VALLEY NATIONAL BANCORP
Form 10-Q
May 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended March 31, 2018
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 1-11277

VALLEY NATIONAL BANCORP
(Exact name of registrant as specified in its charter)

New Jersey	22-2477875
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
1455 Valley Road Wayne, NJ	07470
(Address of principal executive office)	(Zip code)

973-305-8800
(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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one):
Large accelerated filer x Accelerated filer ¨ Emerging growth company ¨

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common Stock (no par value), of which 331,261,486 shares were outstanding as of May 9, 2018

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
VALLEY NATIONAL BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(in thousands, except for share data)

	March 31, 2018 (Unaudited)	December 31, 2017
Assets		
Cash and due from banks	$222,311	$243,310
Interest bearing deposits with banks	274,349	172,800
Investment securities:		
Held to maturity (fair value of $2,014,954 at March 31, 2018 and $1,837,620 at December 31, 2017)	2,048,583	1,842,691
Available for sale	1,843,514	1,493,905
Total investment securities	3,892,097	3,336,596
Loans held for sale, at fair value	8,449	15,119
Loans	22,552,767	18,331,580
Less: Allowance for loan losses	(132,862)	(120,856)
Net loans	22,419,905	18,210,724
Premises and equipment, net	346,700	287,705
Bank owned life insurance	436,334	386,079
Accrued interest receivable	86,804	73,990
Goodwill	1,078,892	690,637
Other intangible assets, net	86,487	42,507
Other assets	612,029	542,839
Total Assets	$29,464,357	$24,002,306
Liabilities		
Deposits:		
Non-interest bearing	$6,124,256	$5,224,928
Interest bearing:		
Savings, NOW and money market	11,077,789	9,365,013
Time	4,757,801	3,563,521
Total deposits	21,959,846	18,153,462
Short-term borrowings	1,618,416	748,628
Long-term borrowings	2,353,548	2,315,819
Junior subordinated debentures issued to capital trusts	55,109	41,774
Accrued expenses and other liabilities	232,435	209,458
Total Liabilities	26,219,354	21,469,141
Shareholders’ Equity		
Preferred stock, no par value; 50,000,000 shares authorized:		
Series A (4,600,000 shares issued at March 31, 2018 and December 31, 2017)	111,590	111,590
Series B (4,000,000 shares issued at March 31, 2018 and December 31, 2017)	98,101	98,101
Common stock (no par value, authorized 450,000,000 shares; issued 331,202,537 shares at March 31, 2018 and 264,498,643 shares at December 31, 2017)	115,824	92,727
Surplus	2,784,194	2,060,356
Retained earnings	199,555	216,733
Accumulated other comprehensive loss	(64,103)	(46,005)
Treasury stock, at cost (12,678 common shares at March 31, 2018 and 29,792 common shares at December 31, 2017)	(158)	(337)

Total Shareholders’ Equity	3,245,003	2,533,165
Total Liabilities and Shareholders’ Equity	$29,464,357	$24,002,306

See accompanying notes to consolidated financial statements.

VALLEY NATIONAL BANCORP
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(in thousands, except for share data)

	Three Months Ended March 31,	
	2018	2017
Interest Income		
Interest and fees on loans	$237,586	$ 174,353
Interest and dividends on investment securities:		
Taxable	21,323	17,589
Tax-exempt	5,721	4,031
Dividends	1,939	2,151
Interest on federal funds sold and other short-term investments	926	331
Total interest income	267,495	198,455
Interest Expense		
Interest on deposits:		
Savings, NOW and money market	22,317	10,183
Time	14,616	9,553
Interest on short-term borrowings	5,732	3,901
Interest on long-term borrowings and junior subordinated debentures	17,232	12,950
Total interest expense	59,897	36,587
Net Interest Income	207,598	161,868
Provision for credit losses	10,948	2,470
Net Interest Income After Provision for Credit Losses	196,650	159,398
Non-Interest Income		
Trust and investment services	3,230	2,744
Insurance commissions	3,821	5,061
Service charges on deposit accounts	7,253	5,236
Losses on securities transactions, net	(765)	(23)
Fees from loan servicing	2,223	1,815
Gains on sales of loans, net	6,753	4,128
Bank owned life insurance	1,763	2,463
Other	7,973	4,296
Total non-interest income	32,251	25,720
Non-Interest Expense		
Salary and employee benefits expense	93,292	65,927
Net occupancy and equipment expense	27,924	23,035
FDIC insurance assessment	5,498	5,127
Amortization of other intangible assets	4,293	2,536
Professional and legal fees	17,047	4,695
Amortization of tax credit investments	5,274	5,324
Telecommunication expense	3,594	2,659
Other	16,830	11,649
Total non-interest expense	173,752	120,952
Income Before Income Taxes	55,149	64,166
Income tax expense	13,184	18,071
Net Income	$41,965	$ 46,095
Dividends on preferred stock	3,172	1,797
Net Income Available to Common Shareholders	$38,793	$ 44,298

Earnings Per Common Share:		
Basic	$0.12	$0.17
Diluted	0.12	0.17
Cash Dividends Declared per Common Share	0.11	0.11
Weighted Average Number of Common Shares Outstanding:		
Basic	330,727,416	263,797,024
Diluted	332,465,527	264,546,266

See accompanying notes to consolidated financial statements.

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VALLEY NATIONAL BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2018	2017
Net income	$41,965	$46,095
Other comprehensive income, net of tax:		
Unrealized gains and losses on available for sale securities		
Net (losses) gains arising during the period	(20,929)	1,307
Less reclassification adjustment for net losses included in net income	548	13
Total	(20,381)	1,320
Non-credit impairment losses on available for sale securities		
Net change in non-credit impairment losses on securities	(268)	113
Less reclassification adjustment for accretion of credit impairment losses included in net income	(16)	(87)
Total	(284)	26
Unrealized gains and losses on derivatives (cash flow hedges)		
Net gains on derivatives arising during the period	1,960	127
Less reclassification adjustment for net losses included in net income	1,036	1,475
Total	2,996	1,602
Defined benefit pension plan		
Amortization of net loss	112	59
Total other comprehensive (loss) income	(17,557)	3,007
Total comprehensive income	$24,408	$49,102

See accompanying notes to consolidated financial statements.

VALLEY NATIONAL BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$41,965	$46,095
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,247	6,260
Stock-based compensation	7,395	4,127
Provision for credit losses	10,948	2,470
Net amortization of premiums and accretion of discounts on securities and borrowings	8,495	6,043
Amortization of other intangible assets	4,293	2,536
Losses on securities transactions, net	765	23
Proceeds from sales of loans held for sale	237,360	161,325
Gains on sales of loans, net	(6,753)	(4,128)
Originations of loans held for sale	(227,660)	(112,682)
Losses on sales of assets, net	97	34
Net change in:		
Fair value of borrowings hedged by derivative transactions	—	(454)
Cash surrender value of bank owned life insurance	(1,763)	(2,463)
Accrued interest receivable	(691)	(1,429)
Other assets	19,480	(7,103)
Accrued expenses and other liabilities	(15,295)	(35,145)
Net cash provided by operating activities	85,883	65,509
Cash flows from investing activities:		
Net loan originations and purchases	(475,346)	(323,470)
Investment securities held to maturity:		
Purchases	(52,945)	(52,160)
Maturities, calls and principal repayments	58,227	77,141
Investment securities available for sale:		
Purchases	(174,047)	(207,402)
Sales	38,625	—
Maturities, calls and principal repayments	60,858	50,543
Death benefit proceeds from bank owned life insurance	560	1,998
Proceeds from sales of real estate property and equipment	7,378	4,970
Purchases of real estate property and equipment	(4,260)	(5,627)
Cash and cash equivalents acquired in acquisition	156,612	—
Net cash used in investing activities	(384,338)	(454,007)
Cash flows from financing activities:		
Net change in deposits	241,541	(399,567)
Net change in short-term borrowings	219,809	564,004
Proceeds from issuance of long-term borrowings, net	—	200,000
Repayments of long-term borrowings	(50,000)	—
Cash dividends paid to preferred shareholders	(3,172)	(1,797)
Cash dividends paid to common shareholders	(29,611)	(29,012)
Purchase of common shares to treasury	(2,083)	(2,151)
Common stock issued, net	2,521	1,246

Net cash provided by financing activities	379,005	332,723
Net change in cash and cash equivalents	80,550	(55,775)
Cash and cash equivalents at beginning of year	416,110	392,501
Cash and cash equivalents at end of period	$496,660	$336,726

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VALLEY NATIONAL BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(in thousands)

	Three Months Ended March 31,	
	2018	2017
Supplemental disclosures of cash flow information:		
Cash payments for:		
Interest on deposits and borrowings	$58,881	$56,735
Federal and state income taxes	8,843	1,599
Supplemental schedule of non-cash investing activities:		
Transfer of loans to other real estate owned	$145	$4,813
Transfer of loans to loans held for sale	—	103,884
Acquisition:		
Non-cash assets acquired:		
Investment securities held to maturity	$214,217	$—
Investment securities available for sale	308,385	—
Loans	3,744,682	—
Premises and equipment	62,066	—
Bank owned life insurance	49,052	—
Accrued interest receivable	12,123	—
Goodwill	388,255	—
Other intangible assets	45,906	—
Other assets	98,134	—
Total non-cash assets acquired	$4,922,820	$—
Liabilities assumed:		
Deposits	$3,564,843	$—
Short-term borrowings	649,979	—
Long-term borrowings	87,283	—
Junior subordinated debentures issued to capital trusts	13,249	—
Accrued expenses and other liabilities	26,848	—
Total liabilities assumed	4,342,202	—
Net non-cash assets acquired	$580,618	$—
Net cash and cash equivalents acquired in acquisition	$156,612	$—
Common stock issued in acquisition	$737,230	$—

See accompanying notes to consolidated financial statements.

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VALLEY NATIONAL BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The unaudited consolidated financial statements of Valley National Bancorp, a New Jersey corporation ("Valley"), include the accounts of its commercial bank subsidiary, Valley National Bank (the “Bank”), and all of Valley’s direct or indirect wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated. The accounting and reporting policies of Valley conform to U.S. generally accepted accounting principles (U.S. GAAP) and general practices within the financial services industry. In accordance with applicable accounting standards, Valley does not consolidate statutory trusts established for the sole purpose of issuing trust preferred securities and related trust common securities. Certain prior period amounts have been reclassified to conform to the current presentation.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly Valley’s financial position, results of operations and cash flows at March 31, 2018 and for all periods presented have been made. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the entire fiscal year.

In preparing the unaudited consolidated financial statements in conformity with U.S. GAAP, management has made estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of financial condition and results of operations for the periods indicated. Material estimates that are particularly susceptible to change are: the allowance for loan losses; the evaluation of goodwill and other intangible assets, and investment securities for impairment; fair value measurements of assets and liabilities; and income taxes. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are deemed necessary. While management uses its best judgment, actual amounts or results could differ significantly from those estimates. The current economic environment has increased the degree of uncertainty inherent in these material estimates.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP and industry practice have been condensed or omitted pursuant to rules and regulations of the SEC. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Valley’s Annual Report on Form 10-K for the year ended December 31, 2017.

Note 2. Business Combinations

On January 1, 2018, Valley completed its acquisition of USAmeriBancorp, Inc. (USAB) and its wholly-owned subsidiary, USAmeriBank, headquartered in Clearwater, Florida. USAB had approximately $5.1 billion in assets, $3.7 billion in net loans and $3.6 billion in deposits, after purchase accounting adjustments, and maintained a branch network of 29 offices. The acquisition represents a significant addition to Valley's Florida franchise, specifically in the Tampa Bay market. The acquisition also brought Valley to the Birmingham, Montgomery, and Tallapoosa areas in Alabama, where Valley now operates 15 of its branches. The common shareholders of USAB received 6.1 shares of Valley common stock for each USAB share they owned. The total consideration for the acquisition was approximately $737 million.

Merger expenses totaled $13.4 million for the three months ended March 31, 2018, which primarily related to salary and employee benefits and professional and legal fees included in non-interest expense on the consolidated statements of income.

The following table sets forth assets acquired and liabilities assumed in the USAB acquisition, at their estimated fair values as of the closing date of the transaction:

	January 1, 2018 (in thousands)
Assets acquired:	
Cash and cash equivalents	$156,612
Investment securities held to maturity	214,217
Investment securities available for sale	308,385
Loans	3,744,682
Premises and equipment	62,066
Bank owned life insurance	49,052
Accrued interest receivable	12,123
Goodwill	388,255
Other intangible assets	45,906
Other assets:	
Deferred taxes	8,698
Other real estate owned	4,073
FHLB and FRB stock	38,809
Tax credit investments	20,138
Other	26,416
Total other assets	98,134
Total assets acquired	$5,079,432
Liabilities assumed:	
Deposits:	
Non-interest bearing	$887,083
Savings, NOW and money market	1,678,115
Time	999,645
Total deposits	3,564,843
Short-term borrowings	649,979
Long-term borrowings	87,283
Junior subordinated debentures issued to capital trusts	13,249
Accrued expenses and other liabilities	26,848
Total liabilities assumed	$4,342,202
Common stock issued in acquisition	737,230

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The determination of the fair value of the assets acquired and liabilities assumed required management to make estimates about discount rates, future expected cash flows, market conditions, and other future events that are highly subjective in nature and subject to change. The fair value estimates are subject to change for up to one year after the closing date of the transaction if additional information (existing at the date of closing) relative to closing date fair values becomes available. As Valley continues to analyze the acquired assets and liabilities, there may be adjustments to the recorded carrying values. However, Valley does not expect significant future adjustments to the recorded amounts at January 1, 2018.

Fair Value Measurement of Assets Acquired and Liabilities Assumed

Described below are the methods used to determine the fair values of the significant assets acquired and liabilities assumed in the USAB acquisition.

Cash and cash equivalents. The estimated fair values of cash and cash equivalents approximate their stated face amounts, as these financial instruments are either due on demand or have short-term maturities.

Investment securities. The estimated fair values of the investment securities were calculated utilizing Level 2 inputs. The prices for these instruments are obtained through an independent pricing service when available, or dealer market participants with whom Valley has historically transacted both purchases and sales of investment securities. The prices are derived from market quotations and matrix pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions, among other things. Management reviewed the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data.

Loans. The acquired loan portfolio was segregated into categories for valuation purposes primarily based on loan type (commercial, commercial real estate, residential and consumer) and credit risk rating. The estimated fair values were computed by discounting the expected cash flows from the respective portfolios. Management estimated the contractual cash flows expected to be collected at the acquisition date by using valuation models that incorporated estimates of current key assumptions, such as prepayment speeds, default rates, and loss severity rates. Prepayment assumptions were developed by reference to recent or historical prepayment speeds observed for loans with similar underlying characteristics. Prepayment assumptions were influenced by many factors, including, but not limited to, forward interest rates, loan and collateral types, payment status, and current loan-to-value ratios. Default and loss severity rates were developed by reference to recent or historical default and loss rates observed for loans with similar underlying characteristics. Default and loss severity assumptions were influenced by many factors, including, but not limited to, underwriting processes and documentation, vintages, collateral types, collateral locations, estimated collateral values, loan-to-value ratios, and debt-to-income ratios.

The expected cash flows from the acquired loan portfolios were discounted to present value based on the estimated market rates. The market rates were estimated using a buildup approach based on the following components: funding cost, servicing cost and consideration of liquidity premium. The funding cost estimated for the loans was based on a mix of wholesale borrowing and equity funding. The methods used to estimate the Level 3 fair values of loans are extremely sensitive to the assumptions and estimates used. While management attempted to use assumptions and estimates that best reflected the acquired loan portfolios and current market conditions, a greater degree of subjectivity is inherent in these values than in those determined in active markets.

The difference between the fair value and the expected cash flows from the acquired loans will be accreted to interest income over the remaining term of the loans in accordance with Accounting Standards Codification (ASC) Subtopic

310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality.” See Note 8 for further details.

Other intangible assets. Other intangible assets mostly consisting of core deposit intangibles (CDI) are measures of the value of non-maturity checking, savings, NOW and money market deposits that are acquired in a business combination. The fair value of the CDI is based on the present value of the expected cost savings attributable to the core deposit funding, relative to an alternative source of funding. The CDI is amortized over an estimated useful life of 10 years to approximate the existing deposit relationships acquired.

Deposits. The fair values of deposit liabilities with no stated maturity (i.e., non-interest bearing accounts and savings, NOW and money market accounts) are equal to the carrying amounts payable on demand. The fair values of certificates of deposit represent contractual cash flows, discounted to present value using interest rates currently offered on deposits with similar characteristics and remaining maturities.

Short-term borrowings. The short-term borrowings consist of securities sold under agreements to repurchase and FHLB advances. The carrying amounts approximate their fair values because they frequently re-price to a market rate.

Long-term borrowings. The fair values of long-term borrowings consisting of subordinated notes and FHLB advances were estimated by discounting the estimated future cash flows using market discount rates for borrowings with similar characteristics, terms and remaining maturities.

Junior subordinated debentures issued to capital trusts. There is no active market for the trust preferred securities issued by Alient Statutory Trust II; therefore, the fair value of junior subordinated debentures was estimated utilizing the income approach. Valuation methods under the income approach include those methods that provide for the direct capitalization of earnings estimates, as well as valuation methods calling for the forecasting of future benefits (earnings or cash flows) and then discounting those benefits to the present at an appropriate discount rate. Under the income approach, the expected cash flows over the remaining estimated life were discounted to the present at an appropriate discount rate.

Note 3. Earnings Per Common Share

The following table shows the calculation of both basic and diluted earnings per common share for the three months ended March 31, 2018 and 2017.

	Three Months Ended March 31,	
	2018	2017
	(in thousands, except for share data)	
Net income available to common shareholders	$38,793	$ 44,298
Basic weighted average number of common shares outstanding	330,727,416	263,797,024
Plus: Common stock equivalents	1,738,111	749,242
Diluted weighted average number of common shares outstanding	332,465,527	264,546,266
Earnings per common share:		
Basic	$0.12	$ 0.17
Diluted	0.12	0.17

Common stock equivalents represent the dilutive effect of additional common shares issuable upon the assumed vesting or exercise, if applicable, of restricted stock units, common stock options and warrants to purchase Valley's common shares. Common stock options and warrants with exercise prices that exceed the average market price of Valley's common stock during the periods presented have an anti-dilutive effect on the diluted earnings per common share calculation and therefore are excluded from the diluted earnings per share calculation. Anti-dilutive warrants and, to a lesser extent, common stock options equaled approximately 2.9 million and 3.2 million shares for the three months ended March 31, 2018 and 2017, respectively.

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Note 4. Accumulated Other Comprehensive Loss

The following table presents the after-tax changes in the balances of each component of accumulated other comprehensive loss for the three months ended March 31, 2018.

	Components of Accumulated Other Comprehensive Loss				
	Unrealized Gains and Losses on Available for Sale (AFS) Securities	Non-credit Impairment Losses on AFS Securities	Unrealized Gains and (Losses) on Derivatives	Defined Benefit Pension Plan	Total Accumulated Other Comprehensive Loss
	(in thousands)				
Balance at December 31, 2017	$ (12,004)	$ (380)	$ (8,338)	$ (25,283)	$ (46,005)
Reclassification due to the adoption of ASU No. 2016-01	(480)	—	—	—	(480)
Reclassification due to the adoption of ASU No. 2017-12	—	—	(61)	—	(61)
Balance at January 1, 2018	(12,484)	(380)	(8,399)	(25,283)	(46,546)
Other comprehensive (loss) income before reclassifications	(20,929)	(268)	1,960	—	(19,237)
Amounts reclassified from other comprehensive (loss) income	548	(16)	1,036	112	1,680
Other comprehensive (loss) income, net	(20,381)	(284)	2,996	112	(17,557)
Balance at March 31, 2018	$ (32,865)	$ (664)	$ (5,403)	$ (25,171)	$ (64,103)

The following table presents amounts reclassified from each component of accumulated other comprehensive loss on a gross and net of tax basis for the three months ended March 31, 2018 and 2017.

	Amounts Reclassified from Accumulated Other Comprehensive Loss Three Months Ended March 31,		
Components of Accumulated Other Comprehensive Loss	2018	2017	Income Statement Line Item
	(in thousands)		
Unrealized losses on AFS securities before tax	(765)	$ (23)	Losses on securities transactions, net
Tax effect	217	10	
Total net of tax	(548)	(13)	
Non-credit impairment losses on AFS securities before tax:			
Accretion of credit loss impairment due to an increase in expected cash flows	22	149	Interest and dividends on investment securities (taxable)
Tax effect	(6)	(62)	
Total net of tax	16	87	
Unrealized losses on derivatives (cash flow hedges) before tax	(1,451)	(2,518)	Interest expense
Tax effect	415	1,043	
Total net of tax	(1,036)	(1,475)	

Defined benefit pension plan:			
Amortization of net loss	(157)	(101)	*
Tax effect	45	42	
Total net of tax	(112)	(59)	
Total reclassifications, net of tax	$ (1,680)	$ (1,460)	

* Amortization of net loss is included in the computation of net periodic pension cost recognized within other non-interest expense.

Note 5. New Authoritative Accounting Guidance

New Accounting Guidance Adopted in the First Quarter of 2018
Accounting Standards Update (ASU) No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities" amends the hedge accounting recognition and presentation requirements to better align a company’s financial reporting for hedging activities with the economic objectives of those activities. ASU No. 2017-12 is effective for the annual and interim reporting periods beginning January 1, 2019 with early adoption permitted. Valley elected to early adopt ASU No. 2017-12 for annual and interim reporting periods beginning January 1, 2018. The adoption of ASU No. 2017-12 required a modified retrospective method to be used by Valley and resulted in an immaterial cumulative-effect adjustment to retained earnings as of January 1, 2018 to eliminate the separate measurement of ineffectiveness from accumulated comprehensive income (see Note 4).
ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" requires service cost to be reported in the same financial statement line item(s) as other current employee compensation costs. All other components of expense must be presented separately from service cost, and outside any subtotal of income from operations. Only the service cost component of expense is eligible to be capitalized. ASU No. 2017-07 should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. ASU No. 2017-07 was effective for Valley for its annual and interim reporting periods beginning January 1, 2018. ASU No. 2017-07 did not have a significant impact on the presentation of Valley's consolidated financial statements.
ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Asset Transfers of Assets Other than Inventory”. Under current GAAP, the tax effects of intercompany sales are deferred until the transferred asset is sold to a third party or otherwise recovered through amortization. This is an exception to the accounting for income taxes that generally requires recognition of current and deferred income taxes. ASU No. 2016-16 eliminates the exception for intercompany sales of assets. ASU No. 2016-16 was effective for Valley on January 1, 2018 and it was applied using the modified retrospective method. As a result, Valley recorded a $15.4 million cumulative effect adjustment that reduced retained earnings effective January 1, 2018 to record net deferred tax liabilities related to pre-existing transactions.
ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" clarifies how certain cash receipts and cash payments should be classified and presented in the statement of cash flows. ASU No. 2016-15 includes guidance on eight specific cash flow issues with the objective of reducing the existing diversity of practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU No. 2016-15 was effective for Valley for annual and interim reporting periods beginning January 1, 2018 and it was applied using a retrospective transition method to each period presented. ASU No. 2016-15 did not have a significant impact on the presentation of Valley's consolidated statements of cash flows.
ASU No. 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” requires that: (i) equity investments with readily determinable fair values must be measured at fair value with changes in fair value recognized in net income, (ii) equity investments without readily determinable fair values must be measured at either fair value or at cost adjusted for changes in observable prices minus impairment with changes in value under either of these methods recognized in net income, (iii) entities that record financial liabilities at fair value due to a fair value option election must recognize changes in fair value in other comprehensive income if it is related to instrument-specific credit risk, (iv) entities must assess whether a valuation allowance is required for deferred tax assets related to available-for-sale debt securities, and (v) entities are required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU No. 2016-01 also eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet (see Note 6). ASU No. 2016-01 was effective for Valley for

reporting periods beginning January 1, 2018 and did not have a material effect on Valley’s consolidated financial statements.

ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)" and subsequent related updates modify the guidance used to recognize revenue from contracts with customers for transfers of goods or services and transfers of non-financial assets, unless those contracts are within the scope of other guidance. The updates also require new qualitative and quantitative disclosures, including disaggregation of revenues and descriptions of performance obligations. Valley adopted the guidance on January 1, 2018 using the modified retrospective method with a cumulative-effect adjustment to opening retained earnings. The guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other U.S. GAAP. Accordingly, the new revenue recognition standard was not expected to have a material impact on Valley’s consolidated financial statements. Valley has completed its review of non-interest income revenue streams within the scope of the guidance and an assessment of its revenue contracts and did not identify material changes related to the timing or amount of revenue recognition. Therefore, Valley did not record an adjustment to opening retained earnings at January 1, 2018 due to the adoption of this standard. Valley has also concluded that additional disaggregation of revenue categories (as reported herein and consistent with the Annual Report on Form 10-K for the year ended December 31, 2017) that are within the scope of the new guidance is not necessary. Qualitative disclosures regarding such revenues, as required by the new guidance, are presented in Note 12.

New Accounting Guidance Not Yet Adopted

ASU No. 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities" shortens the amortization period for certain callable debt securities held at a premium. ASU No. 2017-08 requires the premium to be amortized to the earliest call date. The accounting for securities held at a discount does not change and the discount continues to be amortized as an adjustment to yield over the contractual life (to maturity) of the instrument. ASU No. 2017-08 is effective for Valley for the annual and interim reporting periods beginning January 1, 2019 with early adoption permitted, and is to be applied using modified retrospective method. Additionally, in the period of adoption, entities should provide disclosures about a change in accounting principle. ASU No. 2017-08 is not expected to have a significant impact on Valley's consolidated financial statements.

ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" eliminates the requirement to calculate the implied fair value of goodwill (i.e., Step 2 of the current goodwill impairment test guidance) to measure a goodwill impairment charge. Instead, an entity will be required to record an impairment charge based on the excess of a reporting unit’s carrying amount over its fair value (i.e., measure the charge based on Step 1 of the current guidance). In addition, ASU No. 2017-04 eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. However, an entity will be required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU No. 2017-04 is effective for Valley for its annual or any interim goodwill impairment tests in fiscal years beginning January 1, 2020 and is not expected to have a significant impact on the presentation of Valley's consolidated financial statements. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017.

ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" amends the accounting guidance on the impairment of financial instruments. ASU No. 2016-13 adds to U.S. GAAP an impairment model (known as the current expected credit loss (CECL) model) that is based on all expected losses over the lives of the assets rather than incurred losses. Under the new guidance, an entity is required to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. ASU No. 2016-13 is effective for Valley for reporting periods beginning January 1, 2020. Management is currently evaluating the impact of the ASU on Valley’s consolidated financial statements. Management has initiated a working group with multiple members from applicable departments to evaluate the requirements of the new standard, planning for loss modeling requirements

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consistent with lifetime expected loss estimates, and assessing the impact it will have on current processes. Valley expects that the adoption of ASU No. 2016-13 will result in an increase in its allowance for credit losses due to several factors, including: (i) the allowance related to Valley loans will increase to include credit losses over the full remaining expected life of the portfolio, and will consider expected future changes in macroeconomic conditions, (ii) the nonaccretable difference (as defined in Note 8) on PCI loans will be recognized as an allowance, offset by an increase in the carrying value of the related loans, and (iii) an allowance will be established for estimated credit losses on investment securities classified as held to maturity. The extent of the increase is under evaluation, but will depend upon the nature and characteristics of Valley's loan and investment portfolios at the adoption date, and the economic conditions and forecasts at that date.

ASU No. 2016-02, “Leases (Topic 842)” requires the recognition of a right of use asset and related lease liability by lessees for leases classified as operating leases under current GAAP. Topic 842, which replaces the current guidance under Topic 840, retains a distinction between finance leases and operating leases. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee also will not significantly change from current GAAP. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize right of use assets and lease liabilities. Topic 842 will be effective for Valley for reporting periods beginning January 1, 2019, with early adoption permitted. Valley must apply a modified retrospective transition approach for the applicable leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Management is currently evaluating the impact of Topic 842 on Valley’s consolidated financial statements and presently evaluating all of its known leases for compliance with the new lease accounting guidance. Management has also made substantial progress in the review of contractual arrangements for embedded leases in an effort to identify Valley’s full lease population. Valley expects a gross-up of its consolidated statements of financial condition as a result of recognizing lease liabilities and right of use assets; the extent of such gross-up is under evaluation. Valley does not expect material changes to the recognition of operating lease expense in its consolidated statements of income.

Note 6. Fair Value Measurement of Assets and Liabilities

ASC Topic 820, “Fair Value Measurements and Disclosures,” establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1	Unadjusted exchange quoted prices in active markets for identical assets or liabilities, or identical liabilities traded as assets that the reporting entity has the ability to access at the measurement date.
Level 2	Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly (i.e., quoted prices on similar assets), for substantially the full term of the asset or liability.
Level 3	Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Assets and Liabilities Measured at Fair Value on a Recurring and Non-Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring and nonrecurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial condition at March 31, 2018 and December 31, 2017. The assets presented under "nonrecurring fair value measurements" in the table below are not measured at fair value on an ongoing basis but are subject to fair value adjustments under certain circumstances (e.g., when an impairment loss is recognized).

		Fair Value Measurements at Reporting Date Using:		
	March 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Recurring fair value measurements:				
Assets				
Investment securities:				
Available for sale:				
U.S. Treasury securities	$48,906	$ 48,906	$ —	$ —
U.S. government agency securities	40,590	—	40,590	—
Obligations of states and political subdivisions	221,174	—	221,174	—
Residential mortgage-backed securities	1,474,075	—	1,467,577	6,498
Trust preferred securities	3,183	—	3,183	—
Corporate and other debt securities	55,586	7,690	47,896	—
Total available for sale	1,843,514	56,596	1,780,420	6,498
Loans held for sale (1)	8,449	—	8,449	—
Other assets (2)	25,982	—	25,982	—
Total assets	$1,877,945	$ 56,596	$ 1,814,851	$ 6,498
Liabilities				
Other liabilities (2)	$30,119	$ —	$ 30,119	$ —
Total liabilities	$30,119	$ —	$ 30,119	$ —
Non-recurring fair value measurements:				
Collateral dependent impaired loans (3)	$40,872	$ —	$ —	$ 40,872
Loan servicing rights	2,831	—	—	2,831
Foreclosed assets	923	—	—	923
Total	$44,626	$ —	$ —	$ 44,626

	December 31, 2017	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Recurring fair value measurements:				
Assets				
Investment securities:				
Available for sale:				
U.S. Treasury securities	$49,642	$ 49,642	$ —	$ —
U.S. government agency securities	42,505	—	42,505	—
Obligations of states and political subdivisions	112,884	—	112,884	—
Residential mortgage-backed securities	1,223,295	—	1,215,935	7,360
Trust preferred securities	3,214	—	3,214	—
Corporate and other debt securities	51,164	7,783	43,381	—
Equity securities	11,201	1,382	9,819	—
Total available for sale	1,493,905	58,807	1,427,738	7,360
Loans held for sale (1)	15,119	—	15,119	—
Other assets (2)	26,417	—	26,417	—
Total assets	$1,535,441	$ 58,807	$ 1,469,274	$ 7,360
Liabilities				
Other liabilities (2)	$24,330	$ —	$ 24,330	$ —
Total liabilities	$24,330	$ —	$ 24,330	$ —
Non-recurring fair value measurements:				
Collateral dependent impaired loans (3)	$48,373	$ —	$ —	$ 48,373
Loan servicing rights	5,350	—	—	5,350
Foreclosed assets	3,472	—	—	3,472
Total	$57,195	$ —	$ —	$ 57,195

(1) Represents residential mortgage loans originated for sale that are carried at fair value and had contractual unpaid principal balances totaling approximately $8.3 million and $14.8 million at March 31, 2018 and December 31, 2017, respectively.
(2) Derivative financial instruments are included in this category.
(3) Excludes PCI loans.

The changes in Level 3 assets measured at fair value on a recurring basis for the three months ended March 31, 2018 and 2017 are summarized below:

	Available for Sale Securities Three Months Ended March 31, 2018	2017
	(in thousands)	
Balance, beginning of the period	$7,360	$11,888
Total net (losses) gains included in other comprehensive income	(398)	44
Settlements, net	(464)	(565)

Balance, end of the period	$6,498	$11,367

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No changes in unrealized gains or losses on Level 3 securities were included in earnings during the three months ended March 31, 2018 and 2017. There were no transfers of assets into or out of Level 3, or between Level 1 and Level 2, during the three months ended March 31, 2018 and 2017.

There have been no material changes in the valuation methodologies used at March 31, 2018 from December 31, 2017.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following valuation techniques were used for financial instruments measured at fair value on a recurring basis. All the valuation techniques described below apply to the unpaid principal balance, excluding any accrued interest or dividends at the measurement date. Interest income and expense are recorded within the consolidated statements of income depending on the nature of the instrument using the effective interest method based on acquired discount or premium.

Available for sale securities.

All U.S. Treasury securities, certain corporate and other debt securities, and certain preferred equity securities are reported at fair value utilizing Level 1 inputs. The majority of other investment securities are reported at fair value utilizing Level 2 inputs. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom Valley has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Management reviews the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data. For certain securities, the inputs used by either dealer market participants or an independent pricing service may be derived from unobservable market information (Level 3 inputs). In these instances, Valley evaluates the appropriateness and quality of the assumption and the resulting price. In addition, Valley reviews the volume and level of activity for all available for sale and trading securities and attempts to identify transactions which may not be orderly or reflective of a significant level of activity and volume. For securities meeting these criteria, the quoted prices received from either market participants or an independent pricing service may be adjusted, as necessary, to estimate fair value and this results in fair values based on Level 3 inputs. In determining fair value, Valley utilizes unobservable inputs which reflect Valley's own assumptions about the inputs that market participants would use in pricing each security. In developing its assertion of market participant assumptions, Valley utilizes the best information that is both reasonable and available without undue cost and effort.

In calculating the fair value for the available for sale securities under Level 3, Valley prepared present value cash flow models for four private label mortgage-backed securities. The cash flows for the Level 3 securities incorporated the expected cash flow of each security adjusted for default rates, loss severities and prepayments of the individual loans collateralizing the security.

The following table presents quantitative information about Level 3 inputs used to measure the fair value of these securities at March 31, 2018:

Security Type	Valuation Technique	Unobservable Input	Range	Weighted Average	
Private label mortgage-backed securities	Discounted cash flow	Prepayment rate	4.8 - 33.8%	19.1	%
		Default rate	3.3 - 47.0	8.3	

	Loss severity	45.8 - 61.6	56.5

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Significant increases or decreases in any of the unobservable inputs in the table above in isolation would result in a significantly lower or higher fair value measurement of the securities. Generally, a change in the assumption used for the default rate is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

The cash flow assumptions for the Level 3 securities incorporated independent third party market participant data based on vintage year for each security. The discount rate utilized in determining the present value of cash flows for the mortgage-backed securities was arrived at by combining the yield on orderly transactions for similar maturity government sponsored mortgage-backed securities with (i) the historical average risk premium of similar structured private label securities, (ii) a risk premium reflecting current market conditions, including liquidity risk, and (iii) if applicable, a forecasted loss premium derived from the expected cash flows of each security. The estimated cash flows for each private label mortgage-backed security were then discounted at the aforementioned effective rate to determine the fair value. The quoted prices received from either market participants or independent pricing services are weighted with the internal price estimate to determine the fair value of each instrument.

Loans held for sale. The conforming residential mortgage loans originated for sale are reported at fair value using Level 2 inputs. The fair values were calculated utilizing quoted prices for similar assets in active markets. To determine these fair values, the mortgages held for sale are put into multiple tranches, or pools, based on the coupon rate and maturity of each mortgage. The market prices for each tranche are obtained from both Fannie Mae and Freddie Mac. The market prices represent a delivery price, which reflects the underlying price each institution would pay Valley for an immediate sale of an aggregate pool of mortgages. The market prices received from Fannie Mae and Freddie Mac are then averaged and interpolated or extrapolated, where required, to calculate the fair value of each tranche. Depending upon the time elapsed since the origination of each loan held for sale, non-performance risk and changes therein were addressed in the estimate of fair value based upon the delinquency data provided to both Fannie Mae and Freddie Mac for market pricing and changes in market credit spreads. Non-performance risk did not materially impact the fair value of mortgage loans held for sale at March 31, 2018 and December 31, 2017 based on the short duration these assets were held, and the high credit quality of these loans.

Derivatives. Derivatives are reported at fair value utilizing Level 2 inputs. The fair value of Valley’s derivatives are determined using third party prices that are based on discounted cash flow analysis using observed market inputs, such as the LIBOR and Overnight Index Swap rate curves. The fair value of mortgage banking derivatives, consisting of interest rate lock commitments to fund residential mortgage loans and forward commitments for the future delivery of such loans (including certain loans held for sale at March 31, 2018 and December 31, 2017), is determined based on the current market prices for similar instruments provided by Fannie Mae and Freddie Mac. The fair values of most of the derivatives incorporate credit valuation adjustments, which consider the impact of any credit enhancements to the contracts, to account for potential nonperformance risk of Valley and its counterparties. The credit valuation adjustments were not significant to the overall valuation of Valley’s derivatives at March 31, 2018 and December 31, 2017.

Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

The following valuation techniques were used for certain non-financial assets measured at fair value on a nonrecurring basis, including impaired loans reported at the fair value of the underlying collateral, loan servicing rights and foreclosed assets, which are reported at fair value upon initial recognition or subsequent impairment as described below.

Impaired loans. Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral and are commonly referred to as “collateral dependent impaired loans.” Collateral values are estimated using Level 3 inputs, consisting of individual appraisals that may be adjusted based on certain discounting criteria. At March 31, 2018, certain appraisals were discounted based on specific market data by location and property type. During the quarter ended March 31, 2018, collateral dependent impaired loans were individually re-measured and reported at fair value through direct loan charge-offs to the allowance for loan losses and/or a specific valuation allowance allocation based on the fair value of the underlying collateral. There were no

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collateral dependent loan charge-offs to the allowance for loan losses for the three months ended March 31, 2018 as compared to $219 thousand for the three months ended March 31, 2017. At March 31, 2018, collateral dependent impaired loans with a total recorded investment of $60.9 million were reduced by specific valuation allowance allocations totaling $20.0 million to a reported total net carrying amount of $40.9 million.

Loan servicing rights. Fair values for each risk-stratified group of loan servicing rights are calculated using a fair value model from a third party vendor that requires inputs that are both significant to the fair value measurement and unobservable (Level 3). The fair value model is based on various assumptions, including but not limited to, prepayment speeds, internal rate of return (“discount rate”), servicing cost, ancillary income, float rate, tax rate, and inflation. The prepayment speed and the discount rate are considered two of the most significant inputs in the model. At March 31, 2018, the fair value model used prepayment speeds (stated as constant prepayment rates) from 0 percent up to 25 percent and a discount rate of 8 percent for the valuation of the loan servicing rights. A significant degree of judgment is involved in valuing the loan servicing rights using Level 3 inputs. The use of different assumptions could have a significant positive or negative effect on the fair value estimate. Impairment charges are recognized on loan servicing rights when the amortized cost of a risk-stratified group of loan servicing rights exceeds the estimated fair value. Valley recorded net recoveries of net impairment charges on its loan servicing rights totaling $227 thousand for the three months ended March 31, 2018. Valley recorded an immaterial net recovery of net impairment charges on its loan servicing rights for the three months ended March 31, 2017.

Foreclosed assets. Certain foreclosed assets (consisting of other real estate owned and other repossessed assets), upon initial recognition and transfer from loans, are re-measured and reported at fair value through a charge-off to the allowance for loan losses based upon the fair value of the foreclosed assets. The fair value of a foreclosed asset, upon initial recognition, is typically estimated using Level 3 inputs, consisting of an appraisal that is adjusted based on certain discounting criteria, similar to the criteria used for impaired loans described above. There were no discount adjustments of the appraisals of foreclosed assets at March 31, 2018. At March 31, 2018, foreclosed assets included