BERKSHIRE HILLS BANCORP INC
Form 10-K
March 16, 2006

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

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _________ to __________

Commission File Number: 0-58514

BERKSHIRE HILLS BANCORP, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $235 million, based upon the closing price of $33.32 as quoted on the American Stock Exchange as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares outstanding of the registrant's common stock as of March 1, 2006, was 8,584,230.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of Berkshire Hills Bancorp, Inc. (the "Company" or "Berkshire Hills") and Berkshire Bank (the "Bank"). These forward-looking statements are generally identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. The Company and the Bank's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of Berkshire Hills and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in Berkshire Hills' and the Bank's market area, changes in real estate market values in Berkshire Hills' and the Bank's market area, and changes in relevant accounting principles and guidelines. Additionally, on June 1, 2005, the Company completed the acquisition of Woronoco Bancorp, Inc. ("Woronoco"). Risks and uncertainties related to the acquisition include the achievement of anticipated future earnings benefits. These risks and uncertainties should be considered in evaluating forward looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, Berkshire Hills does not undertake, and specifically disclaims any obligation to release publicly the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

GENERAL

Berkshire Hills Bancorp, Inc. is a Delaware corporation and the holding company for Berkshire Bank. Established in 1846, Berkshire Bank is one of Massachusetts' oldest and largest independent banks and is the largest banking institution based in Western Massachusetts. The Bank is headquartered in Pittsfield, Massachusetts and operates 24 full-service banking offices serving communities throughout Western Massachusetts and in Northeastern New York. The Bank is structured to operate in three regions: its traditional Berkshire County Region; the Pioneer Valley Region along the Connecticut River valley in Massachusetts; and the New York Region serving Albany and the surrounding area in Northeastern New York.

The Bank is aggressively transitioning from a community bank to a regional bank. It plans to approximately double the size of its branch office network over the next three years by opening additional full-service offices, and to grow its commercial banking program. Additionally, the Bank seeks growth through acquisitions, including possible expansion into Southern Vermont and Northern Connecticut. The Bank entered the Pioneer Valley area of Massachusetts in 2005 with the acquisition of Woronoco Bancorp, Inc., and has made acquisitions of insurance and financial planning providers in the last two years. Berkshire Bank is positioning itself as the financial institution of choice in its three regions. These three regions are viewed as having favorable demographics and provide an attractive regional niche for the Bank to distinguish itself as the preferred choice compared to larger super-regional banks and smaller community banks.

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

COMPANY WEBSITE AND AVAILABILITY OF SECURITIES AND EXCHANGE COMMISSION FILINGS

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

COMPETITION

The Bank is subject to strong competition from banks and other financial institutions and financial service providers. Its competition includes national and super-regional banks such as Bank of America, TD Banknorth, and Citizens Bank, which have substantially greater resources and lending limits. Non-bank competitors include credit unions, brokerage firms, insurance

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providers, financial planners, and the mutual fund industry. New technology is reshaping customer interaction with financial service providers and the increase of Internet-accessible financial institutions increases competition for Berkshire Bank's customers. The Bank generally competes on the basis of customer service, relationship management, and the pricing of loan and deposit products and wealth management services. The location and convenience of branch offices is also a significant competitive factor, particularly regarding new offices. The Bank has recently designated regional headquarters led by regional presidents as an important component of its market management. The Company offers a customer-focused brand of "Trusted Solutions" to maintain hometown, common sense values, building emotionally connected relationships with customers, and delivering a customized set of products and services and a consistent and familiar experience.

LENDING ACTIVITIES

General. The Bank originates loans in the four basic portfolio categories discussed below. Lending activities are limited by federal and state laws and regulations. Loan interest rates and other key loan terms are affected principally by the Bank's asset/liability strategy, loan demand, competition, and the supply of money available for lending purposes. These factors, in turn, are affected by general and economic conditions, monetary policies of the federal government, including the Federal Reserve Board, legislative tax policies and governmental budgetary matters. The majority of the Bank's loans are secured by real estate in its primary markets, and lending activities are therefore affected by activity in these real estate markets. The loan portfolio includes loans acquired through the acquisition of Woronoco Bancorp, Inc. in 2005.

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

	2005		2004		2003		2002		2001	
(Dollars in millions)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Residential mortgages	$ 549.8	39%	$ 235.2	28%	$ 265.5	34%	$ 241.6	33%	$ 232.6	29%
Commercial mortgages	410.7	29	260.5	32	206.4	26	157.1	22	128.6	16
Commercial business	158.7	11	150.9	18	166.3	21	165.3	23	170.3	21
Consumer	297.2	21	181.5	22	154.0	19	159.0	22	271.0	34
Total loans	1,416.4	100%	828.1	100%	792.2	100%	723.0	100%	802.5	100%
Allowance for loan losses	(13.0)		(9.3)		(9.0)		(10.3)		(11.0)	
Net loans	$ 1,403.4		$ 818.8		$ 783.2		$ 712.7		$ 791.5	

Residential mortgages. The Bank originates first mortgage loans to individuals, secured by one-to-four family residences in its markets. The Bank originates both fixed-rate and adjustable rate mortgages to finance primary and secondary residences, as well as non-owner occupied properties. The Bank also provides construction and land development first mortgage loans to individuals.

The Bank's loan products generally conform to secondary market guidelines, including Fannie Mae and Freddie Mac guidelines. The Bank also offers jumbo loan products. Berkshire Bank generally underwrites, processes and closes its residential mortgages following conforming secondary market guidelines. The Bank also participates in certain programs to provide financing for low- and moderate-income families, including offering Federal Housing Authority, Veterans Administration, and Massachusetts Housing Finance Agency mortgages.

Berkshire Bank also originates construction and land development loans to individuals for the construction and acquisition of personal residences. These loans generally provide for the payment of interest only during the construction phase, which is usually up to fifteen months. At the end of the construction phase, the loan converts to a permanent mortgage loan. Construction and land development loans are generally made on the same underwriting terms as Berkshire Bank's one-to four-family mortgage loans. Residential construction loans totaled $35.4 million at year-end 2005.

The Bank generally originates adjustable rate mortgage loans for its own portfolio. The Bank normally sells on a flow basis most 15 year and 30 year fixed rate mortgages at the time of origination, and forward sale commitments are made when customers choose to rate-lock their mortgage applications. Sometimes the Bank also sells or securitizes some existing residential mortgages to adjust interest rate risk or to provide liquidity. Adjustable-rate mortgage loans help reduce the Bank's exposure to changes in interest rates, subject to the limitations of periodic and lifetime interest rate caps which are common to these loans. Adjustable-rate mortgage loans have potentially higher credit risk in periods of rising interest rates due to the impact of increased payments on borrowers. There has been no material adverse impact on the Bank to date related to the interest rate risk and credit risk of adjustable-rate mortgages.

Commercial Mortgages. The Bank originates commercial mortgages on properties used for business purposes such as small office buildings, industrial, healthcare, lodging, recreation, or retail facilities predominantly located in Berkshire Bank's primary market area. This portfolio also includes 1-4 family and multifamily properties. Loans may generally be made with terms of up to 20 years and with interest rates that adjust periodically (primarily from floating to five years) and are generally indexed to Berkshire Bank's base rate.

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

The Bank also originates construction loans, including multifamily properties, commercial properties, single-family subdivisions, and condominiums. These loans generally have an interest-only phase during construction and then convert to permanent financing. Berkshire Bank also originates land loans to local contractors and developers for the purpose of holding or developing the land for sale. Land loans are offered with a term of three years in which only interest is required to be paid each month. A balloon payment for the principal plus any accrued interest is due at the end of the loan term. Commercial construction loans totaled $59.0 million at year-end 2005.

Commercial mortgages generally involve larger principal amounts and a greater degree of risk than residential mortgages. They also often provide higher yields and involve less interest rate risk, compared to residential mortgages. Because commercial mortgage payments are often dependent on the successful operation or management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy. Additionally, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than on established cash flows. If the Bank is forced to foreclose on a construction project before or at completion, there is a higher risk of credit loss. Berkshire Bank seeks to minimize these risks through strict adherence to its underwriting standards and portfolio management processes.

Commercial Business Loans. Berkshire Bank makes commercial business loans primarily in its market area to a variety of professionals, sole proprietorships and small businesses. The Bank offers secured commercial term loans, which have maturities of greater than one year and the repayment of which is dependent on future earnings. The term for repayment will normally be limited to the lesser of the expected useful life of the asset being financed or a fixed amount of time, generally seven years or less. Berkshire Bank also offers loans originated to finance a business' equipment and machinery, revolving loans, lines of credit, letters of credit, time notes and Small Business Administration guaranteed loans. Business lines of credit have adjustable rates of interest and are payable on demand, subject to annual review and renewal.

Commercial lending policies regarding debt-service coverage ability and guarantees are similar to those which govern commercial real estate lending. Commercial business loans are generally secured by a variety of collateral such as accounts receivable, inventory and equipment, and are generally supported by personal guarantees. Depending on the collateral used to secure the loans, commercial loans are generally made in amounts of up to 95% of the liquidation value of the collateral securing the loan. Some commercial loans may also be secured by liens on real estate. Berkshire Bank generally does not make unsecured commercial loans.

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

Consumer Loans. Berkshire Bank's consumer lending strategy is focused on automobile loans and home equity loans. The Bank has been offering indirect auto loans through auto dealers primarily in its market area for more than fifteen years. The auto loan portfolio is largely comprised of these indirect loans, along with auto loans originated directly through the branch network. The Bank offers fixed-rate automobile loans with terms of up to 72 months for new and recent model used cars and up to 66 months for older model used cars. The Bank generally makes such loans up to 100% of the retail value shown in the *NADA Used Car Guide*. The interest rates offered differ depending on the age of the automobile and interest rates offered by competitors. This program is targeted towards prime grade credits; the Bank does not offer subprime lending programs. The auto loans have produced a higher loan charge-off rate than the Bank's other loan portfolios, which is viewed as normal for this segment.

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Collections are more sensitive to changes in borrower financial circumstances, and the collateral can be depreciated or damaged prior to repossession. Additionally, collections are more subject to the limitations of federal and state laws. Auto loans outstanding totaled $147.3 million at year-end 2005.

The Bank's home equity portfolio consists chiefly of borrowings under home equity lines of credit, which are typically secured by second mortgages on borrower's residences. Home equity lines have an initial revolving period up to ten years, followed by an amortizing term up to fifteen years. These loans are normally indexed to the prime rate. Home equity loans also include amortizing fixed rate second mortgages with terms up to fifteen years. Lending policies for combined debt service and collateral coverage are similar to those used for residential first mortgages, although underwriting verifications are more streamlined. Home equity line credit risks are similar to those of adjustable rate first mortgages, although these loans may be more sensitive to losses when interest rates are rising due to more sensitivity to rate changes and more possible compression of collateral coverage on second liens. The Bank also includes all other consumer loans in this portfolio total, including personal secured and unsecured loans and overdraft protection facilities. Home equity and other loans outstanding at year-end 2005 totaled $149.9 million.

Maturity and Sensitivity of Loan Portfolio. The following table shows contractual final maturities of selected loan categories at year-end 2005. The contractual maturities do not reflect premiums, discounts, and deferred costs, and do not reflect prepayments.

Contractual Maturity *(In thousands)*	One Year or Less	More than One to Five Years	More Than Five Years	Total
Construction mortgage loans:				
Residential	$ 1,880	$ 33,488	$ -	$ 35,368
Commercial	16,192	34,967	7,809	58,968
Commercial business loans	58,725	38,592	61,429	158,746
Total	$ 76,797	$ 107,047	$ 69,238	$ 253,082

For the $176.3 million total of loans above which mature in more than one year, $31.4 million of these loans are fixed rate and $144.9 million are variable rate.

Loan Administration. Lending activities are governed by a loan policy approved by the Board of Directors. The loan policy sets certain limits on concentrations of credit and requires periodic reporting of concentrations to the Board. The Bank has designated internal staff who perform post-closing loan documentation review, quality control and ongoing loan review. The Bank's policy is to assign a risk rating to all commercial loans and loan review staff perform an ongoing program of loan and risk rating reviews. Management also employs an independent third party for loan reviews, as discussed in "Allowance for Loan Losses."

The Bank's lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by Berkshire Bank's Board of Directors and management. All commercial loans in excess of $1.5 million require the approval of the Risk Management Committee of the Board of Directors or the full Board of Directors. The Bank's lending activities are conducted by its salaried and commissioned loan personnel and through its relationships with automobile dealers. From time to time, the Bank will purchase whole loans or participations in loans. These loans are underwritten according to Berkshire Bank's underwriting criteria and procedures and are generally serviced by the originating lender under terms of the applicable participation agreement. The Bank from time to time will sell or securitize residential mortgages in the secondary market based on prevailing market interest rate conditions and an analysis of the composition and risk of the loan portfolio, the Bank's interest rate risk profile and liquidity needs. The Bank sells a limited number of commercial loan participations on a non-recourse basis. The Bank issues loan commitments to its prospective borrowers conditioned on the occurrence of certain events. Commitments are made in writing on specified terms and conditions and are generally honored for up to 60 days from approval.

Nonperforming Assets. While Berkshire Bank generally prefers to work with borrowers to resolve problems, Berkshire Bank generally will initiate foreclosure or other proceedings no later than the 90th day of a delinquency, as necessary, to minimize any potential loss. Management reports to the Board of Directors monthly on the amount of loans delinquent more than 30 days, all loans in foreclosure, and all foreclosed and repossessed property that Berkshire Bank owns. Berkshire Bank generally ceases accruing interest on all commercial and residential loans when principal or interest payments are delinquent 90 days or more unless management determines the loan principal and interest to be fully-secured and in the process of collection. Delinquent automobile loans remain on accrual status until they reach 120 days delinquent. At that time they are charged-off, except for those customers who are in bankruptcy proceedings with a secured loan, in which case the loan is transferred to nonaccrual status.

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

(Dollars in thousands)	2005	2004	2003	2002	2001
Nonaccruing loans:					
Residential mortgages	$ 261	$ 327	$ 348	$ 230	$ 310
Commercial mortgages	271	147	496	-	-
Commercial business	553	523	1,887	2,850	2,077
Consumer	101	155	468	661	315
Total nonperforming loans	1,186	1,152	3,199	3,741	2,702
Real estate owned	-	-	-	1,500	-
Total nonperforming assets	$ 1,186	$ 1,152	$ 3,199	$ 5,241	$ 2,702
Troubled debt restructurings	$ 1,234	$ 510	$ 214	$ -	$ -
Accruing loans 90+ days past due	110	65	306	590	1,306
Total nonperforming loans/total loans	0.08%	0.14%	0.40%	0.52%	0.34%
Total nonperforming assets/total assets	0.06%	0.09%	0.26%	0.36%	0.26%

Interest income that would have been recorded for 2005 had nonaccruing loans been current according to their original terms, amounted to $112,000. The amount of interest income on those loans that was included in net income in 2005 was $14,000.

Real estate acquired by Berkshire Bank as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until sold. When property is acquired it is recorded at fair market value less estimated selling costs at the date of foreclosure, establishing a new cost basis. Holding costs and decreases in fair value after acquisition are expensed. At year-end 2005, Berkshire Bank had no foreclosed real estate.

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

At year-end 2005, there were no loan balances classified as loss. The balance of loans classified as doubtful was $338,000. Loans classified as substandard totaled $9.5 million. Berkshire Bank had no substandard loans greater than $500,000, which were not performing according to their terms at year-end 2005. The largest three substandard commercial relationships totaled $5.4 million. These relationships were performing in accordance with their terms at year-end 2005. Loans classified as substandard are collectively regarded as having the potential to be nonperforming in the future. Loans rated special mention totaled $26.5 million at year end 2005.

Allowance for Loan Losses. Berkshire Bank maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance represents management's estimate of probable losses based on information available as of the date of the financial statements.

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

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In assessing the allowance for loan losses, loss factors are applied to various pools of outstanding loans. Loss factors are based on management's judgment, including consideration of the collectibility of the loan portfolio, including past loan loss experience, known and inherent risks in the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values and economic conditions. The loss factors may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. Generally, nonaccruing commercial loans are deemed impaired and evaluated for specific valuation allowances. Berkshire Bank primarily segregates the loan portfolio according to the primary loan types: residential mortgages, commercial mortgages, commercial business loans and consumer loans.

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

Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making its determinations. Because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loan deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect Berkshire Bank's financial condition and results of operations.

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

(Dollars in thousands)	2005	2004	2003	2002	2001
Balance at beginning of year	$ 9,337	$ 8,969	$ 10,308	$ 11,034	$ 10,216
Charged-off loans:					
Residential mortgages	-	-	-	-	2
Commercial mortgages	-	138	-	510	222
Commercial business	432	218	157	444	797
Consumer	1,110	1,846	4,207	9,074	6,041
Total charged-off loans	1,542	2,202	4,364	10,028	7,062
Recoveries on charged-off loans					
Commercial business	55	296	440	178	265
Consumer	517	709	1,125	2,944	440
Total charged-off recoveries	572	1,005	1,565	3,122	705
Net loans charged-off	970	1,197	2,799	6,906	6,357
Allowance attributed to loans acquired by merger	3,321	-	-	-	-
Provision for loan losses	1,313	1,565	1,460	6,180	7,175
Allowance for loan losses, Balance at end of year	$ 13,001	$ 9,337	$ 8,969	$ 10,308	$ 11,034
Ratios:					
	0.08%	0.15%	0.35%	0.87%	0.78%

Net loans charged-off/average total loans					
Recoveries/charged-off loans	37.09	45.64	35.86	31.13	9.98
Net loans charged-off/allowance for loan losses	7.46	12.82	31.21	67.00	57.61
Allowance for loan losses/total loans	0.92	1.13	1.13	1.43	1.37
Allowance for loan losses/nonperforming loans	10.96x	8.11x	2.80x	2.76x	4.08x

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The following table presents year-end data for the approximate allocation of the allowance for loan losses by loan categories at the dates indicated and the percentage of loans in each category. Management believes that the allowance can be allocated by category only on an approximate basis. The allocation of the allowance to each category is not indicative of future losses and does not restrict the use of any of the allowance to absorb losses in any category.

	2005		2004		2003		2002		2001	
(Dollars in thousands)	Amount Allocated	Percent of Loans in Each Category to Total Loans	Amount Allocated	Percent of Loans in Each Category to Total Loans	Amount Allocated	Percent of Loans in Each Category to Total Loans	Amount Allocated	Percent of Loans in Each Category to Total Loans	Amount Allocated	Percent of Loans in Each Category to Total Loans
Residential mortgages	$ 1,649	39%	$ 435	28%	$ 491	34%	$ 446	33%	$ 430	29%
Commercial mortgages	5,933	29	3,828	32	2,945	26	1,843	22	1,917	16
Commercial business	3,517	11	3,344	18	3,362	21	3,369	23	4,470	21
Consumer	1,902	21	1,730	22	2,171	19	4,650	22	4,217	34
Total	$ 13,001	100%	$ 9,337	100%	$ 8,969	100%	$ 10,308	100%	$ 11,034	100%

INVESTMENT SECURITIES ACTIVITIES

The investment securities portfolio is primarily used to provide for Berkshire Bank's cash flow needs, to provide adequate liquidity to protect the safety of customer deposits and to earn a reasonable return on investment. The average maturity or repricing and the types of securities are based upon the composition, maturity, and quality of the loan portfolio, interest rate risk and Berkshire Bank's liquidity position and deposit structure.

The Risk Management Committee of the Board of Directors is responsible for developing and reviewing Berkshire Bank's investment policy. Investment decisions are made in accordance with the Bank's investment policy and are based upon the quality of a particular investment, its inherent risks, the Bank's liquidity needs, prospects for yield and/or appreciation and the potential tax consequences. General investment strategies are developed and authorized by the Risk Management Committee. The execution of specific investment actions and the day-to-day oversight of the Bank's investment portfolio rests with the President and the Treasurer. The Board of Directors receives a monthly report of all securities transactions made during the previous month.

The majority of the Bank's investments in recent years have been in mortgage-backed securities issued or guaranteed by U.S. Government sponsored enterprises. The Bank has focused on buying adjustable rate pass-through mortgage-backed securities that have limited extension risk, such as five- and seven-year hybrid and 10-year fixed rate mortgage-backed securities. These securities typically have an average duration of 3-5 years. Securities acquired as a result of the Woronoco acquisition also were primarily U.S. Government sponsored enterprise pass-through mortgage-backed securities, although these securities were mostly backed by fixed rate loans. Nearly all the mortgage-backed securities owned by the Bank are issued by Fannie Mae or Freddie Mac. No other issuer concentrations exceeding 10% of stockholders' equity existed at year-end 2005. The Bank also purchases municipal bonds and obligations, and purchases and originates industrial revenue bonds. Some of these securities support local municipal relationships and these securities provide a tax-advantaged yield. Other corporate bonds are primarily investment grade trust preferred securities issued by financial institutions. The equity securities portfolio consists primarily of investments in the common stock of the Federal Home Loan Bank of Boston. Berkshire Bank historically had an actively managed portfolio of exchange traded equity securities of bank, utility and industrial stocks, but this portfolio has been decreasing due to securities sales to reduce price risk in this portfolio. The cost basis of exchange traded stocks was $2.4 million at year-end 2005.

In 2005, the Bank executed a deleveraging program in conjunction with the Woronoco acquisition in order to reduce the leverage of the combined institutions. This was accomplished primarily through the sale of mortgage-backed securities, along with the sale of primarily fixed rate residential mortgage loans. In recent years, the securities portfolio has been partially funded through borrowings. Due to the flat interest rate yield curve in 2005, there were fewer opportunities to earn an attractive spread via this strategy, and purchases of securities were accordingly de-emphasized.

Berkshire Bank's investment policy allows the use of certain hedging strategies, including the purchase of options in an effort to increase the return and decrease the risk on the securities portfolio. The Bank has used covered call option strategies in the

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past and may continue to do so in the future. The Bank has not used interest rate futures or options on futures as part of its interest rate hedging strategies.

The following table presents the year-end amortized cost and fair value of Berkshire Bank's securities, by type of security, for the years indicated

	2005		2004		2003	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale securities						
U.S. Government agencies	$ 69	$ 63	$ 1,106	$ 1,113	$ 20,840	$ 20,969
Municipal bonds and obligations	63,701	63,673	19,169	19,172	12,294	12,282
Mortgage-backed securities	264,705	258,504	323,956	322,585	239,586	239,870
Other bonds and obligations	24,356	24,703	9,418	9,429	19,668	19,416
Equity securities	41,667	43,933	24,210	32,122	21,481	29,854
Total available for sale securities	$ 394,498	$ 390,876	$ 377,859	$ 384,421	$ 313,869	$ 322,391
Hold to maturity securities						
Municipal bonds and obligations	$ 23,851	$ 23,851	$ 25,227	$ 25,227	$ 20,545	$ 20,545
Mortgage-backed securities	6,057	5,912	4,715	4,672	16,358	16,323
Total held to maturity securities	$ 29,908	$ 29,763	$ 29,942	$ 29,899	$ 36,903	$ 36,868

The following table summarizes year-end 2005 amortized cost, weighted average yields and contractual maturities of debt securities. Yields are stated on a book basis (not fully taxable equivalent).

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
(Dollars in millions)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
U.S. Government agencies	$ -	-%	$ 0.1	5.26%	$ -	-%	$ -	-%	$ 0.1	5.26%
Municipal bonds and obligations	8.3	3.49	5.0	4.50	2.9	3.85	71.3	4.20	87.5	4.14

Mortgage-backed securities		-	-		15.1	3.59		81.1	4.22		174.6	4.36	270.8	4.27
Other bonds and obligations		-	-		-	-		3.0	5.18		21.3	5.90	24.3	5.82
Total	$	8.3	3.49%	$	20.2	3.82%	$	87.0	4.24%	$	267.2	4.44%	$ 382.7	4.34%

DEPOSIT ACTIVITIES AND OTHER SOURCES OF FUNDS

Deposits are the major source of funds for Berkshire Bank's lending and investment activities. Deposit accounts are the primary product and service interaction with the Bank's customers. The Bank also uses borrowings from the Federal Home Loan Bank of Boston (FHLBB) as an additional source of funding, particularly for daily cash management and for funding longer duration assets. FHLBB advances also provide more pricing and option alternatives for particular asset/liability needs. In 2005, the Company created a trust subsidiary to issue $15.0 million in trust preferred securities, which provided funds which were invested in the Bank as additional paid in capital, thereby increasing its regulatory capital.

Most of the Bank's deposits are generated from the areas surrounding its branch offices. The Bank offers a wide variety of deposit accounts with a range of interest rates and terms. The Bank also periodically offers promotional interest rates and terms for limited periods of time. Berkshire Bank's deposit accounts consist of interest-bearing checking, noninterest-bearing checking, regular savings, money market savings and time certificates of deposit. The Bank emphasizes its transaction deposits - checking and NOW accounts for personal accounts and checking accounts promoted to businesses. These accounts have the lowest marginal cost to the Bank and are also often a core account for a customer relationship. The Bank offers a courtesy overdraft program to improve customer service, and also provides debit cards and other electronic fee producing payment services to transaction account customers. Money market accounts have increased in popularity due to their interest rate structure. Savings accounts include traditional passbook and statement accounts. The Bank's time accounts provide maturities from three months to ten years. Additionally, the Bank offers a variety of retirement deposit accounts to personal and business customers. The Bank added brokered time deposit accounts with the acquisition of Woronoco Bancorp, and may utilize brokered deposits from time to time in the future. The balance of brokered time deposits was $56.9 million at year-end 2005.

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The following table presents information concerning average balances and weighted average interest rates on Berkshire Bank's deposit accounts for the years indicated.

	2005			2004			2003		
		Percent of Total	Weighted		Percent of Total	Weighted		Percent of Total	Weighted
(Dollars in millions)	Average Balance	Average Deposits	Average Rate	Average Balance	Average Deposits	Average Rate	Average Balance	Average Deposits	Average Rate
Demand	$ 149.6	13%	-%	$ 103.7	12%	-%	$ 91.6	11%	-%
NOW	121.7	11	0.39	97.9	11	0.09	90.2	11	0.17
Money market	209.0	18	2.13	160.3	19	1.29	132.5	16	1.24
Savings	205.8	18	0.90	168.5	20	0.77	170.7	21	1.01
Time	445.2	40	2.14	321.0	38	2.78	330.1	41	3.13
Total	$ 1,131.3	100%	-%	$ 851.4	100%	1.46%	$ 815.1	100%	1.70%

At year-end 2005, Berkshire Bank had time deposit accounts in amounts of $100,000 or more maturing as follows:

Maturity Period	Amount	Weighted Average Rate
(Dollars in thousands)		
Three months or less	$ 30,858	2.89%
Over 3 months through 6 months	40,127	3.12
Over 6 months through 12 months	76,983	4.24
Over 12 months	118,945	4.50
Total	$ 266,913	4.03%

The FHLBB functions as a central reserve bank providing credit for member institutions. As an FHLBB member, Berkshire Bank is required to own capital stock of the FHLBB. Member banks are eligible to borrow money from the FHLBB, with borrowings generally secured by most of the member's mortgage loans and mortgage-related securities, as well as certain other assets. Provided certain creditworthiness standards have been met, advances are made under several different credit programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit.

WEALTH MANAGEMENT SERVICES

The Bank's Asset Management/Trust Group provides client-centered consultative trust relationship management to individuals, businesses, and institutions, with an emphasis on personal investment management to individuals. The group has built a ten year track record with its dedicated in-house investment management team. At year-end 2005, assets under management totaled $418 million. The group also provides brokerage and investment management services in association with Commonwealth Financial Network.

INSURANCE

With the acquisition of Woronoco Bancorp, the Bank acquired a team of licensed insurance agents operating at two full service offices in Westfield and Longmeadow Massachusetts. The insurance group offers a complete line of property and casualty insurance, as well as various life insurance, group life products, disability, and health insurance products. Berkshire Bank has also separately acquired insurance agencies to expand the geographic footprint of this business line. The Bank intends to continue to expand this business line through agency acquisitions and through inclusion in its cross sell programs in the branch network.

GOVERNMENT BANKING

Berkshire Bank offers full-service government banking for cities, towns and municipal school districts in its primary markets and southern Vermont. The Bank offers municipalities all aspects of financial advisory services for the sale of notes and bonds, actively working with bond counsel, rating agencies, consulting agencies and bond buyers. Additionally, the Bank offers a wide range of municipal deposit products and checking accounts. In October 2005, Berkshire Bank opened Berkshire Municipal Bank, an FDIC-insured, New York-chartered limited purpose commercial bank, organized principally to accept deposits from New York municipalities and other governmental entities.

PERSONNEL

As of year-end 2005, the Bank had 399 full-time equivalent employees. The employees are not represented by a collective bargaining unit and the Bank will strive to continue its strong relationship with its employees.

SUBSIDIARY ACTIVITIES

Berkshire Hills Bancorp, Inc. wholly owns two active subsidiaries: Berkshire Bank and Berkshire Hills Capital Trust I. The capital trust subsidiary was created under Delaware law in 2005 to facilitate the issuance of trust preferred securities. The Company also owns one dormant Massachusetts subsidiary, Berkshire Hills Technology, Inc., which discontinued operations in 2004.

Berkshire Bank is a Massachusetts chartered savings bank which wholly owns six subsidiaries. The Bank owns three subsidiaries which are qualified as “securities corporations” for Massachusetts income tax purposes: North Street Securities Corporation, Woodland Securities, Inc., and Gold Leaf Securities Corporation. Berkshire Bank also owns Berkshire Municipal Bank, which was previously discussed under “Government Banking”, and Berkshire Insurance Group, Inc., which is further discussed below. Additionally, the Bank owns the inactive subsidiary, Berkshire Financial Planning, Inc., which ceased offering brokerage services in 2004. Except for Berkshire Municipal Bank, all subsidiaries of Berkshire Bank are incorporated in Massachusetts.

During 2005, the Company acquired Woronoco Bancorp. Between the acquisition date and the end of the year, all of the Woronoco subsidiaries were merged into existing Berkshire entities, except for Woronoco Insurance Group, Inc., which was acquired by Berkshire Bank and renamed Berkshire Insurance Group, Inc.

SEGMENT REPORTING

Management monitors the revenue streams of the various products and services in evaluating the Company’s operations and financial performance. All of the Company’s operations are considered by management to be aggregated in one reportable operating segment. Prior to its discontinuation, the operations of Berkshire Hills Technology, Inc., were evaluated on a stand-alone basis.

REGULATION AND SUPERVISION

The following discussion describes elements of an extensive regulatory framework applicable to bank holding companies and banks and specific information about the Company and its subsidiaries. Federal and state regulation of banks and bank holding companies is intended primarily for the protection of depositors and the Bank Insurance Fund rather than for the protection of stockholders and creditors.

GENERAL

As a savings and loan holding company, Berkshire Hills is required by federal law to file reports with, and otherwise comply with the rules and regulations of, the Office of Thrift Supervision (“OTS”). As a savings bank chartered by the Commonwealth of Massachusetts, Berkshire Bank is subject to extensive regulation, examination and supervision by the Massachusetts Commissioner of Banks (the “Commissioner”), as its primary regulator, and the Federal Deposit Insurance Corporation (“FDIC”), as the deposit insurer. Berkshire Bank is a member of the Federal Home Loan Bank system and, with respect to deposit insurance, of the Bank Insurance Fund managed by the FDIC. Berkshire Bank must file reports with the Commissioner and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other savings institutions. The Commissioner and/or the FDIC conduct periodic examinations to test Berkshire Bank's safety and soundness and compliance with various regulatory requirements. The regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the Commissioner, the FDIC or Congress, could have a material adverse impact on the Company, the Bank and their operations. Certain regulatory requirements applicable to Berkshire Bank and to the Company are referred to below or elsewhere herein. The description of statutory provisions and regulations applicable to savings institutions and their holding companies set forth in this Form 10-K does not purport to be a complete description of such statutes and regulations and their effects on Berkshire Bank and Berkshire Hills and is qualified in its entirety by reference to the actual laws and regulations.

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MASSACHUSETTS BANKING LAWS AND SUPERVISION

Massachusetts savings banks are regulated and supervised by the Massachusetts Commissioner of Banks (the “Commissioner”), who oversees regular bank examinations. The Commissioner’s approval is required to establish or close branches, to merge with another bank, to form a holding company, to issue stock or to undertake many other activities. Any Massachusetts bank that does not operate in accordance with the Commissioner’s regulations, policies and directives may be sanctioned. The Commissioner may suspend or remove directors or officers of a bank who have violated the law, conducted a bank’s business in a manner that is unsafe, unsound or contrary to the depositors’ interests, or been negligent in the performance of their duties. In addition, the Commissioner has the authority to appoint a receiver or conservator if it is determined that the bank is conducting its business in an unsafe or unauthorized manner, and under certain other circumstances.

All Massachusetts-chartered savings banks are required to be members of the Depositors Insurance Fund, a private deposit insurer, which insures all deposits in member banks in excess of FDIC deposit insurance limits. Member banks are required to pay fund assessments. In addition, the Mutual Savings Central Fund acts as a source of liquidity to its members in supplying them with low-cost funds, and purchasing qualifying obligations from them.

Berkshire Bank must adhere to the Massachusetts banking laws, which govern activities such as authorized investments, lending activities and dividend payments. In particular, a Massachusetts savings bank may only pay dividends on its capital stock if such payment would not impair the bank’s capital stock. No dividends may be paid to stockholders of a bank if such dividends would reduce stockholders’ equity of the bank below the amount of the liquidation account required by the Massachusetts conversion regulations. Additionally, the Commissioner may restrict the payment of dividends by a bank if it is determined that such payment would result in safety and soundness concerns.

FEDERAL REGULATIONS

CAPITAL REQUIREMENTS

Under FDIC regulations, federally insured state-chartered banks that are not members of the Federal Reserve System (“state non-member banks”), such as Berkshire Bank, are required to comply with minimum leverage capital requirements. For an institution determined by the FDIC to not be anticipating or experiencing significant growth and to be in general a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System established by the Federal Financial Institutions Examination Council, the minimum capital leverage requirement is a ratio of Tier 1 capital to total assets of 3%. For all other institutions, the minimum leverage capital ratio is not less than 4%. Tier 1 capital is the sum of common stockholders’ equity, noncumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and a percentage of certain nonfinancial equity investments.

Berkshire Bank must also comply with the FDIC risk-based capital guidelines. The FDIC guidelines require state non-member banks to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0% to 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

State non-member banks must maintain a minimum ratio of total capital to risk-weighted assets of at least 8%, of which at least one-half must be Tier 1 capital. Total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, cumulative preferred stock, a portion of the net unrealized gain on equity securities and other capital instruments. The includable amount of Tier 2 capital cannot exceed the amount of the institution’s Tier 1 capital.

As a savings and loan holding company regulated by the OTS, Berkshire Hills is not subject to any separate regulatory capital requirements. Berkshire Bank's regulatory capital is included in the Stockholders' Equity note of the Company's financial statements in Item 8 of this report. For the dates shown, Berkshire Bank met each of its capital requirements.

INTERSTATE BANKING AND BRANCHING

Federal law permits a bank, such as Berkshire Bank, to acquire an institution by merger in a state other than Massachusetts unless the other state has opted out. Federal law also authorizes de novo branching into another state if the host state enacts a law expressly permitting out of state banks to establish such branches within its borders. In 2004, Berkshire Bank purchased a branch in Oriskany Falls, New York. At year-end 2005, Berkshire Bank had received regulatory approval for a new branch in East Greenbush, New York and was in the process of obtaining regulatory approval for new branches in Delmar and Guilderland, New York. During 2005, Berkshire Bank opened branches in Albany and Clifton Park, New York. At its interstate branches, Berkshire Bank may conduct any activity that is authorized under Massachusetts law that is permissible either for a New York

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savings bank (subject to applicable federal restrictions) or a New York branch of an out-of-state national bank. The New York State Superintendent of Banks may exercise certain regulatory authority over the Bank's New York branches.

PROMPT CORRECTIVE REGULATORY ACTION

Federal law requires, among other things, that federal bank regulatory authorities take "prompt corrective action" with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes three categories of capital deficient institutions: undercapitalized, significantly undercapitalized and critically undercapitalized.

The FDIC has adopted regulations to implement the prompt corrective action legislation. An institution is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater, and a leverage ratio of 5% or greater. An institution is "adequately capitalized" if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater and generally a leverage ratio of 4% or greater. An institution is "undercapitalized" if it has a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 4%, or generally a leverage ratio of less than 4% (3% or less for institutions with the highest examination rating). An institution is deemed to be "significantly undercapitalized" if it has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 3%, or a leverage ratio of less than 3%. An institution is considered to be "critically undercapitalized" if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%. As of December 31, 2005, Berkshire Bank met the conditions to be classified as a "well capitalized" institution.

"Undercapitalized" banks must adhere to growth, capital distribution (including dividend) and other limitations and are required to submit a capital restoration plan. No institution may make a capital distribution, including payment as a dividend, if it would be "undercapitalized" after the payment. A bank's compliance with such plans is required to be guaranteed by its parent holding company in an amount equal to the lesser of 5% of the institution's total assets when deemed undercapitalized or the amount needed to comply with regulatory capital requirements. If an "undercapitalized" bank fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." "Significantly undercapitalized" banks must comply with one or more of a number of additional restrictions, including but not limited to an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce assets and cease receipt of deposits from correspondent banks or dismiss directors or officers, and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company. "Critically undercapitalized" institutions must comply with additional sanctions including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

TRANSACTIONS WITH AFFILIATES

Under current federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. In a holding company context, at a minimum, the parent holding company of a savings bank and any companies which are controlled by such parent holding company are affiliates of the savings bank. Generally, Section 23A limits the extent to which the savings bank or its subsidiaries may engage in "covered transactions," such as loans, with any one affiliate to 10% of such savings bank's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to 20% of capital stock and surplus. Loans to affiliates and certain other specified transactions must comply with specified collateralization requirements. Section 23B requires that transactions with affiliates be on terms that are no less favorable to the savings bank or its subsidiary as similar transactions with non-affiliates.

Further, federal law restricts an institution with respect to loans to directors, executive officers, and principal stockholders ("insiders"). Loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution’s total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the board of directors. Further, loans to insiders must be made on terms substantially the same as offered in comparable transactions to other persons, except that such insiders may receive preferential loans made under a benefit or compensation program that is widely available to Berkshire Bank’s employees and does not give preference to the insider over the employees. Federal law places additional limitations on loans to executive officers.

ENFORCEMENT

The FDIC has extensive enforcement authority over insured savings banks, including Berkshire Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist orders and to remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices. The FDIC has authority under federal law to appoint a conservator or receiver for an insured bank under limited circumstances.

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INSURANCE OF DEPOSIT ACCOUNTS

The FDIC maintains a risk-based assessment system. The FDIC assigns an institution to one of three capital categories based on the institution's financial information and one of three supervisory subcategories within each capital group. The supervisory subgroup to which an institution is assigned is based on a supervisory evaluation provided to the FDIC by the institution's primary federal regulator and information which the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance fund. Assessment rates currently range from 0 basis points for the healthiest institutions to 27 basis points of assessable deposits for the riskiest. The FDIC is authorized to raise the assessment rates. The FDIC has exercised this authority several times in the past and may raise insurance premiums in the future. If the FDIC takes such action, it could have an adverse effect on the earnings of Berkshire Bank.

The FDIC may terminate insurance of deposits if it finds that the institution is in an unsafe or unsound condition to continue operations, has engaged in unsafe or unsound practices, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Federal Deposit Insurance Reform Act of 2005. The Federal Deposit Insurance Reform Act of 2005 (the "Act"), signed by the President on February 8, 2006, revised the laws governing the federal deposit insurance system. The Act provides for the consolidation of the Bank and Savings Association Insurance Funds into a combined "Deposit Insurance Fund."

Under the Act, insurance premiums are to be determined by the FDIC based on a number of factors, primarily the risk of loss that insured institutions pose to the Deposit Insurance Fund. The legislation eliminates the current minimum 1.25% reserve ratio for the insurance funds, the mandatory assessments when the ratio falls below 1.25% and the prohibition on assessing the highest quality banks when the ratio is above 1.25%. The Act provides the FDIC with flexibility to adjust the new insurance fund's reserve ratio between 1.15% and 1.5%, depending on projected losses, economic changes and assessment rates at the end of a calendar year.

The Act increased deposit insurance coverage limits from $100,000 to $250,000 for certain types of Individual Retirement Accounts, 401(k) plans and other retirement savings accounts. While it preserved the $100,000 coverage limit for individual accounts and municipal deposits, the FDIC was furnished with the discretion to adjust all coverage levels to keep pace with inflation beginning in 2010. Also, institutions that become undercapitalized will be prohibited from accepting certain employee benefit plan deposits.

The consolidation of the Bank and Savings Association Insurance Funds must occur no later than the first day of the calendar quarter that begins 90-days after the date of the Act's enactment, i.e., July 1, 2006. The Act also states that the FDIC must promulgate final regulations implementing the remainder of its provisions not later than 270 days after its enactment.

At this time, management cannot predict the effect, if any, that the Act will have on insurance premiums paid by the Bank.

FEDERAL HOME LOAN BANK SYSTEM

The Bank is a member of the Federal Home Loan Bank system, which consists of 12 regional Federal Home Loan Banks that provide a central credit facility primarily for member institutions. Berkshire Bank, as a member, is required to acquire and hold shares of capital stock in the Federal Home Loan Bank of Boston. Berkshire Bank was in compliance with this requirement with an investment in Federal Home Loan Bank of Boston stock at year-end 2005 of $36.7 million.

The Federal Home Loan Banks are required to provide funds for certain purposes including contributing funds for affordable housing programs. These requirements could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. For the years 2005, 2004, 2003, 2002 and 2001, cash dividends from the Federal Home Loan Bank of Boston to Berkshire Bank amounted to approximately $1,300,000, $513,000, $249,000, $283,000 and $304,000, respectively.

HOLDING COMPANY REGULATION

Federal law allows a state savings bank that qualifies as a “Qualified Thrift Lender,” discussed below, to elect to be treated as a savings association for purposes of the savings and loan holding company provisions of federal law. Such election allows its holding company to be regulated as a savings and loan holding company by the OTS rather than as a bank holding company by the Federal Reserve Board. Berkshire Bank made such election and the Company is a non-diversified unitary savings and loan holding company within the meaning of federal law. As such, the Company is registered with the OTS and must adhere to the OTS’s regulations and reporting requirements. In addition, the OTS may examine, supervise and take enforcement action against

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the Company and has enforcement authority over the Company and its non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. Additionally, Berkshire Bank is required to notify the OTS at least 30 days before declaring any dividend to the Company. By regulation, the OTS may restrict or prohibit the Bank from paying dividends.

As a unitary savings and loan holding company, the Company is generally unrestricted under existing laws as to the types of business activities in which it may engage. The Gramm-Leach-Bliley Act of 1999 provided that unitary savings and loan holding companies may only engage in activities permitted to a financial holding company under that legislation and those permitted for a multiple savings and loan holding company. Unitary savings and loan companies existing prior to May 4, 1999, such as the Company, were grandfathered as to the unrestricted activities. The Company would become subject to activities restrictions upon the acquisition of another savings institution that is held as a separate subsidiary.

Federal law prohibits a savings and loan holding company from, directly or indirectly, acquiring more than 5% of the voting stock of another savings association or savings and loan holding company or from acquiring such an institution or company by merger, consolidation or purchase of its assets, without prior written approval of the OTS. In evaluating applications by holding companies to acquire savings associations, the OTS considers the financial and managerial resources and future prospects of the Company and the institution involved, the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community and competitive factors.

To be regulated as a savings and loan holding company by the OTS (rather than as a bank holding company by the Federal Reserve Board), the Bank must qualify as a Qualified Thrift Lender. To qualify as a Qualified Thrift Lender, the Bank must maintain compliance with the test for a “domestic building and loan association,” as defined in the Internal Revenue Code, or with a Qualified Thrift Test. Under the Qualified Thrift Lender Test, a savings institution is required to maintain at least 65% of its “portfolio assets” (total assets less: (1) specified liquid assets up to 20% of total assets; (2) intangibles, including goodwill; and (3) the value of property used to conduct business) in certain “qualified thrift investments” (primarily residential mortgages and related investments, including certain mortgage-backed and related securities) in at least 9 months out of each 12-month period. At year-end 2005, Berkshire Bank maintained 96% of its portfolio assets in qualified thrift investments. Berkshire Bank also met the QTL test in each of the prior twelve months and, therefore, met the QTL Test.

Acquisition of the Company. Under the Federal Change in Bank Control Act, a notice must be submitted to the OTS if any person (including a company), or group acting in concert, seeks to acquire “control” of a savings and loan holding company. Under certain circumstances, a change in control may occur, and prior notice is required, upon the acquisition of 10% or more of the Company’s outstanding voting stock, unless the OTS has found that the acquisition will not result in a change of control of the Company.

Massachusetts Holding Company Regulation. In addition to the federal holding company regulations, a bank holding company organized or doing business in Massachusetts must comply with regulations under Massachusetts law. Approval of the Massachusetts regulatory authorities would be required for the Company to acquire 25% or more of the voting stock of another depository institution. Similarly, prior regulatory approval would be necessary for any person or company to acquire 25% or more of the voting stock of the Company. The term “bank holding company,” for the purpose of Massachusetts law, is defined generally to include any company which, directly or indirectly, owns, controls or holds with power to vote more than 25% of the voting stock of each of two or more banking institutions, including commercial banks and state co-operative banks, savings banks and savings and loan association and national banks, federal savings banks and federal savings and loan associations. In general, a holding company controlling, directly or indirectly, only one banking institution will not be deemed to be a bank holding company for the purposes of Massachusetts law. Under Massachusetts law, the prior approval of the Board of Bank Incorporation is required before the following: any company may become a bank holding company; any bank holding company acquires direct or indirect ownership or control of more than 5% of the voting stock of, or all or substantially all of the assets of, a banking institution; or any bank holding company mergers with another bank holding company. Although the Company is not a bank holding company for purposes of Massachusetts law, any future acquisition of ownership, control, or the power to vote 25% or more of the voting stock of another banking institution or bank holding company would cause it to become such. The Company has no current plan or arrangement to acquire ownership or control, directly or indirectly, of 25% or more of the voting stock of another banking institution.

BERKSHIRE MUNICIPAL BANK

In 2005, Berkshire Bank established a new subsidiary, Berkshire Municipal Bank, as a state chartered limited purpose commercial bank in New York, to accept deposits of municipalities and other governmental entities in the State of New York. Berkshire Municipal Bank is subject to extensive regulation, examination and supervision by the New York State Superintendent

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of Banks, as its primary regulator and the FDIC, as the deposit insurer. It is also subject to regulation as to certain matters by the Federal Reserve.

FEDERAL AND MASSACHUSETTS INCOME TAXATION

The Company and the Bank report their income on a calendar year basis using the accrual method of accounting. The federal income tax laws apply to the Company and Berkshire Bank in the same manner as to other corporations with some exceptions, including particularly Berkshire Bank's reserve for bad debts discussed below. This discussion of tax matters is only a summary and is not a comprehensive description of the tax rules applicable to the Company and its subsidiaries.

Prior to 1995, the Bank was permitted to use certain favorable provisions to calculate deductions from taxable income for annual additions to its bad debt reserve. Federal legislation in 1996 repealed this reserve method and required savings institutions to recapture or take into income certain portions of their accumulated bad debt reserves. Approximately $844,000 of the Bank's accumulated bad debt reserves will not be recaptured into taxable income unless the Bank makes a "nondividend distribution" to the Company, including distributions in excess of the Bank's current and accumulated earnings and profits. In the event of a nondividend distribution, approximately 150% of the amount of the distribution up to $844,000 would be includable in income for federal income tax purposes, resulting in an increase in tax of $346,000 assuming a marginal federal and state tax rate of 41%. The Bank does not intend to pay dividends that would result in a recapture of any portion of its bad debt reserves.

The Massachusetts excise tax rate for savings banks is currently 10.5% of federal taxable income, adjusted for certain items. Taxable income includes gross income as defined under the Internal Revenue Code, plus interest from municipal obligations of any state, less deductions, but not the credits, allowable under the provisions of the Internal Revenue Code, except no deduction is allowed for bonus depreciation or state income taxes. Carryforwards and carrybacks of net operating losses are not allowed. A qualifying limited purpose corporation is generally entitled to special tax treatment as a "securities corporation." The Bank's three securities corporations all qualify for this treatment, and are taxed at a 1.32% rate on their gross income.

ITEM 1A. RISK FACTORS

An investment in the Company's common stock involves certain risks. To understand these risks and to evaluate an investment in the Company's common stock, you should read this entire report, including the following risk factors.

Berkshire Bank's emphasis on commercial and consumer lending may expose it to increased lending risks. Both commercial loans and consumer loans are more sensitive to economic downturns and the possible impact of higher interest rates. Such sensitivity includes potentially higher default rates and possible diminution of collateral values. Additionally, commercial loans typically involve larger loan balances and larger relationship exposures. Commercial lending also involves more development financing, which is dependent on the future success of new operations. In expanding into new commercial lending markets, the Bank will have less knowledge and experience with local conditions, compared to its traditional markets, which could affect the success of its underwriting and loan collections. In conducting its lending activities, the Bank generally avoids lending practices identified as high risk by bank regulators, as well as lending concentrations that would be viewed as high risk under regulatory guidelines.

The Company's geographic expansion and growth, if not successful, could negatively impact earnings. The Company plans to achieve significant growth both organically and through acquisitions. It has recently expanded into new geographic markets and anticipates that it will expand into additional new geographic markets as it transforms itself into a regional bank. The success of this expansion will depend on the acceptance by customers of the Company and its services in these new markets. Additionally, the profitability of Berkshire Bank's expansion strategy will depend on whether the income it generates in the new markets will offset the increased expenses of operating a larger entity with increased personnel, more branch locations and additional product offerings. Berkshire Bank expects that it may take a period of time before certain of its new branches can become profitable, especially in areas in which Berkshire Bank does not have an established physical presence. During this period, operating these new branches may negatively impact net income. Additionally, in connection with the Company's expansion, the Company will need to increase its operational and financial procedures, systems and controls. If the Company has difficulty in doing so, it could harm the Company's business, results of operations and financial condition.

The Company acquired Woronoco Bancorp, Inc. in 2005, and has purchased insurance and financial planning businesses in the last two years. The Company will pursue additional opportunities for acquisitions in the future, including acquisitions in adjacent states. The success of acquisitions depends on many factors, including the long term retention of acquired customer relationships. The Company recorded goodwill and other intangible assets in conjunction with the Woronoco acquisition, and such assets may be recorded in future acquisitions. If these investments were to become impaired, the Company would be required to write them down.

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The Company is subject to risks which are common to its industry. Large changes in market interest rates can compress its margins and make its asset and liability management less reliable. A downturn in the local economy or a decline in real estate values could hurt the Company's profits. Most of the Bank's loans are secured by real estate. In recent years, there has been a significant increase in real estate values in the Bank's market areas. A decline in real estate values could expose the Company to a greater risk of loss. Additionally, strong competition within the Bank's market area could hurt the Company's profit and growth. Berkshire Bank faces intense competition both in making loans and attracting deposits. Some competitors have substantially greater resources and lending limits than it has and may offer services that Berkshire Bank does not provide. Competition will likely increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. The Company's profitability depends on the Bank's continued ability to compete successfully in its market area.

Berkshire Bank and the Company operate in a highly regulated environment and may be adversely affected by changes in laws and regulations. The Company is subject to extensive regulation, supervision and examination by the Office of Thrift Supervision, its chartering authority, and Berkshire Bank is subject to extensive supervision and examination by the Massachusetts Division of Banks, its chartering authority, and the Federal Deposit Insurance Corporation, as insurer of Berkshire Bank's deposits. Such regulations and supervision govern the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and depositors. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and determination of the level of allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory claim may have a material impact on Berkshire Bank's operations. The Company primarily depends on the Bank for dividends as a source of funds to service its indebtedness and to pay dividends to shareholders. Such dividends may be restricted or prohibited by regulatory authorities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's headquarters is located in an owned facility located in Pittsfield, Massachusetts. The Company also owns or leases other facilities within its primary market areas: Berkshire County, Massachusetts; Pioneer Valley, Massachusetts; and Capital Region, Northeastern New York. The Company operates 24 full service banking offices, of which 14 operate in premises owned by the Company. At year-end 2005, the Company occupied an additional six office properties, of which three were owned. The Company considers its properties to be suitable and adequate for its present and immediately foreseeable needs.

ITEM 3. LEGAL PROCEEDINGS

At December 31, 2005, 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, neither the Company nor the Bank is a 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.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2005.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The common shares of Berkshire Hills trade on the NASDAQ National Market under the symbol "BHLB". Since its initial public offering, the Company's shares had traded on the American Stock Exchange under the symbol "BHL". The Company's shares began trading on the NASDAQ National Market on October 25, 2006.

The following table sets forth the quarterly high and low price information and dividends declared per share of common stock in 2005 and 2004. On March 1, 2006, the closing market price of Berkshire Hills common stock was $33.11. Berkshire Hills increased its quarterly dividend to $0.14 per share in the third quarter of 2005.

	High	Low	Dividends Declared
2005			
First quarter	$37.64	$33.40	$ 0.12
Second quarter	34.90	30.97	0.12
Third quarter	35.20	31.90	0.14
Fourth quarter	35.57	31.75	0.14
2004			
First quarter	$39.20	$34.40	$ 0.12
Second quarter	37.30	32.46	0.12
Third quarter	39.20	34.80	0.12
Fourth quarter	38.20	34.55	0.12

Holders

The Company had approximately 2,052 holders of record of common stock at March 1, 2006.

Dividends

The principal source of the Company's cash reserves is dividends received from the Bank. In addition, the Company has issued subordinated debt to its wholly owned subsidiary grantor trust. The banking regulators may prohibit banks and holding companies from paying dividends that would constitute an unsafe or unsound banking practice, or which would reduce the amount of its capital below that necessary to minimum applicable regulatory capital requirements. The Company is subject to the requirements of Delaware law, which generally limits dividends to an amount equal to the excess of the net assets of the Company (the amount by which total assets exceed total liabilities) over its statutory capital or, if there is no excess, to its net profits for the current and/or immediately preceding fiscal year.

Securities Authorized for Issuance under Equity Compensation Plans

Information regarding securities authorized for issuance under equity compensation plans appears in Part III, Item 12 of this report.

Recent Sale of Unregistered Securities; Use of Proceeds From Registered Securities

No unregistered securities were sold by the Company within the last three years. Registered securities were exchanged as part of the consideration for the acquisition of Woronoco Bancorp.

Purchases of Equity Securities by the Issuer and Affiliated Purchases

The following table provides information with respect to any purchase made by or on behalf of the Company or any "affiliated purchaser", as defined by Section 240.10b-18(a)(3) of the Securities and Exchange Act of 1934, of shares of the Company's common stock.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Number of Shares Purchased of Total That were Part of Publicly Announced Plans or Programs	Maximum number of Shares That May Yet Be Purchased Under the Plans or Programs
October 1-31, 2005	4,500	$ 31.92	4,500	53,100
November 1-30, 2005	10,000	32.00	10,000	43,100
December 1-31, 2005	--	--	--	--
Total	14,500	$ 31.98	14,500	43,100

On May 25, 2005, the Company authorized the purchase of up to 150,000 shares, from time to time, subject to market conditions. The repurchase plan will continue until it is completed or terminated by the Board of Directors. As of December 31, 2005, 43,100 shares remained available for purchase under the plan. No plans expired during the fourth quarter of 2005. The Company has no plans that it has elected to terminate prior to expiration or under which it does not intend to make further purchases.

Other Events

The annual meeting of shareholders will be held on Thursday, May 4, 2006 at the Crowne Plaza Hotel, One West Street, Pittsfield, Massachusetts.

ITEM 6. SELECTED FINANCIAL DATA

The following summary data is based in part on the consolidated financial statements and accompanying notes, and other schedules appearing elsewhere in this Form 10-K. Historical data is also based in part on, and should be read in conjunction with, prior filings with the SEC.

	At or For the Years Ended December 31,				
(Dollars in thousands, except per share data)	2005	2004	2003	2002	2001
Selected Financial Data:					
Total assets	$ 2,035,553	$ 1,310,115	$ 1,218,548	$ 1,045,947	$ 1,030,701
Securities	420,784	414,363	359,294	226,919	146,779
Loans, net	1,403,448	818,842	783,258	712,714	791,920
Goodwill and intangibles	99,616	7,254	10,233	10,436	10,592
Deposits	1,371,218	845,789	830,244	782,360	742,729
Borrowings	412,917	327,926	251,465	133,702	135,854
Total stockholders' equity	246,066	131,736	123,175	120,569	139,323
Selected Operating Data:					
Total interest and dividend income	$ 87,732	$ 61,081	$ 56,308	$ 64,128	$ 75,796
Total interest expense	36,115	20,724	18,742	23,428	33,560
Net interest income	51,617	40,357	37,566	40,700	42,236
Provision for loan losses	1,313	1,565	1,460	6,180	7,175
Service charge and fee income	9,373	5,493	5,023	4,659	4,289
All other non-interest income	5,550	2,271	1,425	1,768	2,794
Total non-interest expense	48,998	28,977	28,243	37,279	28,927
Provision for income taxes	8,003	5,639	5,161	885	4,334
Net (loss) income from discontinued operations	-	(431)	(185)	(686)	28
Net income	$ 8,226	$ 11,509	$ 8,965	$ 2,097	$ 8,911
Dividends per share	$ 0.52	$ 0.48	$ 0.48	$ 0.48	$ 0.43
Earnings per share					
Basic	$ 1.16	$ 2.18	$ 1.70	$ 0.39	$ 1.42
Diluted	$ 1.10	$ 2.01	$ 1.57	$ 0.36	$ 1.35
Average shares outstanding					
Basic	7,122	5,284	5,266	5,435	6,264
Diluted	7,503	5,731	5,703	5,867	6,604

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(Dollars in thousands, except per share data)	At or For the Years Ended December 31, 2005	2004	2003	2002	2001
Selected Operating Ratios and Other Data:					
Performance Ratios (1):					
Return on average assets	0.47%	0.89%	0.80%	0.20%	0.86%
Return on average equity	4.19	9.06	7.28	1.54	5.74
Interest rate spread	3.00	3.10	3.29	3.70	3.61
Net interest margin	3.33	3.37	3.61	4.18	4.41
Non-interest income/total net revenue	22.43	16.13	14.65	13.64	14.36
Non-interest expense/average assets	2.81	2.25	2.53	3.54	2.80
Dividend payout ratio	45.06	22.02	28.24	123.08	30.28
Capital Ratios:					
Tier 1 capital to average assets - Bank	7.79	8.08	7.87	8.60	9.02
Total capital to risk-weighted assets - Bank	11.12	12.69	12.55	13.48	13.40
Shareholders' equity/total assets	12.09	10.06	10.11	11.53	13.52
Asset Quality Ratios:					
Nonperforming/total loans	0.08	0.14	0.40	0.52	0.34
Nonperforming assets/total assets	0.06	0.09	0.26	0.36	0.26
Net loans charged-off/average total loans	0.08	0.15	0.35	0.87	0.78
Allowance for loan losses/total loans	0.92	1.13	1.13	1.43	1.37
Allowance for loan losses/nonperforming loans	10.96x	8.11x	2.80x	2.76x	4.08x
Share Data:					
Book value per share	$ 28.81	$ 22.43	$ 20.87	$ 19.71	$ 26.91
Tangible book value per share (2)	$ 17.15	$ 21.19	$ 19.13	$ 18.00	$ 24.87
Market price at year end	$ 33.50	$ 37.15	$ 36.20	$ 23.55	$ 20.25

(1) All performance ratios are based on average balance sheet amounts where applicable.
(2) Tangible book value is total shareholders' equity less goodwill and other intangible assets.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

GENERAL

This discussion is intended to assist in understanding the financial condition and results of operations of the Company. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes contained in this report.

CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements. Please see those policies in conjunction with this discussion.

Critical accounting policies are as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. Management believes that our most critical accounting policies, which involve the most complex or subjective decisions or assessments, are as follows:

Allowance for Loan Losses. Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The allowance for loan losses provides for probable losses based upon evaluations of known and inherent risks in the loan portfolio. Management uses historical information, as well as current economic data, to assess the adequacy of the allowance for loan losses as it is affected by changing economic conditions and various external factors, which may impact the portfolio in

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ways currently unforeseen. Although we believe that we use the appropriate information available to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that cause actual results to differ from the assumptions used in making the evaluation. For example, a downturn in the local economy could cause an increase in non-performing loans. Additionally, a decline in real estate values could cause some of our loans to become inadequately collateralized. In either case, this may require us to increase our provisions for loan losses, which would negatively impact earnings. The allowance for loan losses discussion in Item 1 provides additional information about the allowance.

Income Taxes. Management considers accounting for income taxes as a critical accounting policy due to the subjective nature of certain estimates that are involved in the calculation and evaluation of the timing and recognition of resulting tax liabilities and assets. Management uses the asset liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Management must assess the realizability of the deferred tax asset, including the carry forward of a portion of the charitable contribution, and to the extent that management believes that recovery is not likely, a valuation allowance is established. Adjustments to increase or decrease the valuation allowance are generally charged or credited, respectively, to income tax expense.

Goodwill and Identifiable Intangible Assets. In conjunction with the acquisition of Woronoco Bancorp in 2005, goodwill was recorded as an intangible asset equal to the excess of the purchase price over the estimated fair value of the net assets acquired. Other intangible assets were recorded for the fair value of core deposits and non-compete agreements. The valuation techniques used by management to determine the carrying value of assets acquired in the acquisition and the estimated lives of identifiable intangible assets involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates which were used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affects their value or estimated lives could have a material adverse impact on future results of operations.

SUMMARY

The Company completed its acquisition of Woronoco Bancorp on June 1, 2005. The income statement includes the operations of Woronoco Bancorp beginning on that date. Most categories in the income statement and balance sheet increased primarily due to this acquisition. Most major financial statement categories also increased due to the organic growth of Berkshire's business lines, as well as expansion into New York and acquisitions of fee producing businesses in 2004 and 2005. Income in 2005 included a non-cash charge of $8.8 million for the termination of the Employee Stock Ownership Plan (ESOP), which did not reduce stockholders' equity due to offsetting credits to equity. Results in 2005 also included expenses totaling $2.1 million related to merger and conversion expense.

Highlights of the year's performance included:

- Acquired and integrated Woronoco Bancorp, doubling the Massachusetts branch office network, achieved 37% cost savings on acquired operations, and increased related loans and deposits subsequent to the acquisition.
- Achieved double digit organic growth in most key business lines.
- Converted core banking systems to new technology.
- Opened two new branches in New York, opened special purpose Berkshire Municipal Bank in New York, and acquired two insurance agencies in Massachusetts. Three additional new branches in New York were pending at year-end.

- Announced new three year plan to transition to a regional bank, including doubling branch network and major expansion of commercial banking activities.

- Implemented new regional leadership structure in New York Capital Region and Massachusetts Pioneer Valley Region.

- Achieved 0.96% annualized return on assets in fourth quarter, the first full quarter after Woronoco integration.

- Credit quality remained strong.

COMPARISON OF FINANCIAL CONDITION AT YEAR-END DECEMBER 31, 2005 AND 2004

Total Assets. Total assets were $2.04 billion at year-end 2005 compared to $1.31 billion at year-end 2004. The Company acquired $849 million in assets and $702 million in liabilities in connection with the Woronoco acquisition, and most categories of assets and liabilities increased primarily due to this event. The balance sheet impact of the acquisition was partially offset by a $243 million deleveraging plan through which borrowings were paid down with proceeds from sales of securities and residential mortgage loans.

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Loans. Loans totaled $1.42 billion at December 31, 2005, increasing by $588 million (71%) from $828 million at year-end 2004. Loan growth included $526 million related to the Woronoco acquisition. Loans added through this acquisition were primarily concentrated in residential mortgages and home equity line borrowings. Excluding the impact of the loans acquired through the Woronoco acquisition and $4 million in loan sales, total loans increased by $66 million (8%) for the year. Growth was spread among all major loan categories and in all major markets. Organic commercial loan growth totaled $36 million (9%) for 2005, and organic consumer loan growth totaled $24 million (13%) for the year. Loan originations have benefited from the Bank's expansion into New York State. Loan originations also benefited from a strong local real estate market, which was supported by a generally favorable interest rate environment.

Asset Quality. Asset quality indicators remained favorable throughout the year. The loans added through the Woronoco acquisition were primarily concentrated in comparatively low risk residential mortgage and home equity loans. At year-end, the ratio of nonperforming loans to total loans decreased to 0.08% in 2005, compared to 0.14% in 2004. There was no foreclosed real estate at either year-end. Total impaired loans increased to $1.91 million from $1.18 million during 2005. The ratio of net loan charge-offs decreased to 0.08% of average total loans in 2005, compared to 0.15% in 2004. While the Company believes that the long run credit losses implicit in the portfolio are higher than the current level of charge-offs, management did not feel at year-end that there were any evident signals of near term changes in the levels of charge-offs and problem loans.

The allowance for loan losses declined to 0.92% of total loans at year-end 2005, compared to 1.13% at the prior year-end. This was primarily due to the addition of low risk residential mortgage and home equity loans from Woronoco. The total loan loss allowance increased by $3.7 million to $13.0 million at year-end 2005, primarily due to a $3.3 million allowance for loan losses acquired from Woronoco. The specific allowance for impaired loans increased only slightly to $257,000 from $230,000 during this period. This reserve decreased to 13% of total impaired loans from 20% during the year, indicating better average collateral coverage of impaired loans. The ratio of the allowance to nonperforming loans improved to 10.96x at year-end 2005, compared to 8.11x at year-end 2004.

Investment Securities. Investment securities totaled $421 million at year-end 2005, increasing by $7 million (2%) compared to $414 million at year-end 2004. This increase was due to securities acquired through the Woronoco acquisition, net of sales and maturities under the deleveraging plan, along with the sale of securities by the Bank, including $46 million sold in the second quarter to provide funds for the acquisition. Securities acquired from Woronoco totaled $182 million. The end result of the year’s changes in 2005 was an increase in municipal bonds and obligations (including industrial revenue bonds) and a decrease in mortgage-backed securities. The Bank had increased its mortgage-backed securities portfolio in 2004 to leverage the Bank's capital and to take advantage of a steep yield curve. Due to the leverage of the Woronoco acquisition and the flattening of the yield curve in 2005, the Bank decreased this portfolio. The increase in the municipal securities portfolio was due to the acquisition of Woronoco, which had a higher concentration in these tax advantaged securities. Additionally, equity securities increased due to the additional FHLBB stock added through the Woronoco acquisition. FHLBB stock totaled $36.7 million at year-end 2005.

The total net unrealized loss on investment securities was $3.8 million at year-end 2005, compared to a gain of $6.5 million at the prior year-end. This $10.3 million decline was primarily due to gains realized on the sale of equity securities and to lower market prices for mortgage-backed securities. The Company realized total gross securities gains of $6.1 million in 2005, and the unrealized gains on equity securities decreased by $5.6 million. The net unrealized loss on mortgage-backed securities increased by $4.8 million in 2005 due to lower prices resulting from higher interest rates at year-end. The net unrealized loss on these securities was 2.3% of their unamortized cost at year-end 2005. Management determined that there were no losses which were other than temporary at year-end 2005.

Deposits and Borrowings. Deposits totaled $1.37 billion at year-end 2005, increasing by $525 million (62%) from year-end 2004. Deposit growth included $443 million related to the Woronoco acquisition. Excluding the impact of this acquisition, organic deposit growth measured $82 million (10%) for the year 2005. Included in this growth was $32 million in New York deposits related to the Bank's expansion in that region. Additionally, the Bank recorded a $42 million (9%) increase in Pioneer Valley deposits since the Woronoco acquisition, including growth of $7 million (2%) in core account balances. The Bank has promoted lower cost transaction accounts as a significant component of its strategic growth. Excluding the impact of acquired balances, total transaction deposits increased by $27 million (13%) during the year.

Borrowings totaled $413 million at year-end 2005, increasing by $85 million (26%) from $328 million at year-end 2004. This increase included $243 million in borrowings acquired with Woronoco, partially offset by the deleveraging program, under which the proceeds of loan and securities sales were used to repay borrowings. Additionally, proceeds from deposit growth were used to replace maturing borrowings during the year. Borrowings included $15.5 million of junior subordinated debentures issued

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by the Company in June 2005 in conjunction with a trust preferred security offering used to supplement the Bank's regulatory capital.

Equity. Stockholders' equity totaled $246 million at year-end 2005, increasing by $114 million, or 87%, from year-end 2004. Consideration for the Woronoco acquisition included the issuance of 2.93 million new common shares valued at $108 million, with an additional $4 million credit to equity for the value of outstanding Woronoco stock options. The ESOP termination had no negative impact on stockholders' equity because the related charge to earnings was offset by credits to unearned compensation and additional paid in capital. These credits also offset the $5 million impact of the prepayment of the ESOP loan, which resulted in the transfer of 146,971 shares to treasury stock. The contribution of earnings was mostly offset by dividends, additional treasury stock purchases of $8.0 million, and a $6.5 million net decrease in accumulated other comprehensive income due to gains recorded on securities sales and lower debt securities prices due to higher interest rates. The Company announced an increase in the quarterly cash dividend to $0.14 per share in August, representing a 17% increase from $0.12 per share in prior quarters.

Goodwill increased to $88.1 million and identifiable intangible assets increased to $11.5 million at year-end 2005 due mainly to the Woronoco acquisition. As a result, year-end tangible book value per share was $17.15, compared to $21.19 at year-end 2004. The ratio of stockholders' equity to total assets measured 12.1% at year-end 2005, compared to 10.1% at the prior year-end, due to the issuance of new common shares and the deleveraging program executed in conjunction with the Woronoco acquisition. The ratio of tangible equity to tangible assets measured 7.6% at year-end 2005, a decrease from 9.6% at year-end 2004, reflecting the impact of the higher goodwill and intangible assets resulting from the acquisition. At year-end 2005, the Bank met all regulatory capital requirements and the Bank continued to satisfy the conditions necessary to be classified as "Well Capitalized" in accordance with federal regulatory standards. The Bank paid $43 million in cash dividends to the Company during 2005 relating to the acquisition of Woronoco Bancorp. Substantially all of the net assets acquired were contributed to the Bank by the Company as additional paid in capital. Because the Bank's dividends exceeded retained earnings from recent operations in accordance with certain regulatory measurements, the Bank's dividends to the Company in 2005 required specific regulatory approval. Any such dividends in the immediate future would also require specific regulatory approval. At year-end 2005, the Bank had received regulatory approval to dividend $10 million to the Company in 2006. Such payment is subject to various conditions, including that the Bank maintain its "well capitalized" classification after factoring in the payment.

Derivative Instruments. Woronoco used on-balance sheet derivative instruments primarily for asset/liability management. The Company assumed these instruments through the Woronoco acquisition, including a $5 million interest rate swap agreement to hedge variable rate home equity line borrowings and $20 million in outstanding interest rate swaps used to hedge brokered certificates of deposit. These instruments are described more fully in the notes to consolidated financial statements.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

Net Income. Net income for 2005 was $8.2 million, compared to $11.5 million in 2004. Results in 2005 included a non-cash charge of $8.8 million for the termination of the Employee Stock Ownership Plan (ESOP). This charge had no negative impact on stockholders' equity due to offsetting credits to unearned compensation and additional paid in capital. Diluted earnings per share totaled $1.10 in 2005, compared to $2.01 in 2004.

The fourth quarter was the first full quarter after the integration of the acquired Woronoco operations. Fourth quarter net income totaled $4.8 million in 2005, compared to $3.2 million in 2004. Fourth quarter diluted earnings per share totaled $0.55 in both years, due to the impact of additional shares issued in conjunction with the Woronoco acquisition. The fourth quarter return on assets measured 0.96% in 2005, compared to 0.97% in 2004. The fourth quarter return on equity measured 7.9% compared to 9.7%, reflecting the additional equity recorded for the issuance of shares for the acquisition.

Net Interest Income. Net interest income increased by $11.3 million, (28%) due to the balance sheet growth. The net interest margin (fully taxable equivalent) decreased to 3.33% from 3.37%, including the impact of the Woronoco acquisition and deleveraging. The primary impact of market conditions was the flattening of the interest rate yield curve, which narrowed the marginal earnings spread on many asset/liability combinations. The flattening of the yield curve was due to a steady increase in short term rates during the year, with a much smaller increase in long term rates. The increase in short term rates benefited the Bank's interest sensitive assets, but also produced significant competition for deposits, which had fallen to very low rates in recent years. The net impact of these market conditions was unfavorable, and management sought to mitigate this by promoting transaction deposit accounts and relationship deposit offerings, and also by continuing to focus on commercial loan growth. The decline in the net interest margin also included a 0.02% annualized impact from the purchase of bank owned life insurance in the fourth quarter of 2004.

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Due to rising interest rates, both asset yields and liability costs increased during 2005. In recent years, the Bank has generally positioned itself to be slightly asset sensitive in order to obtain the benefit of anticipated rising interest rates. In the case of a sudden interest rate shock, the Bank was modestly liability sensitive at the end of 2005. This change in sensitivity primarily reflected the effect of higher optionality in the Woronoco balance sheet under the higher interest rate conditions prevailing at the end of 2005. The Bank believed that its year-end 2005 interest rate risk was generally neutral to the impact of gradual parallel shifts in interest rates based on its interest sensitivity model. However, changes in the yield curve and in other market conditions could continue to be unfavorable based on the year-end conditions and outlook, and the Bank continued to pursue strategies aimed at mitigating this impact.

Provision for Loan Losses. The provision for loan losses was $1.3 million in 2005, compared to $1.6 million in 2004. The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company. The level of the allowance is a critical accounting estimate, which is subject to uncertainty. The level of the allowance at December 31, 2005 was discussed in the previous section on Asset Quality in the discussion of financial condition at year-end 2005. Net loan charge-offs were at a five year low in 2005, and the ratio of net charge-offs to average loans declined to a relatively low 0.08% in 2005. The provision for loan losses was also the lowest amount in the five year history, and the provision has generally trended down as charge-offs have declined. The provision measured 135% of net charge-offs in 2005, compared to 131% in the prior year.

Non-Interest Income. Non-interest income increased by $7.2 million (92%) in 2005 compared to 2004. This increase was primarily due to the addition of the Woronoco contribution beginning on June 1, together with higher securities gains and organic revenue growth.

Service fee income totaled $9.4 million for the year, and measured 0.54% of average assets, compared to 0.43% of average assets in the previous year. About half of the improvement in this ratio was due to growth in insurance commissions and loan servicing fees, and this growth was directly tied to the Woronoco acquisition. Woronoco operated a property and casualty insurance subsidiary which has been renamed the Berkshire Insurance Group. Additionally, Woronoco had a larger residential mortgage loan servicing portfolio. The other half of the improvement in this ratio was primarily due to growth in overdraft fees, as 2005 was the first full year of operations of the Bank's courtesy overdraft protection program. Many other categories of fee income also increased in line with the organic growth of loans and deposits during the year. Additionally, total wealth management fees increased by 3% to $2.7 million, and the total amount of assets under management increased by 17% to $418 million at year-end 2005, compared to $358 million at the prior year-end.

Net realized securities gains totaled $3.5 million in 2005, compared to $1.4 million in 2004. These gains were related to the sale of equity securities, reducing equity price risk in the investment portfolio. Non-interest income also benefited from gains on the sale of loans and securitized loans, which totaled $773,000 in 2005. These gains followed steps taken by the Company in 2003 and 2004 to improve liquidity by securitizing residential mortgages. Other non-interest income included $893,000 in revenues recorded on life insurance policies, compared to $638,000 in the prior year, reflecting the purchase of additional bank owned life insurance policies in the fourth quarter of 2004.

Non-Interest Expense. Non-interest expense increased by $20.0 million (69%) in 2005. The increase included the $8.8 million non-cash charge related to the ESOP termination, together with merger and conversion charges totaling $2.1 million. Excluding these charges, the increase was $9.0 million (31%), primarily reflecting the impact of the acquired Woronoco operations on all expense categories. The merger and system conversion charges included indirect costs of the Woronoco acquisition, together with costs of converting the Company's core banking systems and of converting the acquired Woronoco systems and integrating the Woronoco operations. Also included in these charges were interim staffing and systems costs of Woronoco operations in the third quarter through the conversion in August.

The ratio of non-interest expense to average assets was 2.81% in 2005, compared to 2.25% in 2004. Excluding the ESOP termination and merger and conversion expenses, this ratio decreased to 2.18% in 2005, illustrating the efficiencies resulting from the merger. The Company estimated that total cost savings and integration efficiencies related to the Woronoco acquisition equated to about 37% of Woronoco's first quarter non-interest expense, excluding merger-related charges. These cost savings exceeded the Company's original 30% objective for cost savings.

Expenses in 2005 included $573,000 in operating costs of new branches and expanded commercial lending. Additionally, amortization of intangible assets increased to $1.1 million in 2005 due to the amortization of the core deposit intangible and non-competition agreement intangible assets recorded as part of the Woronoco acquisition.

Income Tax Expense and Discontinued Operations. The effective income tax rate measured 33% in 2005, excluding the ESOP termination charge and a related $288,000 benefit, compared to 32% in 2004. The Bank benefits from securities purchased in the Bank's subsidiary securities corporations, which are taxed at a lower state income tax rate. Additionally, the effective income tax rate benefits from tax preferences on income from municipal securities, equity securities qualifying for the dividends received deduction, and bank owned life insurance contracts. Results in 2004 also included net losses of $431,000 in the first six months, representing the after-tax loss on discontinued operations of EastPoint Technologies, LLC, which was sold in June 2004.

Comprehensive Income. Comprehensive income includes changes in accumulated other comprehensive income, which consist of changes (after-tax) in the unrealized market gains and losses of investment securities available for sale and net gain/(loss) on derivative instruments. The Company recorded $1.8 million in total comprehensive income in 2005 compared to $10.2 million in 2004. This reflected the lower net income recorded, along with a $6.5 million other net comprehensive loss in 2005 related primarily to changes in securities values, which is discussed further in the Securities note of the consolidated financial statements.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

Net Income. Net income for the year 2004 was a record $11.5 million, compared to $9.0 million for 2003. Net income from continuing operations totaled $11.9 million for the year 2004, compared to $9.2 million for 2003, excluding the loss from discontinued operations of EastPoint Technologies, LLC, which was sold in June 2004. Earnings from continuing operations were a record $2.08 per diluted share for the year 2004, an increase of 30% over prior year results. Net income after the loss from discontinued operations was $2.01 per diluted share, an increase of 28% over prior year results. The Company's performance in 2004 benefited from a $2.8 million increase in net interest income, resulting from growth in loans and investments. Total service fee income increased by 9% in 2004, while non-interest expense growth was limited to 3%. The return on average stockholders' equity increased to 9.06% in 2004, compared to 7.28% in 2003. The return on average assets increased to 0.89% from 0.80% for the same periods.

Net Interest Income. Net interest income increased by $2.8 million, or 7%, to $40.4 million in 2004, compared to $37.6 million in 2003. Average earning assets increased by $171 million, or 16% in 2004. This growth in earning assets more than offset the impact of a decrease in the net interest margin to 3.37% in 2004 from 3.61% in the prior year. Interest rates had declined to relative lows in 2003 and 2004, prompting higher prepayment speeds for loans and mortgage backed securities. These proceeds were reinvested at lower yields, reflecting lower market rates and management's strategy to shorten the duration of these assets. The Company used borrowings to fund earning asset growth, lowering the cost of new funds compared to higher costing time certificates of deposit.

Average earning asset growth was concentrated in average investment securities, which increased by $180 million in 2004, reflecting securities purchased during 2003 and 2004, as well as the securitization of $56 million in residential mortgages during that period. The yield on investment securities improved to 4.28% in 2004 from 3.66% in 2003. The yield on loans decreased to 5.51% from 5.96%. The benefit of prime rate increases in 2004 was more than offset by the impact of prepayments and the mortgage securitization. Due to the declining loan yield and the shift in mix towards lower yielding investment securities, the yield on earning assets decreased to 5.07% from 5.39%.

Average interest bearing liabilities increased by $162 million, or 18%, in 2004. Growth in average interest bearing deposits totaled $24 million, or 3%, and was concentrated in money market accounts, the average balance of which increased by $28 million, or 21%. In the generally low rate environment, and with short-term rates increasing for the first time in several years, deposit demand favored money market accounts compared to time certificates of deposit, the average balance of which decreased by $9 million during the year. NOW and savings account rates also decreased in the low rate environment. These changes led to a decrease in the cost of interest bearing deposits to 1.66% in 2004, compared to 1.92% in the prior year. Average borrowings increased by $138 million, or 82%, in 2004 as the Bank borrowed in a range of targeted maturities from one month to four years to fund asset growth. The cost of borrowings decreased to 2.73% from 2.91%. These decreases in deposit and borrowing costs both contributed to the decline in the cost of interest bearing liabilities to 1.97% from 2.10%.

The reduction in funding costs helped to mitigate the impact of declining asset yields. Additionally, the decrease in the net interest margin reflected the higher leveraging strategy in 2004. Also contributing to this change was a $10 million investment in a bank owned life insurance (“BOLI”) contract, shifting earnings on this amount from interest income to non-interest income. The Bank benefited from a $12 million, or 13%, increase in average non-interest bearing demand deposit accounts. The Bank’s relationship oriented promotional strategies has resulted in the growth of these attractive balances.

Provision for Loan Losses. The provision for loan losses was $1.57 million in 2004, an increase of $105,000, or 7%, from 2003. The provision measured 131% of net loan charge-offs in 2004. This measurement was 52% in 2003 due primarily to the reversal of about $1.0 million of previously provided loan loss provision subsequent to the sale of the remaining sub-prime automobile loan portfolio in December 2003.

Non-Interest Income. Non-interest income increased by $1.32 million, or 20%, to $7.76 million in 2004 from $6.45 million in 2003. Wealth management service fees increased by $395,000, or 17%, due to the Company's focus on building this source of revenues. Total assets under management increased by 19% to $358 million at year-end 2004, compared to $302 million at the prior year-end. Net gains and losses on sales of loans and securities totaled $1.57 million in 2004 compared to $1.22 million in 2003. Securities gains in 2004 were primarily related to sales of equity securities, as the Company continued to reduce its exposure to potential equity price risk. The Company also reported an $81,000 gain on the sale of $11 million in securitized mortgages in the fourth quarter. In 2003, the Company recorded higher securities gains, along with $1.85 million in loan sale losses related to the sale of sub-prime automobile loans. All other non-interest income increased by $501,000, or 248%, to $703,000 in 2004 primarily due to higher income earned on cash surrender value related to the purchase of additional bank owned life insurance in October 2004.

Non-Interest Expense. Total non-interest expense increased by $734,000, or 3%, to $29.0 million in 2004, compared to $28.2 million in 2003. Excluding foreclosed asset expense and all other non-interest expense, the other categories of expense all increased, with the increase totaling $1.85 million, or 8%, in 2004 compared to 2003. This growth primarily related to overall growth in the business activities of the Company. Full-time equivalent employees of the Bank totaled 241 at year-end 2004, decreasing by 2% from 247 at year-end 2003. Salary and benefit expenses increased by $716,000, or 4%, due to higher benefits, commissions, and stock awards expense. The net expense of foreclosed real estate and repossessed assets decreased by $525,000, or 50%, due to the sale of sub-prime automobile loans in December 2003. The $587,000 reduction in all other non-interest expense included the benefit of a $243,000 reduction in FDIC insurance expense, a $211,000 refund of Delaware franchise tax, and a $131,000 reduction in meetings and travel expense.

Income Tax Expense. Total income tax expense increased by $353,000, or 7%, in 2004 compared to 2003. The effective tax rate declined to 32.0% in 2004 compared to 35.7% in 2003. The higher rate in 2003 was largely due to the disallowance by Massachusetts of the dividends received deduction from the Bank's REIT. The Bank benefits from securities purchased in the Bank's subsidiary securities corporations, which are taxed at a lower state income tax rate. Additionally, the effective income tax rate benefits from tax preferences on income from additional purchases of municipal securities and bank owned life insurance contracts in 2004.

Net Loss from Discontinued Operations. The Company sold its interest in the assets of EastPoint Technologies, LLC in June 2004. All revenues and expenses related to EastPoint were reclassified as related to discontinued operations. A $75,000 loss recorded on the sale was included with the loss from operations reported in 2004. The net loss from discontinued operations, after applicable income tax expense, was $431,000 in 2004, compared to $185,000 in 2003. Results in 2003 included project related revenues of $2.82 million, which declined to $623,000 for the nearly six months that EastPoint was operating in 2004.

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Average Balances, Interest and Average Yields/Cost

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

	2005			2004			2003		
(Dollars in millions)	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate
Interest-earning assets:									
Loans (1)	$ 1,182.3	$ 70.1	5.93%	$ 795.5	$ 43.8	5.51%	$ 800.1	$ 47.7	5.96%
Investment securities (2)	413.0	19.2	4.64	424.0	18.1	4.28	244.0	8.9	3.66
Short-term investments	2.8	0.1	3.30	3.0	0.1	1.28	7.7	0.1	1.41
Total interest-earning assets	1,598.1	89.4	5.59	1,222.5	62.0	5.07	1,051.8	56.7	5.39
Intangible assets	62.0			8.7			10.3		
Other non-interest earning assets	85.1			58.3			53.7		
Total assets	$ 1,745.2			$ 1,289.5			$ 1,115.8		
Interest-bearing liabilities:									
Deposits:									
NOW accounts	121.7	0.5	0.39%	97.9	0.1	0.09%	90.2	0.2	0.17%
Money market accounts	209.0	4.4	2.13	160.3	2.1	1.29	132.5	1.7	1.24
Savings accounts	205.8	1.8	0.90	168.5	1.3	0.77	170.7	1.7	1.01
Certificates of deposit	445.2	14.3	3.20	321.0	8.9	2.78	330.1	10.3	3.13
Total interest-bearing deposits	981.7	21.0	2.14	747.7	12.4	1.66	723.5	13.9	1.92
Borrowings	410.8	15.1	3.67	305.6	8.3	2.73	167.7	4.8	2.91
Total interest-bearing liabilities	1,392.5	36.1	2.59	1,053.3	20.7	1.97	891.2	18.7	2.10
Non-interest-bearing demand deposits	149.6			103.7			91.7		
Other non-interest-bearing liabilities	6.6			5.4			9.8		
Total liabilities	1,548.7			1,162.4			992.7		

Equity	196.5		127.1		123.1	
Total liabilities and equity	$ 1,745.2		$ 1,289.5		$ 1,115.8	
Net interest-earning assets	$ 205.6		$ 169.2		$ 160.6	
Net interest income		$ 53.3		$ 41.3		$ 38.0
Interest rate spread		3.00%		3.10%		3.29%
Net interest margin		3.33%		3.37%		3.61%
Interest-earning assets/ interest-bearing liabilities		114.76%		116.06%		118.01%
Fully taxable equivalent adjustment		$ 1.6		$ 0.9		$ 0.4

(1) The average balances of loans includes nonaccrual loans, loans held for sale, and deferred fees and costs.
(2) The average balance of investment securities is based on ammortized cost.

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RATE/VOLUME ANALYSIS

The following table presents the effects of changing rates and volumes on the fully taxable equivalent net interest income. Changes attributable to changes in both rate and volume have been allocated proportionately based on the absolute value of the change due to rate and the change due to volume.

	2005 Compared with 2004 Increase (Decrease) Due to			2004 Compared with 2003 Increase (Decrease) Due to		
(In thousands)	Rate	Volume	Net	Rate	Volume	Net
Interest income:						
Loans	$ 3,555	$ 22,782	$ 26,337	$ (3,644)	$ (273)	$ (3,917)
Investment securities	1,474	(477)	997	1,696	7,534	9,230
Short-term investments	76	(3)	73	(9)	(61)	(70)
Total interest income	5,105	22,302	27,407	(1,957)	7,200	5,243
Interest expense:						
NOW accounts	1,624	759	2,383	(82)	15	(67)
Money market accounts	355	26	381	65	357	422
Savings accounts	259	315	574	(413)	(22)	(435)
Certificates of deposit	1,483	3,834	5,317	(1,113)	(276)	(1,389)
Total deposits	3,721	4,934	8,655	(1,543)	74	(1,469)
Borrowings	3,375	3,361	6,736	(281)	3,732	3,451
Total interest expense	7,096	8,295	15,391	(1,824)	3,806	1,982
Change in net interest income	$ (1,991)	$ 14,007	$ 12,016	$ (133)	$ 3,394	$ 3,261

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is the ability to meet cash needs at all times with available cash or by conversion of other assets to cash at a reasonable price. The primary source of funding for the Company is dividend payments from the Bank. Additional sources of liquidity are proceeds from borrowings and capital offerings. The main uses of liquidity are the payment of stockholder dividends, purchases of treasury stock, and debt service on outstanding debentures. There are certain restrictions on the payment of dividends as discussed in the Stockholders' Equity note to the consolidated financial statements.

The Bank's primary source of liquidity is customer deposits. Additional sources are borrowings, repayments of loans and investment securities, and the sale and repayments of investment securities. The Bank closely monitors its liquidity position on a daily basis. Sources of borrowings include advances from the FHLBB and a repurchase agreement line of credit with a nationally recognized broker-dealer. The greatest sources of uncertainty affecting liquidity are deposit withdrawals and usage of loan commitments, which are influenced by interest rates, economic conditions, and competition. The Bank relies on competitive rates, customer service, and long-standing relationships with customers to manage deposit and loan liquidity. Based on its historical experience, management believes that it has adequately provided for deposit and loan liquidity needs.