BROOKLINE BANCORP INC
Form 10-K
March 10, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

ý	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934,**

for the Fiscal Year Ended December 31, 2005

or

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

for the transition period from N/A to

Commission File Number: 0-23695

BROOKLINE BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation of organization)	**04-3402944** (I.R.S. Employer Identification No.)
160 Washington Street, Brookline, Massachusetts (Address of principal executive offices)	**02447-0469** (Zip Code)

(617) 730-3500
(Registrant s telephone number, including area code)

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

Title of Each Class	**Name of Each Exchange on Which Registered**

None	None

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

Common Stock, par value of $0.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1934.

YES ý NO o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Act of 1934.

YES o NO ý

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 requirement for the past 90 days. YES ý NO o

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

Indicate by check mark whether the registrant is a large accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer . Large accelerated filer ý Accelerated filer o Non-accelerated filer o

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

The number of shares of common stock held by nonaffiliates of the registrant as of March 1, 2006 was 60,898,612 for an aggregate market value of $922.6 million. This excludes 685,161 shares held by Brookline Bank Employee Stock Ownership Plan and Trust.

At March 1, 2006, the number of shares of common stock, par value $0.01 per share, issued and outstanding were 62,989,384 and 61,583,773, respectively.

DOCUMENTS INCORPORATED BY REFERENCE

1. Sections of the Annual Report to Stockholders for the year ended December 31, 2005 (Part II and Part III)

2. Proxy Statement for the Annual Meeting of Stockholders dated March 14, 2006 (Part I and Part III)

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

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PRIVATE SECURITIES LITIGATION REFORM ACT SAFE HARBOR STATEMENT

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that may be identified by the use of such words as may , could , should , will , would , believe , expect , anticipate , intend , plan , assume or similar expressions. Examples of forward-looking statements include, but are not limited to, estimates with respect to the Company s financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from those estimates. 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.

PART I

Item 1. Business

General

Brookline Bancorp, Inc. (the Company) was organized in November 1997 for the purpose of acquiring all of the capital stock of Brookline Savings Bank (Brookline or the Bank) upon completion of the reorganization of Brookline from a mutual savings bank into a mutual holding company structure. In January 2003, Brookline Savings Bank changed its name to Brookline Bank. Brookline was established as a savings bank in 1871. Brookline Bancorp, MHC (the MHC), a mutual holding company, owned 15,420,350 of the Company s shares of outstanding common stock through July 9, 2002.

In June 2000, the Company commenced operations of Lighthouse Bank (Lighthouse) as New England s first-chartered internet-only bank. On July 17, 2001, Lighthouse was merged into Brookline.

The Company, the MHC, Brookline and Lighthouse converted from state to federal charters on July 16, 2001. As a result, each of these entities became subject to regulation by the Office of Thrift Supervision (OTS).

On July 9, 2002, the Boards of Directors of the MHC, the Company and Brookline completed a Plan of Conversion and Reorganization. As of that date, the 15,420,350 shares owned by the MHC were retired and the Company sold 33,723,750 shares of common stock for $10.00 per share. After taking into consideration related expenses of $4.5 million, net proceeds from the stock offering amounted to $332.7 million. An additional 24,888,478 shares were issued to existing stockholders based on an exchange rate of 2.186964 new shares of common stock for each existing share, resulting in 58,612,228 total new shares outstanding. Cash was paid in lieu of fractional shares.

Upon completion of the Plan of Conversion and Reorganization, (a) Brookline Bancorp, Inc. became a Delaware corporation and the holding company parent of the Bank, (b) the MHC ceased to exist and (c) the net assets of the MHC, $8.5 million, were transferred into Brookline.

On January 7, 2005, the Company completed the acquisition of Mystic Financial, Inc. (Mystic) for approximately $69.1 million. That amount consisted of $27.7 million in cash (including approximately $3.9 million for the cancellation of Mystic stock options), issuance of 2,516,525 shares of the Company s common stock, $1.6 million in income tax benefits related to cancellation of the Mystic stock options , $4.7 million of direct acquisition costs, net of related tax benefits, and a credit of $1.1 million for 70,312 shares of Company common stock obtained and placed in treasury resulting from termination of Mystic s employee stock option plan and Company common stock owned by Mystic.

Mystic was the parent of Medford Co-operative Bank, a bank headquartered in Medford, Massachusetts with seven banking offices serving customers primarily in Middlesex County in Massachusetts. The acquisition of Mystic has provided expanded commercial and retail banking opportunities in that market and enabled the Company to deploy some of its excess capital. For additional information about the acquisition, see note 2 to the consolidated financial statements in the Company s Annual Report to Stockholders for the year ended December 31, 2005 which is incorporated herein by reference.

On February 28, 2006, the Company signed a merger agreement to increase its ownership interest in Eastern Funding LLC (Eastern) from approximately 29% to 86% through a cash payment of approximately $16.2 million, excluding related transaction costs. Eastern, which had total assets of approximately $106 million at December 31, 2005, specializes primarily in the financing of coin-operated laundry and dry cleaning equipment in the greater metropolitan New York area and selected other locations in the Northeast. The acquisition, which is subject to the approval of Eastern investors and the

Company s regulators, is expected to be completed in the second quarter of 2006 and to be modestly accretive to earnings immediately thereafter.

Market Area and Credit Risk Concentration

As of December 31, 2005, Brookline operated fifteen full-service banking offices in Brookline, Medford and adjacent communities in Middlesex County and Norfolk County in Massachusetts.

Brookline s deposits are gathered from the general public primarily in the communities in which its banking offices are located. Brookline s lending activities are concentrated primarily in the greater Boston metropolitan area and eastern Massachusetts. The greater Boston metropolitan area benefits from the presence of numerous institutions of higher learning, medical care and research centers and the corporate headquarters of several significant mutual fund investment companies. Eastern Massachusetts also has many high technology companies employing personnel with specialized skills. It should be noted, however, that Massachusetts is the only state in the United States that has lost population for two years in a row. These factors affect the demand for residential homes, multi-family apartments, office buildings, shopping centers, industrial warehouses and other commercial properties.

Brookline s urban and suburban market area is characterized by a large number of apartment buildings, condominiums and office buildings. As a result, for many years, Brookline has emphasized multi-family and commercial real estate mortgage lending. These types of loans typically generate higher yields, but also involve greater credit risk than one-to four-family mortgage loans. Many of Brookline s borrowers have more than one multi-family or commercial real estate loan outstanding with Brookline. Moreover, the loans are concentrated in the market area described in the preceding paragraph.

In the first quarter of 2003, the Company commenced originating indirect automobile loans. In general, the success of lending in this business segment depends on many factors, the more significant of which include the policies established for loan underwriting, the monitoring of portfolio performance, and the effect of economic conditions on consumers and the automobile industry. For regulatory purposes, the Company s loan portfolio is not classified as subprime lending . Most of the Company s loans are originated through automobile dealerships in Massachusetts.

In February 2006, Brookline hired a senior officer with 34 years of experience to be responsible for commercial loans to businesses for working capital and other business-related purposes. It is contemplated that such lending will be to companies located primarily in Massachusetts. As with commercial real estate mortgage loans, commercial business loans involve greater credit risk. Success of lending in this segment likewise depends on many factors including the policies established for loan underwriting, the monitoring of borrower performance, competitive factors affecting a borrower s business and the state of the economy.

Economic Conditions and Governmental Policies

The earnings and business of the Company are affected by external influences such as general economic conditions and the policies of governmental authorities, including the Federal Reserve Board. The Federal Reserve Board regulates the supply of money and bank credit to influence general economic conditions throughout the United States. The instruments of monetary policy employed by the Federal Reserve Board affect interest rates earned on investment securities and loans and interest rates paid on deposits and borrowed funds.

Repayment of multi-family and commercial real estate loans made by the Company generally is dependent on sufficient income from the properties to cover operating expenses and debt service. Repayment of commercial loans generally is dependent on the demand for the borrowers products or services and the ability of the borrower to compete and operate on a profitable basis. Repayment of indirect automobile loans generally is dependent on the financial well-being of the borrowers and their capacity to service their debt levels. The asset quality of the Company s loan portfolio, therefore, is greatly affected by the economy in the Company s market area.

Since June 2004, the Federal Reserve Board has increased the federal funds rate for overnight borrowings between banks fourteen times resulting in a rate of 4.50% as of the end of February 2006, the highest level in the past four and one-half years. As a result of these rate setting actions, a flat yield curve has evolved that has put pressure on the Company s net interest margin. The rate increases also prompted some of the Company s borrowers to refinance existing loans and seek new loans at fixed rates of interest for extended periods of time. If further rate increases are approved by the Federal Reserve Board, the ability of borrowers to service their debt could be adversely affected as well as the value of properties and assets pledged as collateral for loans.

Competition

The Company faces significant competition both in making loans and in attracting deposits. The Boston metropolitan area has a high density of financial institutions, many of which are branches of significantly larger institutions which have greater financial resources than the Company, and all of which are competitors of the Company to varying degrees. The Company s competition for loans comes principally from commercial banks, savings banks, savings and loan associations, mortgage banking companies, credit unions, insurance companies and other financial service companies. Its most direct competition for deposits has historically come from commercial banks, savings banks, savings and loan associations and credit unions. The Company faces additional competition for deposits from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

Competition for loans and deposits intensified greatly in 2005. As a result, rates paid for deposits increased more rapidly than the increases in rates set by the Federal Reserve Board for borrowings between banks. Rates offered on new loans, however, did not increase at the same price needed to sustain historic levels of profit margin.

Investment Securities

The investment policy of the Company is reviewed and approved by the Board of Directors on an annual basis. The current policy states that investments should generally be of high quality and credit risk should be limited through diversification. Investment decisions are made based on the safety of the investment, expected earnings in relation to investment risk, the liquidity needs of the Company, the interest rate risk profile of the Company, and economic and market trends.

Generally, debt securities must be rated A or better by at least one nationally-recognized rating agency at the time of purchase. Debt securities rated BBB at the time of purchase are allowed provided the security has a scheduled maturity of no more than two years and the purchase is authorized by the chief executive officer of the Company. The carrying value of all debt securities in the Company s investment portfolio that are not rated or rated BBB or lower are not to exceed 10.0% of stockholders equity, excluding unrealized gains on securities available for sale (core capital). At December 31, 2005, $1.5 million of debt securities were rated BBB or lower, an amount equal to 0.3% of core capital.

U.S. Government-Sponsored Enterprises

The Company invests in debt securities issued by U.S. Government-sponsored enterprises. Such investments include debt securities issued by the Federal Home Loan Banks, Fannie Mae, Ginnie Mae and the Federal Farm Credit Bank. None of those obligations is backed by the full faith and credit of the U.S. Government. The aggregate carrying value of such debt securities are not to exceed 60% of the Company s stockholders equity and the aggregate carrying value of debt securities issued by the Federal Home Loan Banks and any other U.S. Government-sponsored enterprise should be no more than 50% and 25%, respectively, of the Company's total investments in debt securities issued by U.S. Government-sponsored enterprises.

In 2005, most of the Company s investment purchases were debt securities issued by U.S. Government-sponsored enterprises with maturities primarily in the eighteen month to two year range. The Company concentrated on acquiring debt securities with short maturities to reduce interest rate risk during a period of rising interest rates. The aggregate carrying value of debt securities issued by U.S. Government-sponsored enterprises of $293.5 million at December 31, 2005 equalled 48.7% of the Company s stockholders equity at that date. Of that total, $151.2 million, or 51.5%, was invested in debt securities issued by the Federal Home Loan Banks and $74.2 million, or 25.3%, was invested in debt securities issued by Fannie Mae. These percentages slightly exceeded the Company s policy limits of 50% and 25%, respectively. All of such debt securities were rated AAA except for one debt security with a carrying value of $2.0 million that was rated AA .

Corporate Obligations

Regarding investments in corporate obligations, no more than $5.0 million of any debt security should mature beyond one year at the time of purchase, no investment of more than $3.0 million in any debt security can be made without the prior approval of the chief executive officer of the Company and no investment of over $8.0 million can be made without the prior approval of the Executive Committee of the Board of Directors. To maintain diversification in the portfolio, the aggregate carrying value of debt securities issued by one company (excluding short-term investments) must not exceed $15.0 million and the aggregate carrying value of debt securities issued by companies considered to be in the same industry must not exceed $75.0 million. The latter limit is allowed provided the aggregate value of investments rated less than AA does not exceed $50.0 million. At December 31, 2005, the total of corporate obligations was $8.5 million and the total amount of debt securities issued by corporate entities in the same industry was $3.0 million.

Mortgage Securities

The Company also invests in mortgage related securities, including collateralized mortgage obligations (CMOs). These securities are considered attractive investments because they (a) generate positive yields with minimal administrative expense, (b) impose minimal credit risk as a result of the guarantees usually provided, (c) can be utilized as collateral for borrowings, (d) generate cash flows useful for liquidity management and (e) are qualified thrift investments for purposes of the thrift lender test that the Company is obliged to meet for regulatory purposes.

Mortgage related securities are created by the pooling of mortgages and the issuance of a security with an interest rate that is less than the average interest rate on the underlying mortgages. Mortgage related securities purchased by the Company generally are comprised of a pool of single-family mortgages. The issuers of such securities are generally U.S. Government-sponsored enterprises such as Fannie Mae, Freddie Mac and Ginnie Mae who pool and resell participation interests in the form of securities to investors and guarantee the payment of principal and interest to the investors. Occasionally, the Company purchases mortgage related securities that are not issued by U.S. Government-sponsored enterprises. Such purchases are usually made for community reinvestment (CRA) purposes. Mortgage related securities generally yield less than the loans that underlie such securities because of the cost of payment guarantees and credit enhancements.

Investments in mortgage related securities generally do not entail significant credit risk. Such investments, however, are susceptible to significant interest rate and cash flow risks when actual cash flows from the investments differ from cash flows estimated at the time of purchase. Additionally, the market value of such securities can be affected adversely by market changes in interest rates. Prepayments that are faster than anticipated may shorten the life of a security and result in the accelerated expensing of any premiums paid, thereby reducing the net yield earned on the security. Although prepayments of underlying mortgages depend on many factors, the difference between the interest rates on the underlying mortgages and prevailing mortgage interest rates generally is the most significant determinant of the rate of prepayments. During periods of declining interest rates, refinancing generally increases and accelerates the prepayment of underlying mortgages and the related security. Such an occurrence can also create reinvestment risk because of the unavailability of other investments with a comparable rate of return in relation to the nature and maturity of the alternative investment. Conversely, in a rising interest rate environment, prepayments may decline, thereby extending the estimated life of the security and depriving the Company of the ability to reinvest cash flows at the higher market rates of interest.

CMOs are a type of debt security issued by a special purpose entity that aggregates pools of mortgages and mortgage related securities and creates different classes of CMO securities with varying maturities and amortization schedules as well as residual interest with each class possessing different risk characteristics. The cash flows from the underlying collateral are generally divided into tranches , or classes, whereby tranches have descending priorities with respect to the distribution of principal and interest repayment of the underlying mortgages and mortgage related securities, as opposed to pass through mortgage-backed securities where cash flows are distributed pro rata to all security holders. In contrast to mortgage-backed securities from which cash flow is received pro rata by all security holders (and hence, prepayment risk is shared), the cash flow from the mortgages or mortgage related securities underlying CMOs is paid in accordance with predetermined priority to investors holding various tranches of such securities. A particular tranche of a CMO may therefore carry prepayment risk that differs from that of both the underlying collateral and other tranches.

An analysis is performed of the characteristics of a mortgage related security under consideration prior to its purchase. The purchase of any mortgage related security with high price sensitivity (price decline of more than 10% under an adverse parallel change in interest rates) must be approved by the chief executive officer of the Company.

Generally, the Company has purchased the first tranche of CMOs so as to keep the expected maturities of its investments relatively short and to reduce the exposure to prepayment and reinvestment risks. The first tranche of CMOs are commonly classified as PAC-1-1 securities. No purchase of any mortgage related security in excess of $5.0 million or involving payment of a premium of 2.0% or more or having an expected average life of more than three years can be made without the approval of the chief executive officer of the Company. Purchases of all mortgage related securities not classified as PAC-1-1 securities or issued by other than U.S. Government-sponsored enterprises also require approval of the chief executive officer. It is the Company s policy that aggregate unamortized premiums on all mortgage related securities in the Company s portfolio must not exceed $5.0 million. At December 31, 2005, aggregate unamortized premiums on all mortgage related securities in the portfolio amounted to $174,000.

In the second half of 2002 and the first quarter of 2003, the Company invested a substantial part of the proceeds from the 2002 stock offering in CMO and pass-through mortgage-backed securities (collectively mortgage securities) with expected maturities in the two to three year range for CMOs and in the four to five year range for mortgage-backed securities. Because of the declining interest rate environment, the securities were purchased at a premium.

The Company s investment in mortgage securities increased from $109 million at June 30, 2002 to $315 million at March 31, 2003. From that date, the mortgage securities portfolio declined to $137 million at December 31, 2003, $71 million at December 31, 2004 and $49 million at December 31, 2005. While the Company did not purchase any mortgage securities in 2005, it obtained $38.7 million of mortgage-backed securities in connection with the Mystic acquisition.

Unprecedented prepayment of loans underlying the mortgage securities subsequent to their purchase caused the rapid decrease in the portfolio and shortened the estimated life of the securities significantly. This necessitated the accelerated expensing of part of the premiums paid to purchase the securities. Total accelerated premium amortization was $2.4 million in 2003, $266,000 in 2004 and $25,000 in 2005.

Municipal Obligations

The total of municipal obligations owned by the Company, resulting either from purchase or through the Mystic acquisition, increased from $2.7 million at December 31, 2004 to $8.5 million at December 31, 2005. Of the total, $7.8 million will mature within three years. Obligations owned at December 31, 2005 were issued by municipalities located throughout the United States and were rated AAA at that date, except for obligations with a carrying value of $1.4 million that were rated AA . At December 31, 2005, the Company also owned $12.8 million of auction rate municipal bonds. These bonds are variable rate securities with long-term maturities whose interest rates are set periodically through an auction process. The auction rate period for the bonds outstanding at December 31, 2005 ranged from 28 days to 35 days.

Preferred Stock and Marketable Equity Securities

At December 31, 2005, the Company owned marketable equity securities with a market value of $3.5 million, including net unrealized gains of $662,000, and no auction rate preferred stocks. Auction rate preferred stocks are securities issued by national companies that generally are called after 49 days from the date of issuance or are offered in a new auction. Most of the marketable equity securities include stocks of banks and utility companies. The Company s policy limits the aggregate cost of marketable equity securities issued by one company to no more than $10.0 million without prior approval of the Executive Committee of the Board of Directors. The aggregate cost of marketable equity securities issued by companies considered to be in the same industry must not exceed $30.0 million and the aggregate cost of the entire marketable equity securities portfolio must not exceed $50.0 million. The Company purchases marketable equity securities as long-term investments that can provide the opportunity for capital appreciation and dividend income that is taxed on a more favorable basis than operating income. There can be no assurance that investment in marketable equity securities will achieve appreciation in value and, therefore, such investments involve higher risk.

The following table sets forth the composition of the Company s debt and equity securities portfolios at the dates indicated:

	At December 31,					
	2005		2004		2003	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
	(Dollars in thousands)					
Debt securities:						
U.S. Government-sponsored enterprises	$ 293,516	73.67%	$ 169,165	60.59%	$ 123,324	41.01%
Municipal obligations	8,504	2.14	2,697	0.97	6,305	2.10

Auction rate municipal obligations		12,750	3.20						
Corporate obligations		7,520	1.89		8,749	3.13		10,250	3.41
Other obligations		600	0.15		1,000	0.36		1,250	0.42
Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises		210	0.05		45,935	16.45		111,061	36.93
Mortgage-backed securities issued by U.S. Government-sponsored enterprises		48,673	12.22		24,735	8.86		25,776	8.57
Total debt securities		371,773	93.32		252,281	90.36		277,966	92.44
Auction rate preferred stock					5,000	1.79		5,000	1.66
Other marketable equity securities		3,543	0.89		4,460	1.60		6,329	2.11
Restricted equity securities		23,081	5.79		17,444	6.25		11,401	3.79
Total investment securities	$	398,397	100.00%	$	279,185	100.00%	$	300,696	100.00%
Debt and equity securities available for sale	$	374,906	94.11%	$	260,852	93.43%	$	287,952	95.76%
Debt securities held to maturity		410	0.10		889	0.32		1,343	0.45
Restricted equity securities		23,081	5.79		17,444	6.25		11,401	3.79
Total investment securities	$	398,397	100.00%	$	279,185	100.00%	$	300,696	100.00%

The following table sets forth certain information regarding the amortized cost and market value of the Company s investment securities at the dates indicated:

	At December 31,					
	2005		2004		2003	
	Amortized cost	Market value	Amortized cost	Market value	Amortized cost	Market value
	(Dollars in thousands)					
Securities available for sale:						
Debt securities:						
U.S. Government-sponsored enterprises	$ 295,232	$ 293,516	$ 169,888	$ 169,165	$ 122,522	$ 123,324
Municipal obligations	8,671	8,504	2,706	2,697	6,309	6,305
Auction rate municipal obligations	12,750	12,750				
Corporate obligations	7,478	7,520	8,584	8,749	9,937	10,250
Other obligations	500	500	500	500	500	500
Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises	211	210	46,016	45,935	111,269	111,061
Mortgage-backed securities issued by U.S. Government-sponsored enterprises	49,681	48,363	24,346	24,346	25,167	25,183
Total debt securities	374,523	371,363	252,040	251,392	275,704	276,623
Auction rate preferred stock			5,000	5,000	5,000	5,000
Marketable equity securities	2,881	3,543	2,940	4,460	3,305	6,329
Total securities available for sale	377,404	374,906	259,980	260,852	284,009	287,952
Net unrealized gains (losses) on securities available for sale	(2,498)		872		3,943	
Total securities available for sale, net	$ 374,906	$ 374,906	$ 260,852	$ 260,852	$ 287,952	$ 287,952
Securities held to maturity:						
Other obligations	$ 100	$ 100	$ 500	$ 500	750	750
Mortgage-backed securities issued by U.S. Government-sponsored enterprises	310	323	389	414	593	631
Total securities held to maturity	$ 410	$ 423	$ 889	$ 914	$ 1,343	$ 1,381
Restricted equity securities:						
Federal Home Loan Bank of Boston stock	$ 22,707		$ 17,070		$ 11,027	
Massachusetts Savings Bank Life Insurance Company stock	253		253		253	
Other stock	121		121		121	
Total restricted equity securities	$ 23,081		$ 17,444		$ 11,401	

The table below sets forth certain information regarding the carrying value, weighted average yields and contractual maturities of the Company s securities portfolio at the date indicated.

	At December 31, 2005									
	One year or less		After one year through five years		After five years through ten years		After ten years		Total	
	Carrying value	Weighted average yield	Carrying value	Weighted average yield	Carrying value	Weighted average yield	Carrying value	Weighted average yield	Carrying value	Weighted average yield
	(Dollars in thousands)									
Securities available for sale:										
Debt securities:										
U.S. Government-sponsored enterprises	$ 200,353	3.67%	$ 93,163	4.36%	$	%	$	%	$ 293,516	3.89%
Municipal obligations (1)			7,761	3.88	743	5.52			8,504	4.02
Auction rate municipal obligations (2)							12,750	4.81	12,750	4.81
Corporate obligations	998	3.99	493	4.07			6,029	6.43	7,520	5.95
Other obligations	500	5.50							500	5.50
Collateralized mortgage obligations	210	3.50							210	3.50
Mortgage-backed securities			9,286	4.39	24,709	4.01	14,368	4.66	48,363	4.28
Total debt securities	202,061	3.68	110,703	4.33	25,452	4.05	33,147	5.04	371,363	4.02
Other marketable equity securities (1)									3,543	5.96
Total securities available for sale	202,061	3.68	110,703	4.33	25,452	4.05	33,147	5.04	374,906	4.04
Securities held to maturity:										
Other obligations	100	7.50							100	7.50
Mortgage-backed securities	2	8.00	76	9.10			232	6.10	310	6.85
Total securities held to maturity	102	7.51	76	9.10			232	6.10	410	7.01
Restricted equity securities:										
Federal Home Loan Bank of Boston stock									22,707	4.50
Massachusetts Savings Bank Life Insurance Company stock (1)									253	4.18
Other stock									121	
Total restricted equity securities (1).									23,081	4.47
Total securities	$ 202,163	3.68%	$ 110,779	4.33%	$ 25,452	4.05%	$ 33,379	5.05%	$ 398,397	4.06%

(1) The yields have been calculated on a tax equivalent basis.

(2) These obligations are variable rate securities whose interest rates are set periodically through an auction process. Auctions occurred on these obligations within 35 days after December 31, 2005.

Loans

The following table sets forth the comparison of the Company s loan portfolio in dollar amounts and in percentages by type of loan at the dates indicated.

	At December 31,									
	2005		2004		2003		2002		2001	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
	(Dollars in thousands)									
Mortgage loans:										
One-to-four family	$ 287,450	16.77%	$ 135,995	10.32%	$ 122,524	11.00%	$ 134,445	15.94%	$ 159,887	18.25%
Multi-family	379,767	22.15	334,884	25.42	339,998	30.53	324,755	38.50	338,973	38.70
Commercial real estate	377,462	22.02	297,014	22.55	312,647	28.08	281,952	33.43	272,061	31.06
Construction and development	36,035	2.10	35,237	2.67	24,813	2.23	16,691	1.98	20,901	2.38
Home equity	42,924	2.50	14,066	1.07	12,082	1.09	10,802	1.28	8,924	1.02
Second	22,978	1.34	53,499	4.06	43,650	3.92	36,323	4.31	29,408	3.36
Total mortgage loans	1,146,616	66.88	870,695	66.09	855,714	76.85	804,968	95.44	830,154	94.77
Commercial loans	105,384	6.15	75,349	5.72	44,207	3.97	35,096	4.16	42,637	4.87
Indirect automobile loans	459,234	26.79	368,962	28.01	211,206	18.97				
Other consumer loans	3,119	0.18	2,406	0.18	2,401	0.21	3,409	0.40	3,130	0.36
Total gross loans, excluding money market loan participations	1,714,353	100.00%	1,317,412	100.00%	1,113,528	100.00%	843,473	100.00%	875,921	100.00%
Less:										
Unadvanced funds on loans	(88,659)		(57,205)		(46,777)		(39,684)		(47,157)	
Deferred loan origination costs (fees):										
Indirect automobile loans	11,150		9,732		6,254					
Other consumer loans	(89)		(302)		(265)		(364)		(404)	
Total loans, excluding money market loan participations	1,636,755		1,269,637		1,072,740		803,425		828,360	
Money market loan participations					2,000		4,000		6,000	
Total loans, net	$ 1,636,755		$ 1,269,637		$ 1,074,740		$ 807,425		$ 834,360	

The Company s loan portfolio consists primarily of first mortgage loans secured by multi-family, commercial and one-to-four family residential real estate properties located in the Company s primary lending area and indirect automobile loans. The Company also provides financing for construction and development projects, commercial lines of credit primarily to business entities and condominium associations, home equity and second mortgage loans, and other consumer loans. The Company also purchases participations in commercial loans to national companies and organizations originated and serviced primarily by money center banks. Generally, the participations mature between one day and three months and are viewed by the Company as an alternative short-term investment for liquidity management purposes rather than as traditional commercial loans.

The Company relies on community contacts as well as referrals from existing customers, attorneys and other real estate professionals to generate business within its lending area. In addition, existing borrowers are an important source of business since many of its multi-family and commercial real estate customers have more than one loan outstanding with the Company. Three commissioned loan originators on the staff of the Company are also used to generate residential mortgage loan business. The Company s ability to originate loans depends on the strength of the economy, trends in interest rates, customer demands and competition.

Many of the Company s borrowers have done business with the Company for years and have more than one mortgage loan outstanding. It is the Company s current policy that the aggregate amount of loans outstanding to any one borrower or related entities may not exceed $25.0 million. At December 31, 2005, the Company s largest borrower had a commercial loan outstanding of $20.0 million collateralized by marketable securities. Including this borrower, there were 34 borrowers each with aggregate loans outstanding of $5.0 million or greater at December 31, 2005. The cumulative total of those loans was $297.0 million, or 18% of loans outstanding. Most of this cumulative amount is comprised of multi-family and commercial real estate mortgage loans.

The Company has written underwriting policies to control the inherent risks in origination of mortgage loans. The policies address approval limits, loan-to-value ratios, appraisal requirements, debt service coverage ratios, loan concentration limits and other matters relevant to loan underwriting.

Multi-Family and Commercial Real Estate Mortgage Loans

A number of factors are considered in originating multi-family and commercial real estate mortgage loans. The qualifications and financial condition of the borrower (including credit history), profitability and expertise, as well as the value and condition of the underlying property, are evaluated. When evaluating the qualifications of the borrower, the Company considers the financial resources of the borrower, the borrower s experience in owning or managing similar property and the borrower s payment history with the Company and other financial institutions. Factors considered in evaluating the underlying property include the net operating income of the mortgaged premises before debt service and depreciation, the debt service coverage ratio (the ratio of net operating income to debt service) and the ratio of the loan amount to the appraised value.

Frequently, multi-family and commercial real estate mortgage loans are made for five to ten year terms, with an amortization period of twenty to twenty-five years, and are priced on an adjustable-rate basis with the borrower s option to fix the interest rate at the time of origination or later during the term of the loan. Generally, a yield maintenance fee and other fees are collected when a fixed-rate loan is paid off prior to its maturity.

For the past several years, a stable and then declining interest rate environment prompted many multi-family and commercial real estate borrowers to exercise their options to convert loans from an adjustable-rate to a fixed-rate basis. Additionally, many new loans originated during that time have been priced at inception on a fixed-rate basis generally for periods ranging from two to seven years. When interest rates increase during the fixed-rate phase of these loans, the Company s net interest income is negatively affected. Occasionally, the Company has partially funded loans originated on or converted to a fixed-rate basis by borrowing funds from the FHLB on a fixed-rate basis for periods that approximate the fixed-rate terms of the loans.

One-to-Four Family Mortgage Loans

The Company offers both fixed-rate and adjustable-rate mortgage loans secured by one-to-four family residences. Generally, fixed-rate residential mortgage loans with maturities beyond ten years are not maintained in the Company s loan portfolio.

The increase in one-to-four family mortgage loans from $136.0 million at December 31, 2004 to $287.4 million at December 31, 2005 resulted primarily from the inclusion of loans resulting from the Mystic acquisition. Shortly after completion of the acquisition, the Company sold $30 million of residential mortgage loans with 15 to 30 year maturities to eliminate the interest rate risk associated with holding such long-term assets in a rising interest rate environment.

Construction and Development Loans

At December 31, 2005, construction and development loans amounted to $36.0 million, $6.5 million of which had not been advanced as of that date. The $36.0 million is comprised of $6.3 million pertaining to construction of multi-family properties, $6.8 million pertaining to construction of commercial properties, $21.6 million pertaining to construction of one-to-four family residential homes and $1.3 million pertaining to land loans. Different criteria are applied in underwriting construction loans for which the primary source of repayment is the sale of the property than in underwriting construction loans for which the primary source of repayment is the stabilized cash flow from the completed project. For those loans where the primary source of repayment is from resale of the property, in addition to the normal credit analysis performed for other loans, the Company also analyzes project costs, the attractiveness of the property in relation to the market in which it is located and demand within the market area. For those construction loans where the source of repayment is the stabilized cash flow from the completed project, the Company analyzes not only project costs but also how long it might take to achieve satisfactory occupancy and the reasonableness of projected rental rates in relation to market rental rates.

Construction and development financing is generally considered to involve a higher degree of risk than long-term financing on improved, occupied real estate. Risk of loss on a construction loan is largely dependent upon the accuracy of the initial estimate of construction costs, the estimated time to sell or rent the completed property at an adequate price or rate of occupancy, and market conditions. If the estimates and projections prove to be inaccurate, the Company may be confronted with a project which, upon completion, has a value that is insufficient to assure full loan repayment.

Commercial Loans

Commercial loans, which amounted to $105.4 million at December 31, 2005, compared to $75.3 million at December 31, 2004, included loans to condominium associations of $56.7 million and $53.1 million, respectively. Typically, such loans are for the purpose of funding capital improvements, are made for five to ten year terms and are secured by a general assignment of the revenue of the condominium association. Among the factors considered in the underwriting of such loans are the level of owner occupancy, the financial condition and history of the condominium association, the attractiveness of the property in relation to the market in which it is located and the reasonableness of estimates of the cost of capital improvements to be made. Depending on loan size, funds are advanced as capital improvements are made and, in more complex situations, after completion of engineering inspections.

The Company also provides commercial banking services to small businesses in its market area. Product offerings include lines of credit for working capital as well as financing for capital expenditures and owner-occupied mortgage financing. Interest rates on these loans typically are tied to the prime rate and adjust when changes occur in that benchmark.

This type of commercial lending commenced with the acquisition of Mystic in January 2005. In February 2006, the Company hired a senior vice president with 34 years of loan experience to be in charge of commercial lending. The Company expects to grow its commercial lending business in a measured way by focusing on credit fundamentals and service to established business concerns. At December 31, 2005, commercial business loans amounted to $48.7 million, including $7.8 million in standby letters of credit. This part of the portfolio included a $20.0 million loan fully collateralized by marketable securities that was mentioned on the second preceding page.

Indirect Automobile Loans

The Company commenced originating indirect automobile loans in the first quarter of 2003. Such loans amounted to $459.2 million at December 31, 2005 compared to $369.0 million at December 31, 2004. Indirect automobile loans are loans for automobiles (both new and used) and light duty trucks primarily to individuals, but also to corporations and other organizations.

Indirect automobile loans are originated through dealerships and assigned to the Company. The senior vice president responsible for indirect automobile lending must approve the application of any dealer with whom the Company does business. The Company does business with approximately 175 dealerships located primarily in eastern Massachusetts. Dealer relationships are reviewed monthly for application quality, the ratio of loans approved to applications submitted and loan performance.

Loan applications are generated by approved dealers and data is entered into an application processing system. Two types of scorecard models are used in the underwriting process - credit bureau scorecard models and a custom scorecard model. Credit bureau scorecard models are based on data accumulated by nationally recognized credit bureaus. The models are risk assessment tools that analyze an individual s credit history and assign a numeric credit score. The models meet the requirements of the Equal Credit Opportunity Act. The custom scorecard model is a judgmentally derived scoring model that includes features selected for analysis by the Company. It does not contain any factors prohibited by the Equal Credit Opportunity Act. Management generates reports periodically to track and monitor scorecards in use and the consistency of application processing.

The indirect automobile loan policy limits the aggregate number of loans with credit scores of less than 660 to 15% of loans outstanding. At December 31, 2005, loans with credit scores below 660 were less than 10% of loans outstanding. The average credit score of loans in the portfolio at that date was 731.

The application processing system statistically grades each application according to score ranges. Depending on the data received, an application is either approved automatically or submitted to a credit underwriter for review. Credit underwriters may override system-designated approvals.

Loans approved by the underwriters must meet criteria guidelines established in the Company s loan policy. Credit profile measurements such as debt to income ratios, payment to income ratios and loan to value ratios are utilized in the underwriting process and to monitor the performance of loans falling within specified ratio ranges. Regarding loan to value ratios, the Company considers automobile loans to be essentially unsecured credits that are partially collateralized. When borrowers cease to make required payments, repossession and sale of the vehicle financed usually results in insufficient funds to fully pay the remaining loan balance.

Indirect automobile loans are assigned a particular tier based on the credit score determined by the credit bureau. The tier is used for pricing purposes only so as to assure consistency in loan pricing. Tier rates can be modified if certain conditions exist as outlined in the Company s loan policy. The rate paid by a borrower usually differs with the buy rate earned by the Company. A significant part of the difference between the two rates is retained by the dealer in accordance with terms agreed to between the dealer and the Company. The difference is commonly referred to as the spread . Most of the spread is paid after the end of the month in which the loan is made and is comprised of the agreed-upon rate differential multiplied by the expected average balance of the loan over its scheduled maturity. If a loan is repaid in entirety within 120 days of the loan origination date, the dealer must pay a proportionate part of the spread to the Company. If a loan is repaid after ninety days, the dealer is not obliged to repay any part of the spread amount previously received. Spread payments to dealers are amortized as a reduction of interest received from borrowers over the life of the related loans. When loans are prepaid, any remaining unamortized balance is charged to expense at that time.

Various reports are generated to monitor receipt of required loan documents, adherence to loan policy parameters, dealer performance, loan delinquencies and loan charge-offs. Summary reports are submitted to the chief executive officer, the risk management officer and the board of directors on a monthly basis.

The following table shows the contractual maturity and repricing dates of the Company s gross loans, net of unadvanced funds, at December 31, 2005. The table does not include prepayments or scheduled principal amortization.

	At December 31, 2005								
	Real estate mortgage loans								
	One-to-four family	Multi-family	Commercial real estate	Construction and development	Home equity and second mortgage	Commercial loans	Indirect automobile loans	Other loans	Total loans
					(In thousands)				
Amounts due:									
Within one year	$ 19,379	$ 125,366	$ 71,361	$ 27,521	$ 49,189	$ 38,134	$ 777	$ 2,970	$ 334,697
After one year:									
More than one year to three years	81,108	128,008	145,062	1,358	7,608	6,060	79,507	71	448,782
More than three years to five years	114,440	54,709	81,064	691	4,039	12,323	311,142	69	578,477
More than five years to ten years	31,495	33,221	68,577		2,266	9,431	67,808		212,798
More than ten years	35,292	10,311	4,399			2,000			52,002
Total due after one year	262,335	226,249	299,102	2,049	13,913	29,814	458,457	140	1,292,059
Total amount due	$ 281,714	$ 351,615	$ 370,463	$ 29,570	$ 63,102	$ 67,948	$ 459,234	$ 3,110	1,626,756
Add (deduct):									
Deferred loan origination costs (fees):									
Indirect automobile loans									11,150
Other loans									(89)
Acquisition fair value adjustments									(1,062)
Net loans									$ 1,636,755

The following table sets forth at December 31, 2005 the dollar amount of gross loans, net of unadvanced funds, contractually due or scheduled to reprice after one year and whether such loans have fixed interest rates or adjustable interest rates.

	Due after one year		
	Fixed	Adjustable	Total
		(In thousands)	
Mortgage loans:			
One-to-four family	$ 56,020	$ 206,315	$ 262,335
Multi-family	65,150	161,099	226,249
Commercial real estate	88,388	210,714	299,102
Construction and development		2,049	2,049
Home equity and second mortgage	9,962	3,951	13,913
Total mortgage loans	219,520	584,128	803,648
Commercial loans	11,770	18,044	29,814
Indirect automobile loans	458,457		458,457
Other consumer loans	140		140

Total loans	$	689,887	$	602,172	$	1,292,059

Non-Performing Assets and Allowance for Loan Losses

For information about the Company s non-performing assets and allowance for loan losses, see pages 9 through 12 of the Management s Discussion and Analysis of Financial Condition and Results of Operations section of the Company s 2005 Annual Report to Stockholders which is incorporated herein by reference.

Deposits

Historically, deposits have been the Company s primary source of funds. The Company offers a variety of deposit accounts with a range of interest rates and terms. The Company s deposit accounts consist of non-interest-bearing checking accounts and interest-bearing NOW accounts, savings accounts and money market savings accounts (referred to in the aggregate as transaction deposit accounts) and certificate of deposit accounts. The Company offers individual retirement accounts (IRAs) and other qualified plan accounts.

The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and the relative attractiveness of competing deposit and investment alternatives. Brookline s deposits are obtained predominantly from customers in the communities in which its banking offices are located. Deposits are also gathered via the internet. The Company relies primarily on competitive pricing of its deposit products, customer service and long-standing relationships with customers to attract and retain deposits. Market interest rates and rates offered by competing financial institutions significantly affect the Company s ability to attract and retain deposits. The Company does not use brokers to obtain deposits.

The following table presents the deposit activity of the Company for the years indicated.

	Year ended December 31, 2005	2004	2003
	(Dollars in thousands)		
Net deposits	$ 371,186	$ 82,328	$ 18,303
Interest credited on deposit accounts	23,163	11,709	12,293
Total increase in deposit accounts	$ 394,349	$ 94,037	$ 30,596

In 2003, transaction deposit accounts increased $47.1 million, or 12.4%, and certificates of deposit declined $16.5 million, or 6.1%. The increase in transaction deposits was attributable in part to marketing initiatives. The decline in certificates of deposit was due to the low interest rate environment which prompted some depositors to place their funds in higher yielding non-bank financial instruments or in transaction deposit accounts with no maturities.

In 2004, transaction deposit accounts increased $29.5 million, or 6.9%, and certificates of deposit increased $64.5 million, or 25.5%. The increases were due to the opening of new branches in the fall of 2004 and 2003, marketing initiatives and a rise in interest rates in the second half of 2004 which prompted some customers to place funds in higher yielding deposit accounts.

In 2005, transaction deposit accounts increased $65.1 million, or 14.3%, and certificates of deposit increased $329.2 million, or 103.8%. Of the total increase in deposits, $332 million resulted from the acquisition of Mystic. The rise in interest rates during 2005 added to the increase in certificate of deposit accounts.

The following table sets forth the distribution of the Company s average deposit accounts for the years indicated and the weighted average interest rates on each category of deposits presented. Averages for the years presented utilize average daily balances.

	Year ended December 31, 2005			Year ended December 31, 2004		
	Average balance	Percent of total average deposits	Weighted average rate	Average balance	Percent of total average deposits	Weighted average rate
			(Dollars in thousands)			
NOW accounts	$ 96,853	8.53%	0.22%	$ 62,543	8.67%	0.14%
Savings accounts	147,922	13.02	1.36	69,364	9.62	1.69
Money market savings accounts	268,026	23.59	1.62	279,590	38.76	1.18

Non-interest-bearing demand checking accounts		67,081	5.90			35,789	4.96	
Total transaction deposit accounts		579,882	51.04	1.13		447,286	62.01	1.02
Certificate of deposit accounts:								
Six months or less		89,427	7.87	2.68		57,721	8.00	1.52
Over six months through 12 months		264,447	23.28	2.90		78,397	10.87	1.97
Over 12 months through 24 months		134,708	11.86	2.73		88,572	12.28	3.00
Over 24 months		67,630	5.95	4.24		49,344	6.84	4.22
Total certificate of deposit accounts		556,212	48.96	2.99		274,034	37.99	2.61
Total average deposits	$	1,136,094	100.00%	2.04%	$	721,320	100.00%	1.62%

	Year ended December 31, 2003		
	Average balance	Percent of total average deposits	Weighted average rate
	(Dollars in thousands)		
NOW accounts	$ 61,673	9.29%	0.17%
Savings accounts	21,792	3.28	0.59
Money market savings accounts	296,714	44.70	1.54
Non-interest-bearing demand checking accounts	30,063	4.53	
Total transaction deposit accounts	410,242	61.80	1.17
Certificate of deposit accounts:			
Six months or less	72,899	10.98	1.85
Over six months through 12 months	68,341	10.30	2.22
Over 12 months through 24 months	58,773	8.85	3.58
Over 24 months	53,542	8.07	4.73
Total certificate of deposit accounts	253,555	38.20	2.96
Total average deposits	$ 663,797	100.00%	1.85%

At December 31, 2005, the Company had outstanding $232.2 million in certificate of deposit accounts of $100,000 or more, maturing as follows:

Maturity Period	Amount	Weighted average rate
	(Dollars in thousands)	
Three months or less	$ 58,964	3.47%
Over three months through six months	54,548	3.82
Over six months through 12 months	76,892	3.70