

BROOKLINE BANCORP INC  
Form 10-Q  
July 31, 2008  
Table of Contents

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

## FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

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

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

Commission file number 0-23695

**Brookline Bancorp, Inc.**

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(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**04-3402944**

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

**160 Washington Street, Brookline, MA**

(Address of principal executive offices)

**02447-0469**

(Zip Code)

**(617) 730-3500**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

As of July 30, 2008, the number of shares of common stock, par value \$0.01 per share outstanding was 58,369,261.

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Table of Contents

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**

**FORM 10-Q**

**Index**

|   | <b>Page</b> |
|---|-------------|
| <b><u>Part I</u></b>  |             |
| <b><u>Financial Information</u></b>   |             |
| <b><u>Item 1.</u></b>   |             |
| <b><u>Financial Statements</u></b>  |             |
| <u>Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007</u>  | 1           |
| <u>Consolidated Statements of Income for the three months and six months ended June 30, 2008 and 2007</u>               | 2           |
| <u>Consolidated Statements of Comprehensive Income for the three months and six months ended June 30, 2008 and 2007</u> | 3           |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the six months ended June 30, 2008 and 2007</u>       | 4           |
| <u>Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2007</u>                            | 6           |
| <u>Notes to Unaudited Consolidated Financial Statements</u>   | 8           |
| <b><u>Item 2.</u></b>   |             |
| <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>                     | 15          |
| <b><u>Item 3.</u></b>   |             |
| <b><u>Quantitative and Qualitative Disclosures about Market Risks</u></b>   | 25          |
| <b><u>Item 4.</u></b>   |             |
| <b><u>Controls and Procedures</u></b>   | 25          |
| <b><u>Part II</u></b>   |             |
| <b><u>Other Information</u></b>   |             |
| <b><u>Item 1.</u></b>   |             |
| <b><u>Legal Proceedings</u></b>   | 25          |
| <b><u>Item 1A.</u></b>  |             |
| <b><u>Risk Factors</u></b>  | 25          |
| <b><u>Item 2.</u></b>   |             |
| <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>   | 25          |
| <b><u>Item 3.</u></b>   |             |
| <b><u>Defaults Upon Senior Securities</u></b>   | 26          |
| <b><u>Item 4.</u></b>   |             |
| <b><u>Submission of Matters to a Vote of Security Holders</u></b>   | 26          |
| <b><u>Item 5.</u></b>   |             |
| <b><u>Other Information</u></b>   | 26          |
| <b><u>Item 6.</u></b>   |             |
| <b><u>Exhibits</u></b>  | 26          |
| <u>Signatures</u>   | 27          |

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Table of Contents**Part I - Financial Information****Item 1. Financial Statements****BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(In thousands except share data)**

|   | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---|--------------------------|------------------------------|
|   | <b>(unaudited)</b>       |                              |
| <b><u>ASSETS</u></b>  |                          |                              |
| Cash and due from banks   | \$ 17,139                | \$ 17,699                    |
| Short-term investments  | 86,737                   | 135,925                      |
| Securities available for sale   | 316,052                  | 284,051                      |
| Securities held to maturity (market value of \$175 and \$199, respectively)   | 166                      | 189                          |
| Restricted equity securities  | 32,638                   | 28,143                       |
| Loans   | 1,983,313                | 1,890,896                    |
| Allowance for loan losses   | (25,722)                 | (24,445)                     |
| Net loans   | 1,957,591                | 1,866,451                    |
| Accrued interest receivable   | 8,899                    | 9,623                        |
| Bank premises and equipment, net  | 9,489                    | 9,045                        |
| Deferred tax asset  | 12,247                   | 10,849                       |
| Prepaid income taxes  | 462                      | 2,105                        |
| Goodwill  | 43,241                   | 42,545                       |
| Identified intangible assets, net of accumulated amortization of \$7,494 and \$6,618, respectively                          | 5,458                    | 6,334                        |
| Other assets  | 4,497                    | 5,551                        |
| Total assets  | \$ 2,494,616             | \$ 2,418,510                 |
| <b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>  |                          |                              |
| Retail deposits   | \$ 1,282,114             | \$ 1,250,337                 |
| Brokered deposits   | 27,047                   | 67,904                       |
| Borrowed funds  | 652,798                  | 548,015                      |
| Subordinated debt   |                          | 7,008                        |
| Mortgagors' escrow accounts   | 5,478                    | 5,051                        |
| Accrued expenses and other liabilities  | 20,122                   | 20,116                       |
| Total liabilities   | 1,987,559                | 1,898,431                    |
| Minority interest in subsidiary   | 1,212                    | 1,371                        |
| Stockholders' equity:   |                          |                              |
| Preferred stock, \$0.01 par value; 50,000,000 shares authorized; none issued  |                          |                              |
| Common stock, \$0.01 par value; 200,000,000 shares authorized; 63,742,994 shares and 63,323,703 shares issued, respectively | 637                      | 633                          |
| Additional paid-in capital  | 517,268                  | 513,949                      |
| Retained earnings, partially restricted   | 53,433                   | 68,875                       |
| Accumulated other comprehensive (loss) income   | (393)                    | 121                          |
| Treasury stock, at cost - 5,373,733 shares and 5,333,633 shares, respectively   | (62,107)                 | (61,735)                     |

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|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Unallocated common stock held by ESOP 548,868 shares and 574,974 shares, respectively |    | (2,993)   |    | (3,135)   |
| Total stockholders' equity  |    | 505,845   |    | 518,708   |
| Total liabilities and stockholders' equity  | \$ | 2,494,616 | \$ | 2,418,510 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Consolidated Statements of Income****(In thousands except share data)**

|   | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2008                           | 2007      | 2008                         | 2007      |
|   | (unaudited)                    |           |                              |           |
| <b>Interest income:</b>                               |                                |           |                              |           |
| Loans   | \$ 30,852                      | \$ 30,329 | \$ 61,806                    | \$ 59,922 |
| Debt securities                                       | 3,740                          | 3,560     | 7,156                        | 7,340     |
| Marketable equity securities                          | 55                             | 7         | 123                          | 35        |
| Restricted equity securities                          | 326                            | 403       | 733                          | 884       |
| Short-term investments                                | 405                            | 1,798     | 1,411                        | 3,483     |
| Total interest income                                 | 35,378                         | 36,097    | 71,229                       | 71,664    |
| <b>Interest expense:</b>                              |                                |           |                              |           |
| Retail deposits                                       | 10,163                         | 11,138    | 21,676                       | 21,856    |
| Brokered deposits                                     | 569                            | 1,046     | 1,480                        | 2,073     |
| Borrowed funds  | 6,600                          | 5,704     | 12,803                       | 11,160    |
| Subordinated debt                                     |                                | 158       | 65                           | 391       |
| Total interest expense                                | 17,332                         | 18,046    | 36,024                       | 35,480    |
| Net interest income                                   | 18,046                         | 18,051    | 35,205                       | 36,184    |
| Provision for credit losses                           | 2,579                          | 1,107     | 4,693                        | 2,357     |
| Net interest income after provision for credit losses | 15,467                         | 16,944    | 30,512                       | 33,827    |
| <b>Non-interest income:</b>                           |                                |           |                              |           |
| Fees and charges                                      | 1,107                          | 1,272     | 2,086                        | 2,291     |
| Loss on write-down of securities                      |                                |           | (1,249)                      |           |
| Other income  | 16                             | 9         | 31                           | 40        |
| Total non-interest income                             | 1,123                          | 1,281     | 868                          | 2,331     |
| <b>Non-interest expense:</b>                          |                                |           |                              |           |
| Compensation and employee benefits                    | 5,210                          | 5,246     | 10,558                       | 10,485    |
| Occupancy   | 905                            | 836       | 1,839                        | 1,691     |
| Equipment and data processing                         | 1,676                          | 1,653     | 3,373                        | 3,172     |
| Professional services                                 | 519                            | 536       | 1,005                        | 1,015     |
| Advertising and marketing                             | 203                            | 279       | 337                          | 406       |
| Amortization of identified intangible assets          | 438                            | 504       | 876                          | 1,007     |
| Other   | 1,484                          | 1,172     | 2,750                        | 2,280     |
| Total non-interest expense                            | 10,435                         | 10,226    | 20,738                       | 20,056    |
| Income before income taxes and minority interest      | 6,155                          | 7,999     | 10,642                       | 16,102    |
| Provision for income taxes                            | 2,417                          | 3,103     | 4,164                        | 6,221     |
| Net income before minority interest                   | 3,738                          | 4,896     | 6,478                        | 9,881     |
| Minority interest in earnings of subsidiary           | 64                             | 44        | 109                          | 88        |
| Net income  | \$ 3,674                       | \$ 4,852  | \$ 6,369                     | \$ 9,793  |
| <b>Earnings per common share:</b>                     |                                |           |                              |           |
| Basic   | \$ 0.06                        | \$ 0.08   | \$ 0.11                      | \$ 0.16   |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Diluted   | 0.06       | 0.08       | 0.11       | 0.16       |
| Weighted average common shares outstanding during the period: |            |            |            |            |
| Basic   | 57,571,596 | 59,749,897 | 57,530,047 | 60,139,899 |
| Diluted   | 57,821,388 | 60,346,901 | 57,792,627 | 60,762,771 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Consolidated Statements of Comprehensive Income****(In thousands)**

|  | Three months ended<br>June 30, |                     | Six months ended<br>June 30, |          |
|--|--------------------------------|---------------------|------------------------------|----------|
|  | 2008                           | 2007<br>(unaudited) | 2008                         | 2007     |
| Net income   | \$ 3,674                       | \$ 4,852            | \$ 6,369                     | \$ 9,793 |
| Other comprehensive losses, net of taxes:                            |                                |                     |                              |          |
| Unrealized securities holding losses                                 | (3,772)                        | (1,229)             | (2,148)                      | (534)    |
| Income tax benefit   | 1,409                          | 449                 | 837                          | 193      |
| Net unrealized securities holding losses                             | (2,363)                        | (780)               | (1,311)                      | (341)    |
| Adjustment of accumulated obligation for postretirement benefits     | (7)                            | (7)                 | (7)                          | (7)      |
| Income tax benefit   | 3                              | 3                   | 3                            | 3        |
| Net adjustment of accumulated obligation for postretirement benefits | (4)                            | (4)                 | (4)                          | (4)      |
| Net unrealized holding losses  | (2,367)                        | (784)               | (1,315)                      | (345)    |
| Less reclassification adjustment for gains included in net income:   |                                |                     |                              |          |
| Loss on write-down of securities                                     |                                |                     | (1,249)                      |          |
| Income tax benefit   |                                |                     | 448                          |          |
| Net reclassification adjustment                                      |                                |                     | (801)                        |          |
| Net other comprehensive losses                                       | (2,367)                        | (784)               | (514)                        | (345)    |
| Comprehensive income   | \$ 1,307                       | \$ 4,068            | \$ 5,855                     | \$ 9,448 |

See accompanying notes to the unaudited consolidated financial statements.



Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Consolidated Statements of Changes in Stockholders Equity****Six Months Ended June 30, 2008 and 2007 (Unaudited)****(Dollars in thousands)**

|   | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>loss | Treasury<br>stock | Unallocated<br>common stock<br>held by<br>ESOP | Total<br>stockholders<br>equity |
|---|-----------------|----------------------------------|----------------------|---|-------------------|--|---------------------------------|
| Balance at December 31,<br>2006   | \$ 630          | \$ 508,248                       | \$ 96,229            | \$ (640)                                      | \$ (18,144)       | \$ (3,430)                                     | \$ 582,893                      |
| Net income  |                 |                                  | 9,793                |   |                   |  | 9,793                           |
| Other comprehensive losses  |                 |                                  |                      | (345)   |                   |  | (345)                           |
| Common stock dividends of<br>\$0.37 per share   |                 |                                  | (22,404)             |   |                   |  | (22,404)                        |
| Payment of dividend<br>equivalent rights  |                 |                                  | (485)                |   |                   |  | (485)                           |
| Exercise of stock options<br>(92,460 shares)  | 1               | 357                              |                      |   |                   |  | 358                             |
| Treasury stock purchases<br>(2,060,000 shares)  |                 |                                  |                      |   | (24,840)          |  | (24,840)                        |
| Income tax benefit from<br>dividend payments on<br>unexercised stock options<br>and allocated ESOP shares |                 | 310                              |                      |   |                   |  | 310                             |
| Compensation under<br>recognition and retention<br>plans  |                 | 1,404                            |                      |   |                   |  | 1,404                           |
| Common stock held by<br>ESOP committed to be<br>released (27,054 shares)                                  |                 | 192                              |                      |   |                   | 147  | 339                             |
| Balance at June 30, 2007  | \$ 631          | \$ 510,511                       | \$ 83,133            | \$ (985)                                      | \$ (42,984)       | \$ (3,283)                                     | \$ 547,023                      |

Table of Contents

|   | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>gain (loss) | Treasury<br>stock | Unallocated<br>common stock<br>held by<br>ESOP | Total<br>stockholders<br>equity |
|---|-----------------|----------------------------------|----------------------|--|-------------------|--|---------------------------------|
| Balance at December 31,<br>2007   | \$ 633          | \$ 513,949                       | \$ 68,875            | \$ 121   | \$ (61,735)       | \$ (3,135)                                     | \$ 518,708                      |
| Net income  |                 |                                  | 6,369                |  |                   |  | 6,369                           |
| Other comprehensive losses  |                 |                                  |                      | (514)  |                   |  | (514)                           |
| Common stock dividends of<br>\$0.37 per share   |                 |                                  | (21,279)             |  |                   |  | (21,279)                        |
| Payment of dividend<br>equivalent rights  |                 |                                  | (532)                |  |                   |  | (532)                           |
| Exercise of stock options<br>(613,414 shares)   | 4               | 1,167                            |                      |  |                   |  | 1,171                           |
| Reload stock options granted<br>(193,163 shares)  |                 | 97                               |                      |  |                   |  | 97                              |
| Treasury stock purchases<br>(40,100 shares)   |                 |                                  |                      |  | (372)             |  | (372)                           |
| Income tax benefit from<br>dividend payments on<br>unexercised stock options<br>and allocated ESOP shares |                 | 866                              |                      |  |                   |  | 866                             |
| Compensation under<br>recognition and retention<br>plans  |                 | 1,063                            |                      |  |                   |  | 1,063                           |
| Common stock held by<br>ESOP committed to be<br>released (26,106 shares)                                  |                 | 126                              |                      |  |                   | 142  | 268                             |
| Balance at June 30, 2008  | \$ 637          | \$ 517,268                       | \$ 53,433            | \$ (393)   | \$ (62,107)       | \$ (2,993)                                     | \$ 505,845                      |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(In thousands)**

|  | 2008 | Six months ended<br>June 30,<br>(unaudited) | 2007     |
|--|------|---|----------|
| <b>Cash flows from operating activities:</b>   |      |   |          |
| Net income   | \$   | 6,369                                       | \$ 9,793 |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |      |   |          |
| Provision for credit losses  |      | 4,693                                       | 2,357    |
| Compensation under recognition and retention plans                                       |      | 1,063                                       | 1,404    |
| Release of ESOP shares   |      | 268   | 339      |
| Depreciation and amortization  |      | 664   | 725      |
| Net accretion of securities premiums and discounts                                       |      | (382)                                       | (539)    |
| Amortization of deferred loan origination costs  |      | 5,361                                       | 4,870    |
| Amortization of identified intangible assets   |      | 876   | 1,007    |
| Accretion of acquisition fair value adjustments  |      | (227)                                       | (437)    |
| Amortization of mortgage servicing rights  |      | 10  | 10       |
| Loss on write-down of securities   |      | 1,249                                       |          |
| Write-down of other real estate owned  |      | 67  |          |
| Minority interest in earnings of subsidiary  |      | 109   | 88       |
| Deferred income taxes  |      | (1,709)                                     | 134      |
| <b>(Increase) decrease in:</b>   |      |   |          |
| Accrued interest receivable  |      | 724   | 867      |
| Prepaid income taxes   |      | 1,643                                       | (2,014)  |
| Other assets   |      | 977   | (220)    |
| <b>Increase (decrease) in:</b>   |      |   |          |
| Accrued expenses and other liabilities   |      | (20)  | 2,083    |
| Net cash provided from operating activities  |      | 21,735                                      | 20,467   |
| <b>Cash flows from investing activities:</b>   |      |   |          |
| Proceeds from sales of securities available for sale                                     |      | 7,450                                       |          |
| Proceeds from redemptions and maturities of securities available for sale                |      | 65,993                                      | 110,003  |
| Proceeds from redemptions and maturities of securities held to maturity                  |      | 23  | 17       |
| Purchase of securities available for sale  |      | (107,150)                                   | (50,552) |
| Purchase of Federal Home Loan Bank of Boston stock                                       |      | (4,495)                                     |          |
| Proceeds from redemptions of Federal Home Loan Bank of Boston stock                      |      |   | 2,004    |
| Net increase in loans  |      | (100,994)                                   | (67,581) |
| Purchase of bank premises and equipment  |      | (1,140)                                     | (680)    |
| Net cash used for investing activities   |      | (140,313)                                   | (6,789)  |

Table of Contents

|  | Six months ended<br>June 30, |            |
|--|------------------------------|------------|
|  | 2008                         | 2007       |
|  | (unaudited)                  |            |
| <b>Cash flows from financing activities:</b>   |                              |            |
| Increase in demand deposits and NOW, savings and money market savings accounts                   | \$ 29,024                    | \$ 265     |
| Increase in retail certificates of deposit   | 2,754                        | 20,807     |
| Decrease in brokered certificates of deposit   | (40,857)                     | (189)      |
| Proceeds from Federal Home Loan Bank of Boston advances  | 540,940                      | 558,500    |
| Repayment of Federal Home Loan Bank of Boston advances   | (436,141)                    | (542,075)  |
| Repayment of subordinated debt   | (7,000)                      | (5,000)    |
| Increase in mortgagors' escrow accounts  | 427                          | 161        |
| Income tax benefit from dividend payments on unexercised stock options and allocated ESOP shares | 866                          | 310        |
| Proceeds from exercise of stock options  | 1,171                        | 358        |
| Reload stock options granted   | 97                           |            |
| Purchase of treasury stock   | (372)                        | (24,840)   |
| Payment of dividends on common stock   | (21,279)                     | (22,404)   |
| Payment of dividend equivalent rights  | (532)                        | (485)      |
| Payment of dividend to minority interest members of subsidiary                                   | (268)                        | (208)      |
| Net cash provided from (used for) financing activities   | 68,830                       | (14,800)   |
| Net decrease in cash and cash equivalents  | (49,748)                     | (1,122)    |
| Cash and cash equivalents at beginning of period   | 153,624                      | 152,654    |
| Cash and cash equivalents at end of period   | \$ 103,876                   | \$ 151,532 |
| <b>Supplemental disclosures of cash flow information:</b>  |                              |            |
| <b>Cash paid during the period for:</b>  |                              |            |
| Interest on deposits and borrowed funds  | \$ 36,462                    | \$ 35,775  |
| Income taxes   | 3,355                        | 7,793      |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**Six Months Ended June 30, 2008 and 2007**

**(Unaudited)**

**(1) Summary of Significant Accounting Policies and Related Matters (Dollars in thousands except per share amounts)**

*Basis of Presentation*

The consolidated financial statements include the accounts of Brookline Bancorp, Inc. (the Company) and its wholly owned subsidiaries, Brookline Bank ( Brookline ) and Brookline Securities Corp. Brookline includes the accounts of its wholly owned subsidiary, BBS Investment Corporation, and its 86.0% (86.3% at December 31, 2007) owned subsidiary, Eastern Funding LLC ( Eastern ).

The Company operates as one reportable segment for financial reporting purposes. All significant intercompany transactions and balances are eliminated in consolidation. Certain amounts previously reported have been reclassified to conform to the current year's presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation have been included. Results for the six months ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

**(2) Investment Securities (Dollars in thousands)**

Securities available for sale and held to maturity are summarized below:

|                                | June 30, 2008     |                              |                               |                         |
|--------------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
|                                | Amortized<br>cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Estimated<br>fair value |
| Securities available for sale: |                   |                              |                               |                         |
| Debt securities:               |                   |                              |                               |                         |

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|   |    |         |    |       |    |       |    |         |
|---|----|---------|----|-------|----|-------|----|---------|
| U.S. Government-sponsored enterprises   | \$ | 41,157  | \$ | 156   | \$ | 29    | \$ | 41,284  |
| Municipal obligations   |    | 3,760   |    |       |    |       |    | 3,760   |
| Auction rate municipal obligations  |    | 5,500   |    |       |    |       |    | 5,500   |
| Corporate obligations   |    | 4,616   |    |       |    | 520   |    | 4,096   |
| Other obligations   |    | 500     |    |       |    |       |    | 500     |
| Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises |    | 117,836 |    | 1,324 |    |       |    | 119,160 |
| Mortgage-backed securities issued by U.S. Government-sponsored enterprises          |    | 140,580 |    | 60    |    | 2,228 |    | 138,412 |
| Total debt securities   |    | 313,949 |    | 1,540 |    | 2,777 |    | 312,712 |
| Marketable equity securities  |    | 3,215   |    | 225   |    | 100   |    | 3,340   |
| Total securities available for sale   | \$ | 317,164 | \$ | 1,765 | \$ | 2,877 | \$ | 316,052 |
| Securities held to maturity:  |    |         |    |       |    |       |    |         |
| Mortgage-backed securities issued by U.S. Government-sponsored enterprises          | \$ | 166     | \$ | 9     | \$ |       | \$ | 175     |

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****Six Months Ended June 30, 2008 and 2007****(Unaudited)**

|   | December 31, 2007 |                              |                               |                         |
|---|-------------------|------------------------------|-------------------------------|-------------------------|
|   | Amortized<br>cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Estimated<br>fair value |
| Securities available for sale:                |                   |                              |                               |                         |
| Debt securities:                              |                   |                              |                               |                         |
| U.S. Government-sponsored enterprises         | \$ 80,621         | \$ 288                       | \$ 5                          | \$ 80,904               |
| Municipal obligations                         | 4,531             | 7                            | 25                            | 4,513                   |
| Auction rate municipal obligations            | 13,050            |                              |                               | 13,050                  |
| Corporate obligations                         | 4,779             |                              | 201                           | 4,578                   |
| Other obligations                             | 500               |                              |                               | 500                     |
| Collateralized mortgage obligations issued by |                   |                              |                               |                         |
| U.S. Government-sponsored enterprises         | 129,137           | 532                          | 118                           | 129,551                 |
| Mortgage-backed securities issued by U.S.     |                   |                              |                               |                         |
| Government-sponsored enterprises              | 47,182            | 79                           | 357                           | 46,904                  |
| Total debt securities                         | 279,800           | 906                          | 706                           | 280,000                 |
| Marketable equity securities                  | 4,464             | 176                          | 589                           | 4,051                   |
| Total securities available for sale           | \$ 284,264        | \$ 1,082                     | \$ 1,295                      | \$ 284,051              |
| Securities held to maturity:                  |                   |                              |                               |                         |
| Mortgage-backed securities issued by U.S.     |                   |                              |                               |                         |
| Government-sponsored enterprises              | \$ 189            | \$ 10                        | \$                            | \$ 199                  |

Debt securities of U.S. Government-sponsored enterprises include obligations issued by Fannie Mae, Freddie Mac, Ginnie Mae, Federal Home Loan Banks and the Federal Farm Credit Bank. None of those obligations is backed by the full faith and credit of the U.S. Government except for mortgage-backed securities issued by Ginnie Mae amounting to \$7 at June 30, 2008 and \$16 at December 31, 2007.

**(3) Loans (Dollars in thousands)**

A summary of loans follows:

|                        | June 30,<br>2008 | December 31,<br>2007 |
|------------------------|------------------|----------------------|
| Mortgage loans:        |                  |                      |
| One-to-four family     | \$ 321,160       | \$ 296,329           |
| Multi-family           | 313,314          | 316,198              |
| Commercial real estate | 450,014          | 396,027              |

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|                                  |              |              |
|----------------------------------|--------------|--------------|
| Construction and development     | 24,762       | 26,807       |
| Home equity                      | 37,026       | 35,110       |
| Second                           | 26,228       | 23,878       |
| Total mortgage loans             | 1,172,504    | 1,094,349    |
| Indirect automobile loans        | 596,775      | 594,332      |
| Commercial loans Eastern         | 144,747      | 141,675      |
| Other commercial loans           | 168,148      | 154,442      |
| Other consumer loans             | 4,265        | 3,909        |
| Total gross loans                | 2,086,439    | 1,988,707    |
| Unadvanced funds on loans        | (120,653)    | (114,651)    |
| Deferred loan origination costs: |              |              |
| Indirect automobile loans        | 15,829       | 15,445       |
| Commercial loans Eastern         | 783          | 824          |
| Other                            | 915          | 571          |
| Total loans                      | \$ 1,983,313 | \$ 1,890,896 |



Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****Six Months Ended June 30, 2008 and 2007****(Unaudited)****(4) Allowance for Loan Losses (Dollars in thousands)**

An analysis of the allowance for loan losses for the periods indicated follows:

|                                |      | Six month ended<br>June 30, |           |
|--------------------------------|------|-----------------------------|-----------|
|                                | 2008 |                             | 2007      |
| Balance at beginning of period | \$   | 24,445                      | \$ 23,024 |
| Provision for loan losses      |      | 4,667                       | 2,258     |
| Charge-offs                    |      | (3,865)                     | (2,312)   |
| Recoveries                     |      | 475                         | 342       |
| Balance at end of period       | \$   | 25,722                      | \$ 23,312 |

During the six months ended June 30, 2008 and 2007, the liability for unfunded credit commitments was increased by charges to the provision for credit losses of \$26 and \$99, respectively. Such liability, which is included in other liabilities, was \$1,513 at June 30, 2008 and \$1,487 at December 31, 2007.

**(5) Deposits (Dollars in thousands)**

A summary of deposits follows:

|  | June 30,<br>2008 | December 31,<br>2007 |
|--|------------------|----------------------|
| Demand checking accounts               | \$ 72,354        | \$ 66,538            |
| NOW accounts                           | 93,469           | 84,875               |
| Savings accounts                       | 71,360           | 67,351               |
| Guaranteed savings accounts            | 20,238           | 19,799               |
| Money market savings accounts          | 225,553          | 215,387              |
| Retail certificate of deposit accounts | 799,140          | 796,387              |
| Total retail deposits                  | 1,282,114        | 1,250,337            |

|                                  |    |           |    |           |
|----------------------------------|----|-----------|----|-----------|
| Brokered certificates of deposit |    | 27,047    |    | 67,904    |
| Total deposits                   | \$ | 1,309,161 | \$ | 1,318,241 |

(6) **Accumulated Other Comprehensive Loss (Dollars in thousands)**

Accumulated other comprehensive loss at June 30, 2008 was comprised of unrealized losses on securities available for sale, net of income taxes, of \$631 and an unrealized gain related to postretirement benefits, net of income taxes, of \$238. Accumulated other comprehensive income at December 31, 2007 was comprised of an unrealized loss on securities available for sale, net of income taxes, of \$121 and an unrealized gain related to postretirement benefits, net of income taxes, of \$242. At June 30, 2008 and December 31, 2007, the resulting deferred tax asset and net income tax liability, amounted to \$309 and \$83, respectively.

(7) **Commitments and Contingencies (Dollars in thousands)**

*Loan Commitments*

At June 30, 2008, the Company had outstanding commitments to originate loans of \$60,096, \$29,663 of which were one-to-four family mortgage loans, \$8,151 were commercial real estate mortgage loans, \$4,123 were multi-family mortgage loans, \$250 were commercial loans to condominium associations and \$17,909 were commercial loans. Unused lines of credit available to customers were \$53,632, of which \$48,063 were equity lines of credit.

Table of Contents

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**Six Months Ended June 30, 2008 and 2007**

**(Unaudited)**

*Legal Proceedings*

On February 21, 2007, Carrie E. Mosca filed a putative class action complaint against Brookline Bank in the Superior Court for the Commonwealth of Massachusetts (the Action). Ms. Mosca defaulted on a loan obligation on an automobile that she co-owned. She alleges that the form of notice of sale of collateral that the Bank sent to her after she and the co-owner became delinquent on the loan obligation did not contain information required to be provided to a consumer under the Massachusetts Uniform Commercial Code. The Action purports to be brought on behalf of a class of individuals who purchased a motor vehicle from a dealer located in Massachusetts and to whom the Bank sent the same form of notice of sale of collateral during the four year period prior to the filing of the Action. The Action seeks statutory damages, an order restraining the Bank from future use of the form of notice sent to Ms. Mosca, an order barring the Bank from recovering any deficiency from other individuals to whom it sent the same form of notice, attorneys' fees, litigation expenses and costs. The Bank has answered, denying liability and has opposed Plaintiff's motion to certify a class. The Court denied Plaintiff's motion for class certification in an order dated July 18, 2008. On July 31, 2008, Plaintiff served a motion for summary judgment seeking an award of damages in the amount of \$3 to her individually. The Bank has not yet served its response to the motion.

In addition to the above matter, the Company and its subsidiaries are involved in litigation that is considered incidental to the business of the Company. Management believes the results of such litigation will be immaterial to the consolidated financial condition or results of operations of the Company.

**(8) Dividend Declaration**

On July 17, 2008, the Board of Directors of the Company approved a regular quarterly dividend of \$0.085 per share and an extra dividend of \$0.20 per share payable August 15, 2008 to stockholders of record on July 31, 2008.

**(9) Share-Based Payment Arrangements (Dollars in thousands, except per share amounts)**

*Recognition and Retention Plans*

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The Company has two recognition and retention plans, the 1999 RRP and the 2003 RRP. Under both of the plans, shares of the Company's common stock were reserved for issuance as restricted stock awards to officers, employees and

non-employee directors of the Company. Shares issued upon vesting may be either authorized but unissued shares or reacquired shares held by the Company as treasury shares. Any shares not issued because vesting requirements are not met will again be available for issuance under the plans. Shares awarded vest over varying time periods ranging from six months up to eight years for the 1999 RRP and from less than three months to over five years for the 2003 RRP. In the event a recipient ceases to maintain continuous service with the Company by reason of normal retirement (applicable to the 1999 RRP and in part to the 2003 RRP), death or disability, or following a change in control, RRP shares still subject to restriction will vest and be free of such restrictions.

Total expense for the RRP plans amounted to \$529, \$776, \$1,063 and \$1,404 for the three months and six months ended June 30, 2008 and 2007, respectively. The compensation cost of non-vested RRP shares at June 30, 2008 is expected to be charged to expense as follows: \$1,064 during the six month period ended December 31, 2008 and \$137 during the year ended December 31, 2009. As of June 30, 2008, the number of shares available for award under the 1999 RRP and the 2003 RRP were 29,774 shares and 132,920 shares, respectively.

### *Stock Option Plans*

The Company has two stock option plans, the 1999 Option Plan and the 2003 Option Plan. Under both of the plans, shares of the Company's common stock were reserved for issuance to directors, employees and non-employee directors of the Company. Shares issued upon the exercise of a stock option may be either authorized but unissued shares or reacquired shares held by the Company as treasury shares. Any shares subject to an award which expire or are terminated unexercised will again be available for issuance under the plans. The exercise price of options awarded is the fair market value of the common stock of the Company on the date the award is made. Options vest over periods ranging from less than one month through over five years. Part of the options granted under the 1999 Option Plan and all of the options granted under the 2003 Option Plan include a reload feature whereby an optionee exercising an option by delivery of shares of common stock would automatically be granted an additional option at the fair market value of stock when such additional option is granted equal to the number of shares so delivered. If an individual to whom a stock option was granted ceases to maintain continuous service by reason of normal retirement, death or disability, or following a change in control, all options and rights granted and not fully exercisable become exercisable in full upon the happening of such an event and shall remain exercisable for a period ranging from three months to five years.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****Six Months Ended June 30, 2008 and 2007****(Unaudited)**

Total expense for the stock option plans amounted to \$97 and \$1 for the six months ended June 30, 2008 and 2007, respectively.

Activity under the Company's stock option plans for the six months ended June 30, 2008 was as follows:

|   |           |
|---|-----------|
| Options outstanding at January 1, 2008                                | 2,722,960 |
| Options exercised at \$4.944 per option                               | (613,414) |
| Reload options granted at:  |           |
| \$ 9.19 per option  | 130,518   |
| \$ 9.85 per option  | 25,378    |
| \$ 10.10 per option   | 37,267    |
| Options forfeited at:   |           |
| \$ 12.91 per option   | (40,000)  |
| \$ 15.02 per option   | (4,000)   |
| Options outstanding at June 30, 2008                                  | 2,258,709 |
| Exercisable at June 30, 2008 at:                                      |           |
| \$ 4.944 per option   | 635,883   |
| \$ 9.19 per option  | 130,518   |
| \$ 9.85 per option  | 25,378    |
| \$ 10.10 per option   | 37,267    |
| \$ 10.36 per option   | 28,717    |
| \$ 10.59 per option   | 23,861    |
| \$ 10.69 per option   | 46,249    |
| \$ 10.87 per option   | 56,836    |
| \$ 12.91 per option   | 1,000     |
| \$ 15.02 per option   | 1,269,000 |
|   | 2,254,709 |
| Aggregate intrinsic value of options outstanding and exercisable      | \$ 2,976  |
| Weighted average exercise price per option                            | \$ 11.40  |
| Weighted average remaining contractual life in years at end of period | 3.44      |

As of June 30, 2008, the number of options available for award under the Company's 1999 Stock Option Plan and 2003 Stock Option Plan were 285,980 options and 1,226,000 options, respectively.

*Employee Stock Ownership Plan*

The Company maintains an ESOP to provide eligible employees the opportunity to own Company stock. Employees are eligible to participate in the Plan after reaching age twenty-one, completion of one year of service and working at least one thousand hours of consecutive service during the year. Contributions are allocated to eligible participants on the basis of compensation, subject to federal tax law limits.

A loan obtained by the ESOP from the Company to purchase Company common stock is payable in quarterly installments over 30 years and bears interest at 8.50% per annum. The loan can be prepaid without penalty. Loan payments are principally funded by cash contributions from the Bank, subject to federal tax law limits. The outstanding balance of the loan at June 30, 2008 and December 31, 2007, which was \$3,627 and \$3,752, respectively, is eliminated in consolidation.

Shares used as collateral to secure the loan are released and available for allocation to eligible employees as the principal and interest on the loan is paid. Employees vest in their ESOP account at a rate of 20% annually commencing in the year of completion of three years of credited service or immediately if service is terminated due to death, retirement, disability or change in control. Dividends on released shares are credited to the participants' ESOP accounts. Dividends on unallocated shares are generally applied towards payment of the loan. ESOP shares committed to be released are considered outstanding in determining earnings per share.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****Six Months Ended June 30, 2008 and 2007****(Unaudited)**

At June 30, 2008, the ESOP held 548,868 unallocated shares at an aggregate cost of \$2,993; the market value of such shares at that date was \$5,242. For the six months ended June 30, 2008 and 2007, \$268 and \$339, respectively, was charged to compensation expense based on the commitment to release to eligible employees 26,106 shares and 27,054 shares in those respective periods.

**(10) Postretirement Benefits (Dollars in thousands)**

Postretirement benefits are provided for part of the annual expense of health insurance premiums for retired employees and their dependents. No contributions are made by the Company to invest in assets allocated for the purpose of funding this benefit obligation.

The following table provides the components of net periodic postretirement benefit costs for the three months and six months ended June 30, 2008 and 2007:

|                            | Three months ended<br>June 30, |       | Six months ended<br>June 30, |       |
|----------------------------|--------------------------------|-------|------------------------------|-------|
|                            | 2008                           | 2007  | 2008                         | 2007  |
| Service cost               | \$ 17                          | \$ 14 | \$ 35                        | \$ 28 |
| Interest cost              | 12                             | 11    | 25                           | 22    |
| Prior service cost         | (7)                            | (7)   | (13)                         | (14)  |
| Actuarial (gain) loss      | (6)                            | (3)   | (7)                          | 2     |
| Net periodic benefit costs | \$ 16                          | \$ 15 | \$ 40                        | \$ 38 |

Benefits paid amounted to \$8 and \$7 for the six months ended June 30, 2008 and 2007, respectively.

**(11) Stockholders' Equity (Dollars in thousands)***Capital Distributions and Restrictions Thereon*

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Regulations of the Office of Thrift Supervision ( OTS ) impose limitations on all capital distributions by savings institutions. Capital distributions include cash dividends, payments to repurchase or otherwise acquire the institution's shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital. The regulations establish three tiers of institutions. An institution, such as the Bank, that exceeds all capital requirements before and after a proposed capital distribution ( Tier 1 institution ) may, after prior notice but without the approval of the OTS, make capital distributions during a year up to 100% of its current year net income plus its retained net income for the preceding two years not previously distributed. Any additional capital distributions require OTS approval.

### *Common Stock Repurchases*

During the first half of 2008, 40,100 shares of the Company's common stock were repurchased at an average cost of \$9.29, exclusive of transaction costs.

As of June 30, 2008, the Company was authorized to repurchase up to 4,804,410 shares of its common stock. The Board of Directors has delegated to the discretion of the Company's senior management the authority to determine the timing of the repurchases and the prices at which the repurchases will be made.

### *Restricted Retained Earnings*

As part of the stock offering in 2002 and as required by regulation, Brookline Bank established a liquidation account for the benefit of eligible account holders and supplemental eligible account holders who maintain their deposit accounts at Brookline Bank after the stock offering. In the unlikely event of a complete liquidation of Brookline Bank (and only in that event), eligible depositors who continue to maintain deposit accounts at Brookline Bank would be entitled to receive a distribution from the liquidation account. Accordingly, retained earnings of the Company are deemed to be restricted up to the balance of the liquidation account. The liquidation account balance is reduced annually to the extent that eligible depositors have reduced their qualifying deposits as of each anniversary date. Subsequent increases in deposit account balances do not restore an account holder's interest in the liquidation account. The liquidation account totaled \$33,151 at December 31, 2007.



Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements****Six Months Ended June 30, 2008 and 2007****(Unaudited)****(12) Fair Value Disclosures (Dollars in thousands)**

Effective January 1, 2008, the Company adopted *Statement of Financial Accounting Standards No. 157 ( SFAS 157 )*, *Fair Value Measurements*, which provides a framework for measuring fair value under U.S. generally accepted accounting principles. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In addition, SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have the following fair value hierarchy:

Level 1 - Quoted prices for identical instruments in active markets

Level 2 - Quoted prices for similar instruments in active or non-active markets and model-derived valuations in which all significant inputs and value drivers are observable in active markets

Level 3 - Valuation derived from significant unobservable inputs

The Company uses fair value measurements to record certain assets at fair value on a recurring basis. Additionally, the Company may be required to record at fair value other assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or market value accounting or write-downs of individual assets. In accordance with *Financial Accounting Standards Board ( FASB ) Staff Position No. 157-2, Effective Date of FASB Statement No. 157*, we have delayed the application of SFAS 157 for nonfinancial assets, such as goodwill and real property held for sale, and nonfinancial liabilities until January 1, 2009.

The only assets of the Company recorded at fair value on a recurring basis at June 30, 2008 were securities available for sale. The following table presents the level of valuation assumptions used to determine the fair value of such securities:

|                               | Carrying Value |            |          | Total      |
|-------------------------------|----------------|------------|----------|------------|
|                               | Level 1        | Level 2    | Level 3  |            |
| Securities available for sale | \$ 3,340       | \$ 305,812 | \$ 6,900 | \$ 316,052 |

The securities comprising the balance at June 30, 2008 in the level 3 column included \$5,500 of auction rate municipal obligations, a \$500 obligation of a foreign country maturing September 30, 2008 and \$900 trust preferred obligations

issued by financial institutions, all of which lacked quoted prices in active markets. In the judgment of management, the fair value of these securities was considered to approximate their carrying value because they were deemed to be fully collectible and the rates paid on the securities were at least equal to rates paid on securities with similar maturities. While it is possible that unrealized depreciation may have existed at June 30, 2008 with respect to the auction rate municipal obligations, such unrealized depreciation, if any, would be immaterial to the Company's consolidated financial statements as of and for the six months ended June 30, 2008 and would not be considered as other than temporary in nature.

Between April 1, 2008 and June 30, 2008, the fair value of securities available for sale using significant unobservable inputs (level 3) declined by \$3,875 as a result of \$4,275 of sales and redemptions of auction rate municipal obligations at their face value and the addition of \$400 of trust preferred obligations.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Forward Looking Statements**

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements made by or on behalf of the Company.

The following discussion contains forward-looking statements based on management's current expectations regarding economic, legislative and regulatory issues that may impact the Company's earnings and financial condition in the future. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Any statements included herein preceded by, followed by or which include the words "may", "could", "should", "will", "would", "believe", "expect", "anticipate", "estimate", "intend", "plan", "assume" or similar words constitute forward-looking statements.

Forward-looking statements, implicitly and explicitly, include assumptions underlying the statements. While the Company believes the expectations reflected in its forward-looking statements are reasonable, the statements involve risks and uncertainties that are subject to change based on various factors, some of which are outside the control of the Company. The following factors, among others, could cause the Company's actual performance to differ materially from the expectations, forecasts and projections expressed in the forward-looking statements: general and local economic conditions, changes in interest rates, demand for loans, real estate values, deposit flows, regulatory considerations, competition, technological developments, retention and recruitment of qualified personnel, and market acceptance of the Company's pricing, products and services.

**Executive Level Overview**

The following is a summary of operating and financial condition highlights as of and for the three months and six months ended June 30, 2008 and 2007.

**Operating Highlights**

|                                  | Three months ended<br>June 30,          |           | Six months ended<br>June 30, |           |
|----------------------------------|---|-----------|------------------------------|-----------|
|                                  | 2008                                    | 2007      | 2008                         | 2007      |
|                                  | (In thousands except per share amounts) |           |                              |           |
| Net interest income              | \$ 18,046                               | \$ 18,051 | \$ 35,205                    | \$ 36,184 |
| Provision for credit losses      | 2,579                                   | 1,107     | 4,693                        | 2,357     |
| Loss on write-down of securities |   |           | (1,249)                      |           |
| Non-interest income              | 1,123                                   | 1,281     | 2,117                        | 2,331     |

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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Amortization of identified intangible assets     | 438     | 504     | 876     | 1,007   |
| Other non-interest expenses                      | 9,997   | 9,722   | 19,862  | 19,049  |
| Income before income taxes and minority interest | 6,155   | 7,999   | 10,642  | 16,102  |
| Provision for income taxes                       | 2,417   | 3,103   | 4,164   | 6,221   |
| Minority interest in earnings of subsidiary      | 64      | 44      | 109     | 88      |
| Net income                                       | 3,674   | 4,852   | 6,369   | 9,793   |
| Basic earnings per common share                  | \$ 0.06 | \$ 0.08 | \$ 0.11 | \$ 0.16 |
| Diluted earnings per common share                | 0.06    | 0.08    | 0.11    | 0.16    |
| Interest rate spread                             | 2.21%   | 2.13%   | 2.12%   | 2.11%   |
| Net interest margin                              | 3.03%   | 3.18%   | 2.99%   | 3.18%   |

Table of Contents**Financial Condition Highlights**

|                                      | At<br>June 30,<br>2008 | At<br>December 31,<br>2007<br>(In thousands) | At<br>June 30,<br>2007 |
|--------------------------------------|------------------------|--|------------------------|
| Total assets                         | \$ 2,494,616           | \$ 2,418,510                                 | \$ 2,371,609           |
| Net loans                            | 1,957,591              | 1,866,451                                    | 1,829,777              |
| Retail deposits                      | 1,282,114              | 1,250,337                                    | 1,231,252              |
| Brokered deposits                    | 27,047                 | 67,904                                       | 77,871                 |
| Borrowed funds and subordinated debt | 652,798                | 555,023                                      | 487,250                |
| Stockholders' equity                 | 505,845                | 518,708                                      | 547,023                |
| Stockholders' equity to total assets | 20.28%                 | 21.45%                                       | 23.07%                 |
| Allowance for loan losses            | \$ 25,722              | \$ 24,445                                    | \$ 23,312              |
| Non-performing assets                | 6,939                  | 5,399  | 4,224                  |

Among the factors that influenced the operating and financial condition highlights summarized above were the following:

- The interest rate environment.** Interest rate spread and net interest margin are greatly influenced by the rate setting actions of the Federal Open Market Committee (the FOMC) of the Federal Reserve System. The FOMC lowered the rate for overnight federal fund borrowings between banks seven times from 5.25% on September 17, 2007 (the rate that had been in effect since June 29, 2006) to 4.25% at December 31, 2007, 2.25% at March 31, 2008 and 2.00% on April 30, 2008. The rapidity of the rate reductions had an immediate negative effect in the 2008 first quarter on the yield of the Company's assets adjustable to market rates and those assets that either matured or were refinanced. The impact on rates paid for certificates of deposit and borrowed funds, however, was less rapid as many of those liabilities matured later on. Interest rate spread and net interest margin improved in the 2008 second quarter as maturing certificates of deposit and borrowed funds were refinanced at lower rates. That trend is expected to continue in the second half of 2008, provided there are no major rapid changes by the FOMC in the overnight rate for borrowings.
- Foregone interest income.** As a result of repurchases of the Company's common stock and the payment of semi-annual extra dividends, the average balance of stockholders' equity was \$51.4 million less in the 2008 second quarter than in the 2007 second quarter and \$56.8 million less in the first half of 2008 than in the first half of 2007. Foregone interest income as a result of these reductions in stockholders' equity was \$762,000 (\$463,000 after taxes) in the 2008 second quarter and \$1,718,000 (\$1,046,000 after taxes) in the first half of 2008.
- Higher provisions for credit losses.** The provision for credit losses was \$1,472,000 (\$856,000 after taxes) higher in the 2008 second quarter than in the 2007 second quarter and \$2,336,000 (\$1,359,000 after taxes) higher in the first half of 2008 than in the first half of 2007 due primarily to rising charge-offs in the indirect automobile (auto)

loan portfolio and growth in the mortgage and commercial loan portfolios.

- **Loss on write-down of securities.** The carrying values of preferred stock of Merrill Lynch & Co., Inc. ( Merrill ) and Federal National Mortgage Association ( FNMA ) acquired by the Company were written down to their market values at March 31, 2008 by a charge to 2008 first quarter earnings of \$1,249,000 (\$801,000 after taxes). At June 30, 2008, the combined market value of the securities exceeded their carrying value by \$6,000. Subsequently, the market value of the securities declined based on public information about operating difficulties at Merrill and FNMA. As of July 29, 2008, the market value of the securities was \$1,763,000. If it becomes evident that other than temporary impairment has occurred in these securities, a charge to earnings will be recorded in an amount that adjusts their carrying value to their market value as of the date of determination of impairment.

- **Assets quality and stockholders equity remain strong.** Non-performing assets remained modest at \$6.9 million, or 0.28% of total assets at June 30, 2008 compared to \$5.4 million or 0.22% at December 31, 2007. The allowance for loan losses (\$25.7 million) equaled 1.30% of total loans outstanding at June 30, 2008 and stockholders equity was \$505.8 million, resulting in an equity to assets ratio of 20.3% as of that date.

Table of Contents**Average Balances, Net Interest Income, Interest Rate Spread and Net Interest Margin**

The following tables set forth information about the Company's average balances, interest income and rates earned on average interest-earning assets, interest expense and rates paid on interest-bearing liabilities, interest rate spread and net interest margin for the three months and six months ended June 30, 2008 and 2007. Average balances are derived from daily average balances and yields include fees and costs which are considered adjustments to yields.

|   | 2008            |              | Three months ended June 30,                  |                 | 2007         |                    |
|---|-----------------|--------------|--|-----------------|--------------|--------------------|
|   | Average balance | Interest (1) | Average yield/cost<br>(Dollars in thousands) | Average balance | Interest (1) | Average yield/cost |
| <b>Assets</b>   |                 |              |  |                 |              |                    |
| Interest-earning assets:  |                 |              |  |                 |              |                    |
| Short-term investments  | \$ 73,119       | \$ 405       | 2.22%  | \$ 138,758      | \$ 1,798     | 5.20%              |
| Debt securities (2)   | 328,553         | 3,797        | 4.62   | 288,231         | 3,646        | 5.06               |
| Equity securities (2)   | 34,009          | 402          | 4.74   | 27,254          | 413          | 6.08               |
| Mortgage loans (3)  | 1,087,848       | 16,032       | 5.89   | 1,032,270       | 16,488       | 6.39               |
| Commercial loans - Eastern (3)                                      | 144,326         | 3,536        | 9.80   | 129,088         | 3,444        | 10.70              |
| Other commercial loans (3)  | 109,966         | 1,511        | 5.50   | 69,274          | 1,234        | 7.13               |
| Indirect automobile loans (3)                                       | 609,887         | 9,715        | 6.39   | 594,485         | 9,098        | 6.14               |
| Other consumer loans (3)  | 3,924           | 58           | 5.91   | 3,328           | 65           | 7.81               |
| Total interest-earning assets                                       | 2,391,632       | 35,456       | 5.93%  | 2,282,688       | 36,186       | 6.35%              |
| Allowance for loan losses   | (24,892)        |              |  | (23,162)        |              |                    |
| Non-interest earning assets   | 99,772          |              |  | 97,926          |              |                    |
| Total assets  | \$ 2,466,512    |              |  | \$ 2,357,452    |              |                    |
| <b>Liabilities and Stockholders</b>                                 |                 |              |  |                 |              |                    |
| <b>Equity</b>   |                 |              |  |                 |              |                    |
| Interest-bearing liabilities:                                       |                 |              |  |                 |              |                    |
| Deposits:   |                 |              |  |                 |              |                    |
| NOW accounts  | \$ 88,338       | 61           | 0.28%  | \$ 86,446       | 69           | 0.32%              |
| Savings accounts  | 90,768          | 300          | 1.33   | 97,496          | 407          | 1.67               |
| Money market savings accounts                                       | 226,999         | 1,205        | 2.13   | 221,129         | 1,566        | 2.84               |
| Retail certificates of deposit                                      | 816,158         | 8,597        | 4.22   | 753,724         | 9,096        | 4.84               |
| Total retail deposits   | 1,222,263       | 10,163       | 3.34   | 1,158,795       | 11,138       | 3.86               |
| Brokered certificates of deposit                                    | 42,275          | 569          | 5.40   | 77,958          | 1,046        | 5.38               |
| Total deposits  | 1,264,538       | 10,732       | 3.40   | 1,236,753       | 12,184       | 3.95               |
| Borrowed funds  | 602,133         | 6,600        | 4.34   | 468,236         | 5,704        | 4.82               |
| Subordinated debt   |                 |              |  | 8,260           | 158          | 7.57               |
| Total interest-bearing liabilities                                  | 1,866,671       | 17,332       | 3.72%  | 1,713,249       | 18,046       | 4.22%              |
| Non-interest-bearing demand checking accounts                       | 68,077          |              |  | 61,803          |              |                    |
| Other liabilities   | 25,158          |              |  | 24,376          |              |                    |
| Total liabilities   | 1,959,906       |              |  | 1,799,428       |              |                    |
| Stockholders' equity  | 506,606         |              |  | 558,024         |              |                    |
| Total liabilities and stockholders' equity                          | \$ 2,466,512    |              |  | \$ 2,357,452    |              |                    |
| Net interest income (tax equivalent basis)/interest rate spread (4) |                 | 18,124       | 2.21%  |                 | 18,140       | 2.13%              |

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|                                      |    |        |       |           |
|--------------------------------------|----|--------|-------|-----------|
| Less adjustment of tax exempt income |    | 78     |       | 89        |
| Net interest income                  | \$ | 18,046 |       | \$ 18,051 |
| Net interest margin (5)              |    |        | 3.03% | 3.18%     |

- 
- (1) Tax exempt income on equity securities and municipal obligations is included on a tax equivalent basis.
  - (2) Average balances include unrealized gains (losses) on securities available for sale. Equity securities include marketable equity securities (preferred and common stocks) and restricted equity securities.
  - (3) Loans on non-accrual status are included in average balances.
  - (4) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
  - (5) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.



Table of Contents

|   | 2008            |              | Six months ended June 30,                    |                 | 2007         |                    |
|---|-----------------|--------------|--|-----------------|--------------|--------------------|
|   | Average balance | Interest (1) | Average yield/cost<br>(Dollars in thousands) | Average balance | Interest (1) | Average yield/cost |
| <b>Assets</b>   |                 |              |  |                 |              |                    |
| Interest-earning assets:  |                 |              |  |                 |              |                    |
| Short-term investments  | \$ 92,176       | \$ 1,411     | 3.07%  | \$ 134,641      | \$ 3,483     | 5.22%              |
| Debt securities (2)   | 308,196         | 7,302        | 4.74   | 301,427         | 7,510        | 4.98               |
| Equity securities (2)   | 33,122          | 902          | 5.46   | 28,135          | 933          | 6.68               |
| Mortgage loans (3)  | 1,067,408       | 32,127       | 6.02   | 1,035,081       | 33,222       | 6.42               |
| Commercial loans - Eastern (3)                                      | 143,307         | 7,043        | 9.83   | 128,597         | 6,926        | 10.77              |
| Other commercial loans (3)  | 107,733         | 3,112        | 5.78   | 69,112          | 2,458        | 7.11               |
| Indirect automobile loans (3)                                       | 607,641         | 19,397       | 6.40   | 578,691         | 17,186       | 5.99               |
| Other consumer loans (3)  | 3,797           | 127          | 6.69   | 3,278           | 130          | 7.93               |
| Total interest-earning assets                                       | 2,363,380       | 71,421       | 6.05%  | 2,278,962       | 71,848       | 6.32%              |
| Allowance for loan losses   | (24,592)        |              |  | (23,069)        |              |                    |
| Non-interest earning assets   | 99,659          |              |  | 98,636          |              |                    |
| Total assets  | \$ 2,438,447    |              |  | \$ 2,354,529    |              |                    |
| <b>Liabilities and Stockholders</b>                                 |                 |              |  |                 |              |                    |
| <b>Equity</b>   |                 |              |  |                 |              |                    |
| Interest-bearing liabilities:                                       |                 |              |  |                 |              |                    |
| Deposits:   |                 |              |  |                 |              |                    |
| NOW accounts  | \$ 84,845       | 107          | 0.25%  | \$ 86,814       | 141          | 0.33%              |
| Savings accounts  | 89,006          | 628          | 1.42   | 97,699          | 804          | 1.66               |
| Money market savings accounts                                       | 223,830         | 2,758        | 2.47   | 215,640         | 2,968        | 2.78               |
| Retail certificates of deposit                                      | 815,833         | 18,183       | 4.47   | 750,982         | 17,943       | 4.82               |
| Total retail deposits   | 1,213,514       | 21,676       | 3.58   | 1,151,135       | 21,856       | 3.83               |
| Brokered certificates of deposit                                    | 55,090          | 1,480        | 5.39   | 77,713          | 2,073        | 5.38               |
| Total deposits  | 1,268,604       | 23,156       | 3.66   | 1,228,848       | 23,929       | 3.93               |
| Borrowed funds  | 567,050         | 12,803       | 4.47   | 461,507         | 11,160       | 4.81               |
| Subordinated debt   | 1,733           | 65           | 7.42   | 10,160          | 391          | 7.65               |
| Total interest bearing liabilities                                  | 1,837,387       | 36,024       | 3.93%  | 1,700,515       | 35,480       | 4.21%              |
| Non-interest-bearing demand checking accounts                       | 65,304          |              |  | 62,072          |              |                    |
| Other liabilities   | 25,647          |              |  | 25,026          |              |                    |
| Total liabilities   | 1,928,338       |              |  | 1,787,613       |              |                    |
| Stockholders' equity  | 510,109         |              |  | 566,916         |              |                    |
| Total liabilities and stockholders equity                           | \$ 2,438,447    |              |  | \$ 2,354,529    |              |                    |
| Net interest income (tax equivalent basis)/interest rate spread (4) |                 | 35,397       | 2.12%  |                 | 36,368       | 2.11%              |
| Less adjustment of tax exempt income                                |                 | 192          |  |                 | 184          |                    |
| Net interest income   |                 | \$ 35,205    |  |                 | \$ 36,184    |                    |
| Net interest margin (5)   |                 |              | 2.99%  |                 |              | 3.18%              |

(1) Tax exempt income on equity securities and municipal obligations is included on a tax equivalent basis.

(2) Average balances include unrealized gains (losses) on securities available for sale. Equity securities include marketable equity securities (preferred and common stocks) and restricted equity securities.

- (3) Loans on non-accrual status are included in average balances.
- (4) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
- (5) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.

Highlights from the preceding tables follow.

- Interest rate spread improved from 2.11% in the first half of 2007 to 2.12% in the first half of 2008 and from 2.13% in the 2007 second quarter and 2.02% in the 2008 first quarter to 2.21% in the 2008 second quarter. The improvements were due primarily to the effect of the changes in the overnight borrowing rate set by the FOMC and the growth of the mortgage and commercial loan portfolios.
- Net interest margin declined from the 3.18% in the first half of 2007 to 2.99% in the first half of 2008 and from 3.18% in the 2007 second quarter to 3.03% in the 2008 second quarter due primarily to foregone income resulting

Table of Contents

from reduction in the average balances of stockholders' equity previously discussed herein. The improvement in net interest margin in the 2008 second quarter compared to the 2008 first quarter (2.96%) resulted from the average rate paid on deposits and borrowings going down faster than the decline in the average yield on interest-earning assets.

- Certificates of deposit comprised 66.8% of the average balance of total retail deposits in the 2008 second quarter compared to 67.7% in the 2008 first quarter and 65.2% in the first half of 2007.

- In the 2008 first quarter, \$260 million of certificates of deposit and advances from the Federal Home Loan Bank of Boston ( FHLB ) with a weighted average rate of 4.67% matured while \$317 million of certificates of deposit and FHLB advances were added or rolled over in that time period at a weighted average rate of 3.61%. In the 2008 second quarter, \$423 million of certificates of deposit, brokered deposits and FHLB advances with a weighted average rate of 4.32% matured while \$478 million of certificates of deposit and FHLB advances were added or rolled over in that time period at a weighted average rate of 2.83%. The reductions in funding costs in the first and second quarter had a positive effect on net interest income. In the 2008 third and fourth quarters, certificates of deposit and FHLB advances amounting to \$491 million and \$201 million, respectively, are scheduled to mature. The weighted average rates on those liabilities are 4.24% and 3.97%, respectively.

- The average balance of loans outstanding as a percent of the average balance of total interest-earning assets increased from 79.6% in the first half of 2007 to 81.7% in the first half of 2008. Generally, the yield on loans is higher than the yield on investment securities.

- The average balance of short-term investments in the 2008 second quarter was \$66 million (47.3%) less than in the 2007 second quarter. As the average rate earned on short-term investments declined from 5.20% in the 2007 second quarter to 2.22% in the 2008 second quarter, funds were shifted into higher yielding debt securities. The average balance invested in debt securities increased \$40 million between the 2007 and 2008 second quarters.

- The average balance of interest-earning assets in the 2008 second quarter was \$109 million (4.8%) higher than the second quarter of 2007. While investments declined \$19 million, loans increased \$128 million (7.0%), \$56 million of which was in mortgage loans, \$41 million in commercial loans, \$15 million in Eastern loans, \$15 million in auto loans and \$1 million in other loans. Of the \$109 million increase in the average balance of interest-earning assets since a year ago, \$57 million occurred in the first quarter of 2008.

- The average yield on interest-earning assets was 6.35% in the 2007 second quarter. The average yield declined from 6.39% in the 2007 fourth quarter to 6.18% in the 2008 first quarter and 5.93% in the 2008 second quarter due primarily to the effect of the rapid rate reductions in the interbank borrowing rate mentioned earlier herein.

- The average balance of borrowings from the FHLB rose from \$468 million in the 2007 second quarter to \$602 million in the 2008 second quarter. Of the \$134 million increase, \$70 million occurred in the 2008 second quarter. The additional borrowings were used primarily to pay down brokered deposits (\$36 million) and subordinated debt (\$8 million) and to fund the \$51 million reduction in stockholders' equity resulting from stock repurchases and payment of semi-annual extra dividends and part of the loan growth. The average rate paid on FHLB borrowings declined from 4.82% in the 2007 second quarter to 4.34% in the 2008 second quarter.

#### **Auto Loans**

The auto portfolio grew modestly from \$591 million at June 30, 2007 to \$594 million at December 31, 2007 and \$597 million at June 30, 2008. Due to rising delinquencies and charge-offs and deteriorating trends in the economy and the auto industry, the Company commenced undertaking steps in the second half of 2007 to tighten its underwriting criteria. Also, effective July 1, 2008, the Company decided to terminate dealer accommodation loans due to higher risks normally associated with such loans. Such changes, coupled with weaker sales in the auto industry, could result in some shrinkage of the auto portfolio in the second half of 2008 and thereafter. On the other hand, the higher underwriting criteria should ultimately result in lower levels of charge-offs. In the next few quarters, however, charge-offs could continue to exceed levels experienced during better economic periods.

The effect of the changes in underwriting is evident in the decline of loans originated to borrowers with credit scores below 660 from \$44.0 million, or 13.7% of all loans originated in the year 2006, and \$25.4 million (13.4%) in the first half of 2007 to \$14.6 million (9.8%) in the second half of 2007 and \$10.5 million (6.8%) in the first half of 2008. At June 30, 2008, the average FICO score of the auto portfolio was 730 and the portion of the portfolio with FICO scores below 660 was 10.4%. Auto loans delinquent 30 days or more at June 30, 2008 were \$9.8 million (1.64% of the portfolio) compared to \$9.0 million (1.53%) at March 31, 2008 and \$11.7 million (1.98%) at December 31, 2007. According to data published by the American Bankers Association, the rate of all indirect auto loans in Massachusetts past due 30 days or more at March 31, 2008 (the latest date available) was 2.69%.

Table of Contents

Net charge-offs of auto loans have elevated over the last several quarters. In the first half of 2007, net charge-offs were \$1,295,000 (an annualized rate of 0.46% based on average loans outstanding). Thereafter, net charge-offs rose to \$1,232,000 (0.82%) in the 2007 third quarter, \$1,462,000 (0.97%) in the 2007 fourth quarter, \$1,371,000 (0.93%) in the 2008 first quarter and \$1,688,000 (1.14%) in the 2008 second quarter. The increases were attributable in part to the higher per unit losses from sales of repossessed vehicles. With the rise in the price of gas and weakening trends in the economy, the value of less fuel efficient vehicles has declined.

**Provision for Credit Losses**

The provision for credit losses was \$2,579,000 in the 2008 second quarter compared to \$1,107,000 in the 2007 second quarter and \$4,693,000 in the first half of 2008 compared to \$2,357,000 in the first half of 2007. The provision is comprised of amounts relating to the auto loan portfolio, the Eastern loan portfolio and the remainder of the Company's loan portfolio and unfunded commitments.

The provision for auto loan losses was \$2,200,000 in the 2008 second quarter compared to \$779,000 in the 2007 second quarter and \$3,746,000 in the first half of 2008 compared to \$1,623,000 in the first half of 2007. All of these amounts exceeded the net charge-offs in those periods of \$1,688,000, \$558,000, \$3,059,000 and \$1,295,000, respectively. Constant provisions in excess of net charge-offs has resulted in the allowance for auto loan losses growing from \$4,176,000 (0.77% of loans outstanding) at December 31, 2006 to \$5,662,000 (0.95%) at December 31, 2007 and \$6,349,000 (1.06%) at June 30, 2008. That latter percent exceed the 1.03% annualized rate of net charge-offs experienced in the first half of 2008. In evaluating the overall adequacy of the allowance for loan losses, one should take into consideration the unallocated portion of the allowance for loan losses of \$3,550,000 at June 30, 2008 that is available to offset any possible future shortfall should future charge-offs in any segments of the Company's loan portfolio exceed current estimates.

The provision for Eastern loan losses was \$129,000 in the 2008 second quarter compared to \$328,000 in the 2007 second quarter and \$397,000 in the first half of 2008 compared to \$709,000 in the first half of 2007. Net charge-offs in those periods were \$111,000, \$288,000, \$331,000 and \$679,000, respectively. The annualized rate of net charge-offs was 0.46% in the first half of 2008 compared to 1.06% in the first half of 2007 and 0.82% for the year 2007. Eastern loans delinquent 30 days or more improved from \$2,699,000 (1.91% of loans outstanding) at December 31, 2007 to \$2,520,000 (1.74%) at March 31, 2008 and \$2,485,000 (1.72%) at June 30, 2008. The allowance for Eastern loan losses at June 30, 2008 was \$2,493,000, or 1.72% of Eastern's \$145 million portfolio.

The remainder of the Company's loan portfolio at June 30, 2008 was comprised of residential mortgage loans (\$321 million), multi-family and commercial real estate mortgage loans (\$785 million), construction loans (\$25 million), home equity loans (\$37 million), commercial loans (\$168 million) and other consumer loans (\$4 million), less unadvanced funds on those loans of \$121 million. These parts of the portfolio, which grew by only \$27 million in the year 2007, grew \$40 million in the 2008 first quarter and \$46 million in the 2008 second quarter. Growth in the first half of the year was concentrated primarily in residential mortgage loans (\$25 million) and other mortgage loans, substantially commercial (\$56 million).

The provision for credit losses related to the portfolio addressed in the preceding paragraph and to unfunded commitments was \$250,000 in the 2008 second quarter compared to none in the 2007 second quarter and \$550,000 in the first half of 2008 compared to \$25,000 in the first half of 2007. The provision was established solely due to loan growth in those periods, as no loan charge-offs were experienced other than an inconsequential amount of consumer loans. (Earnings were charged \$67,000 in the first half of 2008 as a result of write-downs in the carrying value of a foreclosed property in the Company's portfolio.)

**Valuation of Investment Securities**

*Marketable Equity Preferred Stock Securities*

In the second half of 2007, the Company purchased adjustable rate perpetual preferred stock issued by Merrill and FNMA at a total cost of \$3,928,000. The market value of the preferred stock issues declined in the fourth quarter of 2007 due primarily to announcement of losses incurred by Merrill and FNMA in connection with their involvement in the mortgage lending and mortgage securities markets. The magnitude of the losses prompted both Merrill and FNMA to raise additional capital. Further declines in the market value of the preferred stocks occurred in the 2008 first quarter as uncertainty grew regarding how much more in losses Merrill and FNMA might be required to announce and what consequences any such losses might have on their financial soundness. Based on these developments, the Company concluded that an other than temporary impairment in the value of the securities had occurred. A loss of \$1,249,000 was charged to earnings which equaled the entire difference between the cost of the securities and their fair value at March 31, 2008. Fair value was based on the quoted market price of the preferred stocks at that date (Merrill - \$932,000 and FNMA - \$1,747,000).

Table of Contents

At June 30, 2008, the combined market value of the Merrill and FNMA securities owned by the Company exceeded their carrying value by \$6,000. In July, the market value of the securities declined based on public information about operating losses at Merrill and FNMA. As of July 29, 2008, the market value of the Merrill and FNMA securities was \$662,000 and \$1,101,000, respectively. The combination of these amounts was \$923,000 less than the combined carrying value of the securities. It is anticipated that additional information about the two companies will become available in the coming months. If, after evaluating such additional information, it becomes evident that other than temporary impairment in the value of these securities has occurred, a charge to earnings will be recorded in an amount that adjusts the carrying value of the securities to their market value as of the date of determination of impairment.

*Auction Rate Municipal Obligations*

Included in the Company's investment securities at June 30, 2008 were auction rate municipal obligations acquired at a total cost of \$5,500,000. The amount invested in such obligations was \$9,775,000 at March 31, 2008 and \$13,050,000 at December 31, 2007. The reductions since the beginning of the year resulted from a combination of payments received from the debt issuers who called certain obligations and proceeds from sales, all of which were at face value and, accordingly, resulted in no losses.

Auction rate municipal obligations are debt securities issued by municipal, county and state entities that are repaid generally from revenue sources such as hospitals, transportation systems, student education loans and property taxes. The securities are not obligations of the issuing government entity. The obligations are variable rate securities with long-term maturities whose interest rates are set periodically through an auction process. The auction period typically ranges from 7 days to 35 days.

The auction rate municipal obligations owned by the Company were rated AAA at December 31, 2007 due, in part, to the guarantee of third party insurers who would have to pay the obligations if the issuers fail to pay the obligations when they become due. In the 2008 first quarter, public disclosures suggested that certain third party insurers were experiencing financial difficulties and, therefore, might have difficulty meeting their guarantee obligations should issuers fail to pay their contractual obligations. This possibility caused a lowering of the ratings of many auction rate municipal obligations which, in turn, lessened the interest of investors to own such obligations. On a stand-alone basis, that is, without the guarantee of a third-party insurer, all of the auction rate municipal obligations owned by the Company at June 30, 2008 were rated A or better, except for one issue amounting to \$600,000 that did not have a stand-alone rating.

In February 2008, auctions relating to obligations owned by the Company, as well as auctions relating to obligations not owned by the Company, failed to attract a sufficient number of investors. Upon an auction failure, generally the obligations become subject to a penalty imposing a rise in the interest rate to be paid on the obligation. The auction failures effectively created a liquidity problem for those investors who were relying on the obligations to be redeemable through auctions. Continued auction failures can result in an investment that investors expected to be of relatively short duration becoming an investment with a long-term duration.

The Company has consistently classified its investments in auction rate municipal obligations as available for sale. At financial reporting dates, market value was considered to equal the face amount of the obligations since the frequent auctions provided the means to quickly sell the obligations at face value if the Company wished to do so. Prior to February 2008, there were no instances of failed auctions.

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Full collectibility of the obligations has never been of concern to the Company. None of the issuers of the obligations owned by the Company has defaulted in meeting their scheduled payments and their financial condition is considered to be sound. In the opinion of Company management, as of June 30, 2008, no other than temporary impairment in value has occurred.

The failed auctions raise the question as to whether the fair value of the obligations as of June 30, 2008 is less than their face value. No active market has developed with respect to auction rate municipal obligations. It is our understanding that periodic sales have occurred at prices in the range of 90% of face value, although we have not seen any published information to support our understanding. Further we do not know to what extent investors who sold their auction rate municipal obligations were compelled to do so for reasons such as addressing a liquidity concern.

Based on an assessment of the factors mentioned above plus the ample liquidity of the Company, we concluded that the fair value of the Company's auction rate municipal obligations approximated their face value at June 30, 2008. (Subsequent to that date, the Company received \$100,000 from a partial sale of an obligation through an auction, thus reducing its total investment in auction rate municipal obligations to \$5,400,000.) We do not foresee any need to redeem the obligations in the future and, accordingly, we will continue to hold the securities should auctions continue to fail. If a case were to be made that the fair value of the obligations was 10% less than their face value (an assumption which we do not believe is valid), the impact would be to reduce stockholders' equity by \$346,000 (\$540,000 less related income taxes), or less than one-tenth of one percent of stockholders' equity at June 30, 2008. This amount is insignificant in relation to the Company's



Table of Contents

consolidated financial statements.

**Other Operating Highlights**

*Non-Interest Income.* Non-interest income was \$1,281,000 in the 2007 second quarter compared to \$1,123,000 in the 2008 second quarter as mortgage loan prepayment fees declined from \$333,000 to \$157,000 in those respective periods. Excluding the loss on the write-down of securities, non-interest income was \$2,117,000 in the first half of 2008 compared to \$2,331,000 in the first half of 2007. The reduction resulted from a decline in mortgage loan prepayment fees (\$194,000 compared to \$459,000) which was partially offset by fees resulting from introduction of a courtesy overdraft program.

*Non-Interest Expense.* Excluding amortization of intangible assets, non-interest expenses were \$275,000 (2.8%) higher in the 2008 second quarter than in the 2007 second quarter and \$813,000 (4.3%) higher in the first half of 2008 than in the first half of 2007. The increases resulted primarily from higher loan collection and auto repossession costs, data processing expenses and professional fees.

*Provision for Income Taxes.* The effective rate of income taxes applied to the Company's pre-tax income rose from 38.6% in the first half of 2007 to 39.1% in the first half of 2008 due primarily to a lower portion of taxable income being earned by the Company's investment securities subsidiaries. Income in those subsidiaries is subject to a lower rate of state taxation than income earned by the Company and its other subsidiaries.

**Other Financial Condition Highlights**

*Retail Deposits.* Retail deposits at March 31, 2008 were \$60.9 million, or 4.9%, higher than at December 31, 2007. Of that growth, \$17.6 million was in transaction accounts (mostly money market savings accounts) and \$43.3 million in certificate of deposit accounts. In the 2008 second quarter, transaction deposit accounts increased \$11.5 million due to growth of demand checking accounts and NOW accounts while certificate of deposit accounts declined \$40.6 million due to the lowering of rates offered on such deposits.

*Brokered Deposits.* Brokered deposits declined from \$67.9 million at December 31, 2007 and March 31, 2008 to \$27.0 million at June 30, 2008 as a result of payoffs upon maturity. The deposits were not rolled over because the rates offered on new brokered deposits were higher than rates offered on alternative funding sources.

*Borrowed Funds.* Borrowings from the FHLB declined from \$548.0 million at December 31, 2007 to \$540.1 million at March 31, 2008, but increased to \$652.8 million at June 30, 2008. The increased borrowings were used primarily to pay off brokered deposits, replace the \$29.1 million outflow of deposits and fund part of the loan growth.

*Stockholders Equity.* The decline in stockholders equity from \$518.7 million at December 31, 2007 to \$505.8 million at June 30, 2008 resulted primarily from dividend payments exceeding earnings.

On July 17, 2008, the Board of Directors approved payment of a regular quarterly dividend of \$0.085 per share and an extra dividend of \$0.20 per share payable on August 15, 2008 to stockholders of record July 31, 2008. This extra dividend is the eleventh time since August 2003 that an extra dividend of \$0.20 per share is paid. The aggregate amount of the extra dividends, over \$130 million or \$2.20 per share, represents a return of capital rather than a distribution of earnings. (For income tax purposes, such payments have had to be reported as taxable income.) The payout of extra dividends semi-annually has been an effective means to reduce the Company's capital in a measured way and to treat all stockholders equally. While it is the intent of the Board of Directors to continue to return excess capital to stockholders, the decision to pay dividends and the magnitude of any payments will be considered in light of changing opportunities to deploy capital effectively, including the repurchase of the Company's common stock and expansion of the Company's business through acquisitions.

#### **Change in Massachusetts Tax Rates**

On July 3, 2008, the state of Massachusetts enacted a law that included reducing the tax rate on net income applicable to financial institutions. The rate drops from the current rate of 10.5% to 10% for tax years beginning on January 1, 2010, 9.5% for tax years beginning on or after January 1, 2011, and to 9% for tax years beginning on or after January 1, 2012 and thereafter. The Company continues to analyze the impact of this law and, as a result of revaluing its net deferred tax asset, we estimate the impact to be additional tax expense of between \$100,000 and \$150,000. This charge is expected to be recognized during the third quarter of 2008.

Table of Contents**Non-Performing Assets, Restructured Loans and Allowance for Loan Losses**

The following table sets forth information regarding non-performing assets, restructured loans and the allowance for loan losses:

|   | June 30,<br>2008 | December 31,<br>2007 |
|---|------------------|----------------------|
| (Dollars in thousands)                                |                  |                      |
| Non-accrual loans:                                    |                  |                      |
| Mortgage loans:                                       |                  |                      |
| One-to-four family                                    | \$ 634           | \$ 29                |
| Commercial real estate                                | 2,342            |                      |
| Commercial loans - Eastern                            | 2,097            | 2,265                |
| Indirect automobile loans                             | 149              | 427                  |
| Other consumer loans                                  |                  | \$ 9                 |
| Total non-accrual loans                               | 5,222            | 2,730                |
| Repossessed vehicles                                  | 1,145            | 1,621                |
| Repossessed equipment                                 | 472              | 531                  |
| Other real estate owned                               | 100              | 517                  |
| Total non-performing assets                           | \$ 6,939         | \$ 5,399             |
| Restructured loans - Eastern                          | \$ 1,822         | \$ 887               |
| Allowance for loan losses                             | \$ 25,722        | \$ 24,445            |
| Allowance for loan losses as a percent of total loans | 1.30%            | 1.29%                |
| Non-accrual loans as a percent of total loans         | 0.26%            | 0.14%                |
| Non-performing assets as a percent of total assets    | 0.28%            | 0.22%                |

Loans are placed on non-accrual status either when reasonable doubt exists as to the full timely collection of interest and principal or automatically when loans become past due 90 days. At June 30, 2008, the \$2,340,000 of commercial real estate mortgage loans on non-accrual relate to one borrower and the \$634,000 of one-to-four family mortgage loans on non-accrual relate to four borrowers. These loans are considered to be adequately secured.

In addition to identifying non-performing loans, the Company identifies loans that are characterized as impaired pursuant to generally accepted accounting principles. The definition of impaired loans is not the same as the definition of non-accrual loans, although the two categories tend to overlap. All of the Eastern loans on non-accrual at June 30, 2008 and December 31, 2007 and the commercial real estate mortgage loan on non-accrual at June 30, 2008 were considered to be impaired loans. Specific reserves on those loans amounted to \$594,000 and \$515,000 at those respective dates.

Restructured loans represent performing loans for which concessions (such as extension of repayment terms or reductions of interest rates to below market rates) are granted due to a borrower's financial condition. All of the restructured loans at June 30, 2008 and December 31, 2007 were loans originated by Eastern. The increase in restructured loans resulted primarily from extensions of the term over which the loans are to be paid.

The reduction in repossessed vehicles resulted from auction sales. The inventory of repossessed vehicles could rise if auto loan borrowers experience difficulties in meeting their payments on a timely basis. It should also be noted that sales of repossessed vehicles at auctions are resulting in much higher per unit losses. Due to the economy and rising fuel prices, the market for repossessed luxury vehicles and vehicles that are fuel-inefficient is weak. Accordingly, auto loan charge-offs could continue to be high over the remainder of 2008.

For further information about loan delinquencies and charge-offs, see the subsection "Provision for Loan Losses" included herein.

The unallocated portion of the allowance for loan losses was \$3,550,000, or 13.8%, of the total allowance for loan losses at June 30, 2008 compared to \$3,987,000, or 16.3%, of the total allowance for loan losses at December 31, 2007.

#### **Asset/Liability Management**

The Company's Asset/Liability Committee is responsible for managing interest rate risk and reviewing with the Board of Directors on a quarterly basis its activities and strategies, the effect of those strategies on the Company's operating results, the Company's interest rate risk position and the effect changes in interest rates would have on the Company's net interest income.

Table of Contents

Generally, it is the Company's policy to reasonably match the rate sensitivity of its assets and liabilities. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within the same time period.

At June 30, 2008, interest-earning assets maturing or repricing within one year amounted to \$980 million and interest-bearing liabilities maturing or repricing within one year amounted to \$1.278 billion, resulting in a cumulative one year negative gap position of \$298 million, or 11.9% of total assets. At December 31, 2007, the Company had a negative one year cumulative gap position of \$209 million, or 8.6% of total assets. The change in the cumulative one year gap position from the end of 2007 resulted primarily from reduction in the total of short-term investments and an increase in borrowings maturing within one year.

**Liquidity and Capital Resources**

The Company's primary sources of funds are deposits, principal and interest payments on loans and debt securities and borrowings from the FHLB. While maturities and scheduled amortization of loans and investments are predictable sources of funds, deposit flows and mortgage loan prepayments are greatly influenced by interest rate trends, economic conditions and competition.

Based on its monitoring of deposit trends and its current pricing strategy for deposits, management believes the Company will retain a large portion of its existing deposit base. Growth during the remainder of 2008 will depend on several factors, including the interest rate environment and competitor pricing.

The Company utilizes advances from the FHLB to fund growth and to manage part of the interest rate sensitivity of its assets and liabilities. Total advances outstanding at June 30, 2008 amounted to \$652.8 million and the Company had the capacity to increase that amount to \$739.1 million.

The Company's most liquid assets are cash and due from banks, short-term investments and debt securities that generally mature within 90 days. At June 30, 2008, such assets amounted to \$135.5 million, or 5.4% of total assets.

At June 30, 2008, Brookline Bank exceeded all regulatory capital requirements. The Bank's Tier I capital was \$424.9 million, or 17.5% of adjusted assets. The minimum required Tier I capital ratio is 4.00%.

**Recent Accounting Pronouncements**

*Statement of Financial Accounting Standards No. 159 ( SFAS 159 ), Fair Value Option for Financial Assets and Financial Liabilities* . In February 2007, the FASB issued SFAS 159 which generally permits the measurement of selected eligible financial

instruments, including investment securities, at fair value as of specified election dates and to report unrealized gains or losses on those instruments in earnings at each subsequent reporting date. Generally, the fair value option may be applied on an instrument by instrument basis but, once applied, the election is irrevocable and is applied to the entire instrument. The provisions of SFAS 159 were effective as of January 1, 2008. However, the Company has not elected the fair value option under SFAS 159.

*Statement of Financial Accounting Standards No. 141 (Revised 2007), Business Combinations ( SFAS 141R ) and Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 ( SFAS 160 ).* In December 2007, the FASB issued SFAS 141R and SFAS 160. These statements require significant changes in the accounting and reporting for business acquisitions and the reporting of noncontrolling interests in subsidiaries. Among many changes under SFAS 141R, an acquirer will record 100% of all assets and liabilities at fair value for partial acquisitions, contingent consideration will be recognized at fair value at the acquisition date with changes possibly recognized in earnings, and acquisition related costs will be expensed rather than capitalized. SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary. Key changes under the standard are that noncontrolling interests in a subsidiary will be reported as part of equity, losses allocated to a noncontrolling interest can result in a deficit balance, and changes in ownership interests that do not result in a change of control are accounted for as equity transactions and, upon a loss of control, gain or loss is recognized and the remaining interest is remeasured at fair value on the date control is lost. SFAS 141R applies prospectively to business combinations for which the acquisition is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The effective date for applying SFAS 160 is also the first annual reporting period beginning on or after December 15, 2008. Adoption of these statements will affect the Company's accounting for any business acquisitions occurring after the effective date and the reporting of any noncontrolling interests in subsidiaries existing on or after the effective date.

Table of Contents

**Item 3. Quantitative and Qualitative Disclosures about Market Risks**

For a discussion of the Company's management of market risk exposure and quantitative information about market risk, see pages 15 through 17 of the Company's Annual Report incorporated by reference in Part II item 7A of Form 10-K for the fiscal year ending December 31, 2007.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of the Company's management, including its chief executive officer and chief financial officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the chief executive officer and the chief financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to insure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms.

There has been no change in the Company's internal control over financial reporting identified in connection with the quarterly evaluation that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II - Other Information**

**Item 1. Legal Proceedings**

On February 21, 2007, Carrie E. Mosca filed a putative class action complaint against Brookline Bank in the Superior Court for the Commonwealth of Massachusetts (the "Action"). Ms. Mosca defaulted on a loan obligation on an automobile that she co-owned. She alleges that the form of notice of sale of collateral that the Bank sent to her after she and the co-owner became delinquent on the loan obligation did not contain information required to be provided to a consumer under the Massachusetts Uniform Commercial Code. The Action purports to be brought on behalf of a class of individuals who purchased a motor vehicle from a dealer located in Massachusetts and to whom the Bank sent the same form of notice of sale of collateral during the four year period prior to the filing of the Action. The Action seeks statutory damages, an order restraining the Bank from future use of the form of notice sent to Ms. Mosca, an order barring the Bank from recovering any deficiency from other individuals to whom it sent the same form of notice, attorneys' fees, litigation expenses and costs. The Bank has answered, denying liability and has opposed Plaintiff's motion to certify a class. The Court denied Plaintiff's motion for class certification in an order dated July 18, 2008. On July 31, 2008, Plaintiff served a motion for summary judgment seeking an award of damages in the amount of \$2,928 to her individually. The Bank has not yet served its response to the motion.

In addition to the above matter, the Company and its subsidiaries are involved in litigation that is considered incidental to the business of the Company. Management believes the results of such litigation will be immaterial to the consolidated financial condition or results of operations of the Company.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors presented in the Company's Form 10-K for the year ended December 31, 2007 filed on February 28, 2008.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

a) Not applicable.

b) Not applicable.

c) The following table presents a summary of the Company's share repurchases during the quarter ended June 30, 2008.

| Period                        | Total Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid Per<br>Share | Total Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Programs (1) (2) (3) | Maximum<br>Number of Shares<br>that May Yet<br>be Purchased<br>Under the<br>Programs (1) (2) (3) |
|-------------------------------|--|---------------------------------------|--|--|
| April 1 through June 30, 2008 |  |                                       | 2,195,590  | 4,804,410  |

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(1) On April 19, 2007, the Board of Directors approved a program to repurchase 2,500,000 shares of the Company's



Table of Contents

common stock. Prior to April 1, 2008, 2,195,590 shares authorized under this program had been repurchased. At June 30, 2008, 304,410 shares authorized under this program remained available for repurchase.

- (2) On July 19, 2007, the Board of Directors approved another program to repurchase an additional 2,000,000 shares of the Company's common stock. At June 30, 2008, all of the 2,000,000 shares authorized under this program remained available for repurchase.
- (3) On January 17, 2008, the Board of Directors approved another program to repurchase an additional 2,500,000 shares of the Company's common stock. At June 30, 2008, all of the 2,500,000 shares authorized under this program remained available for repurchase.

The Board of Directors has delegated to the discretion of the Company's senior management the authority to determine the timing of the repurchases and the prices at which the repurchases will be made.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

On April 17, 2008, the Company held its annual meeting of stockholders for the purpose of the election of four Directors to three year terms and ratification of the appointment of KPMG LLP as the independent registered public accounting firm for the Company for the year ending December 31, 2008.

The number of votes cast at the meeting was as follow:

|                               | Number of<br>Votes For | Number of<br>Votes Withheld |
|-------------------------------|------------------------|-----------------------------|
| <b>Election of Directors:</b> |                        |                             |
| George C. Caner.              | 52,281,944             | 1,348,586                   |
| Richard P. Chapman, Jr.       | 52,296,857             | 1,333,673                   |
| William V. Tripp, III.        | 52,333,887             | 1,296,643                   |
| Peter O. Wilde.               | 52,311,316             | 1,319,214                   |

|  | Number of<br>Votes For | Number of<br>Votes Against | Number of Votes<br>Abstained |
|--|------------------------|----------------------------|------------------------------|
| Ratification of appointment of the independent registered public accounting firm | 53,068,831             | 458,201                    | 103,498                      |

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

*Exhibits*

Exhibit 11                    Statement Regarding Computation of Per Share Earnings

Exhibit 31.1                Certification of Chief Executive Officer

Exhibit 31.2                Certification of Chief Financial Officer

Exhibit 32.1                Section 1350 Certification of Chief Executive Officer

Exhibit 32.2                Section 1350 Certification of Chief Financial Officer

Table of Contents

**SIGNATURES**

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

**BROOKLINE BANCORP, INC.**

Date: July 31, 2008

By: /s/ Richard P. Chapman, Jr.  
Richard P. Chapman, Jr.  
President and Chief Executive Officer

Date: July 31, 2008

By: /s/ Paul R. Bechet  
Paul R. Bechet  
Senior Vice President, Treasurer and Chief Financial Officer