk rating at June 30, 2018 and December 31, 2017:

## Business Activities Loans

## Commercial Real Estate

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family Real Estate		Total commercial real estate			
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Grade:								
Pass	\$345,896	\$269,206	\$375,907	\$214,289	\$1,566,673	\$1,687,256	\$2,288,476	\$2,170,751
Special mention	—	—	459	504	33,235	12,999	33,694	13,503
Substandard	—	—	2,068	2,290	44,758	31,163	46,826	33,453
Total	\$345,896	\$269,206	\$378,434	\$217,083	\$1,644,666	\$1,731,418	\$2,368,996	\$2,217,707

## Commercial and Industrial Loans

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Total comm. and industrial loans	
	June 30, 2018	December 31, 2017
Grade:		
Pass	\$1,325,226	\$1,156,240
Special mention	14,697	12,806
Substandard	15,941	11,123
Doubtful	—	2,400
Total	\$1,355,864	\$1,182,569

## Residential Mortgages

## Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Grade:						
Pass	\$2,126,733	\$1,805,596	\$7,289	\$5,177	\$2,134,022	\$1,810,773
Special mention	445	242	—	—	445	242
Substandard	2,798	2,186	—	—	2,798	2,186
Total	\$2,129,976	\$1,808,024	\$7,289	\$5,177	\$2,137,265	\$1,813,201

## Consumer Loans

## Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Auto and other		Total consumer loans	
	June 31, 2018	December 31, 2017	June 31, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Performing	\$290,988	\$293,327	\$633,185	\$602,313	\$924,173	\$895,640
Nonperforming	2,462	1,627	1,619	1,454	4,081	3,081
Total	\$293,450	\$294,954	\$634,804	\$603,767	\$928,254	\$898,721



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Acquired Loans

## Commercial Real Estate

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real Estate		Total commercial real estate	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Grade:								
Pass	\$50,934	\$76,611	\$191,132	\$203,624	\$641,490	\$684,846	\$883,556	\$965,081
Special mention	—	—	—	603	9,734	22,070	9,734	22,673
Substandard	8,334	8,354	4,733	1,855	43,970	49,072	57,037	59,281
Total	\$59,268	\$84,965	\$195,865	\$206,082	\$695,194	\$755,988	\$950,327	\$1,047,035

## Commercial and Industrial Loans

## Credit Risk Profile by Creditworthiness Category

(In thousands)	Total comm. and industrial loans	
	June 30, 2018	December 31, 2017
Grade:		
Pass	\$ 500,636	\$ 606,922
Special mention	1,128	1,241
Substandard	17,490	13,207
Total	\$ 519,254	\$ 621,370

## Residential Mortgages

## Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Grade:						
Pass	\$255,272	\$281,160	\$193	\$233	\$255,465	\$281,393
Special mention	268	2,704	—	—	268	2,704
Substandard	4,194	5,509	—	—	4,194	5,509
Total	\$259,734	\$289,373	\$193	\$233	\$259,927	\$289,606

## Consumer Loans

## Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Auto and other		Total consumer loans	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Performing	\$98,464	\$113,262	\$90,230	\$113,510	\$188,694	\$226,772
Nonperforming	916	1,965	469	392	1,385	2,357
Total	\$99,380	\$115,227	\$90,699	\$113,902	\$190,079	\$229,129

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about total loans rated Special Mention or lower as of June 30, 2018 and December 31, 2017. The table below includes consumer loans that are special mention and substandard accruing that are classified in the above table as performing based on payment activity.

(In thousands)	June 30, 2018			December 31, 2017		
	Business Activities	Acquired Loans	Total	Business Activities	Acquired Loans	Total
Non-Accrual	\$14,196	\$ 8,833	\$23,029	\$15,659	\$ 7,240	\$22,899
Substandard Accruing	55,498	71,527	127,025	36,846	73,412	110,258
Total Classified	69,694	80,360	150,054	52,505	80,652	133,157
Special Mention	49,314	11,380	60,694	28,387	26,802	55,189
Total Criticized	\$119,008	\$ 91,740	\$210,748	\$80,892	\$ 107,454	\$188,346



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 6. DEPOSITS

A summary of time deposits is as follows:

(In thousands)	June 30, 2018	December 31, 2017
Time less than \$100,000	\$707,398	\$ 733,785
Time \$100,000 through \$250,000	1,906,803	1,717,050
Time more than \$250,000	445,833	439,370
Total time deposits	\$3,060,034	\$ 2,890,205

Included in total deposits are brokered deposits of \$1.3 billion and \$1.1 billion at June 30, 2018 and December 31, 2017, respectively. Included in total deposits are reciprocal deposits of \$94.0 million and \$99.8 million at June 30, 2018 and December 31, 2017, respectively.

## NOTE 7. BORROWED FUNDS

Borrowed funds at June 30, 2018 and December 31, 2017 are summarized, as follows:

(Dollars in thousands)	June 30, 2018		December 31, 2017	
	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Short-term borrowings:				
Advances from the FHLB	\$ 1,002,000	2.11 %	\$ 667,300	1.48 %
Total short-term borrowings:	1,002,000	2.11	667,300	1.48
Long-term borrowings:				
Advances from the FHLB and other borrowings	272,342	1.69	380,436	1.54
Subordinated borrowings	73,965	7.00	73,875	7.00
Junior subordinated borrowings	15,464	4.18	15,464	3.30
Total long-term borrowings:	361,771	2.88	469,775	2.46
Total	\$ 1,363,771	2.32 %	\$ 1,137,075	1.88 %

Short-term debt includes Federal Home Loan Bank ("FHLB") advances with an original maturity of less than one year and a short-term line-of-credit drawdown through a correspondent bank. The Bank also maintains a \$3.0 million secured line of credit with the FHLB that bears a daily adjustable rate calculated by the FHLB. There was no outstanding balance on the FHLB line of credit for the periods ended June 30, 2018 and December 31, 2017.

The Bank is approved to borrow on a short-term basis from the Federal Reserve Bank of Boston as a non-member bank. The Bank has pledged certain loans and securities to the Federal Reserve Bank to support this arrangement. No borrowings with the Federal Reserve Bank took place for the periods ended June 30, 2018 and December 31, 2017.

Long-term FHLB advances consist of advances with an original maturity of more than one year. The advances outstanding at June 30, 2018 include no callable advances and amortizing advances totaling \$1.3 million. The advances outstanding at December 31, 2017 include no callable advances and amortizing advances totaling \$1.4 million. All FHLB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of maturities of FHLB advances as of June 30, 2018 is as follows:

(In thousands, except rates)	June 30, 2018	
	Principal	Weighted Average Rate
Fixed rate advances maturing:		
2018	\$ 1,063,993	2.07 %
2019	150,079	1.64
2020	53,371	2.04
2021	213	2.71
2022 and beyond	6,686	2.64
Total FHLB advances	\$ 1,274,342	2.02 %

The Company did not have variable-rate FHLB advances for the periods ended June 30, 2018 and December 31, 2017.

In September 2012, the Company issued fifteen year subordinated notes in the amount of \$75.0 million at a discount of 1.15%. The interest rate is fixed at 6.875% for the first ten years. After ten years, the notes become callable and convert to an interest rate of three-month LIBOR rate plus 5.113%. The subordinated note includes reduction to the note principal balance of \$522 thousand and \$583 thousand for unamortized debt issuance costs as of June 30, 2018 and December 31 2017, respectively.

The Company holds 100% of the common stock of Berkshire Hills Capital Trust I ("Trust I") which is included in other assets with a cost of \$0.5 million. The sole asset of Trust I is \$15.5 million of the Company's junior subordinated debentures due in 2035. These debentures bear interest at a variable rate equal to LIBOR plus 1.85% and had a rate of 4.18% and 3.30% at June 30, 2018 and December 31, 2017, respectively. The Company has the right to defer payments of interest for up to five years on the debentures at any time, or from time to time, with certain limitations, including a restriction on the payment of dividends to shareholders while such interest payments on the debentures have been deferred. The Company has not exercised this right to defer payments. The Company has the right to redeem the debentures at par value. Trust I is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, Trust I is not consolidated into the Company's financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8. CAPITAL RATIOS AND SHAREHOLDERS' EQUITY

The actual and required capital ratios were as follows:

	June 30, 2018	Regulatory Minimum to be Well Capitalized	December 31, 2017	Regulatory Minimum to be Well Capitalized
Company (consolidated)				
Total capital to risk weighted assets	12.8 %	N/A	12.4 %	N/A
Common equity tier 1 capital to risk weighted assets	11.3	N/A	11.0	N/A
Tier 1 capital to risk weighted assets	11.5	N/A	11.2	N/A
Tier 1 capital to average assets	9.1	N/A	9.0	N/A
Bank				
Total capital to risk weighted assets	12.0 %	8.0 %	11.2 %	8.0 %
Common equity tier 1 capital to risk weighted assets	11.1	4.5	10.3	4.5
Tier 1 capital to risk weighted assets	11.1	6.0	10.3	6.0
Tier 1 capital to average assets	8.8	4.0	8.3	4.0

At each date shown, the Bank met the conditions to be classified as “well capitalized” under the relevant regulatory framework. 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.

Effective January 1, 2015, the Company and the Bank became subject to the Basel III rule that requires the Company and the Bank to assess their Common equity Tier 1 capital to risk weighted assets. The Bank's Common equity Tier 1 capital to risk weighted assets exceeds the minimum to be well capitalized. In addition, the final capital rules added a requirement to maintain a minimum conservation buffer, composed of Common equity Tier 1 capital, of 2.5% of risk-weighted assets, to be phased in over three years and applied to the Common equity Tier 1 risk-based capital ratio, the Tier 1 risk-based capital ratio, and the Total risk-based capital ratio. Accordingly, banking organizations, on a fully phased in basis no later than January 1, 2019, must maintain a minimum Common equity Tier 1 risk-based capital ratio of 7.0%, a minimum Tier 1 risk-based capital ratio of 8.5%, and a minimum Total risk-based capital ratio of 10.5%.

The required minimum conservation buffer began to be phased in incrementally, starting at 0.625% on January 1, 2016, increased to 1.25% on January 1, 2017, increased to 1.875% on January 1, 2018 and will increase to 2.5% on January 1, 2019. The final capital rules impose restrictions on capital distributions and certain discretionary cash bonus payments if the minimum capital conservation buffer is not met.

At June 30, 2018, the capital levels of both the Company and the Bank exceeded all regulatory capital requirements and the Bank's regulatory capital ratios were above the minimum levels required to be considered well capitalized for regulatory purposes. The capital levels of both the Company and the Bank at June 30, 2018 also exceeded the minimum capital requirements including the currently applicable capital conservation buffer of 1.875%.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accumulated other comprehensive income (loss)

Components of accumulated other comprehensive income is as follows:

(In thousands)	June 30, 2018	December 31, 2017
Other accumulated comprehensive income, before tax:		
Net unrealized holding loss on AFS securities	\$(25,347)	\$ 10,034
Net unrealized holding loss on pension plans	(3,048 )	(3,048 )
Income taxes related to items of accumulated other comprehensive income:		
Net unrealized holding gain on AFS securities	6,326	(4,026 )
Net unrealized holding loss on pension plans	803	1,201
Accumulated other comprehensive (loss)/income	\$(21,266)	\$ 4,161

The following table presents the components of other comprehensive income for the three and six months ended June 30, 2018 and 2017:

(In thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended June 30, 2018			
Net unrealized holding (loss) on AFS securities:	x		
Net unrealized (losses) arising during the period	\$ (7,839 )	\$ 2,001	\$ (5,838 )
Less: reclassification adjustment for gains realized in net income	1	—	1
Net unrealized holding (loss) on AFS securities	(7,840 )	2,001	(5,839 )
Other comprehensive (loss)	\$ (7,840 )	\$ 2,001	\$ (5,839 )
Three Months Ended June 30, 2017			
Net unrealized holding gain on AFS securities:			
Net unrealized gains arising during the period	\$ 3,926	\$ (1,455 )	\$ 2,471
Less: reclassification adjustment for losses realized in net income	(1 )	—	(1 )
Net unrealized holding gain on AFS securities	3,927	(1,455 )	2,472
Other comprehensive income	\$ 3,927	\$ (1,455 )	\$ 2,472

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Before Tax	Tax Effect	Net of Tax
Six Months Ended June 30, 2018			
Net unrealized holding (loss) on AFS securities:	x		
Net unrealized (losses) arising during the period	\$(27,001 )	\$ 6,932	\$(20,069 )
Less: reclassification adjustment for gains realized in net income	1	—	\$1
Net unrealized holding (loss) on AFS securities	(27,002 )	6,932	\$(20,070 )
Other comprehensive (loss)	\$(27,002 )	\$ 6,932	\$(20,070 )
Less: reclassification related to adoption of ASU 2016-01	8,379	(2,126 )	6,253
Less: reclassification related to adoption of ASU 2018-02	—	(896 )	(896 )
Total change to accumulated other comprehensive (loss)	(35,381 )	9,954	(25,427 )
Six Months Ended June 30, 2017			
Net unrealized holding gain on AFS securities:			
Net unrealized gains arising during the period	\$7,064	\$(2,627 )	\$4,437
Less: reclassification adjustment for gains realized in net income	12,569	(4,713 )	7,856
Net unrealized holding (loss) on AFS securities	(5,505 )	2,086	(3,419 )
Net unrealized loss on cash flow hedging derivatives:			
Net unrealized (loss) arising during the period	(449 )	180	(269 )
Less: reclassification adjustment for (losses) realized in net income	(7,022 )	2,769	(4,253 )
Net unrealized gain on cash flow hedging derivatives	6,573	(2,589 )	3,984
Other comprehensive income	\$1,068	\$(503 )	\$565

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the changes in each component of accumulated other comprehensive (loss) income, for the three and six months ended June 30, 2018 and 2017:

(In thousands)	Net unrealized holding gain on AFS Securities	Net loss on effective cash flow hedging derivatives	Net unrealized holding loss on pension plans	Total
<b>Three Months Ended June 30, 2018</b>				
Balance at Beginning of Period	\$ (13,182 )	\$ —	\$ (2,245 )	\$(15,427)
Other comprehensive loss before reclassifications	(5,838 )	—	—	(5,838 )
Less: amounts reclassified from accumulated other comprehensive income (loss)	1	—	—	1
Total other comprehensive (loss)	(5,839 )	—	—	(5,839 )
Balance at End of Period	\$ (19,021 )	\$ —	\$ (2,245 )	\$(21,266)
<b>Three Months Ended June 30, 2017</b>				
Balance at Beginning of Period	\$ 9,649	\$ —	\$ (1,790 )	\$7,859
Other comprehensive gain before reclassifications	2,471	—	—	2,471
Less: amounts reclassified from accumulated other comprehensive income (loss)	(1 )	—	—	(1 )
Total other comprehensive income	2,472	—	—	2,472
Balance at End of Period	\$ 12,121	\$ —	\$ (1,790 )	\$10,331
<b>Six Months Ended June 30, 2018</b>				
Balance at Beginning of Period	\$ 6,008	\$ —	\$ (1,847 )	\$4,161
Other comprehensive (loss) before reclassifications	(20,069 )	—	—	(20,069 )
Less: amounts reclassified from accumulated other comprehensive income	1	—	—	1
Total other comprehensive (loss)	(20,070 )	—	—	(20,070 )
Less: amounts reclassified from accumulated other comprehensive income (loss) related to adoption of ASU 2016-01 and ASU 2018-02	\$ 4,959	\$ —	\$ 398	\$5,357
Balance at End of Period	\$ (19,021 )	\$ —	\$ (2,245 )	\$(21,266)
<b>Six Months Ended June 30, 2017</b>				
Balance at Beginning of Period	\$ 15,540	\$ (3,984 )	\$ (1,790 )	\$9,766
Other comprehensive gain (loss) before reclassifications	4,437	(269 )	—	4,168
Less: amounts reclassified from accumulated other comprehensive income	7,856	(4,253 )	—	3,603
Total other comprehensive (loss) income	(3,419 )	3,984	—	565
Balance at End of Period	\$ 12,121	\$ —	\$ (1,790 )	\$10,331





## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the amounts reclassified out of each component of accumulated other comprehensive (loss) income for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30, 2018	Affected Line Item in the Statement where Net Income is Presented
(In thousands)		
Realized gains on AFS securities:	\$1	Non-interest income
	—	Tax expense
	1	( ) Net of tax
Realized (losses) on cash flow hedging derivatives:	—	Interest expense
	—	Non-interest expense
	—	Tax benefit
	—	Net of tax
Total reclassifications for the period	\$1	(1) Net of tax
		Affected Line Item in the Six Months Ended June 30, 2017
(In thousands)		Statement where Net Income is Presented
Realized gains on AFS securities:	\$1	\$12,569 Non-interest income
	—	(4,713 ) Tax expense
	1	7,856 Net of tax
Realized (losses) on cash flow hedging derivatives:	—	(393 ) Interest expense
	—	(6,629 ) Non-interest expense
	—	2,769 Tax benefit
	—	(4,253 ) Net of tax
Total reclassifications for the period	\$1	\$3,603 Net of tax

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 9. EARNINGS PER SHARE

Earnings per 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		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Net income	\$34,031	\$19,694	\$59,279	\$35,154
Average number of common shares issued	46,212	38,720	46,212	37,731
Less: average number of treasury shares	788	943	828	981
Less: average number of unvested stock award shares	435	453	428	445
Plus: average participating preferred shares	1,043	—	1,043	—
Average number of basic shares outstanding	46,032	37,324	45,999	36,305
Plus: dilutive effect of unvested stock award shares	152	106	176	116
Plus: dilutive effect of stock options outstanding	31	44	31	45
Average number of diluted shares outstanding	46,215	37,474	46,206	36,466
Earnings per common share:				
Basic	\$0.74	\$0.53	\$1.29	\$0.97
Diluted	\$0.74	\$0.53	\$1.28	\$0.96

For the six months ended June 30, 2018, 252 thousand shares of restricted stock and 33 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the six months ended June 30, 2017, 327 thousand shares of restricted stock and 48 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 10. STOCK-BASED COMPENSATION PLANS

A combined summary of activity in the Company's stock award and stock option plans for the six months ended June 30, 2018 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
December 31, 2017	418	\$ 29.68	76	\$ 13.59
Granted	181	37.81	—	—
Stock options exercised	—	—	(8 )	12.46
Stock awards vested	(150 )	28.65	—	—
Forfeited	(15 )	32.93	—	—
Expired	—	—	(11 )	22.61
June 30, 2018	434	\$ 33.18	57	\$ 10.61
Exercisable options at June 30, 2018			57	\$ 10.61

During the six months ended June 30, 2018 and 2017, proceeds from stock option exercises totaled \$101 thousand and \$111 thousand, respectively. During the six months ended June 30, 2018, there were 150 thousand shares issued in connection with vested stock awards. During the six months ended June 30, 2017, there were 133 thousand shares issued in connection with vested stock awards. All of these shares were issued from available treasury stock. Stock-based compensation expense totaled \$2.8 million and \$2.5 million during the six months ended June 30, 2018 and 2017, respectively. Stock-based compensation expense is recognized over the requisite service period for all awards.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 11. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As of June 30, 2018, the Company held derivatives with a total notional amount of \$3.0 billion. The Company had economic hedges and non-hedging derivatives totaling \$2.7 billion and \$0.3 billion, respectively, which are not designated as hedges for accounting purposes with changes in fair value recorded directly through earnings. Economic hedges included interest rate swaps totaling \$2.2 billion, risk participation agreements with dealer banks of \$0.2 billion, and \$0.3 billion in forward commitment contracts.

As part of the Company's risk management strategy, the Company enters into interest rate swap agreements to mitigate the interest rate risk inherent in certain of the Company's assets and liabilities. Interest rate swap agreements involve the risk of dealing with both Bank customers and institutional derivative counterparties and their ability to meet contractual terms. The agreements are entered into with counterparties that meet established credit standards and contain master netting and collateral provisions protecting the at-risk party. The derivatives program is overseen by the Risk Management/Capital Committee of the Company's Board of Directors. Based on adherence to the Company's credit standards and the presence of the netting and collateral provisions, the Company believes that the credit risk inherent in these contracts was not significant at June 30, 2018.

The Company pledged collateral to derivative counterparties in the form of cash totaling \$6.9 million and securities with an amortized cost of \$14.3 million and a fair value of \$13.9 million as of June 30, 2018. The Company does not typically require its commercial customers to post cash or securities as collateral on its program of back-to-back economic hedges. However certain language is written into the International Swaps Dealers Association, Inc. ("ISDA") and loan documents where, in default situations, the Bank is allowed to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

Information about derivative assets and liabilities at June 30, 2018, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Received	Weighted Average Rate Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLB borrowings	\$ —	0	—	%	\$ —
Total cash flow hedges	—				—
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	10,426	11.4	2.35	%	5.09 % (1,175 )
Interest rate swaps on loans with commercial loan customers	1,094,198	6.3	3.90	%	4.40 % 16,744
Reverse interest rate swaps on loans with commercial loan customers	1,094,198	6.3	4.40	%	3.90 % (16,403 )
Risk participation agreements with dealer banks	183,986	6.2			(3 )
Forward sale commitments	338,884	0.2			(658 )
Total economic hedges	2,721,692				(1,495 )
Non-hedging derivatives:					
Commitments to lend	289,750	0.2			7,285
Total non-hedging derivatives	289,750				7,285

Total	\$ 3,011,442	\$ 5,790
-------	--------------	----------

50

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information about derivative assets and liabilities at December 31, 2017, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Received	Average Rate Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLB borrowings	\$ —	0	— %	— %	\$ —
Total cash flow hedges	—				—
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	10,755	11.9	1.73 %	5.09 %	(1,649 )
Interest rate swaps on loans with commercial loan customers	943,795	5.9	3.26 %	4.25 %	(3,195 )
Reverse interest rate swaps on loans with commercial loan customers	943,795	5.9	4.25 %	3.26 %	3,204
Risk participation agreements with dealer banks	142,054	8.4			(26 )
Forward sale commitments	276,572	0.2			(123 )
Total economic hedges	2,316,971				(1,789 )
Non-hedging derivatives:					
Commitments to lend	193,966	0.2			5,259
Total non-hedging derivatives	193,966				5,259
Total	\$ 2,510,937				\$ 3,470

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Cash flow hedges

In the first quarter of 2017, the Company maintained six interest rate swap contracts with an aggregate notional value of \$300 million with original durations of three years. This hedge strategy converted one month rolling FHLB borrowings based on the FHLB's one month fixed interest rate to fixed interest rates, thereby protecting the Company from floating interest rate variability.

On February 7, 2017, the Company initiated and subsequently terminated all of its interest rate swaps associated with FHLB advances with 1-month LIBOR based floating interest rates of an aggregate notional amount of \$300 million. As of March 31, 2017, the Company no longer held the FHLB advances associated with the interest rate swaps. As a result, the Company reclassified \$6.6 million of losses from the effective portion of the unrealized changes in the fair value of the terminated derivatives from other comprehensive income to non-interest income as the forecasted transactions to the related FHLB advances will not occur.

For the periods presented prior to the termination, the effective portion of unrealized changes in the fair value of derivatives accounted for as cash flow hedges was reported in other comprehensive income. Each quarter, the Company assessed the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction. Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company's financial statements during the three and six months ended June 30, 2017.

Amounts included in the Consolidated Statements of Income and in the other comprehensive income section of the Consolidated Statements of Comprehensive Income (related to interest rate derivatives designated as hedges of cash flows), were as follows:

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2017
(In thousands)		
Interest rate swaps on FHLB borrowings:		
Unrealized (loss) recognized in accumulated other comprehensive loss	\$ —	\$ —(449 )
Less: reclassification of unrealized (loss) from accumulated other comprehensive income to interest expense	—	—(393 )
Less: reclassification of unrealized (loss) from accumulated other comprehensive income to other non-interest expense	—	—(6,629 )
Net tax (expense) benefit on items recognized in accumulated other comprehensive income	—	—(2,589 )
Other comprehensive gain (loss) recorded in accumulated other comprehensive income, net of reclassification adjustments and tax effects	\$ —	\$ —\$3,984

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Economic hedges

As of June 30, 2018, the Company has an interest rate swap with a \$10.4 million notional amount to swap out the fixed rate of interest on an economic development bond bearing a fixed rate of 5.09%, currently within the Company's trading portfolio under the fair value option, in exchange for a LIBOR-based floating rate. The intent of the economic hedge is to improve the Company's asset sensitivity to changing interest rates in anticipation of favorable average floating rates of interest over the 21-year life of the bond. The fair value changes of the economic development bond are mostly offset by fair value changes of the related interest rate swap.

The Company also offers certain derivative products directly to qualified commercial borrowers. The Company economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third-party financial institutions. The transaction allows the Company's customer to convert a variable-rate loan to a fixed rate loan. Because the Company acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts mostly offset each other in earnings. Credit valuation adjustments arising from the difference in credit worthiness of the commercial loan and financial institution counterparties totaled \$332 thousand as of June 30, 2018. The interest income and expense on these mirror image swaps exactly offset each other.

The Company has risk participation agreements with dealer banks. Risk participation agreements occur when the Company participates on a loan and a swap where another bank is the lead. The Company gets paid a fee to take on the risk associated with having to make the lead bank whole on Berkshire's portion of the pro-rated swap should the borrower default. Changes in fair value are recorded in current period earnings.

The Company utilizes forward sale commitments to hedge interest rate risk and the associated effects on the fair value of interest rate lock commitments and loans originated for sale. The forward sale commitments are accounted for as derivatives with changes in fair value recorded in current period earnings.

The Company uses the following types of forward sale commitments contracts:

- Best efforts loan sales,
- Mandatory delivery loan sales, and
- To Be Announced ("TBA") mortgage-backed securities sales.

A best efforts contract refers to a loan sale agreement where the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. The Company may enter into a best efforts contract once the price is known, which is shortly after the potential borrower's interest rate is locked.

A mandatory delivery contract is a loan sale agreement where the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. Generally, the Company may enter into mandatory delivery contracts shortly after the loan closes with a customer.

The Company may sell TBA mortgage-backed securities to hedge the changes in fair value of interest rate lock commitments and held for sale loans, which do not have corresponding best efforts or mandatory delivery contracts. These security sales transactions are closed once mandatory contracts are written. On the closing date the price of the security is locked-in, and the sale is paired-off with a purchase of the same security. Settlement of the security purchase/sale transaction is done with cash on a net-basis.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Non-hedging derivatives

The Company enters into interest rate lock commitments (“IRLCs”) for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. The IRLCs are free-standing derivatives which are carried at fair value with changes recorded in noninterest income in the Company’s consolidated statements of income. Changes in the fair value of IRLCs subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time.

Amounts included in the Consolidated Statements of Income related to economic hedges and non-hedging derivatives were as follows:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Economic hedges				
Interest rate swap on industrial revenue bond:				
Unrealized gain recognized in other non-interest income	\$ 163	\$ 2	\$ 474	\$ 124
Interest rate swaps on loans with commercial loan customers:				
Unrealized gain/(loss) recognized in other non-interest income	5,270	(3,810 )	19,939	(1,682 )
Reverse interest rate swaps on loans with commercial loan customers:				
Unrealized gain/(loss) recognized in other non-interest income	(5,270 )	3,810	(19,939 )	1,682
Favorable (Unfavorable) change in credit valuation adjustment recognized in other non-interest income	95	(114 )	332	(276 )
Risk participation agreements:				
Unrealized gain recognized in other non-interest income	7	23	23	5
Forward commitments:				
Unrealized (loss) gain recognized in other non-interest income	(658 )	975	(1,567 )	(276 )
Realized gain (loss) in other non-interest income	1,077	238	4,999	(2,668 )
Non-hedging derivatives				
Commitments to lend				
Unrealized gain recognized in other non-interest income	\$ 7,285	\$ 7,375	\$ 13,816	\$ 15,436
Realized gain in other non-interest income	2,491	7,693	3,094	16,467

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Assets and Liabilities Subject to Enforceable Master Netting Arrangements

## Interest Rate Swap Agreements (“Swap Agreements”)

The Company enters into swap agreements to facilitate the risk management strategies for commercial banking customers. The Company mitigates this risk by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company’s consolidated statements of condition. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of marketable securities is received or posted by the counterparty with net liability positions, respectively, in accordance with contract thresholds.

The Company had net asset positions with its financial institution counterparties totaling \$18.6 million and \$1.1 million as of June 30, 2018 and December 31, 2017, respectively. The Company had net asset positions with its commercial banking counterparties totaling \$4.5 million and \$8.6 million as of June 30, 2018 and December 31, 2017, respectively. The Company had net liability positions with its financial institution counterparties totaling \$3.1 million and \$5.9 million as of June 30, 2018 and December 31, 2017, respectively. The Company had net liability positions with its commercial banking counterparties totaling \$20.9 million and \$5.4 million as of June 30, 2018 and December 31, 2017. The collateral posted by the Company that covered liability positions was \$6.9 million and \$5.9 million as of June 30, 2018 and December 31, 2017, respectively.

The following table presents the assets and liabilities subject to an enforceable master netting arrangement as of June 30, 2018 and December 31, 2017:

## Offsetting of Financial Assets and Derivative Assets

(In thousands)	Gross Amounts of Assets Recognized	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Received	
June 30, 2018						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ 20,015	\$ (1,386 )	\$ 18,629	\$ —	\$ —	\$ 18,629
Commercial counterparties	4,546	—	4,546	—	—	4,546
Total	\$ 24,561	\$ (1,386 )	\$ 23,175	\$ —	\$ —	\$ 23,175

## Offsetting of Financial Liabilities and Derivative Liabilities

(In thousands)	Gross Amounts of Liabilities Recognized	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Pledged	
June 30, 2018						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ (4,468 )	\$ 1,404	\$ (3,064 )	\$ —	\$ 6,853	\$ 3,789
Commercial counterparties	(21,058 )	109	(20,949 )	—	—	(20,949 )

Total                                \$ (25,526 ) \$ 1,513                \$ (24,013 ) \$ — \$ 6,853                        \$ (17,160 )

55

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Offsetting of Financial Assets and Derivative Assets

(In thousands)	Gross Amounts of Recognized Assets	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Received	
December 31, 2017						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ 2,692	\$ (1,622 )	\$ 1,070	\$ —	\$ —	\$ 1,070
Commercial counterparties	8,577	—	8,577	—	—	8,577
Total	\$ 11,269	\$ (1,622 )	\$ 9,647	\$ —	\$ —	\$ 9,647

## Offsetting of Financial Liabilities and Derivative Liabilities

(In thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts of Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Net Amount
				Financial Instruments	Cash Collateral Pledged	
December 31, 2017						
Interest Rate Swap Agreements:						
Institutional counterparties	\$(8,777 )	\$ 2,835	\$(5,942 )	\$ 3,982	\$ 1,960	\$ —
Commercial counterparties	(5,375 )	2	(5,373 )	—	—	(5,373 )
Total	\$(14,152 )	\$ 2,837	\$(11,315 )	\$ 3,982	\$ 1,960	\$ (5,373 )

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 12. FAIR VALUE MEASUREMENTS

A description of the valuation methodologies used for assets and liabilities 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 that are carried at fair value.

## Recurring Fair Value Measurements

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

(In thousands)	June 30, 2018			
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading security	\$—	\$—	—\$11,483	\$ 11,483
Securities available for sale:				
Municipal bonds and obligations	—	112,137	—	112,137
Agency collateralized mortgage obligations	—	915,217	—	915,217
Agency residential mortgage-backed securities	—	184,670	—	184,670
Agency commercial mortgage-backed securities	—	59,513	—	59,513
Corporate bonds	—	101,062	—	101,062
Trust preferred securities	—	11,614	—	11,614
Other bonds and obligations	—	9,037	—	9,037
Marketable equity securities	59,726	—	—	59,726
Loans held for sale	—	149,182	—	149,182
Derivative assets	—	26,031	7,285	33,316
Capitalized servicing rights	—	—	7,839	7,839
Derivative liabilities	—	27,527	—	27,527
	December 31, 2017			
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
(In thousands)				
Trading security	\$—	\$—	—\$12,277	\$ 12,277
Securities available for sale:				
Municipal bonds and obligations	—	118,233	—	118,233
Agency collateralized mortgage obligations	—	851,158	—	851,158
Agency residential mortgage-backed securities	—	216,940	—	216,940
Agency commercial mortgage-backed securities	—	62,305	—	62,305
Corporate bonds	—	110,721	—	110,721
Trust preferred securities	—	11,677	—	11,677
Other bonds and obligations	—	9,880	—	9,880
Marketable equity securities	45,185	—	—	45,185
Loans held for sale	—	153,620	—	153,620
Derivative assets	—	14,049	5,259	19,308
Capitalized servicing rights	—	—	3,834	3,834
Derivative liabilities	—	15,838	19	15,838



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

There were no transfers between levels during the six months ended June 30, 2018 or June 30, 2017.

**Trading Security at Fair Value.** The Company holds one security designated as a trading security. It is a tax advantaged economic development bond issued to the Company by a local nonprofit which provides wellness and health programs. The determination of the fair value for this security is determined based on a discounted cash flow methodology. Certain inputs to the fair value calculation are unobservable and there is little to no market activity in the security; therefore, the security meets the definition of a Level 3 security. The discount rate used in the valuation of the security is sensitive to movements in the 3-month LIBOR rate.

**Securities Available for Sale and Marketable Equity Securities.** Marketable equity securities classified as Level 1 consist of publicly-traded equity securities for which the fair values can be obtained through quoted market prices in active exchange markets. AFS and marketable equity securities classified as Level 2 include most of the Company's debt securities. The pricing on Level 2 was primarily sourced from third party pricing services, overseen by management, and is based on models that consider standard input factors such as 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 condition, among other things.

June 30, 2018

(In thousands)	Fair Value	Amortized Cost	Gains
Marketable equity securities	\$ 59,726	\$ 55,618	\$4,108

December 31, 2017

(In thousands)	Fair Value	Amortized Cost	Gains
Marketable equity securities	\$ 45,185	\$ 36,483	\$8,702

**Loans Held for Sale.** The Company elected the fair value option for all loans held for sale (HFS) originated for sale on or after May 1, 2012. Loans HFS are classified as Level 2 as the fair value is based on input factors such as quoted prices for similar loans in active markets.

June 30, 2018	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
(In thousands)	Fair Value	Unpaid Principal	Unpaid Principal
Loans Held for Sale	\$ 149,182	\$ 145,723	\$ 3,459

December 31, 2017	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
(In thousands)	Fair Value	Unpaid Principal	Unpaid Principal
Loans Held for Sale	\$ 153,620	\$ 149,022	\$ 4,598

The changes in fair value of loans held for sale for the three and six months ended June 30, 2018, were gains of \$1.3 million and losses of \$1.1 million, respectively. The changes in fair value of loans held for sale for the three and six months ended June 30, 2017, were gains of \$1.7 million and \$2.3 million, respectively. The changes in fair value are included in mortgage banking originations in the Consolidated Statements of Income.

**Interest Rate Swaps.** The valuation of the Company's interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and

interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of

58

---



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

Although the Company has determined that the majority of the inputs used to value its interest rate 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 June 30, 2018, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

**Commitments to Lend.** The Company enters into commitments to lend for residential mortgage loans intended for sale, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. The estimated fair value of commitments to originate residential mortgage loans for sale is based on quoted prices for similar loans in active markets. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close, and by the non-refundable costs of originating the loan. The closing ratio is derived from the Bank's internal data and is adjusted using significant management judgment. The costs to originate are primarily based on the Company's internal commission rates that are not observable. As such, these commitments are classified as Level 3 measurements.

**Forward Sale Commitments.** The Company utilizes forward sale commitments as economic hedges against potential changes in the values of the commitments to lend and loans originated for sale. To Be Announced ("TBA") mortgage-backed securities forward commitment sales are used as the hedging instrument, are classified as Level 1, and consist of publicly-traded debt securities for which identical fair values can be obtained through quoted market prices in active exchange markets. The fair values of the Company's best efforts and mandatory delivery loan sale commitments are determined similarly to the commitments to lend using quoted prices in the market place that are observable. However, costs to originate and closing ratios included in the calculation are internally generated and are based on management's judgment and prior experience, which are considered factors that are not observable. As such, best efforts and mandatory forward commitments are classified as Level 3 measurements.

**Capitalized Servicing Rights.** The Company accounts for certain capitalized servicing rights at fair value in its Consolidated Financial Statements, as the Company is permitted to elect the fair value option for each specific instrument. A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans exceed adequate compensation for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy. These capitalized servicing rights are included in other assets on the consolidated balance sheet.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The table below presents the changes in Level 3 assets and liabilities that were measured at fair value on a recurring basis for the three and six months ended June 30, 2018 and 2017.

(In thousands)	Assets (Liabilities)			
	Trading Security	Commitments to Lend	Forward Commitments	Capitalized Servicing Rights
Three Months Ended June 30, 2018				
March 31, 2018	\$ 11,795	\$ 6,531	\$ —	\$ 5,705
Unrealized (loss) gain, net recognized in other non-interest income	(148 )	12,787	—	339
Paydown of trading security	(164 )	—	—	—
Transfers to held for sale loans	—	(12,033 )	—	—
Additions to servicing rights	—	—	—	1,795
June 30, 2018	\$ 11,483	\$ 7,285	\$ —	\$ 7,839
Six Months Ended June 30, 2018				
December 31, 2017	\$ 12,277	\$ 5,259	\$ 19	\$ 3,834
Unrealized (loss) gain, net recognized in other non-interest income	(465 )	25,000	(19 )	804
Paydown of trading security	(329 )	—	—	—
Transfers to held for sale loans	—	(22,974 )	—	—
Additions to servicing rights	\$ —	\$ —	\$ —	\$ 3,201
June 30, 2018	\$ 11,483	\$ 7,285	\$ —	\$ 7,839
Unrealized gains (losses) relating to instruments still held at June 30, 2018	\$ 1,056	\$ 7,285	\$ —	\$ —

(In thousands)	Assets (Liabilities)			
	Trading Security	Commitments to Lend	Forward Commitments	Capitalized Servicing Rights
Three Months Ended June 30, 2017				
March 31, 2017	\$ 12,966	\$ 8,061	\$ (22 )	\$ 976
Unrealized gain (loss), net recognized in other non-interest income	27	16,515	34	(68 )
Paydown of trading security	(156 )	—	—	—
Transfers to held for sale loans	—	(17,202 )	—	—
Additions to servicing rights	—	—	—	660

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

June 30, 2017	\$12,837	\$ 7,374	\$ 12	\$ 1,568
Six Months Ended June 30, 2017				
December 31, 2016	\$13,229	\$4,738	\$100	\$798
Unrealized (loss) gain, net recognized in other non-interest income	(79 )	33,817	(88 )	(70 )
Paydown of trading security	(313 )	—	—	—
Transfers to held for sale loans	—	(31,181)	—	—
Additions to servicing rights	\$—	\$—	\$—	\$840
June 30, 2017	\$12,837	\$7,374	\$12	\$1,568
Unrealized gains (losses) relating to instruments still held at June 30, 2017	\$1,736	\$7,374	\$12	\$—



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Non-Recurring Fair Value Measurements

The Company is required, on a non-recurring basis, to adjust the carrying value or provide valuation allowances for certain assets using fair value measurements in accordance with GAAP. The following is a summary of applicable non-recurring fair value measurements. There are no liabilities measured at fair value on a non-recurring basis.

(In thousands)	June 30, December		Fair Value Measurement Date as of June 30, 2018
	2018	31, 2017	
	Level 3	Level 3	Level 3
	Inputs	Inputs	Inputs
Assets			
Impaired loans	\$8,075	\$23,853	June 2018
Capitalized servicing rights	12,129	12,527	June 2018
Total	\$20,204	\$36,380	

Quantitative information about the significant unobservable inputs within Level 3 non-recurring assets is as follows:

(In thousands)	Fair Value		Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
	June 30, 2018				
Assets					
Impaired Loans	\$8,075		Fair Value of Collateral	Discounted Cash Flow - Loss Severity	38.39% to 0.02% (2.79%)
				Appraised Value	\$2.80 to \$1,387 (\$603.90)
Capitalized servicing rights	12,129		Discounted Cash Flow	Constant Prepayment Rate (CPR)	7.27% to 10.90% (9.62%)
				Discount Rate	10.00% to 13.12% (11.64%)
Total	\$20,204				

Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective (a) assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

(In thousands)	Fair Value		Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
	December 31, 2017				
Assets					
Impaired Loans	\$23,853		Fair Value of Collateral	Discounted Cash Flow - loss severity	38.72% to 0.21% (3.40%)
				Appraised Value	\$10.9 to \$5,967 (\$2,197)
Capitalized servicing rights	12,527		Discounted Cash Flow	Constant Prepayment Rate (CPR)	7.78% to 12.78% (10.38%)
				Discount Rate	10.00% to 13.28% (11.72%)
Total	\$36,380				

Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective (a) assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

There were no Level 1 or Level 2 nonrecurring fair value measurements for the periods ended June 30, 2018 and December 31, 2017.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Impaired loans.** Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Non-recurring adjustments can also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for credit losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. However, the choice of observable data is subject to significant judgment, and there are often adjustments based on judgment in order to make observable data comparable and to consider the impact of time, the condition of properties, interest rates, and other market factors on current values. Additionally, commercial real estate appraisals frequently involve discounting of projected cash flows, which relies inherently on unobservable data. Therefore, nonrecurring fair value measurement adjustments that relate to real estate collateral have generally been classified as Level 3. Estimates of fair value for other collateral that supports commercial loans are generally based on assumptions not observable in the marketplace and therefore such valuations have been classified as Level 3.

**Capitalized loan servicing rights.** A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans exceed adequate compensation for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Adjustments are only recorded when the discounted cash flows derived from the valuation model are less than the carrying value of the asset. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy.

**Other real estate owned (“OREO”).** OREO results from the foreclosure process on residential or commercial loans issued by the Bank. Upon assuming the real estate, the Company records the property at the fair value of the asset less the estimated sales costs. Thereafter, OREO properties are recorded at the lower of cost or fair value less the estimated sales costs. OREO fair values are primarily determined based on Level 3 data including comparable sales and appraisals.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Summary of Estimated Fair Values of Financial Instruments

The following tables summarize the estimated fair values, and related carrying amounts, of the Company's financial instruments. Certain financial instruments and all non-financial instruments are excluded. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

(In thousands)	June 30, 2018				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
<b>Financial Assets</b>					
Cash and cash equivalents	\$ 139,057	\$ 139,057	\$ 139,057	\$—	\$ —
Trading security	11,483	11,483	—	—	11,483
Marketable equity securities	59,726	59,726	59,163	563	—
Securities available for sale	1,393,250	1,393,250	—	1,393,250	—
Securities held to maturity	379,905	377,486	—	358,265	19,221
FHLB bank stock and restricted securities	75,530	N/A	N/A	N/A	N/A
Net loans	8,654,041	8,796,933	—	—	8,796,933
Loans held for sale	149,182	149,182	—	149,182	—
Accrued interest receivable	36,017	36,017	—	36,017	—
Cash surrender value of bank-owned life insurance policies	193,121	193,121	—	193,121	—
Derivative assets	33,316	33,316	—	26,031	7,285
Assets held for sale	1,070	1,070	—	1,070	—
<b>Financial Liabilities</b>					
Total deposits	\$ 8,838,752	\$ 8,809,947	\$—	\$ 8,809,947	\$ —
Short-term debt	1,002,000	1,001,944	—	1,001,944	—
Long-term Federal Home Loan Bank advances	272,342	270,112	—	270,112	—
Subordinated borrowings	89,429	97,006	—	97,006	—
Derivative liabilities	27,527	27,527	658	26,869	—



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	December 31, 2017				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
<b>Financial Assets</b>					
Cash and cash equivalents	\$248,763	\$248,763	\$248,763	\$—	\$ —
Trading security	12,277	12,277	—	—	12,277
Marketable equity securities	45,185	45,185	44,851	334	—
Securities available for sale and other	1,380,914	1,380,914	—	1,380,914	—
Securities held to maturity	397,103	405,276	—	371,458	33,818
FHLB bank stock and restricted securities	63,085	N/A	N/A	N/A	N/A
Net loans	8,247,504	8,422,034	—	—	8,422,034
Loans held for sale	153,620	153,620	—	153,620	—
Accrued interest receivable	33,739	33,739	—	33,739	—
Derivative assets	19,308	19,308	—	14,049	5,259
Assets held for sale	1,392	1,392	—	1,392	—
<b>Financial Liabilities</b>					
Total deposits	\$8,749,530	\$8,731,527	\$—	\$8,731,527	\$ —
Short-term debt	667,300	667,246	—	667,246	—
Long-term Federal Home Loan Bank advances	380,436	378,766	—	378,766	—
Subordinated borrowings	89,339	97,414	—	97,414	—
Derivative liabilities	15,838	15,838	104	15,715	19

Other than as discussed above, the following methods and assumptions were used by management to estimate the fair value of significant classes of financial instruments for which it is practicable to estimate that value.

Cash and cash equivalents. Carrying value is assumed to represent fair value for cash and cash equivalents that have original maturities of ninety days or less.

FHLB bank stock and restricted securities. It is not practical to determine fair value due to the restricted nature of the securities.

Cash surrender value of life insurance policies. Carrying value approximates fair value.

Loans, net. In accordance with recent accounting guidance, the fair value of loans as of June 30, 2018 was measured using the exit price valuation method, determined primarily by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities or cash flows, while incorporating liquidity and credit assumptions.

Accrued interest receivable. Carrying value approximates fair value.

Deposits. The fair value of demand, non-interest bearing checking, savings and money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the estimated future cash flows using market rates offered for deposits of similar remaining maturities.

Borrowed funds. The fair value of borrowed funds is estimated by discounting the future cash flows using market rates for similar borrowings. Such funds include all categories of debt and debentures in the table above.

Subordinated borrowings. The Company utilizes a pricing service along with internal models to estimate the valuation of its junior subordinated debentures. The junior subordinated debentures re-price every ninety days.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Off-balance-sheet financial instruments. Off-balance-sheet financial instruments include standby letters of credit and other financial guarantees and commitments considered immaterial to the Company's financial statements.

## NOTE 13. NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES

Presented below is net interest income after provision for loan losses for the three and six months ended June 30, 2018 and 2017, respectively.

(In thousands)	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Net interest income	\$91,121	\$69,545	\$176,591	\$136,431
Provision for loan losses	6,532	4,889	12,107	9,984
Net interest income after provision for loan losses	\$84,589	\$64,656	\$164,484	\$126,447

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 14. REVENUE

The Company adopted ASU No. 2014-09, "Revenue from Contracts with Customers," and all subsequent ASU's that modified Topic 606 on January 1, 2018. A cumulative effect adjustment to opening retained earnings was not deemed necessary as the implementation of the new standard did not have a material impact on the measurement or recognition of revenue.

Topic 606 requires the Company to follow a five step process: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. Revenue recognition under Topic 606 depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or services. The Company does not have any material significant payment terms as payment is received at or shortly after the satisfaction of the performance obligation. The value of unsatisfied performance obligations for contracts with an original expected length of one year or less are not disclosed. The Company recognizes incremental costs of obtaining contracts as an expense when incurred for contracts with a term of one year or less.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain non-interest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new standard. Topic 606 is applicable to non-interest revenue streams such as wealth management fees, insurance commissions and fees, administrative services for customer deposit accounts, interchange fees, and sale of owned real estate properties.

Non-interest income streams in-scope of Topic 606 are discussed below.

**Service Charges on Deposit Accounts.** Service charges on deposit accounts consist of monthly service fees (i.e. business analysis fees and consumer service charges) and other deposit account related fees. The Company's performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts. The Company may, from time to time, waive certain fees (e.g., NSF fee) for customers but generally do not reduce the transaction price to reflect variability for future reversals due to the insignificance of the amounts. Waiver of fees reduces the revenue in the period the waiver is granted to the customer.

**Insurance Commissions and Fees.** Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later, net of return commissions related to policy cancellations. Policy cancellation is a variable consideration that is not deemed significant and thus, does not impact the amount of revenue recognized.

In addition, the Company may receive additional performance commissions based on achieving certain sales and loss experience measures. Such commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts.

**Wealth Management Fees.** Wealth management fees is primarily comprised of fees earned from consultative investment management, trust administration, tax return preparation, and financial planning. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based on the

daily accrual of the market value of the investment accounts and the applicable fee rate.

**Interchange Fees.** Interchange fees are transaction fees paid to the card-issuing bank to cover handling costs, fraud and bad debt costs, and the risk involved in approving the payment. Due to the day-to-day nature of these fees they are settled on a daily basis and are accounted for as they are received.

67

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Gains/Losses on Sales of OREO. The sale of OREO and other nonfinancial assets are accounted for with the derecognition of the asset in question once a contract exists and control of the asset has been transferred to the buyer. The gain or loss on the sale is calculated as the difference between the carrying value of the asset and the transaction price.

The following presents non-interest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three months ended June 30, 2018 and 2017.

	Three months ended		Six months ended	
	June 30, 2018	2017	June 30, 2018	2017
(In thousands)				
Non-interest income				
In-scope of Topic 606:				
Service charges on deposit accounts	\$4,923	\$4,156	\$10,338	\$8,196
Insurance revenue	2,549	2,588	5,574	5,724
Wealth management fees	2,280	2,286	4,877	4,812
Interchange income	2,391	1,920	4,281	3,668
Non-interest income (in-scope of Topic 606)	12,143	10,950	25,070	22,400
Non-interest income (out-of-scope of Topic 606)	17,887	21,848	34,480	45,155
Total non-interest income	\$30,030	\$32,798	\$59,550	\$67,555

Table of Contents

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

## 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 or prior Forms 10-Q.

	At or for the Three Months Ended June 30, 2018		At or for the Six Months Ended June 30, 2017		
<b>PER SHARE DATA (1)</b>					
Net earnings per common share, diluted	\$0.74	\$0.53	\$1.28	\$0.96	
Adjusted earnings per common share, diluted (1)	0.74	0.58	1.38	1.12	
Total book value per common share	32.49	31.37	32.49	31.37	
Tangible book value per common share (2)	20.28	20.96	20.28	20.96	
Dividend per common share	0.22	0.21	0.44	0.42	
Common stock price:					
High	44.10	38.65	44.10	38.65	
Low	37.05	33.55	35.80	32.90	
Close	40.60	35.15	40.60	35.15	
<b>PERFORMANCE RATIOS (3)</b>					
Return on assets	1.17	% 0.84	% 1.03	% 0.76	%
Adjusted return on assets (1)	1.17	0.92	1.11	0.89	
Return on equity	8.88	6.80	7.79	6.28	
Adjusted return on equity (1)	8.89	7.45	8.41	7.31	
Adjusted return on tangible equity (1)	14.82	11.96	14.13	12.01	
Net interest margin, fully taxable equivalent (FTE) (4)	3.50	3.36	3.43	3.35	
Fee income/Net interest and fee income	24.25	32.23	24.87	31.18	
Efficiency ratio (2)	56.37	61.72	57.91	61.83	
<b>GROWTH RATIOS</b>					
Total commercial loans, (annualized)	9	% 10	% 5	% 13	%
Total loans, (annualized)	16	13	10	10	
Total deposits, (annualized)	7	4	2	3	
Total net revenues, (compared to prior year period)	18	42	16	40	
Earnings per share, (compared to prior year period)	40	2	33	(8	)
Adjusted earnings per share, (compared to prior year period) (2)	28	7	24	5	
<b>FINANCIAL DATA: (In millions)</b>					
Total assets	\$11,902	\$9,627	\$11,902	\$9,627	
Total earning assets	10,827	8,807	10,827	8,807	
Total securities	1,920	1,773	1,920	1,773	
Total borrowings	1,364	1,472	1,364	1,472	
Total loans	8,710	6,864	8,710	6,864	
Allowance for loan losses	56	47	56	47	
Total intangible assets	555	421	555	421	
Total deposits	8,839	6,715	8,839	6,715	
Total stockholders' equity	1,516	1,268	1,516	1,268	

Table of Contents

	At or for the Three Months Ended June 30, 2018		At or for the Six Months Ended June 30, 2017	
<b>ASSET QUALITY AND CONDITION RATIOS (5)</b>				
Net charge-offs (annualized)/average loans	0.21	% 0.20	% 0.19	% 0.20
Total non-performing assets/total assets	0.20	0.25	0.20	0.25
Allowance for loan losses/total loans	0.64	0.69	0.64	0.69
Loans/deposits	99	102	99	102
Shareholders' equity to total assets	12.74	13.17	12.74	13.17
Tangible shareholders' equity to tangible assets (2)	8.47	9.20	8.47	9.20
<b>FOR THE PERIOD: (In thousands)</b>				
Net interest income	\$91,121	\$69,545	\$176,591	\$136,431
Non-interest income	30,030	32,798	59,550	67,555
Net revenue	121,151	102,343	236,141	203,986
Provision for loan losses	6,532	4,889	12,107	9,984
Non-interest expense	72,337	69,523	149,206	143,849
Net income	34,031	19,694	59,279	35,154
Adjusted Income (1)	34,076	21,559	63,957	40,959

(1) Adjusted measurements are non-GAAP financial measures that are adjusted to exclude net non-operating charges primarily related to acquisitions and restructuring activities. Refer to the Reconciliation of Non-GAAP Financial Measures for additional information.

(2) Non-GAAP financial measure.

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

(4) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

(5) Generally accepted accounting principles require that loans acquired in a business combination be recorded at fair value, whereas loans from business activities are recorded at cost. The fair value of loans acquired in a business combination includes expected loan losses, and there is no loan loss allowance recorded for these loans at the time of acquisition. Accordingly, the ratio of the loan loss allowance to total loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Similarly, net loan charge-offs are normally reduced for loans acquired in a business combination since these loans are recorded net of expected loan losses.

Therefore, the ratio of net loan charge-offs to average loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Other institutions may have loans acquired in a business combination, and therefore there may be no direct comparability of these ratios between and among other institutions.



Table of Contents

## AVERAGE BALANCES AND AVERAGE YIELDS/RATES

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:

(\$ In millions)	Three Months Ended June 30, 2018			2017			Six Months Ended June 30, 2018			2017		
	Average Balance (FTE basis)	Yield/Rate		Average Balance (FTE basis)	Yield/Rate		Average Balance (FTE basis)	Yield/Rate		Average Balance (FTE basis)	Yield/Rate	
Assets												
Loans:												
Commercial real estate	\$3,316	5.08	%	\$2,692	4.41	%	\$3,283	4.92	%	\$2,661	4.50	%
Commercial and industrial loans	1,774	5.73		1,130	5.30		1,806	5.46		1,102	5.08	
Residential mortgages	2,269	3.72		1,871	3.62		2,204	3.64		1,889	3.59	
Consumer loans	1,113	4.13		997	3.81		1,114	4.07		988	3.72	
Total loans (1)	8,472	4.73		6,690	4.25		8,407	4.59		6,640	4.22	
Investment securities (2)	1,931	3.47		1,702	3.45		1,932	3.37		1,664	3.42	
Short term investments & loans held for sale (3)	146	3.86		148	3.07		143	3.64		133	2.74	
Total interest-earning assets	10,549	4.48		8,540	4.07		10,482	4.34		8,437	4.04	
Intangible assets	555			422			556			422		
Other non-interest earning assets	507			369			529			378		
Total assets	\$11,611			\$9,331			\$11,567			\$9,237		
Liabilities and shareholders' equity												
Deposits:												
NOW and other	\$819	0.44	%	\$572	0.23	%	\$766	0.36	%	\$574	0.23	%
Money market	2,525	0.88		1,795	0.54		2,522	0.80		1,800	0.53	
Savings	750	0.14		668	0.14		747	0.14		658	0.14	
Time	2,879	1.54		2,473	1.13		2,896	1.47		2,412	1.11	
Total interest-bearing deposits	6,973	1.02		5,508	0.73		6,931	0.96		5,444	0.71	
Borrowings and notes (4)	1,394	2.29		1,410	1.46		1,341	2.16		1,398	1.42	
Total interest-bearing liabilities	8,367	1.23		6,918	0.88		8,272	1.15		6,842	0.86	
Non-interest-bearing demand deposits	1,619			1,156			1,666			1,167		
Other non-interest earning liabilities	92			99			108			108		
Total liabilities	10,078			8,173			10,046			8,117		
Total shareholders' equity (2)	1,533			1,158			1,521			1,120		
Total liabilities and stockholders' equity	\$11,611			\$9,331			\$11,567			\$9,237		

Table of Contents

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	Average Balance	Yield/Rate (FTE basis)	Average Balance	Yield/Rate (FTE basis)
Net interest spread	3.25	%	3.19	%
Net interest margin (5)	3.50		3.36	
Cost of funds	1.03		0.75	
Cost of deposits	0.83		0.60	
Supplementary data				
Total deposits (In millions)	\$8,592		\$6,664	
Fully taxable equivalent income adj. (In thousands) (6)	2,033		2,644	

(1) The average balances of loans include nonaccrual loans and deferred fees and costs.

(2) The average balance for securities available for sale is based on amortized cost. The average balance of equity also reflects this adjustment.

(3) Interest income on loans held for sale is included in loan interest income on the income statement.

(4) The average balances of borrowings includes the capital lease obligation presented under other liabilities on the consolidated balance sheet.

Purchased loan accretion totaled \$6.9 million and \$2.6 million for the three months ended June 30, 2018 and 2017, respectively. Purchased loan accretion totaled \$10.3 million and \$6.2 million for the six months ended June 30, 2018 and 2017, respectively.

(6) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

Table of Contents

NON-GAAP FINANCIAL MEASURES

This document contains certain non-GAAP financial measures in addition to results presented in accordance with Generally Accepted Accounting Principles (“GAAP”). These non-GAAP measures are intended to provide the reader with additional supplemental perspectives on operating results, performance trends, and financial condition. Non-GAAP financial measures are not a substitute for GAAP measures; they should be read and used in conjunction with the Company’s GAAP financial information. A reconciliation of non-GAAP financial measures to GAAP measures is provided below. In all cases, it should be understood that non-GAAP measures do not depict amounts that accrue directly to the benefit of shareholders. An item which management excludes when computing non-GAAP adjusted earnings can be of substantial importance to the Company’s results for any particular quarter or year. The Company’s non-GAAP adjusted earnings information set forth is not necessarily comparable to non-GAAP information which may be presented by other companies. Each non-GAAP measure used by the Company in this report as supplemental financial data should be considered in conjunction with the Company’s GAAP financial information.

The Company utilizes the non-GAAP measure of adjusted earnings in evaluating operating trends, including components for operating revenue and expense. These measures exclude amounts which the Company views as unrelated to its normalized operations, including securities gains/losses, gains on the sale of business operations and assets, losses recorded for hedge terminations, merger costs, restructuring costs, legal settlements, systems conversion costs, and out-of-period adjustments. Securities gains/losses include gains/losses on equity securities beginning in the first quarter of 2018. Non-GAAP adjustments are presented net of an adjustment for income tax expense.

The Company also calculates adjusted earnings per share based on its measure of adjusted earnings and based on diluted common shares. The Company views these amounts as important to understanding its operating trends, particularly due to the impact of accounting standards related to merger and acquisition activity. Analysts also rely on these measures in estimating and evaluating the Company’s performance. Management also believes that the computation of non-GAAP adjusted earnings and adjusted earnings per share may facilitate the comparison of the Company to other companies in the financial services industry.

Charges related to merger and acquisition activity consist primarily of severance/benefit related expenses, contract termination costs, system conversion costs, variable compensation expenses, and professional fees. Systems conversion costs relate primarily to the Company’s core systems conversion and related systems conversions costs. Restructuring costs primarily consist of the Company's continued effort to create efficiencies in operations through calculated adjustments to the branch banking and office footprint. Expense adjustments include variable rate compensation related to non-operating items.

The Company also adjusts certain equity related measures to exclude intangible assets due to the importance of these measures to the investment community.

Table of Contents

## RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

The following table summarizes the reconciliation of non-GAAP items recorded for the periods indicated:

	At or for the Three Months Ended June 30,		At or for the Six Months Ended June 30,	
(in thousands)	2018	2017	2018	2017
GAAP Net income	\$34,031	\$19,694	\$59,279	\$35,154
Adj: (Gains)/losses on securities, net (1)	(718	)1	784	(12,569 )
Adj: Loss on termination of hedges	—	—	—	6,629
Adj: Net losses/(gains) on sale of business operations and assets	21	—	(460	)—
Adj: Merger and acquisition expense	847	2,266	5,940	8,213
Adj: Restructuring and other expense	—	637	—	6,372
Adj: Income taxes	(105	)(1,039 )	(1,586	)(2,840 )
Total adjusted income (non-GAAP) (2)	(A) \$34,076	\$21,559	\$63,957	\$40,959
GAAP Total revenue	\$121,151	\$102,343	\$236,141	\$203,986
Adj: (Gains)/losses on securities, net (1)	(718	)1	784	(12,569 )
Adj: Net (gains) on sale of business operations and assets	21	—	(460	)—
Adj: Loss on termination of hedges	—	—	—	6,629
Total operating revenue (non-GAAP) (2)	(B) \$120,454	\$102,344	\$236,465	\$198,046
GAAP Total non-interest expense	\$72,337	\$69,523	\$149,206	\$143,849
Less: Total non-operating expense (see above)	(847	)(2,903 )	(5,940	)(14,585 )
Operating non-interest expense (non-GAAP) (2)	(C) \$71,490	\$66,620	\$143,266	\$129,264
(in millions, except per share data)				
Total average assets	(D) \$11,611	\$9,331	\$11,567	\$9,238
Total average shareholders' equity	(E) 1,533	1,158	1,521	1,120
Total average tangible shareholders' equity (2)	(F) 979	736	965	698
Total average tangible common shareholders' equity (2)	(G) 938	736	925	698
Total tangible shareholders' equity, period-end (2)(3)	(H) 961	847	961	847
Total tangible common shareholders' equity, period-end (2)(3)	(I) 921	847	921	847
Total tangible assets, period-end (2)(3)	(J) 11,347	9,206	11,347	9,206
Total common shares outstanding, period-end (thousands)	(K) 45,420	40,428	45,420	40,428
Average diluted shares outstanding (thousands)	(L) 46,215	37,474	46,206	36,466
Earnings per common share, diluted	\$0.74	\$0.53	\$1.28	\$0.96
Adjusted earnings per common share, diluted (2)	(A/L)0.74	0.58	1.38	1.12
Book value per common share, period-end	32.49	31.37	32.49	31.37
Tangible book value per common share, period-end (2)	(I/K) 20.28	20.96	20.28	20.96
Total shareholders' equity/total assets	12.74	13.17	12.74	13.17
Total tangible shareholder's equity/total tangible assets (2)	(H/J) 8.47	9.20	8.47	9.20

Table of Contents

Performance ratios (4)						
GAAP return on assets		1.17	%0.84	% 1.03	%0.76	%
Adjusted return on assets (2)	(A/D)	1.17	0.92	1.11	0.89	
GAAP return on equity		8.88	6.80	7.79	6.28	
Adjusted return on equity (2)	(A/E)	8.89	7.45	8.41	7.31	
Adjusted return on tangible common equity (2)(5)	(A+O)/(J)	14.82	11.96	14.13	12.01	
Efficiency ratio (2)	(C-O)/(B+M+P)	56.37	61.72	57.91	61.83	
Supplementary data (in thousands)						
Tax benefit on tax-credit investments (6)	(M)	\$2,119	\$1,696	\$2,715	\$3,320	
Non-interest income charge on tax-credit investments (7)	(N)	(1,594 )	(1,453 )	(2,100 )	(2,782 )	
Net income on tax-credit investments	(M+N)	525	243	615	538	
Intangible amortization	(O)	1,246	770	2,514	1,571	
Fully taxable equivalent income adjustment	(P)	2,033	2,644	3,853	5,154	

- 
- (1) Net securities losses/(gains) for the period ending June 30, 2018 includes the change in fair value of the Company's equity securities in compliance with the Company's adoption of ASU 2016-01.
- (2) Non-GAAP financial measure.
- (3) Total tangible shareholders' equity is computed by taking total shareholders' equity less the intangible assets at period-end. Total tangible assets is computed by taking total assets less the intangible assets at period-end.
- (4) Ratios are annualized and based on average balance sheet amounts, where applicable.  
Adjusted return on tangible common equity is computed by dividing the total adjusted income adjusted for the
- (5) tax-affected amortization of intangible assets, assuming a 27.32% marginal rate for June 30, 2018 and a 40% marginal rate for June 30, 2017, by tangible equity.
- (6) The tax benefit is the direct reduction to the income tax provision due to tax credits and deductions generated from investments in historic rehabilitation and low-income housing.
- (7) The non-interest income charge is the reduction to the tax-advantaged commercial project investments, which are incurred as the tax credits are generated.

Table of Contents

GENERAL

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 the Company's consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2017 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 2018 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 in the first half of 2018 are the result of increasing income from tax-advantaged loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 27% marginal rate (including state income taxes net of federal benefit), which is reduced from 2017 due to the federal tax reform enacted at the end of 2017 and effective beginning in 2018. In the discussion, references to earnings per share and "EPS" refer to diluted earnings per common share unless otherwise specified.

Berkshire Hills Bancorp, Inc. ("Berkshire" or "the Company") is a Delaware corporation headquartered in Boston and the holding company for Berkshire Bank ("the Bank") and Berkshire Insurance Group. Established in 1846, the Bank operates as a commercial bank under a Massachusetts trust company charter. Berkshire Bank operates under the brand America's Most Exciting Bank®.

Berkshire is a regional financial services company that seeks to distinguish itself over the long term based on the following attributes:

- Strong earnings momentum and improving profitability
- Boston-based regional banking company delivering franchise value in attractive markets
- Distinctive culture drives results
- Disciplined regional consolidator
- Focused on profitability goals and building shareholder value

Shown below is a profile of the Company:

## Table of Contents

### FORWARD-LOOKING STATEMENTS

Certain statements contained in this document that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words “may,” “will,” “should,” “could,” “would,” “plan,” “potential,” “estimate,” “believe,” “intend,” “anticipate,” “expect,” “target” and similar expressions. These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that Berkshire Hills Bancorp files with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended December 31, 2017 and the Risk Factors in Item 1A of this report. Because of these and other uncertainties, Berkshire’s actual results, performance or achievements, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, Berkshire’s past results of operations do not necessarily indicate Berkshire’s combined future results. You should not place undue reliance on any of the forward-looking statements, which speak only as of the dates on which they were made. Berkshire is not undertaking an obligation to update forward-looking statements, even though its situation may change in the future, except as required under federal securities law. Berkshire qualifies all of its forward-looking statements by these cautionary statements.

### SUMMARY

2018 results included the operations of Worcester-based Commerce Bancshares Corp., which were acquired in October 2017, expanding Berkshire’s Greater Boston presence and market share. With the benefit of this acquisition and other initiatives, quarterly earnings per share and return on assets increased strongly to record levels in the second quarter of 2018. Highlights of the year-over-year improvement in second quarter performance metrics included:

- 73% increase in net income to \$34 million
- 40% increase in earnings per share to \$0.74
- 48% increase in net revenue to \$121 million
- 39% improvement in return on assets to 1.17%
- 31% improvement in return on equity to 8.9%

These results were achieved while the Company was absorbing the increased compliance costs related to crossing the \$10 billion asset threshold, and while the Company was investing in its Boston headquarters relocation and team buildout. Results also benefited from a lower tax rate following federal tax reform. In recognition of improved earnings, Berkshire increased its quarterly shareholder dividend by 5% to \$0.22 per common share in the first quarter of 2018, matching a similar increase in the first quarter of 2017.

Berkshire’s Xtraordinary Day of Service in June tackled 74 community projects across our markets, totaling nearly 7,000 volunteer hours and 92% of the workforce. Berkshire’s Foundation announced the appointment of a Corporate Social Responsibility (CSR) Officer to expand Berkshire’s multiple community engagement activities and implement an all-encompassing CSR strategy. The Company’s strengthened financial condition was recognized with an A- bank deposit rating assigned by the KBRA Bond Rating Agency. Berkshire’s stock was added to the S&P 600 SmallCap<sup>®</sup> index during the most recent quarter; this index tracks U.S. small cap companies and is included in the S&P Composite 1500<sup>®</sup> index, facilitating an expanded market for the Company’s stock.

Economic conditions remain good in the Company’s markets, and the Company maintains a focus on Greater Boston, Albany, and the Mid-Atlantic as its strongest regional markets. The yield curve increased and flattened in 2018 as a result of three 25 basis point increases by the Federal Reserve Bank in its target fed funds rate in December 2017,

March 2018, and June 2018.

77

---



Table of Contents

COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2018 AND DECEMBER 31, 2017

Summary: Total assets increased by \$0.3 billion, or 3%, in the first half of 2018 due to a \$0.4 billion, or 5%, increase in total loans. The asset growth was funded by \$0.1 billion, or 1%, net growth in deposits and a \$0.2 billion, or 20%, increase in borrowings. Asset quality metrics remained strong, and the strong loan growth resulted in modest changes in liquidity and capital metrics. Interest rate sensitivity remained generally positive to higher rates. Book value per share increased by 1% to \$32.49 and the non-GAAP measure of tangible book value per common share increased by 2% to \$20.28.

Securities: Total securities remained unchanged at \$1.9 billion in the half, and there were no significant changes in the composition of the portfolio. The portfolio yield decreased modestly to 3.47% in the most recent quarter from the fourth quarter of 2017, including the reduction in the benefit of tax advantaged securities as a result of tax reform. This reduction primarily reduced the yield on municipal securities, which continue to meet the Company's investment objectives. The weighted average life of the bond portfolio increased to 6.2 years from 5.6 years at the start of the year, including the effect of slower prepayment speeds resulting from higher interest rates. The unrealized loss on the securities portfolio measured 1.6% of cost at quarter-end, compared to a 0.6% gain at the start of the year, reflecting lower bond prices stemming from the increase in interest rates since the beginning of the year. Due to a change in accounting principles, beginning in 2018, the change in net fair value of marketable equity securities is recorded to non-interest income rather than to accumulated other comprehensive income. The Company has elected to disclose these securities separately on the statement of financial condition.

Loans: The \$411 million, or 5%, increase in total loans included a \$294 million increase in residential mortgages and a \$126 million increase in commercial loans. Mortgage loan growth was primarily comprised of jumbo fixed rate loans in Eastern Massachusetts originated by Berkshire and its local correspondent banks. The Company sells most of its conforming mortgage originations, while local jumbo loans are retained for investment to support relationship and market objectives. Growth in the first half of 2018 included seasonally higher purchase mortgage originations. Growth in commercial loans included the benefit of the Company's expansion in Greater Boston. Commercial loans comprised 60% of total loans at midyear and continue to be a central strategic focus. The Company expanded its commercial teams in Greater Boston and New Jersey based on growth opportunities in those markets. Berkshire's total non-owner occupied commercial real estate exposure measured 242% of regulatory capital at period-end, compared to the 300% regulatory monitoring guidelines (based on regulatory definitions). Construction loan exposure was 37% of bank regulatory capital, compared to the 100% regulatory monitoring guideline.

The second quarter loan portfolio yield increased to 4.73% due to the benefit of higher interest rates and increased purchased loan accretion. The benefit of this accretion was 0.25% in the most recent quarter, compared to 0.21% in the fourth quarter of 2017. At midyear, 42% of total loans contractually repriced within one year, 22% repriced in one to five years, and 36% repriced after five years. While scheduled repricing was unchanged from year-end, the expected average loan lives are estimated to have shortened slightly due to the volume of variable rate commercial loans originated which is believed to have more than offset the growth in fixed rate mortgages and the impact of slower projected prepayment speeds tied to rising rates.

Asset Quality: Asset quality metrics generally remained favorable in the first half of 2018. Annualized net loan charge-offs for this period were 0.19% of average loans and non-performing assets were little changed at 0.20% of total assets at period-end. Accruing delinquent loans increased to 0.62% of loans from 0.55% during the first half of the year, due primarily to one commercial real estate loan which was 90+ days delinquent and well-secured and in the process of collection at midyear. At period-end, the total contractual balance of purchased credit impaired loans was \$172 million, with a \$71 million carrying value. Asset resolution strategies in the first half of the year contributed to the reduction in these balances from \$209 million and \$97 million at the start of the year. The midyear contractual balance included Boston area taxi medallion loans acquired at a significant discount with Commerce, and which had a net carrying value less than \$30 million at midyear. Criticized loans measured 1.8% of total assets at period-end,

compared to 1.6% at the start of the year, as reductions of criticized acquired loans partially offset increases related to commercial real estate loans from business activities. The ratio of the allowance to total loans increased to 0.64% from 0.62% during the first half of the year. At period-end, this ratio measured

78

---

Table of Contents

0.74% for business activities loans and 0.29% for acquired loans, compared to 0.75% and 0.27% respectively at the prior year-end.

Deposits and Borrowings: The \$89 million, or 1%, increase in total deposits in the first half of 2018 included a \$123 million increase in NOW accounts due to higher municipal balances and a new deposit sweep program established with Berkshire's wealth management customers. The decrease in demand deposits and money market accounts included a \$78 million decrease related to commercial payroll service accounts, as well as runoff into higher yielding instruments. Payroll service deposits totaled \$434 million at midyear; these balances fluctuate daily depending on the timing of payroll cycles. Time deposit growth was concentrated in brokered deposits which offset the payroll fluctuations and provided funding for loan growth. Total deposits averaged \$8.6 billion in the most recent quarter, which was a 3% increase over the fourth quarter of 2017. Total borrowings increased by \$227 million during the first half of the year as FHLB borrowings were used primarily to support loan growth. Borrowing costs also increased due to higher rates and a widening of LIBOR spreads. Due primarily to higher market interest rates, the average cost of deposits was 0.83% in the most recent quarter, compared to 0.66% in the fourth quarter of 2017.

Derivative Financial Instruments: The notional balance of derivative financial instruments increased to \$3.0 billion at period-end from \$2.5 billion at the start of the year. This included a \$0.3 billion increase related to commercial loan interest rate swaps and matching hedges originated in the first half of the year. Growth in derivatives also included a \$0.2 billion seasonal increase in residential mortgage interest rate lock commitments. The gains on these mortgage derivatives resulted in a \$2 million increase in the net fair value of total derivatives to \$6 million at period-end.

Shareholders' Equity: Shareholders' equity increased by \$20 million, or 1%, in the first half of 2018. The benefit of retained earnings was partially offset by a reduction in accumulated other comprehensive income resulting from the unrealized bond losses discussed previously in the Securities section. As a result, there was a slight increase in leverage, with the ratio of equity to assets measuring 12.7% at period-end, while the non-GAAP measure of tangible equity to tangible assets was 8.5%. Based on earnings growth, the return on equity improved to 8.9% in the most recent quarter, while the non-GAAP measure of adjusted return on tangible common equity improved to 14.8%. The Company focuses on this measure in assessing internal capital generation to support dividends and organic growth.

Table of Contents

## COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2018 AND JUNE 30, 2017

Summary: Revenue and expense in 2018 included the Commerce operations acquired on October 13, 2017. As a result, most categories of revenue and expense increased over the same period of 2017. Most categories of interest income and expense also increased due to the increase in market interest rates. Additionally, 2018 operations included the benefit of First Choice cost saves and hedge terminations and restructuring actions which affected 2017 results. Based on its pro forma analysis in the Company's Form 10-K, the Company expected the Commerce acquisition to be accretive to earnings and earnings per share, including the cost saves targeted to be achieved in 2018. Operations in 2018 also benefited from the lower federal income tax rate, which reduced the effective tax rate compared to 2017. Earnings per share reflected the shares issued as merger consideration for the Commerce acquisition.

Second quarter net income increased year-over-year by \$14 million, or 73%, while six month net income increased by \$24 million, or 69%. Earnings per share increased by 40% to \$0.74 for the second quarter and by 33% to \$1.28 for the first six months of the year, including the new merger related shares. The Company utilizes the non-GAAP measure of adjusted earnings per share to evaluate earnings related to ongoing operations. This measure excludes merger related costs and other specified net charges. Adjusted earnings per share increased year-over-year by \$0.16, or 28%, to \$0.74 in the second quarter and by \$0.26, or 23%, to \$1.38 in the first six months of the year. Operating results included the benefit of a lower effective tax rate and higher purchased loan accretion in 2018. The return on assets improved to 1.17% in the most recent quarter. The return on equity improved to 8.9% and the non-GAAP measure of adjusted return on tangible common equity improved to 14.8%. The Company evaluates this measure as an indicator of internal capital generation to support dividends and growth. The improvement in profitability in 2018 demonstrated positive operating leverage driven by revenue growth and was further evidenced by an improvement in the efficiency ratio to 56.4% in the most recent quarter.

Revenue: Quarterly net revenue advanced year-over-year by 18% and 16% for the second quarter and first half, respectively. Much of this increase was attributed to the Commerce acquisition, based on the pro forma analysis of combined operations in the most recent Form 10-K. Revenue in the most recent period totaled \$121 million, or \$485 million on an annualized basis. Annualized revenue totaled \$10.49 per share in the most recent quarter, compared to \$10.92 in the same quarter of 2017.

Net Interest Income: Net interest income increased year-over-year by 31% and 29% in the second quarter and first half, respectively. Average earning assets increased by 24% for both of these periods, including the benefit of the Commerce acquisition and growth in loans from business activities. The net interest margin increased year-over-year in both the first and second quarter, reaching 3.50% in the second quarter of 2018 compared to 3.36% in 2017. The contribution from purchased loan accretion in the second quarter was 0.25% in 2018 compared to 0.12% in 2017. Partially offsetting this benefit, the second quarter contribution of taxable equivalent loan and securities yields decreased by 4 basis points due primarily to a lower tax rate resulting from federal income tax reform. The net interest margin increased by 5 basis points before these impacts, reflecting the benefit of the Company's positive interest rate sensitivity and the Commerce acquisition, including a higher average balance of transaction accounts, which have a lower comparative interest cost.

Non-Interest Income: Loan and deposit fee income increased year-over-year 24% for the first half of the year. Loan fee growth included higher SBA loan sale gains and higher commercial loan interest rate swap fee income. Deposit fees increased primarily due to the addition of the Commerce operations; this benefit was partially offset by higher earnings credit rates on commercial demand deposits as compensation for deposit services. Mortgage industry revenue contracted year-over-year due to lower demand as a result of higher interest rates. The Company's first half mortgage banking revenue declined year-over-year by 30% and was mostly offset by a reduction in estimated related expenses. Non-interest income is net of charges related to the amortization of tax credit investments which benefit tax expense. Non-interest income includes items not viewed as related to ongoing operations, including securities gains/losses and

hedge termination losses. Berkshire crossed the \$10 billion asset threshold at the time of the Commerce acquisition. Due to the Durbin Amendment of the Dodd-Frank act, the Company must reduce its card processing fees included in deposit fees, effective July 1, 2018. The Company

80

---

## Table of Contents

estimates that this annualized revenue loss will be approximately \$5 million; this impact was included in the Company's analysis of the net accretive benefits targeted for the Commerce acquisition.

**Loan Loss Provision:** The first half loan loss provision increased by 21% due primarily to the increase in the size of the portfolio. The provision exceeded net loan charge-offs and boosted the ratio of the allowance to total loans. 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. It is an estimate of the probable and estimable loan losses in the portfolio as of period-end. The level of the allowance is a critical accounting estimate and the level of the allowance was included in the discussion of financial condition.

**Non-Interest Expense:** Total non-interest expense increased year-over-year by 4% for the second quarter and first half of 2018. Non-interest expense include charges viewed as not related to future operations, consisting primarily of merger and restructuring charges. The non-GAAP measure of adjusted operating expense excludes these items. This measure increased by 7% and 11% for the above periods respectively, including costs related to the acquired Commerce operations. Management views the year-over-year results as indicating positive operating leverage, as the revenue increase exceeded expense growth. This was achieved while the Company added overhead costs for increased regulatory compliance related to crossing the \$10 billion asset threshold. The Company also increased its investment in employees and its communities as part of the reinvestment of benefits resulting from federal tax reform. Additionally, the Company has added to its banking teams in Greater Boston and in the Mid Atlantic. As previously noted, mortgage banking expenses were reduced as a result of the related revenue decline. Expenses have benefited from the implementation of cost saves for the First Choice Bank and Commerce acquisitions. The Company is assessing plans to consolidate approximately six branch offices during the next several quarters, with a target to reduce ongoing expenses after an initial restructuring charge. Two branches were added in attractive markets in the first half of the year. Due to an amendment to the Dodd-Frank legislation, the Company is no longer required to submit formal capital stress tests and will not have that incremental expense which was planned, although informal stress testing will continue. As a consequence of crossing the \$10 billion asset threshold, management anticipates that FDIC insurance expense will increase by approximately \$1.3 million per year beginning in the fourth quarter of 2018. Total full-time equivalent staff measured 2,004 positions at midyear, compared to 1,992 positions at the start of the year.

**Income Tax Expense:** The Company's statutory tax rate decreased year-over-year reflecting the benefit of federal income tax reform which became effective in 2018. The federal statutory tax rate decreased to 21% from 35%, while the state effective tax rate net of federal benefit increased to 5% from 2%. The overall effective tax rate decreased to 21% from 30% in the first half of the year, falling to 20% in the most recent quarter due to additional benefit from tax credit investment projects, which provided \$0.01 per share in benefit, net of related amortization charges in non-interest income.

**Total Comprehensive Income:** Total comprehensive income includes net income together with other comprehensive income. Other comprehensive income was a loss of \$6 million and \$20 million for the second quarter and first half of 2018, compared to income of \$2 million and \$1 million in the same periods of the prior year. This change primarily reflected the unrealized bond losses in 2018 due to lower bond market prices as a result of increases in market interest rates.

**Liquidity and Cash Flows:** Liquidity declined modestly in the first half of 2018, primarily due to the strong loan growth. The ratio of loans/deposits increased to 99% from 95%. To support additional wholesale funding, the Company increased the assets qualifying to support FHLBB borrowings. At midyear, the Bank had \$1.2 billion in unused FHLBB borrowing availability, compared to \$1.1 billion at the start of the year. At period-end, the holding company had cash and equivalents totaling \$69 million. In the first quarter of 2018, the holding company downstreamed \$50 million in cash into the Bank as paid in capital to support further bank growth. Additional

information about liquidity and cash flows is contained in the related section of the most recent Form 10-K.

Capital Resources: Please see the “Shareholders’ Equity” section of the Comparison of Financial Condition for a discussion of shareholders’ equity together with the note on Shareholders’ Equity in the consolidated financial

Table of Contents

statements. Additional information about regulatory capital is contained in the notes to the consolidated financial statements and in the most recent Form 10-K. There was a slight increase in leverage in the first half of 2018 due to the strong loan growth. The increase in earnings and profitability have increased the Company's internal generation of tangible equity which the Company views as supportive of dividends, organic growth, and long term strengthening of capital metrics. The Company conducts informal capital stress tests but, based on recent amendments to the Dodd-Frank act, it will not be required to submit formal analyses to supervisory authorities. As noted above, the holding company contributed additional cash equity to the Bank in the first quarter. Additionally, subsequent to midyear, the Company converted a \$35 million subordinated note from the Bank into bank equity, to further strengthen Bank capital to support future growth.

**Off-Balance Sheet Arrangements and Contractual Obligations:** In the normal course of operations, Berkshire engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in the Company's financial statements. 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. Further information about the Company's off-balance sheet arrangements and information relating to payments due under contractual obligations is presented in the most recent Form 10-K. Changes in the fair value of derivative financial instruments and hedging activities are included on the balance sheet and information related to these matters is reported in the related footnote to the consolidated financial statements, and was included in management's discussion of changes in financial condition. There were no major changes in off-balance sheet arrangements and contractual obligations during the first half of 2018.

**Fair Value Measurements:** The most significant fair value measurements recorded by the Company are those related to assets and liabilities acquired in business combinations. The premium or discount value of acquired loans has historically been the most significant element of these measurements. Berkshire provides a summary of estimated fair values of financial instruments at each period-end. The premium or discount value of loans has historically been the most significant element of this period-end presentation. This premium or discount is a Level 3 estimate and reflects management's subjective judgments. At period-end, the premium value of the loan portfolio was \$143 million, or 1.7% of the carrying value, compared to \$175 million, or 2.1% of carrying value at year-end 2017. The Company makes further measurements of fair value of certain assets and liabilities, as described in the related note in the financial statements. The most significant measurements of recurring fair values of financial instruments primarily relate to securities available for sale, loans held for sale, and derivative instruments. These measurements were generally based on Level 2 market based inputs.



Table of Contents

**APPLICATION OF CRITICAL ACCOUNTING POLICIES**

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included in its most recent Annual Report on Form 10-K. Modifications to significant accounting policies made during the year are described in Note 1 to the consolidated financial statements included in Item 1 of this report. The preparation of the consolidated financial statements in accordance with GAAP and practices generally applicable to the financial services industry requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates.

Management has identified the Company's most critical accounting policies as related to:

- Allowance for Loan Losses
- Acquired Loans
- Income Taxes
- Goodwill and Identifiable Intangible Assets
- Determination of Other-Than-Temporary Impairment of Securities
- Fair Value of Financial Instruments

These particular significant accounting policies are considered most critical in that they are important to the Company's financial condition and results, and they require management's subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. The accounting policies and estimates, including the nature of the estimates and types of assumptions used, are described in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's most recent Form 10-K and pertain to discussion in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, of this report.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes to the way that the Company measures market risk in the first half of 2018. For further discussion about the Company's Quantitative and Qualitative Aspects of Market Risk, please review Item 7A of the most recent report on Form 10-K which sets forth the methodologies employed by the Company and the various aspects of its analysis of its interest rate sensitivity. Berkshire's objective is to maintain a neutral or asset sensitive interest rate risk profile, as measured by the sensitivity of net interest income to market interest rate changes.

The Company estimates that its interest rate profile remains slightly asset sensitive at midyear 2018. Asset sensitivity decreased in the first half of the year due to growth of loans supported by shorter term funding. At period-end, modeled net interest income was nearly flat in the second year of an up 200 basis point ramp. The loss representing the economic value of equity at risk increased modestly to 7% at midyear from 5% at the start of the year in a 200 basis point upward move in interest rates. Of note, while deposit costs have risen, deposit interest rate sensitivity remains below the 40% beta level utilized in the Company's modeling. The Company's modeling assumes no shift in the deposit mix in rate change scenarios. Estimated net interest income and net income at risk under the forward curve scenario also remained positive. This positive sensitivity is compared to a baseline of flat interest rates; this baseline scenario demonstrates medium term pressure on the net interest margin from the roll-down of long term assets resulting from scheduled repricing.

The Company believes the modeled positive sensitivity of its interest income has been partially offset by the flattening of the yield curve, changes in deposit mix, the mix of business growth, and competitive market conditions. Deposit activity in the banking industry is beginning to react to the trend of increasing short term rates following the prolonged time when rates were very low. Uncertainties also exist regarding the impact of lower federal income taxes on industry pricing competition. The Company believes that its diversified markets and sources may provide it with comparative benefit in managing its deposit pricing and balance sheet management to achieve its market, earnings, and risk objectives.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

a) Disclosure controls and procedures.

The principal executive officers, including the principal financial officer, based on their evaluation of disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that the Company's disclosure controls and procedures were effective.

b) Changes in internal control over financial reporting.

There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II

ITEM 1. LEGAL PROCEEDINGS

As of June 30, 2018, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits involving the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans, and other issues incident to the Bank's business. However, other than the items noted below, neither the Company nor the Bank is a defendant party to any pending legal proceedings that it believes, in the aggregate, would have a material adverse effect on the financial condition or operations of the Company. Additionally, an estimate of future, probable losses cannot be estimated as of June 30, 2018.

On April 28, 2016, Berkshire Hills and Berkshire Bank were served with a complaint filed in the United States District Court, District of Massachusetts, Springfield Division. The complaint was filed by an individual Berkshire Bank depositor, who claims to have filed the complaint on behalf of a purported class of Berkshire Bank depositors, and alleges violations of the Electronic Funds Transfer Act and certain regulations thereunder, among other matters. On July 15, 2016, the complaint was amended to add purported claims under the Massachusetts Consumer Protection Act. The complaint seeks, in part, compensatory, consequential, statutory, and punitive damages. Berkshire Hills and Berkshire Bank deny the allegations contained in the complaint and are vigorously defending this lawsuit.

On January 29, 2018, the Bank was served with an amended complaint filed nominally against Berkshire Hills in the Business Litigation Session of the Massachusetts Superior Court sitting in Suffolk County. The amended complaint was filed by two residuary beneficiaries of an estate planning trust that was administered by the Bank as successor trustee following the death of the trust donor, and alleges the Bank breached its fiduciary duty and violated the Massachusetts Consumer Protection Act in the course of performing its duties as trustee. The complaint seeks compensatory, statutory, and punitive damages. Berkshire Hills and Berkshire Bank deny the allegations contained in the complaint and are vigorously defending this lawsuit.

Table of Contents

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed below and in Part I, “Item 1A. Risk Factors” in our most recent Annual Report on Form 10-K, which could materially affect the Company's business, financial condition, or future operating results. The risks described in this form are not the only risks presently facing the Company. Additional risks and uncertainties not currently known to the Company, or currently deemed to be immaterial, also may materially adversely affect the Company's business, financial condition, and/or operating results.

There were no major changes in risk factors in the first half of 2018.

Table of Contents

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

## (a) Recent Sales of Unregistered Securities

The Company occasionally engages in the practice of transferring unregistered securities for the purpose of completing business transactions. These shares are issued to vendors or other organizations as consideration for services performed in accordance with each contract. During the six months ended June 30, 2018 and June 30, 2017, the Company transferred 1,437 and 8,038 shares, respectively.

(b) Not applicable.

(c) The following table provides certain information with regard to shares repurchased by the Company in the second quarter of 2018:

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
April 1-30, 2018	—	\$ —	—	500,000
May 1-31, 2018	—	—	—	500,000
June 1-30, 2018	—	—	—	500,000
Total	—	\$ —	—	500,000

On December 2, 2015, the Company announced that its Board of Directors authorized a new stock repurchase program, pursuant to which the Company may repurchase up to 500 thousand shares of the Company's common stock, representing approximately 1.6% of the Company's then outstanding shares. The timing of the purchases will depend on certain factors, including but not limited to, market conditions and prices, available funds, and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions or pursuant to a trading plan adopted in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. Any repurchased shares will be recorded as treasury shares. The repurchase plan will continue until it is completed or terminated by the Board of Directors. As of June 30, 2018, no shares had been purchased under this program, and the available shares represented approximately 1.1% of outstanding shares at that date.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

- 3.1 Amended and Restated Certificate of Incorporation of Berkshire Hills Bancorp, Inc.
- 3.2 Amended and Restated Bylaws of Berkshire Hills Bancorp, Inc. (1)
- 4.1 Form of Common Stock Certificate of Berkshire Hills Bancorp, Inc. (2)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 Shareholder Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail.

---

(1) Incorporated herein by reference from the Exhibits to the Form 8-K as filed on June 26, 2017.

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

Table of Contents

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: August 9, 2018 By: /s/ Michael P. Daly  
Michael P. Daly  
Chief Executive Officer

Dated: August 9, 2018 By: /s/ James M. Moses  
James M. Moses  
Senior Executive Vice  
President, Chief  
Financial Officer