VALLEY NATIONAL BANCORP
Form 10-K
March 01, 2006
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

¨	**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 **(State or other jurisdiction of Incorporation or Organization)**	**22-2477875** **(I.R.S. Employer Identification Number)**
1455 Valley Road	**07470**

Wayne, NJ	
(Address of principal executive office)	**(Zip code)**

973-305-8800

(Registrant s telephone number, including area code)

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

Title of each class	Name of exchange on which registered
Common Stock, no par value	New York Stock Exchange
VNB Capital Trust I	New York Stock Exchange
7.75% Trust Originated Securities	
(and the Guarantee by Valley National Bancorp with respect thereto)	

Securities registered pursuant to Section 12(g) of the Act: None

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

Yes þ No ¨

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

Yes ¨ No þ

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 þ No ¨

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 registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large Accelerated Filer þ Accelerated Filer ¨ Non-accelerated Filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes ¨ No þ

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $2.3 billion on June 30, 2005.

There were 111,248,817 shares of Common Stock outstanding at February 17, 2006.

Documents incorporated by reference:

Certain portions of the registrant s Definitive Proxy Statement (the 2006 Proxy Statement) for the 2006 Annual Meeting of Shareholders to be held April 5, 2006 will be incorporated by reference in Part III.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. *Business*

The disclosures set forth in this item are qualified by Item 1A. Risk Factors and the section captioned Cautionary Statement Concerning Forward-Looking Statements in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

Valley National Bancorp (Valley) is a New Jersey corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended (Holding Company Act). At December 31, 2005, Valley had consolidated total assets of $12.4 billion, total deposits of $8.6 billion and total shareholders equity of $931.9 million. In addition to its principal subsidiary, Valley National Bank (VNB), Valley owns 100 percent of the voting shares of VNB Capital Trust I, through which it issued trust preferred securities. VNB Capital Trust I is not a consolidated subsidiary. See Note 12 of the consolidated financial statements.

VNB is a national banking association chartered in 1927 under the laws of the United States. At December 31, 2005, VNB maintained 163 branch offices located in New Jersey and Manhattan. VNB provides a full range of commercial and retail banking services. These services include the following: the acceptance of demand, savings and time deposits; extension of consumer, real estate, Small Business Administration (SBA) loans and other commercial credits; equipment leasing; and personal and corporate trust, as well as pension and fiduciary services.

VNB s wholly-owned subsidiaries are all included in the consolidated financial statements of Valley. These subsidiaries include a mortgage servicing company; a company that owns and services mortgage loans; a title insurance agency; asset management advisors which are Securities and Exchange Commission (SEC) registered investment advisors; an all-line insurance agency offering property and casualty, life and health insurance; subsidiaries which hold, maintain and manage investment assets for VNB; a subsidiary which owns and services auto loans; a subsidiary which specializes in asset-based lending; a subsidiary which offers both commercial equipment leases and financing for general aviation aircraft; and a subsidiary which is a registered broker-dealer. VNB s subsidiaries also include real estate investment trust subsidiaries (the REIT subsidiaries) which own real estate related investments and a REIT subsidiary which owns some of the real estate utilized by VNB and related real estate investments. All subsidiaries mentioned above are directly or indirectly wholly-owned by VNB, except Valley owns less than 1 percent of the holding company for one of the REIT subsidiaries. Each REIT must have 100 or more shareholders to qualify as a REIT, and therefore, each REIT has issued less than 20 percent of their outstanding non-voting preferred stock to individuals, most of whom are non-senior management VNB employees.

VNB has four business segments it monitors and reports on to manage its business operations. These segments are consumer lending, commercial lending, investment management, and corporate and other adjustments. For financial data on the four business segments see Part II, Item 8, Financial Statements and Supplementary Data Note 20 of the consolidated financial statements.

SEC Reports and Corporate Governance

Valley makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments thereto available on its website at www.valleynationalbank.com without charge as soon as reasonably practicable after filing or furnishing them to the SEC. Also available on the website are Valley s corporate code of ethics that applies to all of Valley s employees including principal officers and directors, Valley s Audit Committee Charter, Compensation and Human Resources Committee Charter, Nominating and Corporate Governance Committee Charter as well as a copy of Valley s Corporate Governance Guidelines.

Valley filed the certifications of the Chief Executive Officer and Chief Financial Officer required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 with respect to Valley s Annual Report on Form 10-K as

3

exhibits to this Report. Valley s CEO submitted the required annual CEO s Certification regarding the NYSE s corporate governance listing standards, Section 12(a) CEO Certification to the NYSE within the required timeframe after the 2005 annual shareholders meeting.

Additionally, Valley will provide without charge, a copy of its Annual Report on Form 10-K to any shareholder by mail. Requests should be sent to Valley National Bancorp, Attention: Shareholder Relations, 1455 Valley Road, Wayne, NJ 07470.

Competition

The market for banking and bank-related services is highly competitive. Valley and VNB compete with other providers of financial services such as other bank holding companies, commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, title agencies, asset managers, insurance companies and a growing list of other local, regional and national institutions which offer financial services. Mergers between financial institutions within New Jersey and in neighboring states have added competitive pressure. Competition intensified as a consequence of the Gramm-Leach-Bliley Act (discussed in the Supervision and Regulation section below) and interstate banking laws now in effect. Valley and VNB compete by offering quality products and convenient services at competitive prices. Valley regularly reviews its products, locations, alternative delivery channels and various acquisition prospects and periodically engages in discussions regarding possible acquisitions to maintain and enhance its competitive position.

Employees

At December 31, 2005, VNB and its subsidiaries employed 2,433 full-time equivalent persons. Management considers relations with its employees to be satisfactory.

SUPERVISION AND REGULATION

The banking industry is highly regulated. Statutory and regulatory controls increase a bank holding company s cost of doing business and limit the options of its management to deploy assets and maximize income. The following discussion is not intended to be a complete list of all the activities regulated by the banking laws or of the impact of such laws and regulations on Valley or VNB. It is intended only to briefly summarize some material provisions.

Bank Holding Company Regulation

Valley is a bank holding company within the meaning of the Holding Company Act. As a bank holding company, Valley is supervised by the Board of Governors of the Federal Reserve System (FRB) and is required to file reports with the FRB and provide such additional information as the FRB may require.

The Holding Company Act prohibits Valley, with certain exceptions, from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company which is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to subsidiary banks, except that it may, upon application, engage in, and may own shares of companies engaged in, certain businesses found by the FRB to be so closely related to banking as to be a proper incident thereto. The Holding Company Act requires prior approval by the FRB of the acquisition by Valley of more than five percent of the voting stock of any other bank. Satisfactory capital ratios and Community Reinvestment Act ratings and anti-money laundering policies are generally prerequisites to obtaining federal regulatory approval to make acquisitions. The policy of the FRB provides that a bank holding company is expected to act as a source of financial strength to its subsidiary bank and to commit resources to support the subsidiary bank in circumstances in which it might not do so absent that policy. Acquisitions through VNB require approval of the Office of the Comptroller of the Currency of the United States (OCC). The Holding Company Act does not place territorial restrictions on the activities of non-bank subsidiaries of bank holding companies. The Gramm-Leach-Bliley Act, discussed below, allows Valley to expand into insurance, securities, merchant banking activities, and other activities that are financial in nature.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Banking and Branching Act) enables bank holding companies to acquire banks in states other than its home state, regardless of applicable state law. The Interstate Banking and Branching Act also authorizes banks to merge across state lines, thereby creating interstate banks with branches in more than one state. Under the legislation, each state had the opportunity to opt-out of this provision. Furthermore, a state may opt-in with respect to *de novo* branching, thereby permitting a bank to open new branches in a state in which the bank does not already have a branch. Without *de novo* branching, an out-of-state commercial bank can enter the state only by acquiring an existing bank or branch. The vast majority of states have allowed interstate banking by merger but have not authorized *de novo* branching.

New Jersey enacted legislation to authorize interstate banking and branching and the entry into New Jersey of foreign country banks. New Jersey did not authorize *de novo* branching into the state. However, under federal law, federal savings banks which meet certain conditions may branch *de novo* into a state, regardless of state law.

Regulation of Bank Subsidiary

VNB is subject to the supervision of, and to regular examination by, the OCC. Various laws and the regulations thereunder applicable to Valley and its bank subsidiary impose restrictions and requirements in many areas, including capital requirements, the maintenance of reserves, establishment of new offices, the making of loans and investments, consumer protection, employment practices, bank acquisitions and entry into new types of business. There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, which govern the extent to which a bank subsidiary may finance or otherwise supply funds to its holding company or its holding company s non-bank subsidiaries. Under federal law, no bank subsidiary may, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, its parent or the non-bank subsidiaries of its parent (other than direct subsidiaries of such bank which are not financial subsidiaries) or take their securities as collateral for loans to any borrower. Each bank subsidiary is also subject to collateral security requirements for any loans or extensions of credit permitted by such exceptions.

Dividend Limitations

Valley is a legal entity separate and distinct from its subsidiaries. Valley s revenues (on a parent company only basis) are substantially from dividends paid by VNB. VNB dividend payments, without prior regulatory approval, are subject to regulatory limitations. Under the National Bank Act, dividends may be declared only if, after payment thereof, capital would be unimpaired and remaining surplus would equal 100 percent of capital. Moreover, a national bank may declare, in any one year, dividends only in an amount aggregating not more than the sum of its net profits for such year and its retained net profits for the preceding two years. In addition, the bank regulatory agencies have the authority to prohibit VNB from paying dividends or otherwise supplying funds to Valley if the supervising agency determines that such payment would constitute an unsafe or unsound banking practice.

Loans to Related Parties

VNB s authority to extend credit to its directors and executive officers, as well as to entities controlled by such persons, is currently governed by the requirements of the National Bank Act, Sarbanes-Oxley Act and Regulation O of the FRB thereunder. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of VNB s capital. In addition, extensions of credit in excess of certain limits must be approved by VNB s Board of Directors. Under the Sarbanes-Oxley Act, Valley and its subsidiaries, other than VNB, may not extend or arrange for any personal loans to its directors and executive officers.

Table of Contents

Community Reinvestment

Under the Community Reinvestment Act (CRA), as implemented by OCC regulations, a national bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the OCC, in connection with its examination of a national bank, to assess the association s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such association. The CRA also requires all institutions to make public disclosure of their CRA ratings. VNB received a satisfactory CRA rating in its most recent examination.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting.

The Sarbanes-Oxley Act of 2002 provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O);
- independence requirements for audit committee members;
- independence requirements for company outside auditors;
- certification of financial statements within the Annual Report on Form 10-K and Quarterly Reports on Form 10-Q by the chief executive officer and the chief financial officer;
- the forfeiture by the chief executive officer and the chief financial officer of bonuses or other incentive-based compensation and profits from the sale of an issuer s securities by such officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
- disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing on Form 4;
- disclosure of a code of ethics for financial officers and filing a Current Report on Form 8-K for a change in or waiver of such code;

the reporting of securities violations up the ladder by both in-house and outside attorneys;

restrictions on the use of financial measures determined by methods other than Generally Accepted Accounting Principles in press releases and SEC filings;

the creation of the Public Accounting Oversight Board (PCAOB);

various increased criminal penalties for violations of securities laws;

an assertion by management with respect to the effectiveness of internal control over financial reporting; and

a report by the company s external auditor on management s assertion and the effectiveness of internal control over financial reporting.

Each of the national stock exchanges, including the New York Stock Exchange (NYSE) where Valley s securities are listed, have implemented corporate governance listing standards, including rules strengthening director independence requirements for boards, and requiring the adoption of charters for the nominating, corporate governance and audit committees. These rules require Valley to certify to the NYSE that there are no violations of any corporate listing standards. Valley has provided the NYSE with the certification required by the NYSE Rule.

Table of Contents

USA PATRIOT Act

As part of the USA PATRIOT Act, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the Anti Money Laundering Act). The Anti Money Laundering Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Anti Money Laundering Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Anti Money Laundering Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Regulations implementing the due diligence requirements, require minimum standards to verify customer identity and maintain accurate records, encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of concentration accounts, and requires all covered financial institutions to have in place an anti-money laundering compliance program. The OCC, along with other banking agencies, have strictly enforced various anti-money laundering and suspicious activity reporting requirements using formal and informal enforcement tools to cause banks to comply with these provisions.

The Anti Money Laundering Act amended the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of any financial institution involved in a proposed merger transaction in combating money laundering activities when reviewing an application under these acts.

Regulatory Relief Law

In late 2000, the American Home Ownership and Economic Act of 2000 instituted a number of regulatory relief provisions applicable to national banks, such as permitting national banks to have classified directors and to merge their business subsidiaries into the bank.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Financial Modernization Act of 1999 (Gramm-Leach-Bliley Act) became effective in early 2000. The Gramm-Leach-Bliley Act provides for the following:

- allows bank holding companies meeting management, capital and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than was previously permissible, including insurance underwriting and making merchant banking investments in commercial and financial companies;

- allows insurers and other financial services companies to acquire banks;

- removes various restrictions that previously applied to bank holding company ownership of securities firms and mutual fund advisory companies; and

- establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

If a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals. Valley has not elected to become a financial holding company.

The OCC adopted rules to allow national banks to form subsidiaries to engage in financial activities allowed for financial holding companies. Electing national banks must meet the same management and capital standards as financial holding companies but may not engage in insurance underwriting, real estate development or merchant banking. Sections 23A and 23B of the Federal Reserve Act apply to financial subsidiaries and the capital invested by a bank in its financial subsidiaries will be eliminated from the bank s capital in measuring all capital ratios. VNB wholly owns one financial subsidiary Glen Rauch Securities, Inc. (Glen Rauch).

The Gramm-Leach-Bliley Act modified other financial laws, including laws related to financial privacy and community reinvestment.

Additional proposals to change the laws and regulations governing the banking and financial services industry are frequently introduced in Congress, in the state legislatures and before the various bank regulatory agencies. The likelihood and timing of any such changes and the impact such changes might have on Valley cannot be determined at this time.

FIRREA

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), a depository institution insured by the Federal Deposit Insurance Corp (FDIC) can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. These provisions have commonly been referred to as FIRREA s cross guarantee provisions. Further, under FIRREA, the failure to meet capital guidelines could subject a bank to a variety of enforcement remedies available to federal regulatory authorities.

FIRREA also imposes certain independent appraisal requirements upon a bank s real estate lending activities and further imposes certain loan-to-value restrictions on a bank s real estate lending activities. The bank regulators have promulgated regulations in these areas.

FDICIA

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), each federal banking agency has promulgated regulations, specifying the levels at which a financial institution would be considered well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized, and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution. To qualify to engage in financial activities under the Gramm-Leach-Bliley Act, all depository institutions must be well capitalized. The financial holding company of a national bank will be put under directives to raise its capital levels or divest its activities if the depository institution falls from that level.

The OCC s regulations implementing these provisions of FDICIA provide that an institution will be classified as well capitalized if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a Tier 1 leverage ratio of at least 5.0 percent, and (iv) meets certain other requirements. An institution will be classified as adequately capitalized if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 4.0 percent, (iii) has a Tier 1 leverage ratio of (a) at least 4.0 percent or (b) at least 3.0 percent if the institution was rated 1 in its most recent examination, and (iv) does not meet the definition of well capitalized. An institution will be classified as undercapitalized if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, or (iii) has a Tier 1 leverage ratio of (a) less than 4.0 percent or (b) less than 3.0 percent if the institution was rated 1 in its most recent examination. An institution will be classified as significantly undercapitalized if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 3.0 percent, or (iii) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as critically undercapitalized if it has a tangible equity to total assets ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies.

Table of Contents

In addition, significant provisions of FDICIA required federal banking regulators to impose standards in a number of other important areas to assure bank safety and soundness, including internal controls, information systems and internal audit systems, credit underwriting, asset growth, compensation, loan documentation and interest rate exposure.

Item 1A. *Risk Factors*

The material risks and uncertainties that management believes affect Valley are described below. The risks and uncertainties described below are not the only ones facing Valley. Additional risks and uncertainties that management is not aware of or that management currently deems immaterial may also impair Valley s business operations. This report is qualified in its entirety by these risk factors. If any of the following risks actually occur, Valley s financial condition and results of operations could be materially and adversely affected.

Changes in Interest Rates Can Have an Adverse Effect on Profitability

Valley s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest earning assets such as loans and investment securities and interest expense paid on interest bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond Valley s control, including general economic conditions, competition, and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest Valley receives on loans and investment securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) Valley s ability to originate loans and obtain deposits, (ii) the fair value of Valley s financial assets and liabilities, and (iii) the average duration of Valley s assets and liabilities. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, Valley s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on Valley s results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on Valley s financial condition and results of operations. See Net Interest Income and Interest Rate Sensitivity sections in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to Valley s management of interest rate risk.

Competition in the Financial Services Industry

Valley faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Valley competes with other providers of financial services such as other bank holding companies, commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, title agencies, asset managers, insurance companies and a growing list of other local, regional and national institutions which offer financial services. Mergers between financial institutions within New Jersey and in neighboring states have added competitive pressure. If Valley is unable to compete effectively, it will lose market share and income generated from loans, deposits, and other financial products will decline.

Table of Contents

Changes in Primary Market Areas Could Adversely Impact Results of Operations and Financial Condition

Much of Valley s lending is in New Jersey and Manhattan. As a result of this geographic concentration, a significant broad based deterioration in economic conditions in New Jersey and the New York City metropolitan area could have a material adverse impact on the quality of Valley s loan portfolio, and accordingly, Valley s results of operations. Such a decline in economic conditions could restrict borrowers ability to pay outstanding principal and interest on loans when due, and, consequently, adversely affect the cash flows of Valley s business.

Valley s loan portfolio is largely secured by real estate collateral. A substantial portion of the real and personal property securing the loans in Valley s portfolio is located in New Jersey and Manhattan. Conditions in the real estate markets in which the collateral for Valley s loans are located strongly influence the level of Valley s nonperforming loans and results of operations. A decline in the New Jersey and New York City metropolitan area real estate markets, as well as the other external factors, could adversely affect the performance of Valley s loan portfolio.

Allowance For Loan Losses May Be Insufficient

Valley maintains an allowance for loan losses based on, among other things, national and regional economic conditions, historical loss experience and delinquency trends. However, Valley cannot predict loan losses with certainty, and Valley cannot assure you that charge-offs in future periods will not exceed the allowance for loan losses. If charge-offs exceed Valley s allowance, its earnings would decrease. In addition, regulatory agencies review Valley s allowance for loan losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. An increase in Valley s allowance for loan losses could reduce its earnings.

Acquisitions and Implementation of Growth Strategies

In 2005, Valley acquired Shrewsbury State Bank (Shrewsbury) and NorCrown Bank (NorCrown), which added over $1 billion in assets and 27 branch offices. Although Valley expects both acquisitions to be accretive to earnings within one year, Valley cannot assure you that the acquisitions will achieve Valley s targeted results of them. Factors that may adversely affect Valley s targeted results include the ability to retain the customers of these entities, the ability to successfully integrate both entities and their personnel and the ability to achieve certain cost savings. Valley s future success will depend on the ability of its officers and key employees to continue to implement and improve Valley s operational, financial and management controls and processes and reporting systems and procedures, and to manage a growing number of client relationships. Thus, Valley cannot assure you that its growth strategy will not place a strain on Valley s administrative and operational infrastructure.

Extensive Regulation and Supervision

Valley, primarily through its principal subsidiary VNB and certain non-bank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect Valley s lending practices, capital structure, investment practices, dividend policy and growth, among other things. Valley is also subject to a number of federal laws, which, among other things, require it to lend to various sectors of the economy and population, and establish and maintain comprehensive programs relating to anti-money laundering and customer identification. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect Valley in substantial and unpredictable ways. Such changes could subject Valley to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on Valley s business, financial condition and results of operations. Valley s compliance with certain of these laws will be considered by banking regulators when reviewing bank merger and bank holding company acquisitions. While Valley has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the Supervision and Regulation section in Item 1, Business and Note 16 to consolidated financial statements included in Item 8, Financial Statements and Supplementary Data , which are located elsewhere in this report.

Claims and Litigation Pertaining to Fiduciary Responsibility

From time to time, customers make claims and take legal action pertaining to Valley s performance of its fiduciary responsibilities. If such claims and legal actions are not resolved in a manner favorable to Valley they may result in financial liability and/or adversely affect the market perception of Valley and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on Valley s business, which, in turn, could have a material adverse effect on its financial condition and results of operations.

Inability to Hire and Retain Qualified Employees

Valley s performance is largely dependent on the talents and efforts of highly skilled individuals. There is intense competition in the financial services industry for qualified employees. In addition, Valley faces increasing competition with businesses outside the financial services industry for the most highly skilled individuals. Valley s business could be adversely affected if it were unable to attract new employees and retain and motivate its existing employees.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

VNB s corporate headquarters consist of three office buildings located adjacent to each other in Wayne, New Jersey. These headquarters encompass commercial, mortgage and consumer lending, operations and the executive offices of both Valley and VNB. Two of the three buildings are owned by a subsidiary of VNB and leased to VNB, the other building is leased by VNB from an independent third party.

VNB owns two other office buildings located in Wayne, New Jersey, one of which is occupied by VNB departments and subsidiaries providing trust and investment management services; the other office building is utilized primarily for VNB s mortgage lending and mortgage operations. A subsidiary of VNB also owns an office building and a condominium office in Manhattan, which are leased to VNB and house a portion of its New York lending and operations. In addition, a subsidiary of VNB owns a building in Chestnut Ridge, New York, primarily occupied by Masters Coverage Corp., also a subsidiary of VNB.

As of December 31, 2005, VNB provides banking services at 163 locations of which 72 locations are owned by VNB or a subsidiary of VNB and leased to VNB, and 91 locations are leased from independent third parties.

Item 3. ***Legal Proceedings***

In the normal course of business, Valley may be a party to various outstanding legal proceedings and claims. In the opinion of management, except for the lawsuit noted below, the consolidated statements of financial condition or results of operations of Valley will not be materially affected by the outcome of such legal proceedings and claims.

A lawsuit against Valley was filed by United Bank and Trust Company in the United States District Court, Southern District of New York. The plaintiff alleges, among other claims, that Valley breached its contractual and fiduciary duties to United Bank and Trust Company in connection with Valley s activities as a depository for Southeast Airlines, a now defunct charter airline carrier. Valley believes it has meritorious defenses to this action, although Valley cannot provide any assurances that it will prevail in the litigation or be able to settle the litigation for an immaterial amount. In connection with this litigation, Valley has brought a separate declaratory judgment action in the United States District Court for the District of New Jersey against one of its insurance carriers in which Valley seeks an order from the court that the litigation is covered by Valley s insurance policy with that carrier.

Table of Contents

The anti-money laundering (AML) and bank secrecy (BSA) laws have imposed far-reaching and substantial requirements on financial institutions. The enforcement policy of the OCC with respect to AML/BSA compliance recently has been vigorously applied throughout the industry, with regulatory action taking various forms.

Valley believes that its policies and procedures with respect to combating money laundering are effective and that Valley s AML/BSA policies and procedures are reasonably designed to comply with applicable standards. Due to uncertainties in the requirements for and enforcement of AML/BSA laws and regulations, Valley cannot provide assurance that in the future it will not face a regulatory action, adversely affecting its ability to acquire banks and thrifts, or open new branches. However, Valley is not prohibited from acquiring banks, thrifts or opening branches based upon its most recently completed regulatory examination.

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

None.

Item 4A. ***Executive Officers of the Registrant***

Names	Age at December 31, 2005	Executive Officer Since	Office
Gerald H. Lipkin	64	1975	Chairman of the Board, President and Chief Executive Officer of Valley and VNB
Peter Crocitto	48	1991	Executive Vice President of Valley and VNB
Albert L. Engel	57	1998	Executive Vice President of Valley and VNB
Alan D. Eskow	57	1993	Executive Vice President, Chief Financial Officer and Secretary of Valley and VNB
James G. Lawrence	62	2001	Executive Vice President of Valley and VNB
Robert M. Meyer	59	1997	Executive Vice President of Valley and VNB
Kermit R. Dyke	58	2001	First Senior Vice President of VNB
Robert E. Farrell	59	1990	First Senior Vice President of VNB
Richard P. Garber	62	1992	First Senior Vice President of VNB
Eric W. Gould	37	2001	First Senior Vice President of VNB
Walter M. Horsting	48	2003	First Senior Vice President of VNB
Robert J. Mulligan	58	1991	First Senior Vice President of VNB
Garret G. Nieuwenhuis	65	2001	First Senior Vice President of VNB
John H. Prol	68	1992	First Senior Vice President of VNB
Jack M. Blackin	63	1993	Senior Vice President and Assistant Secretary of Valley and VNB
Stephen P. Davey	50	2002	Senior Vice President and Risk Manager of VNB
Elizabeth E. De Laney	41	2001	Senior Vice President of VNB

All officers serve at the pleasure of the Board of Directors.

Table of Contents

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Valley s common stock is traded on the NYSE under the ticker symbol VLY . The following table sets forth for each quarter period indicated the high and low sales prices for the common stock of Valley, as reported by the NYSE, and the cash dividends declared per common share for each quarter. The amounts shown in the table below have been adjusted for all stock dividends and stock splits.

	Year 2005			Year 2004		
	High	**Low**	**Dividend**	**High**	**Low**	**Dividend**
First Quarter	$ 26.82	$ 23.78	$ 0.214	$ 26.80	$ 24.37	$ 0.204
Second Quarter	25.30	22.80	0.220	26.30	22.98	0.214
Third Quarter	24.61	22.24	0.220	25.01	23.07	0.214
Fourth Quarter	25.15	21.84	0.220	27.10	24.49	0.214

Federal laws and regulations contain restrictions on the ability of Valley and VNB to pay dividends. For information regarding restrictions on dividends, see Part I, Item 1, Business Dividend Limitations and Part II, Item 8, Financial Statements and Supplementary Data Dividend Restrictions, Note 16 of the consolidated financial statements. In addition, under the terms of the trust preferred securities issued by VNB Capital Trust I, Valley could not pay dividends on its common stock if Valley deferred payments on the junior subordinated debentures which provide the cash flow for the payments on the trust preferred securities.

There were 9,307 shareholders of record as of December 31, 2005.

Unregistered Sales of Equity Securities and Use of Proceeds

On June 3, 2005, Valley issued 2,948,255 common shares to NorCrown Bank shareholders, pursuant to the merger of NorCrown into VNB. These shares were exempt from registration under the Securities Act of 1933 because they were issued in a Private Placement under Section 4(2) of the Act and Regulation D thereunder. The shares were subsequently registered for resale on Form S-3 under the Securities Act.

Pursuant to an existing contractual agreement, Valley issued 5,513 shares of its common stock with a value of $132,450 on October 22, 2003, to Michael Guilfoile, President of MG Advisors, Inc., for his consulting services in connection with Valley s acquisition of NIA/Lawyers Title Agency, LLC and Glen Rauch Securities, Inc. These shares were exempt from registration under the Securities Act of 1933 because they were issued in a Private Placement under Section 4(2) of the Act and Regulation D thereunder.

In 2000, Valley issued 87,556 shares of its common stock to the shareholders of Hallmark Capital Management, Inc. pursuant to the merger of Hallmark Capital Management, Inc. into VNB. In 2003, 2002 and 2001, Valley issued an additional 51,014, 52,385 and 38,099 shares or $1.3

million, $1.2 million and $728 thousand, respectively, of its common stock pursuant to subsequent earn-out payments. No additional earn-out payments are required pursuant to this merger. All shares reflect all stock dividends and prior splits. These shares were exempt from registration under the Securities Act of 1933 because they were issued in a Private Placement under Section 4(2) of the Act and Regulation D thereunder. The shares were subsequently registered for resale on Form S-3 under the Securities Act.

Table of Contents

The following table sets forth information for the three months ended December 31, 2005 with respect to repurchases of Valley s outstanding common shares:

Issuer Purchases on Equity Securities (1)

Period		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans (2)	Maximum Number of Shares that May Yet Be Purchased Under the Plans (2)
10/01/2005	10/31/2005	30,000	$ 22.22	11,548,859	2,783,641
11/01/2005	11/30/2005			11,548,859	2,783,641
12/01/2005	12/31/2005	6,010	24.43	11,554,869	2,777,631
		36,010	$ 22.59	11,554,869	2,777,631

(1) Share data reflects the 5 percent stock dividend issued on May 20, 2005.

(2) On May 14, 2003 and August 21, 2001, Valley publicly announced its intention to repurchase 2,756,250 and 11,576,250 outstanding common shares, respectively, in the open market or in privately negotiated transactions. Both repurchase plans expire when all shares have been repurchased. No other repurchase plans or programs expired or terminated during the three months ended December 31, 2005.

Table of Contents

Item 6. ***Selected Financial Data***

The following selected financial data should be read in conjunction with Valley s consolidated financial statements and the accompanying notes thereto presented herein in response to Item 8.

	As of or for the Years Ended December 31,				
	2005	2004	2003	2002	2001
	(in thousands, except for share data)				
Summary of Operations:					
Interest income tax equivalent basis (1)	$ 631,893	$ 525,315	$ 503,621	$ 523,135	$ 559,557
Interest expense	226,659	146,607	148,922	173,453	220,935
Net interest income tax equivalent basis (1)	405,234	378,708	354,699	349,682	338,622
Less: tax equivalent adjustment	6,809	6,389	6,123	5,716	6,071
Net interest income	398,425	372,319	348,576	343,966	332,551
Provision for loan losses	4,340	8,003	7,345	13,644	15,706
Net interest income after provision for loan losses	394,085	364,316	341,231	330,322	316,845
Non-interest income	73,708	84,328	108,197	81,238	68,476
Non-interest expense	237,566	220,049	216,278	192,264	185,966
Income before income taxes	230,227	228,595	233,150	219,296	199,355
Income tax expense	66,778	74,197	79,735	64,680	64,151
Net income	$ 163,449	$ 154,398	$ 153,415	$ 154,616	$ 135,204
Per Common Share (2):					
Earnings per share:					
Basic	$ 1.50	$ 1.49	$ 1.48	$ 1.43	$ 1.20
Diluted	1.49	1.48	1.47	1.43	1.20
Dividends declared	0.87	0.85	0.81	0.77	0.72
Book value	8.37	6.82	6.30	6.03	6.13
Tangible book value (3)	6.42	6.37	5.80	5.65	5.81
Weighted average shares outstanding:					
Basic	108,948,978	103,604,828	103,629,836	107,805,623	112,328,376
Diluted	109,351,675	104,137,633	104,184,728	108,438,679	112,924,386
Ratios:					
Return on average assets	1.39%	1.51%	1.63%	1.78%	1.68%
Return on average shareholders equity	19.17	22.77	24.21	23.59	19.70
Return on average tangible shareholders equity (4)	23.61	24.54	26.09	25.02	20.84
Average shareholders equity to average assets	7.25	6.62	6.74	7.56	8.53
Dividend payout	58.00	57.05	54.60	53.80	59.40
Risked-based capital:					

Tier 1 capital	10.28	11.12	11.25	11.42	14.08
Total capital	12.16	11.95	12.15	12.48	15.14
Leverage capital	7.82	8.28	8.35	8.67	10.25
Financial Condition:					
Assets	$ 12,436,102	$ 10,763,391	$ 9,873,335	$ 9,148,456	$ 8,589,951
Net loans	8,055,269	6,866,459	6,102,039	5,656,072	5,226,593
Deposits	8,570,001	7,518,739	7,162,968	6,683,387	6,306,974
Shareholders equity	931,910	707,598	652,789	631,738	678,375

The 10-K contains supplemental financial information, described in the notes on the following page, which has been determined by methods other than Generally Accepted Accounting Principles (GAAP) that management uses in its analysis of Valley s performance. Valley s management believes these non-GAAP financial measures provide information useful to investors in understanding the underlying operational performance of Valley, its business and performance trends and facilitates comparisons with the performance of others in the financial services industry.

Table of Contents

Notes to Selected Financial Data

(1) In this report a number of amounts related to net interest income and net interest margin are presented on a tax equivalent basis using a 35 percent federal tax rate. Valley believes that this presentation provides comparability of net interest income and net interest margin arising from both taxable and tax-exempt sources and is consistent with industry practice and SEC rules.

(2) All per common share amounts reflect the 5 percent stock dividend issued May 20, 2005, and all prior stock splits and dividends.

(3) Tangible book value, which is a non-GAAP measure, is computed by dividing shareholders equity less goodwill and other intangible assets by common shares outstanding, as follows:

	At Years Ended December 31,				
	2005	2004	2003	2002	2001
			($ in thousands)		
Common shares outstanding	111,326,717	103,798,313	103,536,291	104,792,111	110,651,096
Shareholders equity	$ 931,910	$ 707,598	$ 652,789	$ 631,738	$ 678,375
Less: Goodwill and other intangible assets.	(217,354)	(45,888)	(52,050)	(39,381)	(35,544)
Tangible shareholders equity	$ 714,556	$ 661,710	$ 600,739	$ 592,357	$ 642,831
Tangible book value	$ 6.42	$ 6.37	$ 5.80	$ 5.65	$ 5.81

(4) Return on average tangible shareholders equity, which is a non-GAAP measure, is computed by dividing net income by average shareholders equity less average goodwill and average other intangible assets, as follows:

	As of or for the Years Ended December 31,				
	2005	2004	2003	2002	2001
			($ in thousands)		
Net income	$ 163,449	$ 154,398	$ 153,415	$ 154,616	$ 135,204
Average shareholders equity	852,834	678,068	633,744	655,447	686,159
Less: Average goodwill and other intangible assets.	(160,607)	(48,805)	(45,716)	(37,463)	(37,317)
Average tangible shareholders equity	$ 692,227	$ 629,263	$ 588,028	$ 617,984	$ 648,842
Return on average tangible shareholders equity	23.61%	24.54%	26.09%	25.02%	20.84%

Table of Contents

Item 7. ***Management s Discussion and Analysis (MD&A) of Financial Condition and Results of Operations***

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing Valley s results of operations for each of the past three years and financial condition for each of the past two years. In order to fully appreciate this analysis the reader is encouraged to review the consolidated financial statements and accompanying notes thereto appearing under Item 8 of this report, and statistical data presented in this document.

Cautionary Statement Concerning Forward-Looking Statements

This Annual Report on Form 10-K, both in the MD&A and elsewhere, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management s confidence and strategies and management s expectations about new and existing programs and products, acquisitions, relationships, opportunities, taxation, technology, market conditions and economic expectations. These statements may be identified by an (*) or such forward-looking terminology as expect, anticipate, look, view, opportunities, allow, continues, reflects, believe, may, should, will, estimates or simila such terms. Such forward-looking statements involve certain risks and uncertainties. Actual results may differ materially from such forward-looking statements. Valley assumes no obligation for updating any such forward-looking statement at any time. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, but are not limited to:

- unanticipated changes in the direction of interest rates;
- competition from banks and other financial institutions;
- changes in loan, investment and mortgage prepayment assumptions;
- insufficient allowance for loan losses;
- relationships with major customers;
- changes in effective income tax rates;
- higher or lower cash flow levels than anticipated;
- inability to hire and retain qualified employees;
- slowdown in levels of deposit growth;
- a decline in the economy in New Jersey and New York;

a decrease in loan origination volume;

a change in legal and regulatory barriers including issues related to AML/BSA compliance;

the development of new tax strategies or the disallowance of prior tax strategies;

unanticipated litigation pertaining to fiduciary responsibility; and

retention of loans, deposits, customers and staff from Valley s acquisition of Shrewsbury and NorCrown during 2005.

Critical Accounting Policies and Estimates

The accounting and reporting policies followed by Valley conform, in all material respects, to accounting principles generally accepted in the United States of America. In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates.

Valley s accounting policies are fundamental to understanding Management s Discussion and Analysis of Financial Condition and Results of Operations. The most significant accounting policies followed by Valley are presented in Note 1 of the consolidated financial statements. Valley has identified its policies on the allowance for loan losses and income taxes to be critical because management has to make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available. Additional information on these policies can be found in Note 1 of the consolidated financial statements. Management has reviewed the application of these policies with the Audit Committee of Valley s Board of Directors.

Table of Contents

The allowance for loan losses represents management s estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the statement of consolidated financial condition. Note 1 of the consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this MD&A.

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in Valley s consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact Valley s consolidated financial condition or results of operations. Notes 1 and 14 of the consolidated financial statements include additional discussion on the accounting for income taxes.

Executive Summary

The full year of 2005 was extremely challenging for the banking industry and Valley. Short-term interest rates increased as a result of increases by the Federal Reserve, while market driven longer term interest rates remained mostly unchanged at historically low levels causing a flat yield curve. This resulted in net interest margin compression causing Valley s main source of income to come under pressure. Should the yield curve remain flat or inverted, Valley expects this net interest margin compression to continue into 2006 and likely to hinder the growth of net interest income and net income.* Additionally, as a result of the yield curve Valley does not expect its earning assets to grow at the same pace in 2006 as during 2005.* Valley expects to use the proceeds of maturing investments to fund new loan growth or repay borrowings.*

Despite the interest rate compression, Valley earned record earnings per common share in 2005. Net income was $163.4 million or $1.49 per diluted share, compared with net income of $154.4 million or $1.48 per diluted share in 2004.

During the year, Valley completed the acquisition of two commercial banks adding 27 new branches and expanding into many new communities in New Jersey. The Shrewsbury and NorCrown acquisitions during the first and second quarters of 2005, respectively, expanded Valley s market presence in New Jersey and accordingly should increase Valley s franchise value.*

The loan portfolio grew year over year by approximately $1.2 billion or 17.3 percent and deposits increased by over $1.0 billion, or almost 14.0 percent. During 2005, Valley acquired $688 million of loans and $894 million of deposits from Shrewsbury and NorCrown.

Earnings for 2005, besides the interest rate compression and effect of the acquisitions, were impacted by the decreases in non-interest income, primarily from a decrease in gains on sales of securities, lower fees from title insurance services and other fee income. These decreases were partially offset by an increase in service charges on deposit accounts. Non-interest expense increased largely due to the Shrewsbury and NorCrown acquisitions. A lower effective income tax rate contributed to earnings for 2005. The decreased tax rate resulted from state income tax reductions, increased housing tax credits, tax planning benefits and the reassessment of required tax accruals.

For the year ended December 31, 2005, Valley achieved a return on average shareholders equity (ROE) of 19.17 percent and a return on average assets (ROA) of 1.39 percent which include intangible assets arising from the Shrewsbury and NorCrown acquisitions during the period. Valley s return on average tangible shareholders equity (ROATE) was 23.61 percent for 2005. The comparable ratios for the year ended December 31, 2004, were ROE of 22.77 percent, ROA of 1.51 percent, and ROATE of 24.54 percent. See discussion and reconciliation of ROATE, which is non-GAAP measure, under Item 6, Selected Financial Data.

Table of Contents

Net Interest Income

Net interest income consists of interest income and dividends earned on interest earning assets less interest expense paid on interest bearing liabilities and represents the main source of income of Valley. The net interest margin is calculated by dividing tax equivalent net interest income by average interest earning assets and is a key measurement used in the banking industry to measure income from earning assets. The net interest margin declined each quarter during 2005 and during the last three years. This declining trend may continue in 2006 if the yield curve remains flat or assumes and maintains an inverted shape. During early 2006, Valley adjusted some of its variable rate deposits in an attempt to stabilize the net interest margin. However, management cannot guarantee that this adjustment will stop the net interest margin decline or the resulting decline in net interest income.

Net interest income on a tax equivalent basis increased to $405.2 million for 2005 compared with $378.7 million for 2004. Higher average balances in loans and investments and higher interest rates increased interest income during 2005. For 2005, total average interest bearing liabilities and interest rates paid on these liabilities increased over 2004, resulting in higher interest expense.

During the fourth quarter of 2005, net interest income declined when compared with the third quarter of 2005. As mentioned above, management has taken steps to prevent this decline from continuing into the first quarter of 2006, but the flattened yield curve, increasing short-term interest rates, competitive pricing of deposits and the effect of declining investment security balances may continue to negatively impact net interest income.*

Average loans increased $1.1 billion or 16.8 percent, for the year ended December 31, 2005, while average taxable investments increased $259.1 million or 9.4 percent over the same period in 2004. Interest income on loans increased $90.5 million for the year ended December 31, 2005 compared with the same period in 2004 due to an increase in average interest rates on loans to 6.04 percent in 2005 from 5.67 percent in 2004 and the increase in average loans. Interest on taxable investments increased $13.9 million for the twelve months in 2005 over the same period in 2004, mainly due to the increase in interest rates of 4 basis points to 5.00 percent in 2005, but also from an increase in average investments.

Average interest bearing liabilities for 2005 increased $1.2 billion or 15.2 percent from 2004. Average savings, NOW and money market deposits increased $576.2 million or 16.7 percent and continue to provide a low cost source of funding even though the average interest rate increased to 1.38 percent in 2005 from 0.67 percent in 2004. The increase in deposits was attributed to the Shrewsbury and NorCrown acquisitions during the year, an increase in municipal deposits and an increase in money market deposits. Average time deposits increased $142.5 million during 2005 or 6.5 percent from 2004. Average short-term borrowings increased $164.9 million or 41.1 percent over 2004 balances. Average long-term borrowings increased $295.6 million or 17.0 percent and include mostly Federal Home Loan Bank (FHLB) advances and securities sold under agreements to repurchase. The increase in short-term and long-term borrowings is used as an alternative to deposits and is evaluated based upon need, cost and term. During 2005, deposits lagged loan and investment growth also causing the need for alternative funding sources. Competitive pricing of deposits and the lack of industry deposit growth may cause short-term and long-term borrowings to further escalate in 2006.

The net interest margin on a tax equivalent basis was 3.69 percent for the year ended December 31, 2005 compared with 3.94 percent for the same period in 2004. The change was mainly attributable to increases in interest rates earned on interest earning assets offset by larger increases in interest rates paid on interest bearing liabilities. Average interest rates earned on interest earning assets increased 29 basis points while average interest rates paid on interest bearing liabilities increased 64 basis points causing a compression in the net interest margin for Valley.

During 2005, the Federal Reserve increased short-term interest rates eight times. Valley s prime rate moved in conjunction with each interest rate increase, which resulted in higher interest income during the year. While this helped the interest on loans which adjust with the prime rate, it also increased Valley s cost of funding. Market driven long-term interest rates did not increase in conjunction with the federal funds rate increases and therefore, had no positive impact on interest rates for new and repricing fixed rate long-term loans and

Table of Contents

investments. If short-term interest rates continue an upward movement and long-term rates remain relatively unchanged, it is anticipated that Valley s cost of deposits and borrowings will continue to rise, negatively affecting net interest income during 2006.*

The average interest rate for loans increased 37 basis points to 6.04 percent and the average interest rate for taxable investments increased 4 basis points to 5.00 percent. Average interest rates on total interest earning assets of $11.0 billion increased 29 basis points to 5.75 percent. Average interest rates also increased on total interest bearing liabilities of $8.9 billion by 64 basis points to 2.53 percent from 1.89 percent. The average interest rate for interest bearing deposits increased by 70 basis points to 1.94 percent during 2005 compared to 2004.

In 2004, Valley entered into interest rate swap transactions which effectively converted $300 million of its prime-based floating rate loans to a fixed rate. Valley s objective in using derivatives is to add stability to net interest income and to manage its exposure to interest rate movements. As anticipated, this interest rate swap no longer represents a benefit to net interest income and is expected to have a negative effect on net interest income until it expires in July 2006.*

Table of Contents

The following table reflects the components of net interest income for each of the three years ended December 31, 2005, 2004 and 2003:

ANALYSIS OF AVERAGE ASSETS, LIABILITIES AND SHAREHOLDERS EQUITY AND

NET INTEREST INCOME ON A TAX EQUIVALENT BASIS

	2005			2004			2003		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
				(in thousands)					
Assets									
Interest earning assets									
Loans (1)(2)	$ 7,637,973	$ 461,612	6.04%	$ 6,541,993	$ 371,071	5.67%	$ 6,056,439	$ 364,295	6.02%
Taxable investments (3)	3,001,241	150,066	5.00	2,742,161	136,122	4.96	2,409,851	121,794	5.05
Tax-exempt investments (1)(3)	315,807	18,971	6.01	313,673	17,826	5.68	253,002	16,910	6.68
Federal funds sold and other interest bearing deposits	34,361	1,244	3.62	18,343	296	1.61	52,468	622	1.19
Total interest earning assets	10,989,382	631,893	5.75	9,616,170	525,315	5.46	8,771,760	503,621	5.74
Allowance for loan losses	(72,552)			(68,941)			(67,536)		
Cash and due from banks	217,458			207,326			200,852		
Other assets	639,690			472,678			444,515		
Unrealized (loss) gain on securities available for sale	(15,888)			15,446			50,142		
Total assets	$ 11,758,090			$ 10,242,679			$ 9,399,733		
Liabilities and Shareholders Equity									
Interest bearing liabilities									
Savings, NOW and money market deposits	$ 4,029,093	$ 55,456	1.38%	$ 3,452,862	$ 23,115	0.67%	$ 3,133,705	$ 22,871	0.73%
Time deposits	2,324,192	67,601	2.91	2,181,678	46,832	2.15	2,236,018	48,095	2.15
Total interest bearing deposits	6,353,285	123,057	1.94	5,634,540	69,947	1.24	5,369,723	70,966	1.32
Short-term borrowings	566,433	16,516	2.92	401,564	5,258	1.31	349,160	3,754	1.08
Long-term borrowings	2,029,965	87,086	4.29	1,734,321	71,402	4.12	1,401,800	74,202	5.29
Total interest bearing liabilities	8,949,683	226,659	2.53	7,770,425	146,607	1.89	7,120,683	148,922	2.09
Demand deposits	1,905,103			1,739,452			1,577,817		
Other liabilities	50,470			54,734			67,489		
Shareholders equity	852,834			678,068			633,744		
Total liabilities and shareholders equity	$ 11,758,090			$ 10,242,679			$ 9,399,733		
Net interest income (tax equivalent basis)		405,234			378,708			354,699	
Tax equivalent adjustment		(6,809)			(6,389)			(6,123)	

Net interest income	$ 398,425	$ 372,319	$ 348,576
Net interest rate differential	3.22%	3.57%	3.65%
Net interest margin (4)	3.69%	3.94%	4.04%

(1) Interest income is presented on a tax equivalent basis using a 35 percent tax rate.
(2) Loans are stated net of unearned income and include non-accrual loans.
(3) The yield for securities that are classified as available for sale is based on the average historical amortized cost.
(4) Net interest income on a tax equivalent basis as a percentage of total average interest earning assets.

Table of Contents

The following table demonstrates the relative impact on net interest income of changes in volume of interest earning assets and interest bearing liabilities and changes in rates earned and paid by Valley on such assets and liabilities:

CHANGE IN NET INTEREST INCOME ON A TAX EQUIVALENT BASIS

	2005 Compared to 2004 Increase (Decrease)(1)			2004 Compared to 2003 Increase (Decrease)(1)		
	Interest	Volume	Rate	Interest	Volume	Rate
	(in thousands)					
Interest income:						
Loans (2)	$ 90,541	$ 25,448	$ 65,093	$ 6,776	$ 28,233	$ (21,457)
Taxable investments	13,944	996	12,948	14,328	16,530	(2,202)
Tax-exempt investments (2)	1,145	1,023	122	916	3,681	(2,765)
Federal funds sold and other interest bearing deposits	948	557	391	(326)	(498)	172
	106,578	28,024	78,554	21,694	47,946	(26,252)