

VALLEY NATIONAL BANCORP  
Form 10-Q  
November 08, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended September 30, 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 (I.R.S. Employer  
Incorporation or Organization) 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)

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  No

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted 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 such files.) Yes  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  Accelerated filer  Emerging growth company

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Non-accelerated filer  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

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 331,491,620 shares were outstanding as of November 7, 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)

|   | September 30,<br>2018 | December 31,<br>2017 |
|---|-----------------------|----------------------|
| Assets  |                       |                      |
| Cash and due from banks   | \$262,653             | \$243,310            |
| Interest bearing deposits with banks  | 93,726                | 172,800              |
| Investment securities:  |                       |                      |
| Held to maturity (fair value of \$2,016,354 at September 30, 2018 and \$1,837,620 at December 31, 2017)   | 2,072,363             | 1,842,691            |
| Available for sale  | 1,749,001             | 1,493,905            |
| Total investment securities   | 3,821,364             | 3,336,596            |
| Loans held for sale, at fair value  | 31,675                | 15,119               |
| Loans   | 24,111,290            | 18,331,580           |
| Less: Allowance for loan losses   | (144,963)             | (120,856)            |
| Net loans   | 23,966,327            | 18,210,724           |
| Premises and equipment, net   | 341,060               | 287,705              |
| Bank owned life insurance   | 438,238               | 386,079              |
| Accrued interest receivable   | 92,666                | 73,990               |
| Goodwill  | 1,085,710             | 690,637              |
| Other intangible assets, net  | 80,771                | 42,507               |
| Other assets  | 667,758               | 542,839              |
| Total Assets  | \$30,881,948          | \$24,002,306         |
| Liabilities   |                       |                      |
| Deposits:   |                       |                      |
| Non-interest bearing  | \$6,135,001           | \$5,224,928          |
| Interest bearing:   |                       |                      |
| Savings, NOW and money market   | 11,036,700            | 9,365,013            |
| Time  | 5,416,571             | 3,563,521            |
| Total deposits  | 22,588,272            | 18,153,462           |
| Short-term borrowings   | 2,968,431             | 748,628              |
| Long-term borrowings  | 1,728,805             | 2,315,819            |
| Junior subordinated debentures issued to capital trusts   | 55,283                | 41,774               |
| Accrued expenses and other liabilities  | 238,221               | 209,458              |
| Total Liabilities   | 27,579,012            | 21,469,141           |
| Shareholders' Equity  |                       |                      |
| Preferred stock, no par value; authorized 50,000,000:   |                       |                      |
| Series A (4,600,000 shares issued at September 30, 2018 and December 31, 2017)  | 111,590               | 111,590              |
| Series B (4,000,000 shares issued at September 30, 2018 and December 31, 2017)  | 98,101                | 98,101               |
| Common stock (no par value, authorized 450,000,000 shares; issued 331,622,970 shares at September 30, 2018 and 264,498,643 shares at December 31, 2017) | 116,154               | 92,727               |
| Surplus   | 2,793,158             | 2,060,356            |
| Retained earnings   | 262,368               | 216,733              |
| Accumulated other comprehensive loss  | (76,944)              | (46,005)             |
| Treasury stock, at cost (121,546 common shares at September 30, 2018 and 29,792 common shares at December 31, 2017)                                     | (1,491)               | (337)                |

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|  |              |              |
|--|--------------|--------------|
| Total Shareholders' Equity                                   | 3,302,936    | 2,533,165    |
| Total Liabilities and Shareholders' Equity                   | \$30,881,948 | \$24,002,306 |
| See accompanying notes to consolidated financial statements. |              |              |

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

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2018                                | 2017       | 2018                               | 2017       |
| Interest Income   |                                     |            |                                    |            |
| Interest and fees on loans  | \$265,870                           | \$ 185,864 | \$751,146                          | \$ 541,937 |
| Interest and dividends on investment securities:                    |                                     |            |                                    |            |
| Taxable   | 21,362                              | 17,922     | 64,907                             | 54,439     |
| Tax-exempt  | 5,023                               | 3,752      | 16,383                             | 11,726     |
| Dividends   | 3,981                               | 2,657      | 9,648                              | 6,945      |
| Interest on federal funds sold and other short-term investments     | 805                                 | 546        | 2,570                              | 1,156      |
| Total interest income   | 297,041                             | 210,741    | 844,654                            | 616,203    |
| Interest Expense  |                                     |            |                                    |            |
| Interest on deposits:   |                                     |            |                                    |            |
| Savings, NOW and money market                                       | 28,775                              | 15,641     | 75,848                             | 38,538     |
| Time  | 20,109                              | 10,852     | 51,360                             | 30,571     |
| Interest on short-term borrowings                                   | 15,193                              | 5,161      | 31,838                             | 14,578     |
| Interest on long-term borrowings and junior subordinated debentures | 16,164                              | 15,142     | 50,458                             | 41,883     |
| Total interest expense  | 80,241                              | 46,796     | 209,504                            | 125,570    |
| Net Interest Income   | 216,800                             | 163,945    | 635,150                            | 490,633    |
| Provision for credit losses   | 6,552                               | 1,640      | 24,642                             | 7,742      |
| Net Interest Income After Provision for Credit Losses               | 210,248                             | 162,305    | 610,508                            | 482,891    |
| Non-Interest Income   |                                     |            |                                    |            |
| Trust and investment services                                       | 3,143                               | 3,062      | 9,635                              | 8,606      |
| Insurance commissions   | 3,646                               | 4,519      | 11,493                             | 13,938     |
| Service charges on deposit accounts                                 | 6,597                               | 5,558      | 20,529                             | 16,136     |
| (Losses) gains on securities transactions, net                      | (79                                 | ) 6        | (880                               | ) 5        |
| Fees from loan servicing  | 2,573                               | 1,895      | 6,841                              | 5,541      |
| Gains on sales of loans, net  | 3,748                               | 5,520      | 18,143                             | 14,439     |
| Bank owned life insurance   | 2,545                               | 1,541      | 6,960                              | 5,705      |
| Other   | 6,865                               | 4,896      | 26,637                             | 17,177     |
| Total non-interest income   | 29,038                              | 26,997     | 99,358                             | 81,547     |
| Non-Interest Expense  |                                     |            |                                    |            |
| Salary and employee benefits expense                                | 80,778                              | 69,286     | 253,014                            | 198,777    |
| Net occupancy and equipment expense                                 | 26,295                              | 22,756     | 81,120                             | 68,400     |
| FDIC insurance assessment   | 7,421                               | 4,603      | 20,963                             | 14,658     |
| Amortization of other intangible assets                             | 4,697                               | 2,498      | 13,607                             | 7,596      |
| Professional and legal fees   | 6,638                               | 11,110     | 29,022                             | 20,107     |
| Amortization of tax credit investments                              | 5,412                               | 8,389      | 15,156                             | 21,445     |
| Telecommunication expense   | 3,327                               | 2,464      | 9,936                              | 7,830      |
| Other   | 17,113                              | 11,459     | 52,531                             | 33,943     |
| Total non-interest expense  | 151,681                             | 132,565    | 475,349                            | 372,756    |
| Income Before Income Taxes  | 87,605                              | 56,737     | 234,517                            | 191,682    |
| Income tax expense  | 18,046                              | 17,088     | 50,191                             | 55,873     |
| Net Income  | \$69,559                            | \$ 39,649  | \$184,326                          | \$ 135,809 |
| Dividends on preferred stock  | 3,172                               | 2,683      | 9,516                              | 6,277      |
| Net Income Available to Common Shareholders                         | \$66,387                            | \$ 36,966  | \$174,810                          | \$ 129,532 |

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Earnings Per Common Share:

|   |             |             |             |             |
|---|-------------|-------------|-------------|-------------|
| Basic   | \$0.20      | \$ 0.14     | \$0.53      | \$ 0.49     |
| Diluted   | 0.20        | 0.14        | 0.53        | 0.49        |
| Cash Dividends Declared per Common Share              | 0.11        | 0.11        | 0.33        | 0.33        |
| Weighted Average Number of Common Shares Outstanding: |             |             |             |             |
| Basic   | 331,486,500 | 264,058,174 | 331,180,213 | 263,938,786 |
| Diluted   | 333,000,242 | 264,936,220 | 332,694,080 | 264,754,845 |

See accompanying notes to consolidated financial statements.

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

|   | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|--|----------|------------------------------------|-----------|
|   | 2018                                   | 2017     | 2018                               | 2017      |
| Net income  | \$69,559                               | \$39,649 | \$184,326                          | \$135,809 |
| Other comprehensive income, net of tax:   |  |          |                                    |           |
| Unrealized gains and losses on available for sale securities                                      |  |          |                                    |           |
| Net (losses) gains arising during the period  | (8,675 )                               | 1,457    | (36,065 )                          | 4,660     |
| Less reclassification adjustment for net losses (gains) included in net income                    | 52                                     | (4 )     | 630                                | (4 )      |
| Total   | (8,623 )                               | 1,453    | (35,435 )                          | 4,656     |
| Non-credit impairment losses on available for sale securities                                     |  |          |                                    |           |
| Net change in non-credit impairment losses on securities  | (8 )                                   | (223 )   | (64 )                              | (89 )     |
| Less reclassification adjustment for accretion of credit impairment losses included in net income | 5                                      | (40 )    | 1                                  | (166 )    |
| Total   | (3 )                                   | (263 )   | (63 )                              | (255 )    |
| Unrealized gains and losses on derivatives (cash flow hedges)                                     |  |          |                                    |           |
| Net gains (losses) on derivatives arising during the period                                       | 221                                    | 198      | 2,636                              | (548 )    |
| Less reclassification adjustment for net losses included in net income                            | 472                                    | 1,132    | 2,127                              | 3,963     |
| Total   | 693                                    | 1,330    | 4,763                              | 3,415     |
| Defined benefit pension plan  |  |          |                                    |           |
| Amortization of net loss  | 113                                    | 59       | 337                                | 177       |
| Total other comprehensive (loss) income   | (7,820 )                               | 2,579    | (30,398 )                          | 7,993     |
| Total comprehensive income  | \$61,739                               | \$42,228 | \$153,928                          | \$143,802 |
| See accompanying notes to consolidated financial statements.                                      |  |          |                                    |           |



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

|  | Nine Months Ended<br>September 30, |             |
|--|------------------------------------|-------------|
|  | 2018                               | 2017        |
| Cash flows from operating activities:  |                                    |             |
| Net income   | \$ 184,326                         | \$ 135,809  |
| Adjustments to reconcile net income to net cash provided by operating activities:    |                                    |             |
| Depreciation and amortization  | 20,367                             | 18,408      |
| Stock-based compensation   | 15,840                             | 9,563       |
| Provision for credit losses  | 24,642                             | 7,742       |
| Net amortization of premiums and accretion of discounts on securities and borrowings | 26,262                             | 17,476      |
| Amortization of other intangible assets  | 13,607                             | 7,596       |
| Losses (gains) on securities transactions, net                                       | 880                                | (5 )        |
| Proceeds from sales of loans held for sale   | 591,583                            | 484,102     |
| Gains on sales of loans, net   | (18,143 )                          | (14,439 )   |
| Originations of loans held for sale  | (307,623 )                         | (201,393 )  |
| Losses on sales of assets, net   | 2,122                              | 359         |
| Net change in:   |                                    |             |
| Cash surrender value of bank owned life insurance                                    | (6,960 )                           | (5,705 )    |
| Accrued interest receivable  | (6,553 )                           | (5,247 )    |
| Other assets   | (39,120 )                          | (7,052 )    |
| Accrued expenses and other liabilities   | (5,941 )                           | (17,465 )   |
| Net cash provided by operating activities  | 495,289                            | 429,749     |
| Cash flows from investing activities:  |                                    |             |
| Net loan originations and purchases  | (2,324,977)                        | (1,200,913) |
| Investment securities held to maturity:  |                                    |             |
| Purchases  | (220,192 )                         | (127,318 )  |
| Maturities, calls and principal repayments   | 195,448                            | 219,967     |
| Investment securities available for sale:  |                                    |             |
| Purchases  | (239,226 )                         | (293,788 )  |
| Sales  | 38,625                             | —           |
| Maturities, calls and principal repayments   | 194,312                            | 144,221     |
| Death benefit proceeds from bank owned life insurance                                | 2,546                              | 10,661      |
| Proceeds from sales of real estate property and equipment                            | 6,665                              | 7,717       |
| Purchases of real estate property and equipment                                      | (16,880 )                          | (13,341 )   |
| Cash and cash equivalents acquired in acquisition                                    | 156,612                            | —           |
| Net cash used in investing activities  | (2,207,067)                        | (1,252,794) |
| Cash flows from financing activities:  |                                    |             |
| Net change in deposits   | 869,967                            | (417,942 )  |
| Net change in short-term borrowings  | 1,569,824                          | 401,749     |
| Proceeds from issuance of long-term borrowings, net                                  | —                                  | 965,000     |
| Repayments of long-term borrowings   | (675,682 )                         | (185,000 )  |
| Proceeds from issuance of preferred stock, net                                       | —                                  | 98,101      |
| Cash dividends paid to preferred shareholders  | (9,516 )                           | (6,277 )    |
| Cash dividends paid to common shareholders   | (102,414 )                         | (84,143 )   |
| Purchase of common shares to treasury  | (2,780 )                           | (2,284 )    |
| Common stock issued, net   | 2,648                              | 5,166       |

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|  |           |           |
|--|-----------|-----------|
| Net cash provided by financing activities      | 1,652,047 | 774,370   |
| Net change in cash and cash equivalents        | (59,731 ) | (48,675 ) |
| Cash and cash equivalents at beginning of year | 416,110   | 392,501   |
| Cash and cash equivalents at end of period     | \$356,379 | \$343,826 |

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

|  | Nine Months Ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2018                               | 2017      |
| Supplemental disclosures of cash flow information:           |                                    |           |
| Cash payments for:   |                                    |           |
| Interest on deposits and borrowings                          | \$205,821                          | \$125,433 |
| Federal and state income taxes                               | 47,217                             | 27,003    |
| Supplemental schedule of non-cash investing activities:      |                                    |           |
| Transfer of loans to other real estate owned                 | \$697                              | \$7,147   |
| Transfer of loans to loans held for sale                     | 289,633                            | 225,541   |
| Acquisition:   |                                    |           |
| Non-cash assets acquired:                                    |                                    |           |
| Investment securities held to maturity                       | \$214,217                          | \$—       |
| Investment securities available for sale                     | 308,385                            | —         |
| Loans  | 3,735,162                          | —         |
| Premises and equipment                                       | 62,066                             | —         |
| Bank owned life insurance                                    | 49,052                             | —         |
| Accrued interest receivable                                  | 12,123                             | —         |
| Goodwill   | 395,073                            | —         |
| Other intangible assets                                      | 45,906                             | —         |
| Other assets   | 100,836                            | —         |
| 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. |                                    |           |



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 September 30, 2018 and for all periods presented have been made. The results of operations for the three and nine months ended on September 30, 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; estimated cash flows from purchased credit impaired loans; the evaluation of goodwill, 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. 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 \$1.3 million and \$18.1 million for the three and nine months ended September 30, 2018, respectively, which primarily related to salary and employee benefits and other expense 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,<br>2018<br>(in<br>thousands) |
|---|---|
| Assets acquired:  |   |
| Cash and cash equivalents                               | \$156,612                               |
| Investment securities held to maturity                  | 214,217                                 |
| Investment securities available for sale                | 308,385                                 |
| Loans   | 3,735,162                               |
| Premises and equipment                                  | 62,066                                  |
| Bank owned life insurance                               | 49,052                                  |
| Accrued interest receivable                             | 12,123                                  |
| Goodwill  | 395,073                                 |
| Other intangible assets                                 | 45,906                                  |
| Other assets:   |   |
| Deferred taxes  | 11,400                                  |
| Other real estate owned                                 | 4,073                                   |
| FHLB and FRB stock                                      | 38,809                                  |
| Tax credit investments                                  | 20,138                                  |
| Other   | 26,416                                  |
| Total other assets                                      | 100,836                                 |
| 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                                 |



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. During the third quarter of 2018, Valley revised the estimated fair values of the acquired assets as of the acquisition date as the result of additional information obtained. The adjustments related to the fair value of certain purchased credit-impaired (PCI) loans and deferred tax assets which, on a combined basis, resulted in a \$6.8 million increase in goodwill (see Note 10 for amount of goodwill as allocated to Valley's business segments). While Valley continues to analyze the acquired assets and liabilities, it does not expect any 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)

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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 Aliant 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 and nine months ended September 30, 2018 and 2017:

|  | Three Months Ended                    |             | Nine Months Ended |             |
|--|---------------------------------------|-------------|-------------------|-------------|
|  | September 30,                         |             | September 30,     |             |
|  | 2018                                  | 2017        | 2018              | 2017        |
|  | (in thousands, except for share data) |             |                   |             |
| Net income available to common shareholders                  | \$66,387                              | \$ 36,966   | \$174,810         | \$ 129,532  |
| Basic weighted average number of common shares outstanding   | 331,486,504                           | 304,058,174 | 331,180,212       | 263,938,786 |
| Plus: Common stock equivalents                               | 1,513,742                             | 278,046     | 1,513,867         | 816,059     |
| Diluted weighted average number of common shares outstanding | 333,000,246                           | 304,936,220 | 332,694,079       | 264,754,845 |
| Earnings per common share:                                   |                                       |             |                   |             |
| Basic  | \$0.20                                | \$ 0.14     | \$0.53            | \$ 0.49     |
| Diluted  | 0.20                                  | 0.14        | 0.53              | 0.49        |

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 3.3 million shares for the three and nine months ended September 30, 2018 and 2017, respectively.

Note 4. Accumulated Other Comprehensive Loss

The following tables present the after-tax changes in the balances of each component of accumulated other comprehensive loss for the three and nine months ended September 30, 2018:

|   | Components of Accumulated Other Comprehensive Loss   |   |   |                                    | Total<br>Accumulated<br>Other<br>Comprehensive<br>Loss |
|---|--|---|---|------------------------------------|--|
|   | Unrealized Gains<br>and Losses<br>on<br>Available for<br>(AFS)<br>Securities<br>(in thousands) | Non-credit<br>Impairment<br>Losses on<br>AFS Securities | Unrealized Gains<br>and (Losses)<br>on<br>Derivatives | Defined<br>Benefit<br>Pension Plan |  |
| Balance at June 30, 2018                                    | \$ (39,296 )   | \$ (440 )   | \$ (4,329 )   | \$ (25,059 )                       | \$ (69,124 )   |
| Other comprehensive (loss) income before reclassifications  | (8,675 )   | (8 )  | 221   | —                                  | (8,462 )   |
| Amounts reclassified from other comprehensive (loss) income | 52   | 5   | 472   | 113                                | 642  |
| Other comprehensive (loss) income, net                      | (8,623 )   | (3 )  | 693   | 113                                | (7,820 )   |
| Balance at September 30, 2018                               | \$ (47,919 )   | \$ (443 )   | \$ (3,636 )   | \$ (24,946 )                       | \$ (76,944 )   |

|   | Components of Accumulated Other Comprehensive Loss   |   |   |                                    | Total<br>Accumulated<br>Other<br>Comprehensive<br>Loss |
|---|--|---|---|------------------------------------|--|
|   | Unrealized Gains<br>and Losses<br>on<br>Available for<br>(AFS)<br>Securities<br>(in thousands) | Non-credit<br>Impairment<br>Losses on<br>AFS Securities | Unrealized Gains<br>and (Losses)<br>on<br>Derivatives | Defined<br>Benefit<br>Pension Plan |  |
| 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 reclassification   | (36,065 )  | (64 )   | 2,636   | —                                  | (33,493 )  |
| Amounts reclassified from other comprehensive (loss) income | 630  | 1   | 2,127   | 337                                | 3,095  |
| Other comprehensive (loss) income, net                      | (35,435 )  | (63 )   | 4,763   | 337                                | (30,398 )  |
| Balance at September 30, 2018                               | \$ (47,919 )   | \$ (443 )   | \$ (3,636 )   | \$ (24,946 )                       | \$ (76,944 )   |



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 and nine months ended September 30, 2018 and 2017:

| Components of Accumulated Other Comprehensive Loss                            | Amounts Reclassified from Accumulated Other Comprehensive Loss |            |                                      |            | Income Statement Line Item                                |
|---|--|------------|--------------------------------------|------------|---|
|   | Three Months Ended September 30, 2018                          |            | Nine Months Ended September 30, 2017 |            |   |
|   | 2018   | 2017       | 2018                                 | 2017       |   |
|   | (in thousands)   |            |                                      |            |   |
| Unrealized (losses) gains on AFS securities before tax                        | \$ (79 )   | \$ 6       | \$ (880 )                            | \$ 5       | (Losses) gains on securities transactions, net            |
| Tax effect  | 27   | (2 )       | 250                                  | (1 )       |   |
| Total net of tax  | (52 )  | 4          | (630 )                               | 4          |   |
| Non-credit impairment losses on AFS securities before tax:                    |  |            |                                      |            |   |
| Accretion of credit loss impairment due to an increase in expected cash flows | (7 )   | 67         | (1 )                                 | 283        | Interest and dividends on investment securities (taxable) |
| Tax effect  | 2  | (27 )      | —                                    | (117 )     |   |
| Total net of tax  | (5 )   | 40         | (1 )                                 | 166        |   |
| Unrealized losses on derivatives (cash flow hedges) before tax                | (660 )   | (1,930 )   | (2,977 )                             | (6,762 )   | Interest expense  |
| Tax effect  | 188  | 798        | 850                                  | 2,799      |   |
| Total net of tax  | (472 )   | (1,132 )   | (2,127 )                             | (3,963 )   |   |
| Defined benefit pension plan:   |  |            |                                      |            |   |
| Amortization of net loss  | (157 )   | (101 )     | (471 )                               | (303 )     | *   |
| Tax effect  | 44   | 42         | 134                                  | 126        |   |
| Total net of tax  | (113 )   | (59 )      | (337 )                               | (177 )     |   |
| Total reclassifications, net of tax   | \$ (642)   | \$ (1,147) | \$ (3,095)                           | \$ (3,970) |   |

\* 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 2018

Accounting Standards Update (ASU) No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement" eliminates, amends and adds disclosure requirements for fair value measurements. In addition, the amendments eliminate the term "at a minimum" from the disclosure requirements under Topic 820 to promote an appropriate exercise of discretion to consider materiality when evaluating required disclosures. ASU No. 2018-13 is effective for all entities for reporting periods beginning January 1, 2020 with early adoption permitted. Early adoption is allowed for any period for which the financial statements have not been issued yet or have not been made available for issuance. As a result, Valley elected to early adopt ASU No. 2018-13 for the third quarter ended September 30, 2018. The adoption resulted in the removal of Level 3 assets roll-forward and qualitative and quantitative disclosures regarding valuation techniques and unobservable inputs used to measure the fair value of Level 3 assets from Note 6 due to the immaterial amount of such assets at September 30, 2018.

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

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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 caused by a change in instrument-specific credit risk in other comprehensive income, (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. 2018-15 "Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" requires implementation costs incurred in cloud computing arrangements which do not include a software license to be deferred and expensed over the term of the hosting arrangement. The implementation costs should be deferred using the Topic 350-40 "Internal-Use Software" model to determine which implementation costs are eligible to be capitalized based on the project stage and nature of the cost. The expense should be presented in the same income statement line item as the fees associated with the cloud computing arrangement. ASU No. 2018-15 will be effective for public entities annual and interim reporting periods beginning January 1, 2020 with early adoption permitted. ASU No. 2018-15 should be applied either retrospectively or prospectively. However, prospective transition would be applied to any eligible costs incurred on or after the adoption date related to arrangements entered before and after the adoption date. During the fourth quarter of 2018, Valley adopted ASU No. 2017-08 on a prospective basis. The adoption of ASU No. 2017-08 is not expected to have a significant impact on Valley's consolidated financial statements.

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 the 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.

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

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periods beginning January 1, 2020. Management is currently evaluating the impact of the ASU on Valley's consolidated financial statements. Valley's implementation effort is managed through several cross-functional working groups. These groups continue to evaluate the requirements of the new standard, assess its impact on current operational processes, and develop loss models that accurately project lifetime expected loss estimates. 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)" and subsequent related updates require 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 expects to initially apply Topic 842 at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings as of January 1, 2019 under the new optional transition method provided by ASU No. 2018-11, "Leases (Topic 842): Targeted Improvements". The comparative prior periods reported in the financial statements in the period of adoption will continue to be presented in accordance with current GAAP in Topic 840. In addition, the amendments in ASU No. 2018-11 provide lessors with a practical expedient, by class of underlying asset, to not separate non-lease components from the associated lease component. Those components can be accounted for as a single component if the non-lease components would otherwise be accounted for under the new revenue guidance (Topic 606) when certain criteria are met.

Overall, management continues to evaluate the impact of Topic 842 on Valley's consolidated financial statements and is presently evaluating all of its known leases for compliance with the new lease accounting guidance. Management has completed an initial review of Valley's contractual arrangements for embedded leases, and is currently validating the results of this review, including the accumulated lease data necessary to apply the new guidance. 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. Based upon current estimates, Valley expects to record right of use assets ranging from \$200 million to \$250 million (net of the reversal of the current deferred rent liability) and lease obligations ranging from \$230 million to \$280 million as of January 1, 2019. The estimated range of additional right of use assets is expected to negatively impact total risk-based capital by approximately 10 to 12 basis points and tier 1 capital by approximately 7 to 9 basis points. Actual results of our implementation may differ from the current estimated ranges due to several factors, including, but not limited to changes in our incremental borrowing rates at the date of adoption, expectations regarding exercise of certain lease renewal periods, lease modifications and early terminations, new leases and contracts, or the discovery of additional existing or embedded leases during the fourth quarter of 2018.

#### 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 September 30, 2018 and December 31, 2017. The assets presented under “nonrecurring fair value measurements” in the tables 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: |  |   |   |
|--|--|--|---|---|
|  | September 30, 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                           | \$48,363   | \$ 48,363  | \$ —  | \$ —                                      |
| U.S. government agency securities                  | 36,513   | —  | 36,513  | —   |
| Obligations of states and political subdivisions   | 205,237  | —  | 205,237                                       | —   |
| Residential mortgage-backed securities             | 1,412,849  | —  | 1,406,671                                     | 6,178                                     |
| Trust preferred securities                         | 1,590  | —  | 1,590   | —   |
| Corporate and other debt securities                | 44,449   | 7,587  | 36,862  | —   |
| Total available for sale                           | 1,749,001  | 55,950   | 1,686,873                                     | 6,178                                     |
| Loans held for sale <sup>(1)</sup>                 | 31,675   | —  | 31,675  | —   |
| Other assets <sup>(2)</sup>                        | 28,539   | —  | 28,539  | —   |
| Total assets                                       | \$ 1,809,215                                     | \$ 55,950  | \$ 1,747,087                                  | \$ 6,178                                  |
| Liabilities  |  |  |   |   |
| Other liabilities <sup>(2)</sup>                   | \$44,917   | \$ —   | \$ 44,917                                     | \$ —                                      |
| Total liabilities                                  | \$44,917   | \$ —   | \$ 44,917                                     | \$ —                                      |
| Non-recurring fair value measurements:             |  |  |   |   |
| Collateral dependent impaired loans <sup>(3)</sup> | \$36,957   | \$ —   | \$ —  | \$ 36,957                                 |
| Loan servicing rights                              | 373  | —  | —   | 373                                       |
| Foreclosed assets                                  | 4,450  | —  | —   | 4,450                                     |
| Total  | \$41,780   | \$ —   | \$ —  | \$ 41,780                                 |

|  | December 31,<br>2017 | Fair Value Measurements at Reporting Date Using:                           |  |  |
|--|----------------------|--|--|--|
|  |                      | Quoted Prices<br>in Active Markets<br>for Identical<br>Assets (Level<br>1) | Significant<br>Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(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 <sup>(1)</sup>                 | 15,119               | —  | 15,119   | —  |
| Other assets <sup>(2)</sup>                        | 26,417               | —  | 26,417   | —  |
| Total assets                                       | \$ 1,535,441         | \$ 58,807  | \$ 1,469,274   | \$ 7,360   |
| Liabilities  |                      |  |  |  |
| Other liabilities <sup>(2)</sup>                   | \$24,330             | \$ —   | \$ 24,330  | \$ —   |
| Total liabilities                                  | \$24,330             | \$ —   | \$ 24,330  | \$ —   |
| Non-recurring fair value measurements:             |                      |  |  |  |
| Collateral dependent impaired loans <sup>(3)</sup> | \$48,373             | \$ —   | \$ —   | \$ 48,373  |
| Loan servicing rights                              | 5,350                | —  | —  | 5,350  |
| Foreclosed assets                                  | 3,472                | —  | —  | 3,472  |
| Total  | \$57,195             | \$ —   | \$ —   | \$ 57,195  |

Represents residential mortgage loans originated for sale that are carried at fair value and had contractual unpaid (1) principal balances totaling approximately \$31.4 million and \$14.8 million at September 30, 2018 and December 31, 2017, respectively.

(2) Derivative financial instruments are included in this category.

(3) Excludes PCI loans.

#### 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

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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.

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 September 30, 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 September 30, 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 September 30, 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 September 30, 2018, certain appraisals were discounted based on specific market data by location and property type. During the quarter ended September 30, 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

impaired collateral dependent loan charge-offs to the allowance for loan losses for the three months ended September 30, 2018 and 2017. The collateral dependent loan charge-offs to the allowance for loan losses were immaterial for the nine months ended September 30, 2018 as compared to \$2.1 million for the nine months ended September 30, 2017. At September 30, 2018, collateral dependent impaired loans with a total recorded

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investment of \$60.2 million were reduced by specific valuation allowance allocations totaling \$23.2 million to a reported total net carrying amount of \$37.0 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 September 30, 2018, the fair value model used prepayment speeds (stated as constant prepayment rates) from 0 percent up to 24 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 \$48 thousand and \$365 thousand for the three and nine months ended September 30, 2018, respectively, and \$134 thousand and \$185 thousand for the three and nine months ended September 30, 2017, respectively.

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 September 30, 2018. At September 30, 2018, foreclosed assets included \$4.5 million of assets that were measured at fair value upon initial recognition or subsequently re-measured during the quarter ended September 30, 2018. The foreclosed assets charge-offs to the allowance for the loan losses totaled \$267 thousand and \$536 thousand for the three months ended September 30, 2018 and 2017, respectively, and \$1.5 million and \$1.5 million for the nine months ended September 30, 2018 and 2017, respectively. The re-measurement of foreclosed assets at fair value subsequent to their initial recognition resulted in net losses within non-interest expense of \$245 thousand for the three months ended September 30, 2018, and \$390 thousand and \$290 thousand for the nine months ended September 30, 2018 and 2017, respectively. There were no losses on re-measurement during the three months ended September 30, 2017.

#### Other Fair Value Disclosures

ASC Topic 825, “Financial Instruments,” requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis.

The fair value estimates presented in the following table were based on pertinent market data and relevant information on the financial instruments available as of the valuation date. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire portfolio of financial instruments. Because no market exists for a portion of the financial instruments, fair value estimates may be based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For instance, Valley has certain fee-generating business lines (e.g., its mortgage servicing operation, trust and investment

management departments) that were not considered in these estimates since these activities are

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not financial instruments. In addition, the tax implications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

The carrying amounts and estimated fair values of financial instruments not measured and not reported at fair value on the consolidated statements of financial condition at September 30, 2018 and December 31, 2017 were as follows:

|  | Fair Value Hierarchy | September 30, 2018 |            | December 31, 2017 |            |
|--|----------------------|--------------------|------------|-------------------|------------|
|  |                      | Carrying Amount    | Fair Value | Carrying Amount   | Fair Value |
| (in thousands)   |                      |                    |            |                   |            |
| Financial assets   |                      |                    |            |                   |            |
| Cash and due from banks  | Level 1              | \$262,653          | \$ 262,653 | \$243,310         | \$ 243,310 |
| Interest bearing deposits with banks                                 | Level 1              | 93,726             | 93,726     | 172,800           | 172,800    |
| Investment securities held to maturity:                              |                      |                    |            |                   |            |
| U.S. Treasury securities   | Level 1              | 138,557            | 140,269    | 138,676           | 145,257    |
| U.S. government agency securities                                    | Level 2              | 8,846              | 8,541      | 9,859             | 9,981      |
| Obligations of states and political subdivisions                     | Level 2              | 596,360            | 593,423    | 465,878           | 477,479    |
| Residential mortgage-backed securities                               | Level 2              | 1,259,772          | 1,211,756  | 1,131,945         | 1,118,044  |
| Trust preferred securities   | Level 2              | 37,328             | 31,153     | 49,824            | 40,088     |
| Corporate and other debt securities                                  | Level 2              | 31,500             | 31,212     | 46,509            | 46,771     |
| Total investment securities held to maturity                         |                      | 2,072,363          | 2,016,354  | 1,842,691         | 1,837,620  |
| Net loans  | Level 3              | 23,966,327         | 23,104,688 | 18,210,724        | 17,562,153 |
| Accrued interest receivable  | Level 1              | 92,666             | 92,666     | 73,990            | 73,990     |
| Federal Reserve Bank and Federal Home Loan Bank stock <sup>(1)</sup> | Level 1              | 271,905            | 271,905    | 178,668           | 178,668    |
| Financial liabilities  |                      |                    |            |                   |            |
| Deposits without stated maturities                                   | Level 1              | 17,171,701         | 17,171,701 | 14,589,941        | 14,589,941 |
| Deposits with stated maturities                                      | Level 2              | 5,416,571          | 5,351,921  | 3,563,521         | 3,465,373  |
| Short-term borrowings  | Level 1              | 2,968,431          | 2,786,568  | 748,628           | 679,316    |
| Long-term borrowings   | Level 2              | 1,728,805          | 1,639,788  | 2,315,819         | 2,453,797  |
| Junior subordinated debentures issued to capital trusts              | Level 2              | 55,283             | 47,715     | 41,774            | 37,289     |
| Accrued interest payable <sup>(2)</sup>                              | Level 1              | 17,844             | 17,844     | 14,161            | 14,161     |

(1) Included in other assets.

(2) Included in accrued expenses and other liabilities.

## Note 7. Investment Securities

## Held to Maturity

The amortized cost, gross unrealized gains and losses and fair value of securities held to maturity at September 30, 2018 and December 31, 2017 were as follows:

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value   |
|--|-------------------|------------------------------|-------------------------------|--------------|
|  | (in thousands)    |                              |                               |              |
| September 30, 2018                                     |                   |                              |                               |              |
| U.S. Treasury securities                               | \$ 138,557        | \$ 1,853                     | \$(141)                       | \$ 140,269   |
| U.S. government agency securities                      | 8,846             | —                            | (305)                         | 8,541        |
| Obligations of states and political subdivisions:      |                   |                              |                               |              |
| Obligations of states and state agencies               | 347,775           | 3,717                        | (6,970)                       | 344,522      |
| Municipal bonds  | 248,585           | 2,561                        | (2,245)                       | 248,901      |
| Total obligations of states and political subdivisions | 596,360           | 6,278                        | (9,215)                       | 593,423      |
| Residential mortgage-backed securities                 | 1,259,772         | 1,573                        | (49,589)                      | 1,211,756    |
| Trust preferred securities                             | 37,328            | 38                           | (6,213)                       | 31,153       |
| Corporate and other debt securities                    | 31,500            | 47                           | (335)                         | 31,212       |
| Total investment securities held to maturity           | \$ 2,072,363      | \$ 9,789                     | \$(65,798)                    | \$ 2,016,354 |
| December 31, 2017                                      |                   |                              |                               |              |
| U.S. Treasury securities                               | \$ 138,676        | \$ 6,581                     | \$—                           | \$ 145,257   |
| U.S. government agency securities                      | 9,859             | 122                          | —                             | 9,981        |
| Obligations of states and political subdivisions:      |                   |                              |                               |              |
| Obligations of states and state agencies               | 244,272           | 7,083                        | (1,653)                       | 249,702      |
| Municipal bonds  | 221,606           | 6,199                        | (28)                          | 227,777      |
| Total obligations of states and political subdivisions | 465,878           | 13,282                       | (1,681)                       | 477,479      |
| Residential mortgage-backed securities                 | 1,131,945         | 4,842                        | (18,743)                      | 1,118,044    |
| Trust preferred securities                             | 49,824            | 60                           | (9,796)                       | 40,088       |
| Corporate and other debt securities                    | 46,509            | 532                          | (270)                         | 46,771       |
| Total investment securities held to maturity           | \$ 1,842,691      | \$ 25,419                    | \$(30,490)                    | \$ 1,837,620 |

The age of unrealized losses and fair value of related securities held to maturity at September 30, 2018 and December 31, 2017 were as follows:

|  | Less than<br>Twelve Months |                      | More than<br>Twelve Months |                      | Total       |                      |
|--|----------------------------|----------------------|----------------------------|----------------------|-------------|----------------------|
|  | Fair<br>Value              | Unrealized<br>Losses | Fair Value                 | Unrealized<br>Losses | Fair Value  | Unrealized<br>Losses |
|  | (in thousands)             |                      |                            |                      |             |                      |
| September 30, 2018                                     |                            |                      |                            |                      |             |                      |
| U.S. Treasury securities                               | \$34,660                   | \$(141)              | \$—                        | \$—                  | \$34,660    | \$(141)              |
| U.S. government agency securities                      | 8,541                      | (305)                | —                          | —                    | 8,541       | (305)                |
| Obligations of states and political subdivisions:      |                            |                      |                            |                      |             |                      |
| Obligations of states and state agencies               | 129,321                    | (3,414)              | 48,862                     | (3,556)              | 178,183     | (6,970)              |
| Municipal bonds  | 89,065                     | (2,208)              | 528                        | (37)                 | 89,593      | (2,245)              |
| Total obligations of states and political subdivisions | 218,386                    | (5,622)              | 49,390                     | (3,593)              | 267,776     | (9,215)              |
| Residential mortgage-backed securities                 | 467,711                    | (9,928)              | 662,345                    | (39,661)             | 1,130,056   | (49,589)             |
| Trust preferred securities                             | —                          | —                    | 29,761                     | (6,213)              | 29,761      | (6,213)              |
| Corporate and other debt securities                    | 15,386                     | (114)                | 4,779                      | (221)                | 20,165      | (335)                |
| Total  | \$744,684                  | \$(16,110)           | \$746,275                  | \$(49,688)           | \$1,490,959 | \$(65,798)           |
| December 31, 2017                                      |                            |                      |                            |                      |             |                      |
| Obligations of states and political subdivisions:      |                            |                      |                            |                      |             |                      |
| Obligations of states and state agencies               | \$6,342                    | \$(50)               | \$53,034                   | \$(1,603)            | \$59,376    | \$(1,653)            |
| Municipal bonds  | 4,644                      | (25)                 | 561                        | (3)                  | 5,205       | (28)                 |
| Total obligations of states and political subdivisions | 10,986                     | (75)                 | 53,595                     | (1,606)              | 64,581      | (1,681)              |
| Residential mortgage-backed securities                 | 344,216                    | (2,357)              | 570,969                    | (16,386)             | 915,185     | (18,743)             |
| Trust preferred securities                             | —                          | —                    | 38,674                     | (9,796)              | 38,674      | (9,796)              |
| Corporate and other debt securities                    | 9,980                      | (270)                | —                          | —                    | 9,980       | (270)                |
| Total  | \$365,182                  | \$(2,702)            | \$663,238                  | \$(27,788)           | \$1,028,420 | \$(30,490)           |

The unrealized losses on investment securities held to maturity are primarily due to changes in interest rates (including, in certain cases, changes in credit spreads) and, in some cases, lack of liquidity in the marketplace. Within the held to maturity portfolio, the total number of security positions in an unrealized loss position was 409 at September 30, 2018 and 152 at December 31, 2017.

The unrealized losses within the residential mortgage-backed securities category of the held to maturity portfolio at September 30, 2018 mostly related to investment grade securities issued by Ginnie Mae and Fannie Mae. The unrealized losses existing for more than twelve months for trust preferred securities at September 30, 2018 primarily related to four non-rated single-issuer trust preferred securities issued by bank holding companies. All single-issuer trust preferred securities classified as held to maturity are paying in accordance with their terms, have no deferrals of interest or defaults and, if applicable, the issuers meet the regulatory capital requirements to be considered “well-capitalized institutions” at September 30, 2018.

As of September 30, 2018, the fair value of investments held to maturity that were pledged to secure public deposits, repurchase agreements, lines of credit, and for other purposes required by law, was \$1.2 billion.

The contractual maturities of investments in debt securities held to maturity at September 30, 2018 are set forth in the table below. Maturities may differ from contractual maturities in residential mortgage-backed securities because the





mortgages underlying the securities may be prepaid without any penalties. Therefore, residential mortgage-backed securities are not included in the maturity categories in the following summary.

|  | September 30, 2018 |             |
|--|--------------------|-------------|
|  | Amortized Cost     | Fair Value  |
|  | (in thousands)     |             |
| Due in one year                              | \$21,825           | \$21,850    |
| Due after one year through five years        | 231,676            | 233,954     |
| Due after five years through ten years       | 295,711            | 300,013     |
| Due after ten years                          | 263,379            | 248,781     |
| Residential mortgage-backed securities       | 1,259,772          | 1,211,756   |
| Total investment securities held to maturity | \$2,072,363        | \$2,016,354 |

Actual maturities of debt securities may differ from those presented above since certain obligations provide the issuer the right to call or prepay the obligation prior to scheduled maturity without penalty.

The weighted-average remaining expected life for residential mortgage-backed securities held to maturity was 6.8 years at September 30, 2018.

#### Available for Sale

The amortized cost, gross unrealized gains and losses and fair value of securities available for sale at September 30, 2018 and December 31, 2017 were as follows:

|  | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value  |
|--|----------------|------------------------|-------------------------|-------------|
|  | (in thousands) |                        |                         |             |
| September 30, 2018                                     |                |                        |                         |             |
| U.S. Treasury securities                               | \$50,980       | \$ —                   | \$(2,617)               | \$48,363    |
| U.S. government agency securities                      | 37,618         | 67                     | (1,172)                 | 36,513      |
| Obligations of states and political subdivisions:      |                |                        |                         |             |
| Obligations of states and state agencies               | 106,881        | 41                     | (3,344)                 | 103,578     |
| Municipal bonds  | 103,631        | 137                    | (2,109)                 | 101,659     |
| Total obligations of states and political subdivisions | 210,512        | 178                    | (5,453)                 | 205,237     |
| Residential mortgage-backed securities                 | 1,470,565      | 1,304                  | (59,020)                | 1,412,849   |
| Trust preferred securities                             | 1,789          | —                      | (199)                   | 1,590       |
| Corporate and other debt securities                    | 45,063         | 134                    | (748)                   | 44,449      |
| Total investment securities available for sale         | \$1,816,527    | \$ 1,683               | \$(69,209)              | \$1,749,001 |
| December 31, 2017                                      |                |                        |                         |             |
| U.S. Treasury securities                               | \$50,997       | \$ —                   | \$(1,355)               | \$49,642    |
| U.S. government agency securities                      | 42,384         | 158                    | (37)                    | 42,505      |
| Obligations of states and political subdivisions:      |                |                        |                         |             |
| Obligations of states and state agencies               | 38,435         | 158                    | (374)                   | 38,219      |
| Municipal bonds  | 74,752         | 477                    | (564)                   | 74,665      |
| Total obligations of states and political subdivisions | 113,187        | 635                    | (938)                   | 112,884     |
| Residential mortgage-backed securities                 | 1,239,534      | 2,423                  | (18,662)                | 1,223,295   |
| Trust preferred securities                             | 3,726          | —                      | (512)                   | 3,214       |
| Corporate and other debt securities                    | 50,701         | 623                    | (160)                   | 51,164      |
| Equity securities                                      | 10,505         | 1,190                  | (494)                   | 11,201      |
| Total investment securities available for sale         | \$1,511,034    | \$ 5,029               | \$(22,158)              | \$1,493,905 |



The age of unrealized losses and fair value of related securities available for sale at September 30, 2018 and December 31, 2017 were as follows:

|  | Less than<br>Twelve Months |                      | More than<br>Twelve Months |                      | Total         |                      |
|--|----------------------------|----------------------|----------------------------|----------------------|---------------|----------------------|
|  | Fair<br>Value              | Unrealized<br>Losses | Fair<br>Value              | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (in thousands)   |                            |                      |                            |                      |               |                      |
| September 30, 2018                                     |                            |                      |                            |                      |               |                      |
| U.S. Treasury securities                               | \$897                      | \$(16)               | \$47,467                   | \$(2,601)            | \$48,364      | \$(2,617)            |
| U.S. government agency securities                      | 5,502                      | (77)                 | 23,561                     | (1,095)              | 29,063        | (1,172)              |
| Obligations of states and political subdivisions:      |                            |                      |                            |                      |               |                      |
| Obligations of states and state agencies               | 86,962                     | (2,850)              | 12,297                     | (494)                | 99,259        | (3,344)              |
| Municipal bonds  | 58,259                     | (1,205)              | 22,850                     | (904)                | 81,109        | (2,109)              |
| Total obligations of states and political subdivisions | 145,221                    | (4,055)              | 35,147                     | (1,398)              | 180,368       | (5,453)              |
| Residential mortgage-backed securities                 | 667,551                    | (19,418)             | 723,522                    | (39,602)             | 1,391,073     | (59,020)             |
| Trust preferred securities                             | —                          | —                    | 1,590                      | (199)                | 1,590         | (199)                |
| Corporate and other debt securities                    | 21,317                     | (319)                | 10,473                     | (429)                | 31,790        | (748)                |
| Total  | \$840,488                  | \$(23,885)           | \$841,760                  | \$(45,324)           | \$1,682,248   | \$(69,209)           |
| December 31, 2017                                      |                            |                      |                            |                      |               |                      |
| U.S. Treasury securities                               | \$916                      | \$(2)                | \$48,726                   | \$(1,353)            | \$49,642      | \$(1,355)            |
| U.S. government agency securities                      | 31,177                     | (37)                 | —                          | —                    | 31,177        | (37)                 |
| Obligations of states and political subdivisions:      |                            |                      |                            |                      |               |                      |
| Obligations of states and state agencies               | 13,337                     | (131)                | 7,792                      | (243)                | 21,129        | (374)                |
| Municipal bonds  | 31,669                     | (256)                | 12,133                     | (308)                | 43,802        | (564)                |
| Total obligations of states and political subdivisions | 45,006                     | (387)                | 19,925                     | (551)                | 64,931        | (938)                |
| Residential mortgage-backed securities                 | 406,940                    | (2,461)              | 599,167                    | (16,201)             | 1,006,107     | (18,662)             |
| Trust preferred securities                             | —                          | —                    | 3,214                      | (512)                | 3,214         | (512)                |
| Corporate and other debt securities                    | 5,855                      | (45)                 | 15,115                     | (115)                | 20,970        | (160)                |
| Equity securities                                      | —                          | —                    | 5,150                      | (494)                | 5,150         | (494)                |
| Total  | \$489,894                  | \$(2,932)            | \$691,297                  | \$(19,226)           | \$1,181,191   | \$(22,158)           |

The unrealized losses on investment securities available for sale are primarily due to changes in interest rates (including, in certain cases, changes in credit spreads) and, in some cases, lack of liquidity in the marketplace. The total number of security positions in the securities available for sale portfolio in an unrealized loss position at September 30, 2018 was 572 as compared to 327 at December 31, 2017.

The unrealized losses for the residential mortgage-backed securities category of the available for sale portfolio at September 30, 2018 largely related to several investment grade residential mortgage-backed securities mainly issued by Ginnie Mae, Fannie Mae, and Freddie Mac.

As of September 30, 2018, the fair value of securities available for sale that were pledged to secure public deposits, repurchase agreements, lines of credit, and for other purposes required by law, was \$1.1 billion.

The contractual maturities of debt securities available for sale at September 30, 2018 are set forth in the following table. Maturities may differ from contractual maturities in residential mortgage-backed securities because the mortgages

underlying the securities may be prepaid without any penalties. Therefore, residential mortgage-backed securities are not included in the maturity categories in the following summary.

|  | September 30, 2018 |             |
|--|--------------------|-------------|
|  | Amortized Cost     | Fair Value  |
|  | (in thousands)     |             |
| Due in one year                                | \$9,831            | \$9,893     |
| Due after one year through five years          | 128,006            | 123,837     |
| Due after five years through ten years         | 78,226             | 77,112      |
| Due after ten years                            | 129,899            | 125,310     |
| Residential mortgage-backed securities         | 1,470,565          | 1,412,849   |
| Total investment securities available for sale | \$1,816,527        | \$1,749,001 |

Actual maturities of debt securities may differ from those presented above since certain obligations provide the issuer the right to call or prepay the obligation prior to scheduled maturity without penalty.

The weighted average remaining expected life for residential mortgage-backed securities available for sale was 7.1 years at September 30, 2018.

#### Other-Than-Temporary Impairment Analysis

Valley records impairment charges on its investment securities when the decline in fair value is considered other-than-temporary. Numerous factors, including lack of liquidity for re-sales of certain investment securities; decline in the creditworthiness of the issuer; absence of reliable pricing information for investment securities; adverse changes in business climate; adverse actions by regulators; or unanticipated changes in the competitive environment could have a negative effect on Valley's investment portfolio and may result in other-than-temporary impairment on certain investment securities in future periods. Valley's investment portfolios include private label mortgage-backed securities, trust preferred securities (including one pooled security at September 30, 2018) and corporate bonds (some issued by banks). These investments may pose a higher risk of future impairment charges by Valley as a result of the unpredictable nature of the U.S. economy and its potential negative effect on the future performance of the security issuers and, if applicable, the underlying mortgage loan collateral of the security.

There were no other-than-temporary impairment losses on securities recognized in earnings for the three and nine months ended September 30, 2018 and 2017. Management does not believe that any individual unrealized loss as of September 30, 2018 included in the investment portfolio tables above represents other-than-temporary impairment as management mainly attributes the declines in fair value to changes in interest rates and market volatility, not credit quality or other factors. Based on a comparison of the present value of expected cash flows to the amortized cost, management believes there are no credit losses on these securities.

At September 30, 2018, four previously impaired private label mortgage-backed securities had a combined amortized cost and fair value of \$6.8 million and \$6.2 million, respectively.

#### Realized Gains and Losses

Net losses on securities transactions totaled \$79 thousand and \$880 thousand for the three and nine months ended September 30, 2018, respectively. The net losses on securities transactions for the nine months ended September 30, 2018 were mainly related to sales of equity securities classified as available for sale prior to the adoption of ASU No. 2016-01 on January 1, 2018 and certain municipal securities acquired from USAB. Net gains and losses on securities transactions were immaterial for the three and nine months ended September 30, 2017.

## Note 8. Loans

The detail of the loan portfolio as of September 30, 2018 and December 31, 2017 was as follows:

|                                    | September 30, 2018 |               |              | December 31, 2017 |               |              |
|------------------------------------|--------------------|---------------|--------------|-------------------|---------------|--------------|
|                                    | Non-PCI<br>Loans   | PCI<br>Loans* | Total        | Non-PCI<br>Loans  | PCI<br>Loans* | Total        |
|                                    | (in thousands)     |               |              |                   |               |              |
| Loans:                             |                    |               |              |                   |               |              |
| Commercial and industrial          | \$3,243,622        | \$771,658     | \$4,015,280  | \$2,549,065       | \$192,360     | \$2,741,425  |
| Commercial real estate:            |                    |               |              |                   |               |              |
| Commercial real estate             | 9,607,279          | 2,643,952     | 12,251,231   | 8,561,851         | 934,926       | 9,496,777    |
| Construction                       | 1,022,332          | 393,927       | 1,416,259    | 809,964           | 41,141        | 851,105      |
| Total commercial real estate loans | 10,629,611         | 3,037,879     | 13,667,490   | 9,371,815         | 976,067       | 10,347,882   |
| Residential mortgage               | 3,331,985          | 450,987       | 3,782,972    | 2,717,744         | 141,291       | 2,859,035    |
| Consumer:                          |                    |               |              |                   |               |              |
| Home equity                        | 366,941            | 154,856       | 521,797      | 373,631           | 72,649        | 446,280      |
| Automobile                         | 1,288,500          | 402           | 1,288,902    | 1,208,804         | 98            | 1,208,902    |
| Other consumer                     | 820,596            | 14,253        | 834,849      | 723,306           | 4,750         | 728,056      |
| Total consumer loans               | 2,476,037          | 169,511       | 2,645,548    | 2,305,741         | 77,497        | 2,383,238    |
| Total loans                        | \$19,681,255       | \$4,430,035   | \$24,111,290 | \$16,944,365      | \$1,387,215   | \$18,331,580 |

\* PCI loans include covered loans (mostly consisting of residential mortgage loans) totaling \$29.1 million and \$38.7 million at September 30, 2018 and December 31, 2017, respectively.

Total loans (excluding PCI covered loans) include net unearned premiums and deferred loan costs of \$16.7 million and \$22.2 million at September 30, 2018 and December 31, 2017, respectively. The outstanding balances (representing contractual balances owed to Valley) for PCI loans totaled \$4.6 billion and \$1.5 billion at September 30, 2018 and December 31, 2017, respectively.

Valley transferred \$289.6 million of residential mortgage loans from the loan portfolio to loans held for sale during the nine months ended September 30, 2018 as compared to \$225.5 million of loans transferred during the nine months ended September 30, 2017. There were no other sales of loans from the held for investment portfolio during the nine months ended September 30, 2018 and 2017.

## Purchased Credit-Impaired Loans

PCI loans are accounted for in accordance with ASC Subtopic 310-30 and are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance (i.e., the allowance for loan losses), and aggregated and accounted for as pools of loans based on common risk characteristics. The difference between the undiscounted cash flows expected at acquisition and the initial carrying amount (fair value) of the PCI loans, or the "accretable yield," is recognized as interest income utilizing the level-yield method over the life of each pool. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, as a loss accrual or a valuation allowance. Reclassifications of the non-accretable difference to the accretable yield may occur subsequent to the loan acquisition dates due to increases in expected cash flows of the loan pools.

The following table presents information regarding the estimates of the contractually required payments, the cash flows expected to be collected, and the estimated fair value of the PCI loans acquired in the USAB acquisition as of January 1, 2018 (See Note 2 for more details):

|   |                   |
|---|-------------------|
|   | (in<br>thousands) |
| Contractually required principal and interest                                   | \$4,312,988       |
| Contractual cash flows not expected to be collected (non-accretable difference) | (103,618 )        |
| Expected cash flows to be collected   | 4,209,370         |
| Interest component of expected cash flows (accretable yield)                    | (474,208 )        |
| Fair value of acquired loans  | \$3,735,162       |

The following table presents changes in the accretable yield for PCI loans during the three and nine months ended September 30, 2018 and 2017:

|                                     | Three Months Ended    |                       | Nine Months Ended     |                       |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                     | September 30,<br>2018 | September 30,<br>2017 | September 30,<br>2018 | September 30,<br>2017 |
|                                     | (in thousands)        |                       |                       |                       |
| Balance, beginning of period        | \$630,550             | \$246,278             | \$282,009             | \$294,514             |
| Acquisition                         | —                     | —                     | 474,208               | —                     |
| Accretion                           | (54,367 )             | (20,626 )             | (180,034 )            | (68,862 )             |
| Net increase in expected cash flows | 23,983                | —                     | 23,983                | —                     |
| Balance, end of period              | \$600,166             | \$225,652             | \$600,166             | \$225,652             |

#### Credit Risk Management

For all of its loan types, Valley adheres to a credit policy designed to minimize credit risk while generating the maximum income given the level of risk. Management reviews and approves these policies and procedures on a regular basis with subsequent approval by the Board of Directors annually. Credit authority relating to a significant dollar percentage of the overall portfolio is centralized and controlled by the Credit Risk Management Division and by the Credit Committee. A reporting system supplements the management review process by providing management with frequent reports concerning loan production, loan quality, internal loan classification, concentrations of credit, loan delinquencies, non-performing, and potential problem loans. Loan portfolio diversification is an important factor utilized by Valley to manage its risk across business sectors and through cyclical economic circumstances.

## Credit Quality

The following table presents past due, non-accrual and current loans (excluding PCI loans, which are accounted for on a pool basis) by loan portfolio class at September 30, 2018 and December 31, 2017:

|                                       | Past Due and Non-Accrual Loans                          |   | Accruing Loans<br>90 Days or More<br>Past Due | Non-Accrual<br>Loans | Total<br>Past Due<br>Loans | Current<br>Non-PCI<br>Loans | Total<br>Non-PCI<br>Loans |
|---------------------------------------|---|---|---|----------------------|----------------------------|-----------------------------|---------------------------|
|                                       | 30-59<br>Days<br>Past<br>Due<br>Loans<br>(in thousands) | 60-89<br>Days<br>Past<br>Due<br>Loans<br>(in thousands) |   |                      |                            |                             |                           |
| September 30, 2018                    |   |   |   |                      |                            |                             |                           |
| Commercial and industrial             | \$9,462   | \$1,431   | \$ 1,618                                      | \$ 52,929            | \$65,440                   | \$3,178,182                 | \$3,243,622               |
| Commercial real estate:               |   |   |   |                      |                            |                             |                           |
| Commercial real estate                | 3,387   | 2,502   | 27  | 7,103                | 13,019                     | 9,594,260                   | 9,607,279                 |
| Construction                          | 15,576  | 36  | —   | —                    | 15,612                     | 1,006,720                   | 1,022,332                 |
| Total commercial real estate<br>loans | 18,963  | 2,538   | 27  | 7,103                | 28,631                     | 10,600,980                  | 10,629,611                |
| Residential mortgage                  | 10,058  | 3,270   | 1,877   | 16,083               | 31,288                     | 3,300,697                   | 3,331,985                 |
| Consumer loans:                       |   |   |   |                      |                            |                             |                           |
| Home equity                           | 506   | 265   | —   | 2,060                | 2,831                      | 364,110                     | 366,941                   |
| Automobile                            | 5,950   | 619   | 261   | 72                   | 6,902                      | 1,281,598                   | 1,288,500                 |
| Other consumer                        | 987   | 365   | 21  | 116                  | 1,489                      | 819,107                     | 820,596                   |
| Total consumer loans                  | 7,443   | 1,249   | 282   | 2,248                | 11,222                     | 2,464,815                   | 2,476,037                 |
| Total                                 | \$45,926  | \$8,488   | \$ 3,804                                      | \$ 78,363            | \$136,581                  | \$19,544,674                | \$19,681,255              |
| December 31, 2017                     |   |   |   |                      |                            |                             |                           |
| Commercial and industrial             | \$3,650   | \$544   | \$ —  | \$ 20,890            | \$25,084                   | \$2,523,981                 | \$2,549,065               |
| Commercial real estate:               |   |   |   |                      |                            |                             |                           |
| Commercial real estate                | 11,223  | —   | 27  | 11,328               | 22,578                     | 8,539,273                   | 8,561,851                 |
| Construction                          | 12,949  | 18,845  | —   | 732                  | 32,526                     | 777,438                     | 809,964                   |
| Total commercial real estate<br>loans | 24,172  | 18,845  | 27  | 12,060               | 55,104                     | 9,316,711                   | 9,371,815                 |
| Residential mortgage                  | 12,669  | 7,903   | 2,779   | 12,405               | 35,756                     | 2,681,988                   | 2,717,744                 |
| Consumer loans:                       |   |   |   |                      |                            |                             |                           |
| Home equity                           | 1,009   | 94  | —   | 1,777                | 2,880                      | 370,751                     | 373,631                   |
| Automobile                            | 5,707   | 987   | 271   | 73                   | 7,038                      | 1,201,766                   | 1,208,804                 |
| Other consumer                        | 1,693   | 118   | 13  | 20                   | 1,844                      | 721,462                     | 723,306                   |
| Total consumer loans                  | 8,409   | 1,199   | 284   | 1,870                | 11,762                     | 2,293,979                   | 2,305,741                 |
| Total                                 | \$48,900  | \$28,491  | \$ 3,090                                      | \$ 47,225            | \$127,706                  | \$16,816,659                | \$16,944,365              |

Impaired loans. Impaired loans, consisting of non-accrual commercial and industrial loans and commercial real estate loans over \$250 thousand and all loans which were modified in troubled debt restructuring, are individually evaluated for impairment. PCI loans are not classified as impaired loans because they are accounted for on a pool basis.

The following table presents information about impaired loans by loan portfolio class at September 30, 2018 and December 31, 2017:

|                                    | Recorded Investment With No Allowance | Recorded Investment With Related Allowance | Total Recorded Investment | Unpaid Contractual Principal Balance | Related Allowance |
|------------------------------------|---------------------------------------|--|---------------------------|--------------------------------------|-------------------|
|                                    | (in thousands)                        |  |                           |                                      |                   |
| September 30, 2018                 |                                       |  |                           |                                      |                   |
| Commercial and industrial          | \$5,294                               | \$ 81,319                                  | \$ 86,613                 | \$ 91,998                            | \$ 27,662         |
| Commercial real estate:            |                                       |  |                           |                                      |                   |
| Commercial real estate             | 22,279                                | 28,638                                     | 50,917                    | 54,904                               | 2,768             |
| Construction                       | 421                                   | 460  | 881                       | 881                                  | 14                |
| Total commercial real estate loans | 22,700                                | 29,098                                     | 51,798                    | 55,785                               | 2,782             |
| Residential mortgage               | 6,362                                 | 6,420                                      | 12,782                    | 13,801                               | 620               |
| Consumer loans:                    |                                       |  |                           |                                      |                   |
| Home equity                        | 186                                   | 620  | 806                       | 901                                  | 79                |
| Total consumer loans               | 186                                   | 620  | 806                       | 901                                  | 79                |
| Total                              | \$34,542                              | \$ 117,457                                 | \$ 151,999                | \$ 162,485                           | \$ 31,143         |
| December 31, 2017                  |                                       |  |                           |                                      |                   |
| Commercial and industrial          | \$9,946                               | \$ 75,553                                  | \$ 85,499                 | \$ 90,269                            | \$ 11,044         |
| Commercial real estate:            |                                       |  |                           |                                      |                   |
| Commercial real estate             | 28,709                                | 29,771                                     | 58,480                    | 62,286                               | 2,718             |
| Construction                       | 1,904                                 | 467  | 2,371                     | 2,394                                | 17                |
| Total commercial real estate loans | 30,613                                | 30,238                                     | 60,851                    | 64,680                               | 2,735             |
| Residential mortgage               | 5,654                                 | 8,402                                      | 14,056                    | 15,332                               | 718               |
| Consumer loans:                    |                                       |  |                           |                                      |                   |
| Home equity                        | 3,096                                 | 664  | 3,760                     | 4,917                                | 64                |
| Total consumer loans               | 3,096                                 | 664  | 3,760                     | 4,917                                | 64                |
| Total                              | \$49,309                              | \$ 114,857                                 | \$ 164,166                | \$ 175,198                           | \$ 14,561         |

The following tables present by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2018 and 2017:

|                                    | Three Months Ended September 30, |                     |                             |                     |
|------------------------------------|----------------------------------|---------------------|-----------------------------|---------------------|
|                                    | 2018                             |                     | 2017                        |                     |
|                                    | Average Recorded Investment      | Interest Recognized | Average Recorded Investment | Interest Recognized |
|                                    | (in thousands)                   |                     |                             |                     |
| Commercial and industrial          | \$87,414                         | \$ 422              | \$70,135                    | \$ 300              |
| Commercial real estate:            |                                  |                     |                             |                     |
| Commercial real estate             | 50,809                           | 556                 | 57,712                      | 482                 |
| Construction                       | 987                              | 15                  | 3,049                       | 21                  |
| Total commercial real estate loans | 51,796                           | 571                 | 60,761                      | 503                 |
| Residential mortgage               | 14,112                           | 152                 | 15,630                      | 183                 |
| Consumer loans:                    |                                  |                     |                             |                     |
| Home equity                        | 2,454                            | 17                  | 4,766                       | 49                  |
| Total consumer loans               | 2,454                            | 17                  | 4,766                       | 49                  |
| Total                              | \$155,776                        | \$ 1,162            | \$151,292                   | \$ 1,035            |





|                                    | Nine Months Ended September 30, |            |            |            |
|------------------------------------|---------------------------------|------------|------------|------------|
|                                    | 2018                            |            | 2017       |            |
|                                    | Average                         | Interest   | Average    | Interest   |
|                                    | Recorded                        | Income     | Recorded   | Income     |
|                                    | Investment                      | Recognized | Investment | Recognized |
|                                    | (in thousands)                  |            |            |            |
| Commercial and industrial          | \$88,376                        | \$ 1,348   | \$49,037   | \$ 896     |
| Commercial real estate:            |                                 |            |            |            |
| Commercial real estate             | 52,993                          | 1,735      | 57,718     | 1,290      |
| Construction                       | 1,811                           | 54         | 2,836      | 60         |
| Total commercial real estate loans | 54,804                          | 1,789      | 60,554     | 1,350      |
| Residential mortgage               | 13,707                          | 502        | 17,851     | 575        |
| Consumer loans:                    |                                 |            |            |            |
| Home equity                        | 2,093                           | 83         | 4,820      | 123        |
| Total consumer loans               | 2,093                           | 83         | 4,820      | 123        |
| Total                              | \$158,980                       | \$ 3,722   | \$132,262  | \$ 2,944   |

Interest income recognized on a cash basis (included in the table above) was immaterial for the three and nine months ended September 30, 2018 and 2017.

Troubled debt restructured loans. From time to time, Valley may extend, restructure, or otherwise modify the terms of existing loans, on a case-by-case basis, to remain competitive and retain certain customers, as well as assist other customers who may be experiencing financial difficulties. If the borrower is experiencing financial difficulties and a concession has been made at the time of such modification, the loan is classified as a troubled debt restructured loan (TDR). Valley's PCI loans are excluded from the TDR disclosures below because they are evaluated for impairment on a pool by pool basis. When an individual PCI loan within a pool is modified as a TDR, it is not removed from its pool. All TDRs are classified as impaired loans and are included in the impaired loan disclosures above.

The majority of the concessions made for TDRs involve lowering the monthly payments on loans through either a reduction in interest rate below a market rate, an extension of the term of the loan without a corresponding adjustment to the risk premium reflected in the interest rate, or a combination of these two methods. The concessions rarely result in the forgiveness of principal or accrued interest. In addition, Valley frequently obtains additional collateral or guarantor support when modifying such loans. If the borrower has demonstrated performance under the previous terms of the loan and Valley's underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

Performing TDRs (not reported as non-accrual loans) totaled \$81.1 million and \$117.2 million as of September 30, 2018 and December 31, 2017, respectively. Non-performing TDRs totaled \$54.8 million and \$27.0 million as of September 30, 2018 and December 31, 2017, respectively.

The following tables present loans by loan portfolio class modified as TDRs during the three and nine months ended September 30, 2018 and 2017. The pre-modification and post-modification outstanding recorded investments disclosed in the tables below represent the loan carrying amounts immediately prior to the modification and the carrying amounts at September 30, 2018 and 2017, respectively.

| Troubled Debt Restructurings | Three Months Ended September 30,<br>2018   |  | 2017   |  |           |           |
|------------------------------|--|--|--|--|-----------|-----------|
|                              | Pre-Modification<br>Number<br>of<br>Outstanding<br>Recorded<br>Contracts<br>of<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Pre-Modification<br>Number<br>of<br>Outstanding<br>Recorded<br>Contracts<br>of<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |           |           |
|                              | (\$ in thousands)  |  |  |  |           |           |
| Commercial and industrial    | 6  | \$ 3,970   | \$ 3,751   | 10   | \$ 12,522 | \$ 11,655 |
| Commercial real estate:      |  |  |  |  |           |           |
| Commercial real estate       | 1  | 233  | 231  | 4  | 5,931     | 5,929     |
| Construction                 | —  | —  | —  | 2  | 628       | 625       |
| Total commercial real estate | 1  | 233  | 231  | 6  | 6,559     | 6,554     |
| Residential mortgage         | —  | —  | —  | 2  | 561       | 557       |
| Total                        | 7  | \$ 4,203   | \$ 3,982   | 18   | \$ 19,642 | \$ 18,766 |
| Troubled Debt Restructurings | Nine Months Ended September 30,<br>2018  |  | 2017   |  |           |           |
|                              | Pre-Modification<br>Number<br>of<br>Outstanding<br>Recorded<br>Contracts<br>of<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Pre-Modification<br>Number<br>of<br>Outstanding<br>Recorded<br>Contracts<br>of<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |           |           |
|                              | (\$ in thousands)  |  |  |  |           |           |
| Commercial and industrial    | 22   | \$ 14,719  | \$ 13,904  | 61   | \$ 57,338 | \$ 52,694 |
| Commercial real estate:      |  |  |  |  |           |           |
| Commercial real estate       | 6  | 4,207  | 4,504  | 7  | 23,806    | 23,217    |
| Construction                 | 2  | 565  | 285  | 3  | 1,188     | 994       |
| Total commercial real estate | 8  | 4,772  | 4,789  | 10   | 24,994    | 24,211    |
| Residential mortgage         | 5  | 980  | 952  | 6  | 1,514     | 1,495     |
| Consumer                     | 1  | 88   | 83   | —  | —         | —         |
| Total                        | 36   | \$ 20,559  | \$ 19,728  | 77   | \$ 83,846 | \$ 78,400 |

The total TDRs presented in the above table had allocated specific reserves for loan losses of approximately \$6.3 million and \$5.3 million for September 30, 2018 and 2017. These specific reserves are included in the allowance for loan losses for loans individually evaluated for impairment disclosed in the "Impaired Loans" section above. There were no charge-offs related to TDR modifications during the three and nine months ended September 30, 2018 and 2017, respectively.

The non-PCI loans modified as TDRs within the previous 12 months and for which there was a payment default (90 or more days past due) for the three and nine months ended September 30, 2018 and 2017 were as follows:

|   | Three Months Ended   |   |
|---|--|---|
|   | September 30,  |   |
|   | 2018   | 2017  |
| Troubled Debt Restructurings Subsequently Defaulted<br>Commercial and industrial<br>Residential mortgage<br>Total                           | Number of<br>Contracts<br>4<br>5<br>9                                | Number of<br>Contracts<br>—<br>4<br>4                           |
|   | Amount<br>(\$ in thousands)<br>\$ 3,645<br>1,015<br>\$ 4,660         | Amount<br>(\$ in thousands)<br>\$ —<br>1,093<br>\$ 1,093        |
|   | Nine Months Ended<br>September 30,<br>2018                      2017 |   |
| Troubled Debt Restructurings Subsequently Defaulted<br>Commercial and industrial<br>Commercial real estate<br>Residential mortgage<br>Total | Number of<br>Contracts<br>8<br>—<br>5<br>13                          | Number of<br>Contracts<br>7<br>1<br>—<br>8                      |
|   | Amount<br>(\$ in thousands)<br>\$ 6,770<br>—<br>1,015<br>\$ 7,785    | Amount<br>(\$ in thousands)<br>\$ 6,430<br>732<br>—<br>\$ 7,162 |

Credit quality indicators. Valley utilizes an internal loan classification system as a means of reporting problem loans within commercial and industrial, commercial real estate, and construction loan portfolio classes. Under Valley's internal risk rating system, loan relationships could be classified as "Pass", "Special Mention", "Substandard", "Doubtful" and "Loss". Substandard loans include loans that exhibit well-defined weakness and are characterized by the distinct possibility that Valley will sustain some loss if the deficiencies are not corrected. Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, based on currently existing facts, conditions and values, highly questionable and improbable. Loans classified as Loss are those considered uncollectible with insignificant value and are charged-off immediately to the allowance for loan losses, and, therefore, not presented in the table below. Loans that do not currently pose a sufficient risk to warrant classification in one of the aforementioned categories, but pose weaknesses that deserve management's close attention are deemed Special Mention. Loans rated as Pass do not currently pose any identified risk and can range from the highest to average quality, depending on the degree of potential risk. Risk ratings are updated any time the situation warrants.

The following table presents the credit exposure by internally assigned risk rating by class of loans (excluding PCI loans) at September 30, 2018 and December 31, 2017 based on the most recent analysis performed:

| Credit exposure - by internally assigned risk rating | Pass           | Special<br>Mention | Substandard | Doubtful | Total<br>Non-PCI<br>Loans |
|--|----------------|--------------------|-------------|----------|---------------------------|
|  | (in thousands) |                    |             |          |                           |
| September 30, 2018                                   |                |                    |             |          |                           |
| Commercial and industrial                            | \$3,059,312    | \$52,555           | \$82,212    | \$49,543 | \$3,243,622               |
| Commercial real estate                               | 9,518,179      | 29,334             | 59,766      | —        | 9,607,279                 |
| Construction   | 1,021,179      | 545                | 608         | —        | 1,022,332                 |
| Total  | \$13,598,670   | \$82,434           | \$142,586   | \$49,543 | \$13,873,233              |
| December 31, 2017                                    |                |                    |             |          |                           |
| Commercial and industrial                            | \$2,375,689    | \$62,071           | \$96,555    | \$14,750 | \$2,549,065               |
| Commercial real estate                               | 8,447,865      | 48,009             | 65,977      | —        | 8,561,851                 |
| Construction   | 808,091        | 360                | 1,513       | —        | 809,964                   |
| Total  | \$11,631,645   | \$110,440          | \$164,045   | \$14,750 | \$11,920,880              |

At September 30, 2018 and December 31, 2017, the commercial and industrial loans with doubtful risk ratings in the above table mostly consisted of non-accrual taxi medallion loans.

For residential mortgages, automobile, home equity and other consumer loan portfolio classes (excluding PCI loans), Valley also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in those loan classes based on payment activity as of September 30, 2018 and December 31, 2017:

| Credit exposure - by payment activity | Performing<br>Loans | Non-Performing<br>Loans | Total Non-PCI<br>Loans |
|---------------------------------------|---------------------|-------------------------|------------------------|
|                                       | (in thousands)      |                         |                        |
| September 30, 2018                    |                     |                         |                        |
| Residential mortgage                  | \$3,315,902         | \$16,083                | \$3,331,985            |
| Home equity                           | 364,881             | 2,060                   | 366,941                |
| Automobile                            | 1,288,428           | 72                      | 1,288,500              |
| Other consumer                        | 820,480             | 116                     | 820,596                |
| Total                                 | \$5,789,691         | \$18,331                | \$5,808,022            |
| December 31, 2017                     |                     |                         |                        |
| Residential mortgage                  | \$2,705,339         | \$12,405                | \$2,717,744            |
| Home equity                           | 371,854             | 1,777                   | 373,631                |
| Automobile                            | 1,208,731           | 73                      | 1,208,804              |
| Other consumer                        | 723,286             | 20                      | 723,306                |
| Total                                 | \$5,009,210         | \$14,275                | \$5,023,485            |

Valley evaluates the credit quality of its PCI loan pools based on the expectation of the underlying cash flows of each pool, derived from the aging status and by payment activity of individual loans within the pool. The following table presents the recorded investment in PCI loans by class based on individual loan payment activity as of September 30, 2018 and December 31, 2017:

| Credit exposure - by payment activity | Performing     | Non-Performing | Total       |
|---------------------------------------|----------------|----------------|-------------|
|                                       | Loans          | Loans          | PCI Loans   |
|                                       | (in thousands) |                |             |
| September 30, 2018                    |                |                |             |
| Commercial and industrial             | \$729,872      | \$ 41,786      | \$771,658   |
| Commercial real estate                | 2,622,330      | 21,622         | 2,643,952   |
| Construction                          | 392,873        | 1,054          | 393,927     |
| Residential mortgage                  | 443,776        | 7,211          | 450,987     |
| Consumer                              | 165,762        | 3,749          | 169,511     |
| Total                                 | \$4,354,613    | \$ 75,422      | \$4,430,035 |
| December 31, 2017                     |                |                |             |
| Commercial and industrial             | \$172,105      | \$ 20,255      | \$192,360   |
| Commercial real estate                | 924,574        | 10,352         | 934,926     |
| Construction                          | 39,802         | 1,339          | 41,141      |
| Residential mortgage                  | 135,745        | 5,546          | 141,291     |
| Consumer                              | 76,901         | 596            | 77,497      |
| Total                                 | \$1,349,127    | \$ 38,088      | \$1,387,215 |

Other real estate owned (OREO) totaled \$9.9 million and \$9.8 million at September 30, 2018 and December 31, 2017, respectively. OREO included foreclosed residential real estate properties totaling \$1.6 million and \$7.3 million at September 30, 2018 and December 31, 2017, respectively. Residential mortgage and consumer loans secured by residential real estate properties for which formal foreclosure proceedings are in process totaled \$2.2 million and \$3.8 million at September 30, 2018 and December 31, 2017, respectively.

#### Note 9. Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the allowance for unfunded letters of credit. Management maintains the allowance for credit losses at a level estimated to absorb probable loan losses of the loan portfolio and unfunded letter of credit commitments at the balance sheet date. The allowance for loan losses is based on ongoing evaluations of the probable estimated losses inherent in the loan portfolio, including unexpected additional credit impairment of PCI loan pools subsequent to acquisition. There was no allowance allocation for PCI loan losses at September 30, 2018 and December 31, 2017.

The following table summarizes the allowance for credit losses at September 30, 2018 and December 31, 2017:

| Components of allowance for credit losses: | September 30, December 31, |            |
|--|----------------------------|------------|
|  | 2018                       | 2017       |
|  | (in thousands)             |            |
| Allowance for loan losses                  | \$144,963                  | \$ 120,856 |
| Allowance for unfunded letters of credit   | 4,512                      | 3,596      |
| Total allowance for credit losses          | \$149,475                  | \$ 124,452 |

The following table summarizes the provision for credit losses for the periods indicated:

|  | Three Months Ended |      | Nine Months Ended |      |
|--|--------------------|------|-------------------|------|
|  | September 30,      |      | September 30,     |      |
|  | 2018               | 2017 | 2018              | 2017 |
|  | (in thousands)     |      |                   |      |

Components of provision for credit losses:

|  |         |         |          |         |
|--|---------|---------|----------|---------|
| Provision for loan losses                | \$6,432 | \$1,301 | \$23,726 | \$7,413 |
| Provision for unfunded letters of credit | 120     | 339     | 916      | 329     |
| Total provision for credit losses        | \$6,552 | \$1,640 | \$24,642 | \$7,742 |

The following tables detail activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2018 and 2017:

|                              | Commercial and Industrial | Commercial Real Estate | Residential Mortgage | Consumer | Total     |
|------------------------------|---------------------------|------------------------|----------------------|----------|-----------|
|                              | (in thousands)            |                        |                      |          |           |
| Three Months Ended           |                           |                        |                      |          |           |
| September 30, 2018           |                           |                        |                      |          |           |
| Allowance for loan losses:   |                           |                        |                      |          |           |
| Beginning balance            | \$74,257                  | \$53,812               | \$4,624              | \$6,069  | \$138,762 |
| Loans charged-off            | (833 )                    | —                      | —                    | (1,150 ) | (1,983 )  |
| Charged-off loans recovered  | 1,131                     | 12                     | 9                    | 600      | 1,752     |
| Net recoveries (charge-offs) | 298                       | 12                     | 9                    | (550 )   | (231 )    |
| Provision for loan losses    | 9,442                     | (3,694 )               | 286                  | 398      | 6,432     |
| Ending balance               | \$83,997                  | \$50,130               | \$4,919              | \$5,917  | \$144,963 |
| Three Months Ended           |                           |                        |                      |          |           |
| September 30, 2017           |                           |                        |                      |          |           |
| Allowance for loan losses:   |                           |                        |                      |          |           |
| Beginning balance            | \$51,617                  | \$55,455               | \$4,186              | \$5,188  | \$116,446 |
| Loans charged-off            | (265 )                    | —                      | (129 )               | (1,335 ) | (1,729 )  |
| Charged-off loans recovered  | 2,320                     | 42                     | 220                  | 366      | 2,948     |
| Net recoveries (charge-offs) | 2,055                     | 42                     | 91                   | (969 )   | 1,219     |
| Provision for loan losses    | 1,017                     | (198 )                 | (385 )               | 867      | 1,301     |
| Ending balance               | \$54,689                  | \$55,299               | \$3,892              | \$5,086  | \$118,966 |

|                              | Commercial<br>and Industrial<br>(in thousands) | Commercial<br>Real Estate | Residential<br>Mortgage | Consumer | Total     |
|------------------------------|--|---------------------------|-------------------------|----------|-----------|
| Nine Months Ended            |  |                           |                         |          |           |
| September 30, 2018           |  |                           |                         |          |           |
| Allowance for loan losses:   |  |                           |                         |          |           |
| Beginning balance            | \$57,232                                       | \$ 54,954                 | \$ 3,605                | \$ 5,065 | \$120,856 |
| Loans charged-off            | (1,606 )                                       | (348 )                    | (167 )                  | (3,783 ) | (5,904 )  |
| Charged-off loans recovered  | 4,057  | 396                       | 269                     | 1,563    | 6,285     |
| Net recoveries (charge-offs) | 2,451  | 48                        | 102                     | (2,220 ) | 381       |
| Provision for loan losses    | 24,314   | (4,872 )                  | 1,212                   | 3,072    | 23,726    |
| Ending balance               | \$83,997                                       | \$ 50,130                 | \$ 4,919                | \$ 5,917 | \$144,963 |
| Nine Months Ended            |  |                           |                         |          |           |
| September 30, 2017           |  |                           |                         |          |           |
| Allowance for loan losses:   |  |                           |                         |          |           |
| Beginning balance            | \$50,820                                       | \$ 55,851                 | \$ 3,702                | \$ 4,046 | \$114,419 |
| Loans charged-off            | (4,889 )                                       | (553 )                    | (488 )                  | (3,467 ) | (9,397 )  |
| Charged-off loans recovered  | 3,480  | 824                       | 903                     | 1,324    | 6,531     |
| Net (charge-offs) recoveries | (1,409 )                                       | 271                       | 415                     | (2,143 ) | (2,866 )  |
| Provision for loan losses    | 5,278  | (823 )                    | (225 )                  | 3,183    | 7,413     |
| Ending balance               | \$54,689                                       | \$ 55,299                 | \$ 3,892                | \$ 5,086 | \$118,966 |



The following table represents the allocation of the allowance for loan losses and the related loans by loan portfolio segment disaggregated based on the impairment methodology at September 30, 2018 and December 31, 2017. Loans individually evaluated for impairment represent Valley's impaired loans. Loans acquired with discounts related to credit quality represent Valley's PCI loans.

|   | Commercial<br>and Industrial | Commercial<br>Real Estate | Residential<br>Mortgage | Consumer    | Total        |
|---|------------------------------|---------------------------|-------------------------|-------------|--------------|
|   | (in thousands)               |                           |                         |             |              |
| September 30, 2018                                      |                              |                           |                         |             |              |
| Allowance for loan losses:                              |                              |                           |                         |             |              |
| Individually evaluated for impairment                   | \$27,662                     | \$2,782                   | \$620                   | \$79        | \$31,143     |
| Collectively evaluated for impairment                   | 56,335                       | 47,348                    | 4,299                   | 5,838       | 113,820      |
| Total   | \$83,997                     | \$50,130                  | \$4,919                 | \$5,917     | \$144,963    |
| Loans:  |                              |                           |                         |             |              |
| Individually evaluated for impairment                   | \$86,613                     | \$51,798                  | \$12,782                | \$806       | \$151,999    |
| Collectively evaluated for impairment                   | 3,157,009                    | 10,577,813                | 3,319,203               | 2,475,231   | 19,529,256   |
| Loans acquired with discounts related to credit quality | 771,658                      | 3,037,879                 | 450,987                 | 169,511     | 4,430,035    |
| Total   | \$4,015,280                  | \$13,667,490              | \$3,782,972             | \$2,645,548 | \$24,111,290 |
| December 31, 2017                                       |                              |                           |                         |             |              |
| Allowance for loan losses:                              |                              |                           |                         |             |              |
| Individually evaluated for impairment                   | \$11,044                     | \$2,735                   | \$718                   | \$64        | \$14,561     |
| Collectively evaluated for impairment                   | 46,188                       | 52,219                    | 2,887                   | 5,001       | 106,295      |
| Total   | \$57,232                     | \$54,954                  | \$3,605                 | \$5,065     | \$120,856    |
| Loans:  |                              |                           |                         |             |              |
| Individually evaluated for impairment                   | \$85,499                     | \$60,851                  | \$14,056                | \$3,760     | \$164,166    |
| Collectively evaluated for impairment                   | 2,463,566                    | 9,310,964                 | 2,703,688               | 2,301,981   | 16,780,199   |
| Loans acquired with discounts related to credit quality | 192,360                      | 976,067                   | 141,291                 | 77,497      | 1,387,215    |
| Total   | \$2,741,425                  | \$10,347,882              | \$2,859,035             | \$2,383,238 | \$18,331,580 |

Note 10. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill as allocated to our business segments, or reporting units thereof, for goodwill impairment analysis were:

|                                     | Business Segment / Reporting Unit* |                     |                       |                          | Total       |
|-------------------------------------|------------------------------------|---------------------|-----------------------|--------------------------|-------------|
|                                     | Wealth<br>Management               | Consumer<br>Lending | Commercial<br>Lending | Investment<br>Management |             |
|                                     | (in thousands)                     |                     |                       |                          |             |
| Balance at December 31, 2017        | \$21,218                           | \$200,103           | \$316,258             | \$153,058                | \$690,637   |
| Goodwill from business combinations | —                                  | 87,153              | 242,232               | 65,688                   | 395,073     |
| Balance at September 30, 2018       | \$21,218                           | \$287,256           | \$558,490             | \$218,746                | \$1,085,710 |

\* Wealth Management is comprised of trust, asset management and insurance services. This reporting unit is included in the Consumer Lending segment for financial reporting purposes.

The goodwill from business combinations during 2018 set forth in the table above relates to the USAB acquisition. During the third quarter of 2018, Valley recorded an additional \$6.8 million of goodwill related to the USAB acquisition, reflecting the effect of the combined adjustments to the fair value of certain PCI loans and deferred tax assets as of the acquisition date. See Note 2 for further details related to the USAB acquisition.

There was no impairment of goodwill during three and nine months ended September 30, 2018 and 2017.



The following table summarizes other intangible assets as of September 30, 2018 and December 31, 2017:

|                               | Gross<br>Intangible<br>Assets | Accumulated<br>Amortization | Valuation<br>Allowance | Net<br>Intangible<br>Assets |
|-------------------------------|-------------------------------|-----------------------------|------------------------|-----------------------------|
| (in thousands)                |                               |                             |                        |                             |
| September 30, 2018            |                               |                             |                        |                             |
| Loan servicing rights         | \$86,398                      | \$ (61,507 )                | \$ (106 )              | \$ 24,785                   |
| Core deposits                 | 80,470                        | (26,092 )                   | —                      | 54,378                      |
| Other                         | 3,945                         | (2,337 )                    | —                      | 1,608                       |
| Total other intangible assets | \$170,813                     | \$ (89,936 )                | \$ (106 )              | \$ 80,771                   |
| December 31, 2017             |                               |                             |                        |                             |
| Loan servicing rights         | \$79,138                      | \$ (57,054 )                | \$ (471 )              | \$ 21,613                   |
| Core deposits                 | 43,396                        | (24,297 )                   | —                      | 19,099                      |
| Other                         | 4,087                         | (2,292 )                    | —                      | 1,795                       |
| Total other intangible assets | \$126,621                     | \$ (83,643 )                | \$ (471 )              | \$ 42,507                   |

Loan servicing rights are accounted for using the amortization method. Under this method, Valley amortizes the loan servicing assets in proportion to, and over the period of, estimated net servicing revenues. On a quarterly basis, Valley stratifies its loan servicing assets into groupings based on risk characteristics and assesses each group for impairment based on fair value. Impairment charges on loan servicing rights are recognized in earnings when the book value of a stratified group of loan servicing rights exceeds its estimated fair value. See the "Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis" section of Note 6 for additional information regarding the fair valuation and impairment of loan servicing rights.

Core deposits are amortized using an accelerated method and have a weighted average amortization period of 10 years. The line item labeled "Other" included in the table above primarily consists of customer lists and covenants not to compete, which are amortized over their expected lives generally using a straight-line method and have a weighted average amortization period of approximately 20 years. On January 1, 2018, Valley recorded approximately \$44.6 million and \$1.4 million of core deposit intangibles and loan servicing rights, respectively, resulting from the USAB acquisition. Valley evaluates core deposits and other intangibles for impairment when an indication of impairment exists. No impairment was recognized during the three and nine months ended September 30, 2018 and 2017.

The following table presents the estimated future amortization expense of other intangible assets for the remainder of 2018 through 2022:

|                | Loan<br>Servicing<br>Rights | Core<br>Deposits | Other |
|----------------|-----------------------------|------------------|-------|
| (in thousands) |                             |                  |       |
| 2018           | \$1,654                     | \$ 3,043         | \$ 62 |
| 2019           | 5,437                       | 10,961           | 235   |
| 2020           | 4,411                       | 9,607            | 220   |
| 2021           | 3,456                       | 8,252            | 206   |
| 2022           | 2,791                       | 6,898            | 191   |

Valley recognized amortization expense on other intangible assets, including net impairment (or recovery of impairment) charges on loan servicing rights, totaling approximately \$4.7 million and \$2.5 million for the three months ended September 30, 2018 and 2017, respectively, and \$13.6 million and \$7.6 million for the nine months ended September 30, 2018 and 2017, respectively.



**Note 11. Stock-Based Compensation**

Valley currently has one active employee stock plan, the 2016 Long-Term Stock Incentive Plan (the "2016 Stock Plan"), adopted by Valley's Board of Directors on January 29, 2016 and approved by its shareholders on April 28, 2016. The primary purpose of the 2016 Stock Plan is to provide additional incentive to officers and key employees of Valley and its subsidiaries, whose substantial contributions are essential to the continued growth and success of Valley, and to attract and retain competent and dedicated officers and other key employees whose efforts will result in the continued and long-term growth of Valley's business.

Under the 2016 Stock Plan, Valley may award shares of common stock in the form of stock appreciation rights, both incentive and non-qualified stock options, restricted stock and restricted stock units (RSUs) to its employees, and restricted stock and RSUs to non-employee directors for acting in their role as members of the board of directors. As of September 30, 2018, 5.5 million shares of common stock were available for issuance under the 2016 Stock Plan.

The essential features of each award are described in the award agreement relating to that award. The grant, exercise, vesting, settlement or payment of an award may be based upon the fair value of Valley's common stock on the last sale price reported for Valley's common stock on such date or the last sale price reported preceding such date, except for performance-based awards with a market condition. The grant date fair values of performance-based awards that vest based on a market condition are determined by a third party specialist using a Monte Carlo valuation model.

In connection with the USAB acquisition on January 1, 2018, Valley assumed pre-existing stock awards consisting of options for 1.8 million shares of Valley common stock (of which options for 826 thousand shares remained outstanding as of September 30, 2018) at a weighted average exercise price of \$5.47 and 336 thousand time-based RSUs (of which 179 thousand remained outstanding as of September 30, 2018). The stock plan under which the stock awards were issued is no longer active.

**Restricted Stock.** Restricted stock is awarded to key employees, providing for the immediate award of our common stock subject to certain vesting and restrictions under the 2016 Stock Plan. Compensation expense is measured based on the grant-date fair value of the shares. Valley awarded time-based restricted stock totaling 1.2 million shares and 482 thousand shares during the nine months ended September 30, 2018 and 2017, respectively, to executive officers, key employees and directors of Valley. The majority of the awards have vesting periods of three years. Generally, the restrictions on such awards lapse at an annual rate of one-third of the total award commencing with the first anniversary of the date of grant. The average grant date fair value of the restricted stock awards granted during the nine months ended September 30, 2018 and 2017 was \$11.88 per share and \$11.71 per share, respectively.

**Restricted Stock Units (RSUs).** Valley granted 446 thousand and 371 thousand shares of performance-based RSUs to certain executive officers for the nine months ended September 30, 2018 and 2017, respectively. The performance-based RSUs will vest and be issued as common stock based on the attainment of (i) growth in tangible book value per share plus dividends (75 percent of the RSU award) and (ii) total shareholder return as compared to our peer group (25 percent of the RSU award). The RSUs "cliff" vest after three years based on the cumulative performance of Valley during that time period. The RSUs earn dividend equivalents (equal to cash dividends paid on Valley's common stock) over the applicable performance period. Dividend equivalents are accumulated and paid to the grantee at the vesting date, or forfeited if the performance conditions are not met. The grant date fair value of the RSUs granted during the nine months ended September 30, 2018 and 2017 was \$12.35 per share and \$11.05 per share, respectively.

Valley recorded total stock-based compensation expense of \$3.7 million and \$2.7 million for the three months ended September 30, 2018 and 2017, and \$15.8 million and \$9.6 million for the nine months ended September 30, 2018 and 2017, respectively. The fair values of stock awards are expensed over the shorter of the vesting or required service period. As of September 30, 2018, the unrecognized amortization expense for all stock-based employee compensation totaled approximately \$20.0 million and will be recognized over an average remaining vesting period of 2.2 years.

## Note 12. Revenue Recognition

On January 1, 2018, Valley adopted ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" and subsequent related updates that modify the guidance used to recognize revenue from contracts with customers for transfers of goods and services and transfers of non-financial assets, unless those contracts are within the scope of other guidance. The adoption did not materially change Valley's recognition of revenues within the scope of ASC Topic 606.

Performance obligations. Valley's revenue contracts generally have a single performance obligation, as the promise to transfer the individual goods or services is not separately identifiable, or distinct from other obligations within the contracts. Valley does not have a material amount of long-term customer agreements that include multiple performance obligations requiring price allocation and differences in the timing of revenue recognition. Valley has no customer contracts with variable fee agreements based upon performance.

The following table presents non-interest income for the three and nine months ended September 30, 2018 and 2017:

|  | Three Months   |          | Nine Months   |          |
|--|----------------|----------|---------------|----------|
|  | Ended          |          | Ended         |          |
|  | September 30,  |          | September 30, |          |
|  | 2018           | 2017     | 2018          | 2017     |
|  | (in thousands) |          |               |          |
| Trust and investment services                  | \$3,143        | \$3,062  | \$9,635       | \$8,606  |
| Insurance commissions                          | 3,646          | 4,519    | 11,493        | 13,938   |
| Service charges on deposit accounts            | 6,597          | 5,558    | 20,529        | 16,136   |
| (Losses) gains on securities transactions, net | (79            | ) 6      | (880          | ) 5      |
| Fees from loan servicing                       | 2,573          | 1,895    | 6,841         | 5,541    |
| Gains on sales of loans, net                   | 3,748          | 5,520    | 18,143        | 14,439   |
| Bank owned life insurance                      | 2,545          | 1,541    | 6,960         | 5,705    |
| Other  | 6,865          | 4,896    | 26,637        | 17,177   |
| Total non-interest income                      | \$29,038       | \$26,997 | \$99,358      | \$81,547 |

The following revenues from the table above are within the scope of ASC Topic 606:

Trust and investments services. Trust and investments services include fees from investment management, investment advisory, trust, custody and other products. Trust and investment management fee income is primarily from client assets under management (AUM) for which the fees are determined based upon a tiered scale relative to the market value of the AUM. The revenue from trust and investment services is typically earned over the service period specified in the contract.

Service charges on deposit accounts. Service charges on deposit accounts include fees from checking accounts, savings accounts, overdrafts, insufficient funds, ATM transactions and other activities. The revenues for most deposit related fees are recognized immediately upon performance of the service due to the short-term nature of the contractual terms.

Other income. Other income within the scope of ASC Topic 606 within this revenue category includes fee income related to derivative interest rate swaps executed with commercial loan customers, and fees from interchange, wire transfers, credit cards, safe deposit box, ACH, lockbox and various other products and services-related income. These fees are either recognized immediately at the related transaction date or over the period in which the related service is provided. Other income also consists of items which are outside the scope of ASC Topic 606, including letters of credit fees, net gains and losses on sales of assets and income or expense related to certain changes in FDIC loss-share receivables.



Note 13. Derivative Instruments and Hedging Activities

Valley enters into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future known and uncertain cash amounts, the value of which are determined by interest rates.

**Cash Flow Hedges of Interest Rate Risk.** Valley's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, Valley uses interest rate swaps and caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the payment of either fixed or variable-rate amounts in exchange for the receipt of variable or fixed-rate amounts from a counterparty, respectively. Interest rate caps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium.

Valley terminated an interest rate cap with a notional amount of \$125 million in May 2018. The terminated swap, originally maturing in September 2023, was used to hedge the change in cash flows associated with prime rate indexed deposits, consisting of consumer and commercial money market accounts, which variable rates are indexed to the prime rate.

**Fair Value Hedges of Fixed Rate Assets and Liabilities.** Valley is exposed to changes in the fair value of certain of its fixed rate assets or liabilities due to changes in benchmark interest rates based on one-month LIBOR. From time to time, Valley uses interest rate swaps to manage its exposure to changes in fair value. Interest rate swaps designated as fair value hedges involve the receipt of variable rate payments from a counterparty in exchange for Valley making fixed rate payments over the life of the agreements without the exchange of the underlying notional amount. For derivatives that are designated and qualify as fair value hedges, the gain or loss on the derivative as well as the loss or gain on the hedged item attributable to the hedged risk are recognized in earnings. Valley includes the gain or loss on the hedged items in the same income statement line item as the loss or gain on the related derivatives.

**Non-designated Hedges.** Derivatives not designated as hedges may be used to manage Valley's exposure to interest rate movements or to provide service to customers but do not meet the requirements for hedge accounting under U.S. GAAP. Derivatives not designated as hedges are not entered into for speculative purposes.

Under a program, Valley executes interest rate swaps with commercial lending customers to facilitate their respective risk management strategies. These interest rate swaps with customers are simultaneously offset by interest rate swaps that Valley executes with a third party, such that Valley minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings.

Valley sometimes enters into risk participation agreements with external lenders where the banks are sharing their risk of default on the interest rate swaps on participated loans. Valley either pays or receives a fee depending on the participation type. Risk participation agreements are credit derivatives not designated as hedges. Credit derivatives are not speculative and are not used to manage interest rate risk in assets or liabilities. Changes in the fair value in credit derivatives are recognized directly in earnings. At September 30, 2018, Valley had 17 credit swaps with an aggregate notional amount of \$97.8 million related to risk participation agreements.

At September 30, 2018, Valley has one "steepener" swap with a total current notional amount of \$10.4 million where the receive rate on the swap mirrors the pay rate on the brokered deposits and the rates paid on these types of hybrid instruments are based on a formula derived from the spread between the long and short ends of the constant maturity swap (CMS) rate curve. Although these types of instruments do not meet the hedge accounting requirements, the



change in fair value of both the bifurcated derivative and the stand alone swap tend to move in opposite directions with changes in the three-month LIBOR rate and therefore provide an effective economic hedge.

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Valley regularly enters into mortgage banking derivatives which are non-designated hedges. These derivatives include interest rate lock commitments provided to customers to fund certain residential mortgage loans to be sold into the secondary market and forward commitments for the future delivery of such loans. Valley enters into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future changes in interest rates on Valley's commitments to fund the loans as well as on its portfolio of mortgage loans held for sale.

Amounts included in the consolidated statements of financial condition related to the fair value of Valley's derivative financial instruments were as follows:

|   | September 30, 2018 |                   |                 | December 31, 2017 |                   |                 |
|---|--------------------|-------------------|-----------------|-------------------|-------------------|-----------------|
|   | Fair Value         |                   |                 | Fair Value        |                   |                 |
|   | Other Assets       | Other Liabilities | Notional Amount | Other Assets      | Other Liabilities | Notional Amount |
|   | (in thousands)     |                   |                 |                   |                   |                 |
| Derivatives designated as hedging instruments:          |                    |                   |                 |                   |                   |                 |
| Cash flow hedge interest rate swaps and caps            | \$—                | \$ 44             | \$482,000       | \$650             | \$ 81             | \$607,000       |
| Fair value hedge interest rate swaps                    | —                  | 345               | 7,597           | —                 | 637               | 7,775           |
| Total derivatives designated as hedging instruments     | \$—                | \$ 389            | \$489,597       | \$650             | \$ 718            | \$614,775       |
| Derivatives not designated as hedging instruments:      |                    |                   |                 |                   |                   |                 |
| Interest rate swaps and embedded derivatives            | \$28,205           | \$44,260          | \$3,252,701     | \$25,696          | \$23,494          | \$1,687,005     |
| Mortgage banking derivatives                            | 334                | 268               | 118,176         | 71                | 118               | 113,233         |
| Total derivatives not designated as hedging instruments | \$28,539           | \$44,528          | \$3,370,877     | \$25,767          | \$23,612          | \$1,800,238     |

The Chicago Mercantile Exchange (CME) and London Clearing House (LCH) have enacted rulebook changes that re-characterize variation margin as settlements of the outstanding derivative instead of cash collateral. The CME and LCH variation margins are classified as a single-unit of account with the fair value of certain cash flow and non-designated derivative instruments on a prospective basis effective January 1, 2017 for derivatives outstanding with the CME and January 1, 2018 for derivatives outstanding with the LCH. As a result, the fair value of the designated cash flow interest rate swaps, designated and non-designated interest rate swaps liabilities were offset by variation margins posted by (with) the applicable counterparties totaling \$70 thousand, \$23.1 million and \$318 thousand, respectively, and reported in the table above on a net basis at September 30, 2018. The fair value of the designated cash flow derivatives and non-designated interest rate swaps cleared with the CME were offset by variation margins totaling \$9.5 million and \$951 thousand, respectively, and reported in the table above on a net basis at December 31, 2017.

(Losses) gains included in the consolidated statements of income and in other comprehensive (loss) income, on a pre-tax basis, related to interest rate derivatives designated as hedges of cash flows were as follows:

|   | Three Months Ended |                    | Nine Months Ended  |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
|   | (in thousands)     |                    |                    |                    |
| Amount of loss reclassified from accumulated other comprehensive loss to interest expense | \$(660)            | \$(1,930)          | \$(2,977)          | \$(6,762)          |
| Amount of gain (loss) recognized in other comprehensive (loss) income                     | 310                | 329                | 3,698              | (936)              |



The accumulated net after-tax losses related to effective cash flow hedges included in accumulated other comprehensive loss were \$3.6 million and \$8.3 million at September 30, 2018 and December 31, 2017, respectively. Amounts reported in accumulated other comprehensive loss related to cash flow interest rate derivatives are reclassified to interest expense as interest payments are made on the hedged variable interest rate liabilities. Valley estimates that \$1.2 million will be reclassified as an increase to interest expense over the next 12 months.

Gains (losses) included in the consolidated statements of income related to interest rate derivatives designated as hedges of fair value were as follows:

|                                   | Three Months Ended September 30, 2018 |        | Nine Months Ended September 30, 2017 |         |
|-----------------------------------|---------------------------------------|--------|--------------------------------------|---------|
| Derivative - interest rate swaps: |                                       |        |                                      |         |
| Interest income                   | \$73                                  | \$75   | \$292                                | \$224   |
| Hedged item - loans:              |                                       |        |                                      |         |
| Interest income                   | \$(73)                                | \$(75) | \$(292)                              | \$(224) |

Fee income related to derivative interest rate swaps executed with commercial loan customers totaled \$4.0 million and \$910 thousand for the three months ended September 30, 2018 and 2017, respectively, and \$11.7 million and \$5.7 million for the nine months ended September 30, 2018 and 2017, respectively, and was included in other non-interest income.

The following table presents the hedged items related to interest rate derivatives designated as hedges of fair value and the cumulative basis fair value adjustment included in the net carrying amount of the hedged items at September 30, 2018:

| Line Item in the Statement of Financial Position in Which the Hedged Item is Included | September 30, 2018<br>Cumulative<br>Amount of<br>Fair Value<br>Carrying<br>Amount | Hedging<br>Adjustment<br>Included in<br>the<br>Carrying<br>Amount of<br>the Hedged<br>Asset |
|---|---|---|
| Loans   | \$7,942   | \$ 345  |

The net gains (losses) included in the consolidated statements of income related to derivative instruments not designated as hedging instruments were as follows:

| Three Months Ended September 30, | Nine Months Ended September 30, |
|----------------------------------|---------------------------------|
|                                  |                                 |

2018 2017 2018 2017  
 (in thousands)

|  |        |       |        |          |
|--|--------|-------|--------|----------|
| Non-designated hedge interest rate derivatives |        |       |        |          |
| Other non-interest expense                     | \$ (8) | \$ 37 | \$ 440 | \$ (753) |

Credit Risk Related Contingent Features. By using derivatives, Valley is exposed to credit risk if counterparties to the derivative contracts do not perform as expected. Management attempts to minimize counterparty credit risk through credit approvals, limits, monitoring procedures and obtaining collateral where appropriate. Credit risk exposure associated with derivative contracts is managed at Valley in conjunction with Valley's consolidated counterparty risk management process. Valley's counterparties and the risk limits monitored by management are periodically reviewed and approved by the Board of Directors.

Valley has agreements with its derivative counterparties providing that if Valley defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then Valley could

also be declared in default on its derivative counterparty agreements. Additionally, Valley has an agreement with several of its derivative counterparties that contains provisions that require Valley's debt to maintain an investment grade credit rating from each of the major credit rating agencies from which it receives a credit rating. If Valley's credit rating is reduced below investment grade, or such rating is withdrawn or suspended, then the counterparty could terminate the derivative positions and Valley would be required to settle its obligations under the agreements. As of September 30, 2018, Valley was in compliance with all of the provisions of its derivative counterparty agreements. As of September 30, 2018, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk related to these agreements, was \$1.8 million. Valley has derivative counterparty agreements that require minimum collateral posting thresholds for certain counterparties.

#### Note 14. Balance Sheet Offsetting

Certain financial instruments, including derivatives (consisting of interest rate swaps and caps) and repurchase agreements (accounted for as secured long-term borrowings), may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements or similar agreements. Valley is party to master netting arrangements with its financial institution counterparties; however, Valley does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, usually in the form of cash or marketable investment securities, is posted by the counterparty with net liability positions in accordance with contract thresholds. Master repurchase agreements which include "right of set-off" provisions generally have a legally enforceable right to offset recognized amounts. In such cases, the collateral would be used to settle the fair value of the repurchase agreement should Valley be in default. The table below presents information about Valley's financial instruments that are eligible for offset in the consolidated statements of financial condition as of September 30, 2018 and December 31, 2017.

|                              | Gross Amounts Recognized<br>(in thousands) | Gross Amounts Offset | Net Amounts Presented | Gross Amounts Not Offset<br>Financial Instruments | Cash Collateral           | Net Amount      |
|------------------------------|--|----------------------|-----------------------|---|---------------------------|-----------------|
| <b>September 30, 2018</b>    |  |                      |                       |   |                           |                 |
| <b>Assets:</b>               |  |                      |                       |   |                           |                 |
| Interest rate swaps          | \$28,205                                   | \$ —                 | \$ 28,205             | \$(159 )  | \$ —                      | \$28,046        |
| <b>Liabilities:</b>          |  |                      |                       |   |                           |                 |
| Interest rate swaps          | \$44,649                                   | \$ —                 | \$ 44,649             | \$(159 )  | \$1,436 <sup>(1)</sup>    | \$45,926        |
| Repurchase agreements        | 150,000                                    | —                    | 150,000               | —   | (150,000 ) <sup>(2)</sup> | —               |
| <b>Total</b>                 | <b>\$194,649</b>                           | <b>\$ —</b>          | <b>\$ 194,649</b>     | <b>\$(159 )</b>                                   | <b>\$(148,564)</b>        | <b>\$45,926</b> |
| <b>December 31, 2017</b>     |  |                      |                       |   |                           |                 |
| <b>Assets:</b>               |  |                      |                       |   |                           |                 |
| Interest rate swaps and caps | \$26,346                                   | \$ —                 | \$ 26,346             | \$(5,376)   | \$ —                      | \$20,970        |
| <b>Liabilities:</b>          |  |                      |                       |   |                           |                 |
| Interest rate swaps and caps | \$24,212                                   | \$ —                 | \$ 24,212             | \$(5,376)   | \$(8,141 ) <sup>(1)</sup> | \$10,695        |
| Repurchase agreements        | 200,000                                    | —                    | 200,000               | —   | (200,000 ) <sup>(2)</sup> | —               |
| <b>Total</b>                 | <b>\$224,212</b>                           | <b>\$ —</b>          | <b>\$ 224,212</b>     | <b>\$(5,376)</b>                                  | <b>\$(208,141)</b>        | <b>\$10,695</b> |

(1) Represents the amount of collateral posted with derivative counterparties that offsets net liability positions.

(2) Represents the fair value of non-cash pledged investment securities.

## Note 15. Tax Credit Investments

Valley's tax credit investments are primarily related to investments promoting qualified affordable housing projects, and other investments related to community development and renewable energy sources. Some of these tax-advantaged investments support Valley's regulatory compliance with the Community Reinvestment Act (CRA). Valley's investments in these entities generate a return primarily through the realization of federal income tax credits, and other tax benefits, such as tax deductions from operating losses of the investments, over specified time periods. These tax credits and deductions are recognized as a reduction of income tax expense.

Valley's tax credit investments are carried in other assets on the consolidated statements of financial condition. Valley's unfunded capital and other commitments related to the tax credit investments are carried in accrued expenses and other liabilities on the consolidated statements of financial condition. Valley recognizes amortization of tax credit investments, including impairment losses, within non-interest expense of the consolidated statements of income using the equity method of accounting. An impairment loss is recognized when the fair value of the tax credit investment is less than its carrying value.

The following table presents the balances of Valley's affordable housing tax credit investments, other tax credit investments, and related unfunded commitments at September 30, 2018 and December 31, 2017:

|  | September 30,<br>2018 |    | December 31,<br>2017 |  |
|--|-----------------------|----|----------------------|--|
|  | (in thousands)        |    |                      |  |
| <b>Other Assets:</b>                               |                       |    |                      |  |
| Affordable housing tax credit investments, net     | \$38,807              | \$ | 22,135               |  |
| Other tax credit investments, net                  | 33,440                |    | 42,015               |  |
| Total tax credit investments, net                  | \$72,247              | \$ | 64,150               |  |
| <b>Other Liabilities:</b>                          |                       |    |                      |  |
| Unfunded affordable housing tax credit commitments | \$4,628               | \$ | 3,690                |  |
| Unfunded other tax credit commitments              | 9,071                 |    | 15,020               |  |
| Total unfunded tax credit commitments              | \$13,699              | \$ | 18,710               |  |

The following table presents other information relating to Valley's affordable housing tax credit investments and other tax credit investments for the three and nine months ended September 30, 2018 and 2017:

|   | Three Months<br>Ended<br>September 30,<br>2018 |         | Nine Months<br>Ended<br>September 30,<br>2017 |          |
|---|--|---------|---|----------|
|   | (in thousands)                                 |         |   |          |
| <b>Components of Income Tax Expense:</b>                                      |  |         |   |          |
| Affordable housing tax credits and other tax benefits                         | \$1,761  | \$1,965 | \$5,011                                       | \$4,520  |
| Other tax credit investment credits and tax benefits                          | 5,817  | 7,859   | 16,982  | 22,825   |
| Total reduction in income tax expense   | \$7,578  | \$9,824 | \$21,993                                      | \$27,345 |
| <b>Amortization of Tax Credit Investments:</b>                                |  |         |   |          |
| Affordable housing tax credit investment losses                               | \$708  | \$1,183 | \$1,375                                       | \$1,937  |
| Affordable housing tax credit investment impairment losses                    | 558  | 979     | 1,660   | 1,233    |
| Other tax credit investment losses  | 1,103  | 307     | 2,893   | 2,134    |
| Other tax credit investment impairment losses                                 | 3,043  | 5,920   | 9,228   | 16,141   |
| Total amortization of tax credit investments recorded in non-interest expense | \$5,412  | \$8,389 | \$15,156                                      | \$21,445 |





#### Note 16. Litigation

In the normal course of business, Valley is a party to various outstanding legal proceedings and claims. In the opinion of management, the financial condition, results of operations and liquidity of Valley should not be materially affected by the outcome of such legal proceedings and claims. However, in the event of an adverse outcome or settlement in one or more of our legal proceedings, operating results for a particular period may be negatively impacted. Disclosure is required when a risk of material loss in a litigation or claim is more than remote. Disclosure is also required of an estimate of the reasonably possible loss or range of loss, unless an estimate cannot reasonably be made. Liabilities are established for legal claims when payments associated with the claims become probable and the possible losses related to the matter can be reasonably estimated.

*Maritza Gaston and George Gallart v. Valley National Bancorp and Valley National Bank.* In April 2017, Valley was served with a Class and Collective Action Complaint, filed in the Eastern District of New York, alleging that Valley had violated both Federal and State wage and hour laws and seeking to recover overtime compensation on behalf of a class of Valley employees. While most Branch Service Managers are classified by Valley as “exempt” employees and do not receive overtime pay, plaintiffs' counsel claims that all Branch Service Managers perform non-exempt duties, and should therefore be classified as non-exempt hourly employees and be paid overtime for any time worked in excess of 40 hours per week. Valley filed an answer disputing Plaintiffs' allegations. Plaintiffs filed a notice for conditional certification of the class, which was granted by the Federal Magistrate in December 2017. In January 2018, Valley filed an objection requesting that the Federal Judge assigned to this case overturn the Federal Magistrate's Order for Certification which the Court denied in August 2018. Plaintiffs and Valley entered into non-binding mediation. In October 2018, Valley and Plaintiffs agreed to a settlement in principal which is subject to final Court approval.

#### Note 17. Business Segments

The information under the caption “Business Segments” in Management's Discussion and Analysis of Financial Condition and Results of Operations is incorporated herein by reference.

#### Item 2. Management's Discussion and Analysis (MD&A) of Financial Condition and Results of Operations

The following MD&A should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report. The words "Valley," the "Company," "we," "our" and "us" refer to Valley National Bancorp and its wholly owned subsidiaries, unless we indicate otherwise. Additionally, Valley's principal subsidiary, Valley National Bank, is commonly referred to as the “Bank” in this MD&A.

The MD&A contains supplemental financial information, described in the sections that follow, which has been determined by methods other than U.S. generally accepted accounting principles (U.S. GAAP) that management uses in its analysis of our performance. Management believes these non-GAAP financial measures provide information useful to investors in understanding our underlying operational performance, our business and performance trends and facilitates comparisons with the performance of others in the financial services industry. These non-GAAP financial measures should not be considered in isolation or as a substitute for or superior to financial measures calculated in accordance with U.S. GAAP. These non-GAAP financial measures may also be calculated differently from similar measures disclosed by other companies.

#### Cautionary Statement Concerning Forward-Looking Statements

This Quarterly Report on Form 10-Q, 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 such forward-looking terminology as “should,” “expect,” “believe,” “view,” “will,” “opportunity,” “allow,” “continues,” “reflects,” “typically,” “usually,” “anticipate,” or similar statements or variations of such terms. Such forward-looking statements involve certain risks and uncertainties and our actual results may differ materially from such forward-looking statements. Factors



that may cause actual results to differ materially from those contemplated by such forward-looking statements in addition to those risk factors disclosed in Valley's Annual Report on Form 10-K for the year ended December 31, 2017, include, but are not limited to:

- weakness or a decline in the economy, mainly in New Jersey, New York, Florida and Alabama, as well as an unexpected decline in commercial real estate values within our market areas;
- the inability to retain USAB's customers and employees;
- less than expected cost reductions and revenue enhancement from Valley's cost reduction plans including its earnings enhancement program called "LIFT" and branch transformation strategy;
- greater than expected technology related costs due to, among other factors, prolonged or failed implementations, additional project staffing and obsolescence caused by continuous and rapid market innovations;
- the loss of or decrease in lower-cost funding sources within our deposit base, including our inability to achieve deposit retention targets under Valley's branch transformation strategy;
- higher or lower than expected income tax expense or tax rates, including increases or decreases resulting from the impact of the Tax Cuts and Jobs Act and other changes in tax laws, regulations and case law;
- the loss of or decrease in lower-cost funding sources within our deposit base may adversely impact our net interest income and net income;
- cyber attacks, computer viruses or other malware that may breach the security of our websites or other systems to obtain unauthorized access to confidential information, destroy data, disable or degrade service, or sabotage our systems;
- results of examinations by the OCC, the FRB, the CFPB and other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to increase our allowance for credit losses, write-down assets, reimburse customers, change the way we do business, or limit or eliminate certain other banking activities;
- damage verdicts or settlements or restrictions related to existing or potential litigations arising from claims of breach of fiduciary responsibility, negligence, fraud, contractual claims, environmental laws, patent or trade mark infringement, employment related claims, and other matters;
- changes in accounting policies or accounting standards, including the new authoritative accounting guidance (known as the current expected credit loss (CECL) model) which may increase the required level of our allowance for credit losses after adoption on January 1, 2020;
- our inability or determination not to pay dividends at current levels, or at all, because of inadequate earnings, regulatory restrictions or limitations, changes in our capital requirements or a decision to increase capital by retaining more earnings;
- higher than expected loan losses within one or more segments of our loan portfolio;
- unanticipated loan delinquencies, loss of collateral, decreased service revenues, and other potential negative effects on our business caused by severe weather or other external events;
- unexpected significant declines in the loan portfolio due to the lack of economic expansion, increased competition, large prepayments, changes in regulatory lending guidance or other factors; and
- the failure of other financial institutions with whom we have trading, clearing, counterparty and other financial relationships.

#### Critical Accounting Policies and Estimates

Valley's accounting policies are fundamental to understanding management's discussion and analysis of its financial condition and results of operations. At September 30, 2018, we identified our policies on the allowance for loan losses, purchased credit-impaired loans, security valuations and impairments, goodwill and other intangible assets, and income taxes to be critical because management has to make subjective and/or complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. Management has reviewed the application of these policies with the Audit Committee of Valley's Board of Directors. Our critical accounting policies are described in



detail in Part II, Item 7 in Valley's Annual Report on Form 10-K for the year ended December 31, 2017. Purchased credit-impaired loans became a significant portion of our loan portfolio due to our acquisition of USAB on January 1, 2018 and, as a result, a new critical accounting policy applied to us starting in the first quarter of 2018. See the "Purchased Credit-Impaired Loans" section elsewhere in this MD&A and Note 1 to the consolidated financial statements included in Valley's Annual Report on Form 10-K for the year ended December 31, 2017 for more information on the accounting policy for purchased credit-impaired loans and the other significant accounting policies of Valley.

#### New Authoritative Accounting Guidance

See Note 5 to the consolidated financial statements for a description of new authoritative accounting guidance, including the respective dates of adoption and effects on results of operations and financial condition.

#### Executive Summary

**Company Overview.** At September 30, 2018, Valley had consolidated total assets of approximately \$30.9 billion, total net loans of \$24.0 billion, total deposits of \$22.6 billion and total shareholders' equity of \$3.3 billion. Our commercial bank operations include branch office locations in northern and central New Jersey, the New York City Boroughs of Manhattan, Brooklyn, Queens, and Long Island, Florida and Alabama. Of our current 232 branch network, 59 percent, 16 percent, 19 percent and 6 percent of the branches are located in New Jersey, New York, Florida and Alabama, respectively. Despite targeted branch consolidation activity mainly in 2016, we have significantly grown both in asset size and locations over the past several years primarily through bank acquisitions.

**USAmeriBancorp, Inc.** On January 1, 2018, Valley completed its acquisition of 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 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 branch office locations. 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, and the transaction resulted in \$395 million of goodwill and \$46 million of core deposit intangible assets subject to amortization. Full systems integration was completed in the second quarter of 2018 with minimal disruption to our customers.

**Re-Branding.** During October 2018, Valley National Bank announced a new look and feel for its brand and, in many instances, will start referring to itself with a simpler name: "Valley." The Bank's brand refresh includes a new logo, visual changes to its web and mobile platforms, and a plan for transforming branches with new signage and a sleek, modern look. In conjunction with the re-branding effort, the listing for Valley's common stock, preferred stock and warrants switched from the New York Stock Exchange to NASDAQ. Valley's common stock symbol remained VLY.

**Branch Transformation.** During 2018, Valley embarked on a new strategy to overhaul its retail network. The Bank is striving to create a branch infrastructure that is more reflective of current and future activity within our target markets. We intend to place greater emphasis on service, sales, and efficiency. We are in the process of upgrading many staff and training components placing greater importance on mobile and digital implementation, as well as customer education and promotion of those products. Valley's branch transformation will also include the repositioning, re-branding, functionality, aesthetics, and in many cases, reducing the square footage of our branches.

During the third quarter, we identified 74 branches within New Jersey and New York that presently do not meet certain internal performance measures. Of the 74 identified, we have closed 6 branches to date and expect to consolidate approximately 14 additional branches by the end of first quarter 2019, resulting in an estimated annual

operating expense savings of \$9 million. During the third quarter of 2018, we recognized branch asset impairment charges of \$1.8 million related to the approved (actual and future) branch closures.

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For the remaining 54 branches, we have implemented tailored action plans focused on improving profitability and deposit levels. However, should these branches not experience improvement within a defined period, they may be reviewed for potential consolidation.

While we expect the consolidation process, repositioning and renovations to be mostly complete by the end of 2020, it is important to recognize the evolving retail banking landscape combined with the Bank's expectation regarding profitability will make this activity a permanent component of Valley's overall strategy.

**Earnings Enhancement Program.** In December 2016, Valley announced a company-wide earnings enhancement initiative called LIFT. The LIFT program is a review of our business practices with goals of improving our overall efficiency, targeting resources to more value-added activities and delivering on the financial banking experience expected by our customers. In July 2017, we completed the idea generation and approval phase of the LIFT program. As a result of these efforts, we currently expect to achieve approximately \$22 million in total cost reductions and revenue enhancements on an annualized pre-tax run-rate after the LIFT program is fully phased-in by June 30, 2019. At September 30, 2018, Valley had completed LIFT enhancements that will result in cost reductions greater than 76 percent of the \$22 million annual goal as compared to approximately 60 percent of such goal at June 30, 2018. We believe we remain on track to fully implement the LIFT program generated enhancements and realize the total cost reduction goal by June 30, 2019, although we can provide no assurance that all of the program generated enhancements and cost reductions will ultimately be realized.

**Tax Cuts and Jobs Act.** On December 22, 2017, the President signed the Tax Cuts and Jobs Act (Tax Act) into law. As a result, the federal corporate income tax rate decreased from 35 percent to 21 percent effective January 1, 2018. See the "Income Taxes" section below for more details.

**Quarterly Results.** Net income for the third quarter of 2018 was \$69.6 million, or \$0.20 per diluted common share, compared to \$39.6 million, or \$0.14 per diluted common share, for the third quarter of 2017. The \$30 million increase in quarterly net income as compared to the same quarter one year ago was largely due to: (i) a \$52.9 million increase in our net interest income mostly due to higher average loan balances driven by acquired loans from USAB and strong organic loan growth over the last 12 months, (ii) a \$2.0 million increase in non-interest income caused, in part, by higher income and fees resulting from the USAB acquisition, partially offset by (iii) a \$19.1 million increase in non-interest expense mostly caused by additional operating costs related to the acquisition of USAB and additional salary and employee benefit expense largely related to our expanded team of residential mortgage loan consultants and technology personnel, (iv) a \$4.9 million increase in our provision for credit losses mainly driven by higher reserves allocated to impaired taxi medallion loans, and (v) a \$958 thousand increase in income tax expense largely due to higher pre-tax income. See the "Net Interest Income," "Non-Interest Income," "Non-Interest Expense", and "Income Taxes" sections below for more details on the items above impacting our third quarter 2018 results, as well as other items discussed elsewhere in this MD&A.

**Economic Overview.** During the third quarter of 2018, real gross domestic product (GDP) grew at a 3.5 percent annual rate after advancing 4.2 percent in the second quarter of 2018. The pace of private wage growth for all employees accelerated while hiring slowed somewhat and measures of core inflation remained near the Federal Reserve's two percent target. The trade weighted U.S. dollar index further increased compared to the first half of 2018 which may weigh on import and overall prices. Additionally, growth in consumer spending accelerated as business investment slowed somewhat and residential fixed investment remained weak.

From June 30, 2018 to September 30, 2018, the unemployment rate declined from 4.0 percent to 3.7 percent. The pace of hiring slowed somewhat compared to the prior quarter. The monthly average change in payrolls was approximately 206 thousand last quarter compared to 211 thousand in the second quarter of 2018. Based on a three-month average, wage growth on a year over year basis accelerated to 2.8 percent in the third quarter of 2018 compared to 2.7 percent in the prior quarter which represented the highest level since the middle of 2009.





The pace of business fixed investment, which includes investment in structures, equipment and software, slowed somewhat compared to the second quarter. Private nonresidential fixed investment advanced 0.8 percent in the third quarter of 2018 compared to an increase of 8.7 percent in the second quarter of 2018. While the pace of growth for fixed investment slowed, inventory restocking increased sharply compared to the prior quarter. Separately, investment in residential structures remained weak. Real private residential fixed investment declined 4.0 percent compared to 1.3 percent in the second quarter of 2018. For both multifamily and single family structures, investment declined.

Household spending accelerated compared to the second quarter of 2018. Personal consumption of goods and services grew 4.0 percent in the third quarter compared to 3.8 percent in the second quarter of the year. Both equity and home prices rose further in the third quarter of 2018 and equity market volatility declined which may have benefited consumer spending. In recent weeks, equity prices and measures of volatility have increased.

The Federal Open Market Committee (FOMC or Committee) increased the target range for the federal funds rate from 2.00 to 2.25 percent at their September 2018 meeting. The Committee found that the risks to the economic outlook were roughly balanced between their two objectives of price stability and maximum employment. Further, the Committee expects, based on realized and expected labor market conditions and inflation, additional gradual increases in the target range for the federal funds rate. The FOMC continued its policy of gradually reducing the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities which was initiated in October 2017.

The 10-year U.S. Treasury note yield ended the third quarter at 3.05 percent, 20 basis points higher compared with June 30, 2018. The spread between the 2- and 10-year U.S. Treasury note yields ended the third quarter of 2018 at 0.24 of a percentage point, 9 basis points lower compared to the end of the second quarter of 2018 and 27 basis points lower compared to December 31, 2017.

For all commercial banks in the U.S., loan growth in the third quarter averaged 4.7 percent compared to the same period one year ago. For the industry, banks reported stronger demand for commercial and industrial loan products, particularly from smaller firms, although demand for most consumer loans and those related to commercial real estate weakened during the quarter. The Bank's originations increased across most products, and advantage taken of targeted demand from both new and pre-existing customers within its commercial loan portfolios (See the "Loan" and "Loan Portfolio" sections). However, should demand weaken for commercial loans and the yield curve further compress, these conditions may challenge our business operations and results, as highlighted throughout the remaining MD&A discussion below.

Loans. Loans increased \$876.6 million, or 15.1 percent on an annualized basis, to approximately \$24.1 billion at September 30, 2018 from June 30, 2018. The increase was mainly due to continued strong quarter over quarter organic growth in total commercial real estate loans, residential mortgage loans and commercial and industrial loans. During the third quarter of 2018, Valley also originated \$124 million of residential mortgage loans for sale rather than held for investment. Residential mortgage loans held for sale totaled \$31.7 million and \$15.1 million at September 30, 2018 and June 30, 2018, respectively.

We are optimistic that our lending activity will remain brisk during the fourth quarter of 2018, despite the risk of potential setbacks in customer loan demand due to higher market interest rates or other negative market and economic factors. For the full year 2018, we expect to exceed our prior loan growth estimates of 8 to 10 percent, adjusted for the recent USAB acquisition and loan sales. However, there can be no assurance that we will achieve such levels. See further details on our loan activities under the "Loan Portfolio" section below.

Asset Quality. Our past due loans and non-accrual loans discussed further below exclude PCI loans. Under U.S. GAAP, the PCI loans (acquired at a discount that is due, in part, to credit quality) are accounted for on a pool basis and are not subject to delinquency classification in the same manner as loans originated by Valley. Our PCI loan portfolio totaled \$4.4 billion, or 18.4 percent of our total loan portfolio, at September 30, 2018 and is largely comprised of loans acquired from USAB.



Total accruing past due loans (i.e., loans past due 30 days or more and still accruing interest) were \$58.2 million, or 0.24 percent of total loans, at September 30, 2018 as compared to \$33.3 million, or 0.14 percent of total loans, at June 30, 2018. The \$25 million increase from June 30, 2018 was partially due to a matured performing construction loan in the normal process of renewal totaling \$15.2 million within the 30 - 59 days past due category.

Total non-performing assets, consisting of non-accrual loans, other real estate owned (OREO) and other repossessed assets decreased \$8.4 million to \$88.7 million at September 30, 2018 as compared to June 30, 2018 mainly due to decreases of \$6.1 million and \$1.9 million in non-accrual loans and OREO, respectively, during the third quarter of 2018. The decrease in non-accrual loans was primarily due to improvement in loan performance and a few large loan payoffs in several categories. As a result, non-accrual loans decreased to 0.33 percent of total loans at September 30, 2018 as compared to 0.36 percent of total loans at June 30, 2018.

Our lending strategy is based on underwriting standards designed to maintain high credit quality and we remain optimistic regarding the overall future performance of our loan portfolio. However, management cannot provide assurance that our non-performing assets will not increase from the levels reported as of September 30, 2018. See the "Non-Performing Assets" section below for further analysis of our asset quality.

Deposits and Other Borrowings. The mix of the deposit categories of total average deposits for the third quarter of 2018 remained relatively unchanged as compared to the second quarter of 2018. Average non-interest bearing deposits; savings, NOW and money market deposits; and time deposits represented approximately 27 percent, 49 percent and 24 percent of total deposits as of September 30, 2018, respectively. Overall, average deposits totaled \$22.2 billion for the third quarter of 2018 and increased by \$376.6 million as compared to the second quarter of 2018, and actual ending balances for deposits increased \$947.5 million to approximately \$22.6 billion at September 30, 2018 from June 30, 2018. The increases in both average and ending deposit balances were largely due to increases in money market deposits and time deposits driven by the success of several new commercial and consumer deposit initiatives commenced in the third quarter of 2018, as well as an increase in brokered certificates of deposit, which totaled approximately \$500 million at September 30, 2018. Valley increased its use of brokered CDs partly due to their favorable pricing as compared to other available funding sources with similar terms, including FHLB advances. In addition, Valley implemented several new deposits gathering campaigns and strategies in the later part of the second quarter of 2018 and beginning of the third quarter of 2018 to better position its deposit offerings for both consumers and businesses.

Average short-term borrowings increased \$599.6 million to \$2.8 billion for the third quarter of 2018 as compared to the second quarter of 2018. Actual ending balances for short-term borrowings also increased \$90.5 million to \$3.0 billion at September 30, 2018 as compared to June 30, 2018. Both the increases in average and ending short-term borrowings were largely due to new FHLB advances used for normal loan funding activity and liquidity purposes during the third quarter of 2018.

Average long-term borrowings (including junior subordinated debentures issued to capital trusts which are presented separately on the consolidated statements of condition) decreased by \$292.8 million to \$2.0 billion for the third quarter of 2018 as compared to the second quarter of 2018. Actual ending balances for long-term borrowings also decreased \$375.2 million to \$1.7 billion at September 30, 2018 as compared to June 30, 2018. Both the decreases in average and ending long-term borrowings were mostly due to FHLB advance maturities and a partial shift to both short-term borrowings and brokered CDs at September 30, 2018 for funding purposes.

Selected Performance Indicators. The following table presents our annualized performance ratios for the periods indicated:

|   | Three Months Ended |        | Nine Months Ended  |        |
|---|--------------------|--------|--------------------|--------|
|   | September 30, 2018 | 2017   | September 30, 2018 | 2017   |
| Return on average assets                                | 0.91 %             | 0.67 % | 0.82 %             | 0.78 % |
| Return on average assets, as adjusted                   | 0.96               | 0.79   | 0.94               | 0.81   |
| Return on average shareholders' equity                  | 8.41               | 6.34   | 7.46               | 7.42   |
| Return on average shareholders' equity, as adjusted     | 8.84               | 7.42   | 8.50               | 7.79   |
| Return on average tangible shareholders' equity (ROATE) | 12.96              | 8.96   | 11.54              | 10.61  |
| ROATE, as adjusted                                      | 13.61              | 10.50  | 13.14              | 11.14  |

Adjusted return on average assets, adjusted return on average shareholders' equity, ROATE and adjusted ROATE included in the table above are non-GAAP measures. Management believes these measures provide information useful to management and investors in understanding our underlying operational performance, business and performance trends, and the measures facilitate comparisons of our prior performance with the performance of others in the financial services industry. These non-GAAP financial measures should not be considered in isolation or as a substitute for or superior to financial measures calculated in accordance with U.S. GAAP. These non-GAAP financial measures may also be calculated differently from similar measures disclosed by other companies. The non-GAAP measure reconciliations are presented below.

Adjusted net income is computed as follows:

|  | Three Months Ended |          | Nine Months Ended  |           |
|--|--------------------|----------|--------------------|-----------|
|  | September 30, 2018 | 2017     | September 30, 2018 | 2017      |
|  | (\$ in thousands)  |          |                    |           |
| Net income, as reported  | \$69,559           | \$39,649 | \$184,326          | \$135,809 |
| Add: Losses (gains) on securities transactions (net of tax)      | 56                 | (3)      | 630                | (3)       |
| Add: LIFT program expenses (net of tax) <sup>(1)</sup>           | —                  | 5,753    | —                  | 5,753     |
| Add: Branch related asset impairment (net of tax) <sup>(2)</sup> | 1,304              | —        | 1,304              | —         |
| Add: Legal expenses (litigation reserve impact only, net of tax) | 1,206              | —        | 8,726              | —         |
| Add: Merger related expenses (net of tax) <sup>(3)</sup>         | 935                | 1,043    | 12,949             | 1,044     |
| Add: Income Tax Expense (USAB charge impact only)                | —                  | —        | 2,000              | —         |
| Net income, as adjusted  | \$73,060           | \$46,442 | \$209,935          | \$142,603 |

(1) LIFT program expenses are primarily within professional and legal fees, and salary and employee benefits expense.

(2) Branch related asset impairment is included in net losses on sale of assets within non-interest income.

(3) Merger related expenses are primarily within salary and employee benefits and other expense.

Adjusted annualized return on average assets is computed by dividing adjusted net income by average assets, as follows:

|  | Three Months Ended |              | Nine Months Ended |              |   |
|--|--------------------|--------------|-------------------|--------------|---|
|  | September 30,      |              | September 30,     |              |   |
|  | 2018               | 2017         | 2018              | 2017         |   |
|  | (\$ in thousands)  |              |                   |              |   |
| Net income, as adjusted                          | \$73,060           | \$46,442     | \$209,935         | \$142,603    |   |
| Average assets                                   | \$30,493,175       | \$23,604,252 | \$29,858,764      | \$23,334,491 |   |
| Annualized return on average assets, as adjusted | 0.96               | % 0.79       | % 0.94            | % 0.81       | % |

Adjusted annualized return on average shareholders' equity is computed by dividing adjusted net income by average shareholders' equity, as follows:

|  | Three Months Ended |             | Nine Months Ended |             |   |
|--|--------------------|-------------|-------------------|-------------|---|
|  | September 30,      |             | September 30,     |             |   |
|  | 2018               | 2017        | 2018              | 2017        |   |
|  | (\$ in thousands)  |             |                   |             |   |
| Net income, as adjusted  | \$73,060           | \$46,442    | \$209,935         | \$142,603   |   |
| Average shareholders' equity                                   | \$3,307,690        | \$2,502,538 | \$3,292,439       | \$2,441,227 |   |
| Annualized return on average shareholders' equity, as adjusted | 8.84               | % 7.42      | % 8.50            | % 7.79      | % |

ROATE and adjusted ROATE are computed by dividing net income and adjusted net income, respectively, by average shareholders' equity less average goodwill and average other intangible assets, as follows:

|  | Three Months Ended |             | Nine Months Ended |             |   |
|--|--------------------|-------------|-------------------|-------------|---|
|  | September 30,      |             | September 30,     |             |   |
|  | 2018               | 2017        | 2018              | 2017        |   |
|  | (\$ in thousands)  |             |                   |             |   |
| Net income   | \$69,559           | \$39,649    | \$184,326         | \$135,809   |   |
| Net income, as adjusted                            | \$73,060           | \$46,442    | \$209,935         | \$142,603   |   |
| Average shareholders' equity                       | \$3,307,690        | \$2,502,538 | \$3,292,439       | \$2,441,227 |   |
| Less: Average goodwill and other intangible assets | 1,161,167          | 733,450     | 1,162,980         | 734,738     |   |
| Average tangible shareholders' equity              | \$4,468,857        | \$3,235,988 | \$4,455,419       | \$3,175,965 |   |
| Annualized ROATE                                   | 12.96              | % 8.96      | % 11.54           | % 10.61     | % |
| Annualized ROATE, as adjusted                      | 13.61              | % 10.50     | % 13.14           | % 11.14     | % |

In addition to the items used to calculate net income, as adjusted, in the tables above, our net income is, from time to time, impacted by net gains on sales of loans and net impairment losses on securities recognized in non-interest income. These amounts can vary widely from period to period due to, among other factors, the amount of residential mortgage loans originated for sale and the results of our quarterly impairment analysis of the held to maturity and available for sale investment portfolios. See the "Non-Interest Income" section below for more details.

#### Net Interest Income

Net interest income consists of interest income and dividends earned on interest earning assets, less interest expense on interest bearing liabilities, and represents the main source of income for Valley. For the three and nine months ended September 30, 2018, Valley elected to reclassify fee income related to derivative interest rate swaps executed with commercial loan customers totaling \$4.1 million and \$11.8 million, respectively, from interest and fees on loans to other non-interest income within the presentation of our net interest margin below and consolidated financial statements. The



applicable prior period amounts have also been reclassified to conform to this current presentation. See further discussion of the swap fees in the "Non-Interest Income" section below.

Net interest income on a tax equivalent basis totaling \$218.1 million for the third quarter of 2018 increased \$52.2 million and \$5.9 million as compared to the third quarter of 2017 and second quarter of 2018, respectively. The increase as compared to the third quarter of 2017 was largely due to the USAB acquisition effective January 1, 2018. Interest income on a tax equivalent basis increased \$16.8 million to \$298.4 million for the third quarter of 2018 as compared to the second quarter of 2018 mainly due to a \$819.0 million increase in average loans and a 16 basis point increase in the yield on average loans. Interest expense of \$80.2 million for the third quarter of 2018 increased \$10.9 million as compared to the second quarter of 2018 largely due to higher interest rates on many of our interest bearing deposit products, including new money market and certificate of deposit initiatives, and short-term borrowings, as well as a \$599.6 million increase in average short-term borrowings. The increases were partially offset by a \$293 million decline in average long-term borrowings mostly driven by maturing FHLB advances.

Average interest earning assets increased \$6.3 billion to \$28.0 billion for the third quarter of 2018 as compared to the third quarter of 2017 largely due to \$3.7 billion and \$522.6 million of loans and investments, respectively, acquired from USAB on January 1, 2018, as well as strong organic loan growth over the last 12 month period. Compared to the second quarter of 2018, average interest earning assets increased by \$714.8 million from \$27.3 billion due to the organic loan growth during the first nine months of 2018, partially offset by moderate declines in investments and overnight funds. Average loans increased \$819.0 million to \$23.7 billion for the third quarter of 2018 from the second quarter of 2018 mainly due to solid loan growth within the commercial real estate loan, residential mortgage loan, and commercial and industrial loan portfolios.

Average interest bearing liabilities increased \$5.0 billion to \$20.8 billion for the third quarter of 2018 as compared to the third quarter of 2017 mainly due to \$3.4 billion of interest bearing liabilities assumed in the USAB acquisition and deposit growth primarily from time deposit and money market account initiatives, as well as greater use of short-term FHLB advances as part of our overall funding and liquidity strategy over the last 12 month period. Compared to the second quarter of 2018, average interest bearing liabilities increased \$628.8 million in the third quarter of 2018 primarily due to greater use of short-term FHLB borrowings and higher average time deposits, including a \$158.7 million increase in average brokered certificates of deposit, partially offset by run-off in long-term FHLB advances. See additional information under "Deposits and Other Borrowings" in the Executive Summary section above.

Our net interest margin on a tax equivalent basis of 3.12 percent for the third quarter of 2018 increased by 5 basis points and 1 basis point from 3.07 percent and 3.11 percent for the third quarter of 2017 and second quarter of 2018, respectively. The yield on average interest earning assets increased by 14 basis points on a linked quarter basis mostly due to the higher yield on average loans, partially offset by a lower yield on average investments caused, in part, by calls and other repayments of higher yielding investment securities. The yield on average loans increased by 16 basis points to 4.50 percent for the third quarter of 2018 as compared to the second quarter of 2018 mainly due to the high volume of new loan originations at current market rates, and to a lesser extent better than expected cash flows from certain purchased credit-impaired loan pools. The overall cost of average interest bearing liabilities increased 17 basis points to 1.55 percent for the third quarter of 2018 as compared to the linked second quarter of 2018 due to 16, 19, and 26 basis point increases in the cost of average interest bearing deposits, short-term borrowings, and long-term borrowings, respectively, largely driven by higher market interest rates. Our cost of total average deposits was 0.88 percent for the third quarter of 2018 as compared to 0.76 percent for the second quarter of 2018.

Looking forward, we expect the level of our net interest margin to remain relatively stable for the fourth quarter of 2018 as compared to the third quarter of 2018 with continued modest pressure caused by strong market competition for deposits. However, our net interest margin may decline as compared to the third quarter of 2018 due to a multitude of other conditional and sometimes unpredictable factors.





The following table reflects the components of net interest income for the three months ended September 30, 2018, June 30, 2018 and September 30, 2017:

Quarterly Analysis of Average Assets, Liabilities and Shareholders' Equity and Net Interest Income on a Tax Equivalent Basis

|   | Three Months Ended<br>September 30, 2018 |           |                 | June 30, 2018      |           | September 30, 2017 |                    |           | Average<br>Rate |
|---|--|-----------|-----------------|--------------------|-----------|--------------------|--------------------|-----------|-----------------|
|   | Average<br>Balance<br>(\$ in thousands)  | Interest  | Average<br>Rate | Average<br>Balance | Interest  | Average<br>Rate    | Average<br>Balance | Interest  |                 |
| Assets  |  |           |                 |                    |           |                    |                    |           |                 |
| Interest earning assets:  |  |           |                 |                    |           |                    |                    |           |                 |
| Loans (1)(2)  | \$23,659,190                             | \$265,871 | 4.50 %          | \$22,840,235       | \$247,691 | 4.34 %             | \$18,006,274       | \$185,867 | 4.13 %          |
| Taxable investments (3)   | 3,399,910                                | 25,343    | 2.98            | 3,438,842          | 25,950    | 3.02               | 2,905,400          | 20,579    | 2.83            |
| Tax-exempt investments (1)(3)                                   | 730,711                                  | 6,358     | 3.48            | 750,896            | 7,138     | 3.80               | 556,061            | 5,773     | 4.15            |
| Federal funds sold and other interest bearing deposits          | 181,901                                  | 805       | 1.77            | 226,986            | 839       | 1.48               | 175,111            | 546       | 1.25            |
| Total interest earning assets                                   | 27,971,712                               | 298,377   | 4.27            | 27,256,959         | 281,618   | 4.13               | 21,642,846         | 212,765   | 3.93            |
| Allowance for loan losses                                       | (141,400 )                               |           |                 | (134,741 )         |           |                    | (117,938 )         |           |                 |
| Cash and due from banks   | 289,829                                  |           |                 | 274,557            |           |                    | 231,518            |           |                 |
| Other assets  | 2,428,322                                |           |                 | 2,428,459          |           |                    | 1,860,683          |           |                 |
| Unrealized (losses) gains on securities available for sale, net | (55,288 )                                |           |                 | (47,024 )          |           |                    | (12,857 )          |           |                 |
| Total assets  | \$30,493,175                             |           |                 | \$29,778,210       |           |                    | \$23,604,252       |           |                 |
| Liabilities and shareholders' equity                            |  |           |                 |                    |           |                    |                    |           |                 |
| Interest bearing liabilities:                                   |  |           |                 |                    |           |                    |                    |           |                 |
| Savings, NOW and money market deposits                          | \$11,032,866                             | \$28,775  | 1.04 %          | \$10,978,067       | \$24,756  | 0.90 %             | \$8,799,955        | \$15,641  | 0.71 %          |
| Time deposits   | 4,967,691                                | 20,109    | 1.62            | 4,700,456          | 16,635    | 1.42               | 3,368,153          | 10,852    | 1.29            |
| Total interest bearing deposits                                 | 16,000,557                               | 48,884    | 1.22            | 15,678,523         | 41,391    | 1.06               | 12,168,108         | 26,493    | 0.87            |
| Short-term borrowings   | 2,766,398                                | 15,193    | 2.20            | 2,166,837          | 10,913    | 2.01               | 1,537,562          | 5,161     | 1.34            |

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|   |              |           |        |              |           |        |              |           |        |
|---|--------------|-----------|--------|--------------|-----------|--------|--------------|-----------|--------|
| Long-term borrowings (4)                                | 1,991,294    | 16,164    | 3.25   | 2,284,132    | 17,062    | 2.99   | 2,032,068    | 15,142    | 2.98   |
| Total interest bearing liabilities                      | 20,758,249   | 80,241    | 1.55   | 20,129,492   | 69,366    | 1.38   | 15,737,738   | 46,796    | 1.19   |
| Non-interest bearing deposits                           | 6,222,646    |           |        | 6,168,059    |           |        | 5,184,991    |           |        |
| Other liabilities                                       | 204,590      |           |        | 201,043      |           |        | 178,985      |           |        |
| Shareholders' equity                                    | 3,307,690    |           |        | 3,279,616    |           |        | 2,502,538    |           |        |
| Total liabilities and shareholders' equity              | \$30,493,175 |           |        | \$29,778,210 |           |        | \$23,604,252 |           |        |
| Net interest income/interest rate spread (5)            |              | \$218,136 | 2.72 % |              | \$212,252 | 2.75 % |              | \$165,969 | 2.74 % |
| Tax equivalent adjustment                               |              | (1,336 )  |        |              | (1,500 )  |        |              | (2,024 )  |        |
| Net interest income, as reported                        |              | \$216,800 |        |              | \$210,752 |        |              | \$163,945 |        |
| Net interest margin (6)                                 |              |           | 3.10 % |              |           | 3.09 % |              |           | 3.03 % |
| Tax equivalent effect                                   |              |           | 0.02 % |              |           | 0.02 % |              |           | 0.04 % |
| Net interest margin on a fully tax equivalent basis (6) |              |           | 3.12 % |              |           | 3.11 % |              |           | 3.07 % |

The following table reflects the components of net interest income for the nine months ended September 30, 2018 and 2017:

Analysis of Average Assets, Liabilities and Shareholders' Equity and Net Interest Income on a Tax Equivalent Basis

|   | Nine Months Ended<br>September 30, 2018 |           |                 |  | September 30, 2017 |           |                 |  |
|---|---|-----------|-----------------|--|--------------------|-----------|-----------------|--|
|   | Average<br>Balance<br>(\$ in thousands) | Interest  | Average<br>Rate |  | Average<br>Balance | Interest  | Average<br>Rate |  |
| Assets  |   |           |                 |  |                    |           |                 |  |
| Interest earning assets:  |   |           |                 |  |                    |           |                 |  |
| Loans (1)(2)  | \$22,939,106                            | \$751,149 | 4.37 %          |  | \$17,676,222       | \$541,946 | 4.09 %          |  |
| Taxable investments (3)   | 3,413,492                               | 74,555    | 2.91            |  | 2,903,396          | 61,384    | 2.82            |  |
| Tax-exempt investments (1)(3)                                   | 740,832                                 | 20,738    | 3.73            |  | 583,215            | 18,040    | 4.12            |  |
| Federal funds sold and other interest bearing deposits          | 237,535                                 | 2,570     | 1.44            |  | 176,033            | 1,156     | 0.88            |  |
| Total interest earning assets                                   | 27,330,965                              | 849,012   | 4.14            |  | 21,338,866         | 622,526   | 3.89            |  |
| Allowance for loan losses                                       | (133,299 )                              |           |                 |  | (116,507 )         |           |                 |  |
| Cash and due from banks   | 274,638                                 |           |                 |  | 234,905            |           |                 |  |
| Other assets  | 2,426,795                               |           |                 |  | 1,892,875          |           |                 |  |
| Unrealized (losses) gains on securities available for sale, net | (40,335 )                               |           |                 |  | (15,648 )          |           |                 |  |
| Total assets  | \$29,858,764                            |           |                 |  | \$23,334,491       |           |                 |  |
| Liabilities and shareholders' equity                            |   |           |                 |  |                    |           |                 |  |
| Interest bearing liabilities:                                   |   |           |                 |  |                    |           |                 |  |
| Savings, NOW and money market deposits                          | 11,061,781                              | 75,848    | 0.91 %          |  | 8,883,229          | 38,538    | 0.58 %          |  |
| Time deposits   | 4,755,539                               | 51,360    | 1.44            |  | 3,279,699          | 30,571    | 1.24            |  |
| Total interest bearing deposits                                 | 15,817,320                              | 127,208   | 1.07            |  | 12,162,928         | 69,109    | 0.76            |  |
| Short-term borrowings   | 2,144,854                               | 31,838    | 1.98            |  | 1,646,030          | 14,578    | 1.18            |  |
| Long-term borrowings (4)  | 2,234,373                               | 50,458    | 3.01            |  | 1,737,314          | 41,883    | 3.21            |  |
| Total interest bearing liabilities                              | 20,196,547                              | 209,504   | 1.38            |  | 15,546,272         | 125,570   | 1.08            |  |
| Non-interest bearing deposits                                   | 6,167,869                               |           |                 |  | 5,173,140          |           |                 |  |
| Other liabilities   | 201,909                                 |           |                 |  | 173,852            |           |                 |  |
| Shareholders' equity  | 3,292,439                               |           |                 |  | 2,441,227          |           |                 |  |
| Total liabilities and shareholders' equity                      | \$29,858,764                            |           |                 |  | \$23,334,491       |           |                 |  |
| Net interest income/interest rate spread (5)                    |   | \$639,508 | 2.76 %          |  |                    | \$496,956 | 2.81 %          |  |
| Tax equivalent adjustment                                       |   | (4,358 )  |                 |  |                    | (6,323 )  |                 |  |
| Net interest income, as reported                                |   | \$635,150 |                 |  |                    | \$490,633 |                 |  |
| Net interest margin (6)   |   |           | 3.10 %          |  |                    |           | 3.07 %          |  |
| Tax equivalent effect   |   |           | 0.02 %          |  |                    |           | 0.04 %          |  |
| Net interest margin on a fully tax equivalent basis (6)         |   |           | 3.12 %          |  |                    |           | 3.11 %          |  |

(1) Interest income is presented on a tax equivalent basis using a 21 percent and 35 percent federal tax rate for 2018 and 2017, respectively.

(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) Includes junior subordinated debentures issued to capital trusts which are presented separately on the consolidated

statements of financial condition.

(5) Interest rate spread represents the difference between the average yield on interest earning assets and the average cost of interest bearing liabilities and is presented on a fully tax equivalent basis.

(6) Net interest income as a percentage of total average interest earning assets.

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The following table demonstrates the relative impact on net interest income of changes in the volume of interest earning assets and interest bearing liabilities and changes in rates earned and paid by us on such assets and liabilities. Variances resulting from a combination of changes in volume and rates are allocated to the categories in proportion to the absolute dollar amounts of the change in each category.

## Change in Net Interest Income on a Tax Equivalent Basis

|   | Three Months Ended<br>September 30, 2018<br>Compared to September 30,<br>2017 |                          |                 | Nine Months Ended<br>September 30, 2018<br>Compared to September 30,<br>2017 |                          |                 |
|---|---|--------------------------|-----------------|--|--------------------------|-----------------|
|   | Change<br>Due to<br>Volume<br>(in thousands)                                  | Change<br>Due to<br>Rate | Total<br>Change | Change<br>Due to<br>Volume   | Change<br>Due to<br>Rate | Total<br>Change |
| <b>Interest Income:</b>                                 |   |                          |                 |  |                          |                 |
| Loans*  | \$62,386  | \$17,618                 | \$80,004        | \$170,293  | \$38,910                 | \$209,203       |
| Taxable investments                                     | 3,643   | 1,121                    | 4,764           | 11,085   | 2,086                    | 13,171          |
| Tax-exempt investments*                                 | 1,619   | (1,034)                  | 585             | 4,533  | (1,835)                  | 2,698           |
| Federal funds sold and other interest bearing deposits  | 22  | 237                      | 259             | 496  | 918                      | 1,414           |
| Total increase in interest income                       | 67,670  | 17,942                   | 85,612          | 186,407  | 40,079                   | 226,486         |
| <b>Interest Expense:</b>                                |   |                          |                 |  |                          |                 |
| Savings, NOW and money market deposits                  | 4,621   | 8,513                    | 13,134          | 11,081   | 26,229                   | 37,310          |
| Time deposits   | 6,012   | 3,245                    | 9,257           | 15,370   | 5,419                    | 20,789          |
| Short-term borrowings                                   | 5,586   | 4,446                    | 10,032          | 5,342  | 11,918                   | 17,260          |
| Long-term borrowings and junior subordinated debentures | (309)   | 1,331                    | 1,022           | 11,362   | (2,787)                  | 8,575           |
| Total increase in interest expense                      | 15,910  | 17,535                   | 33,445          | 43,155   | 40,779                   | 83,934          |
| Total increase in net interest income                   | \$51,760  | \$407                    | \$52,167        | \$143,252  | \$(700)                  | \$142,552       |

\* Interest income is presented on a tax equivalent basis using a 21 percent and 35 percent federal tax rate for 2018 and 2017, respectively.

## Non-Interest Income

Non-interest income increased \$2.0 million and \$17.8 million for the three and nine months ended September 30, 2018 as compared to the same periods of 2017. The following table presents the components of non-interest income for the three and nine months ended September 30, 2018 and 2017:

|  | Three Months<br>Ended<br>September 30,<br>2018 |         | Nine Months<br>Ended<br>September 30,<br>2017 |         |
|--|--|---------|---|---------|
|  | 2018   | 2017    | 2018  | 2017    |
|  | (in thousands)                                 |         |   |         |
| Trust and investment services                  | \$3,143  | \$3,062 | \$9,635                                       | \$8,606 |
| Insurance commissions                          | 3,646  | 4,519   | 11,493  | 13,938  |
| Service charges on deposit accounts            | 6,597  | 5,558   | 20,529  | 16,136  |
| (Losses) gains on securities transactions, net | (79)   | 6       | (880)   | 5       |
| Fees from loan servicing                       | 2,573  | 1,895   | 6,841   | 5,541   |
| Gains on sales of loans, net                   | 3,748  | 5,520   | 18,143  | 14,439  |
| Bank owned life insurance                      | 2,545  | 1,541   | 6,960   | 5,705   |
| Other  | 6,865  | 4,896   | 26,637  | 17,177  |

|                           |          |          |          |          |
|---------------------------|----------|----------|----------|----------|
| Total non-interest income | \$29,038 | \$26,997 | \$99,358 | \$81,547 |
|---------------------------|----------|----------|----------|----------|

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Insurance commissions decreased \$2.4 million for the nine months ended September 30, 2018 as compared to the same period in 2017 mainly due to lower volumes of business generated by the Bank's insurance agency subsidiary.

Service charges on deposit accounts increased \$1.0 million and \$4.4 million for the three and nine months ended September 30, 2018 as compared to the same periods in 2017 mostly driven by the acquisition of USAB on January 1, 2018.

Net gains on sales of loans decreased \$1.8 million for the third quarter of 2018 as compared to the third quarter of 2017 largely due to lower volume of residential mortgage loans sales. During the third quarter of 2018, we sold \$151.1 million of residential mortgages as compared to \$175.5 million of residential mortgage loans sold during the third quarter of 2017. During the nine months ended September 30, 2018 the net gain on sales of loans increased \$3.7 million largely due to sales of residential mortgage loans totaling \$581 million as compared to \$472 million for the same period one year ago. Our net gains on sales of loans for each period are comprised of both gains on sales of residential mortgages and the net change in the mark to market gains and losses on our loans originated for sale and carried at fair value at each period end. The net change in the fair value of loans held for sale resulted in net losses of \$318 thousand and \$140 thousand for the three months ended September 30, 2018 and 2017, respectively, and \$53 thousand and \$708 thousand of net losses and net gains for the nine months ended September 30, 2018 and 2017, respectively. See further discussions of our residential mortgage loan origination activity under the "Loan Portfolio" section of this MD&A below.

Other non-interest income increased \$2.0 million and \$9.5 million for the three and nine months ended September 30, 2018 as compared to the same periods in 2017. These increases were due, in part, to increases of \$3.1 million and \$6.0 million in fee income related to derivative interest rate swaps executed with commercial lending customers for the three and nine months ended September 30, 2018 as compared to the same periods of 2017. Swap fee income totaled \$4.0 million and \$910 thousand for the third quarters of 2018 and 2017, respectively, and \$11.7 million and \$5.7 million for the nine months ended September 30, 2018 and 2017, respectively. However, we also recognized branch asset impairment charges of \$1.8 million related to branch closures, included in net losses on sale of assets within this line item, during the third quarter of 2018.

#### Non-Interest Expense

Non-interest expense increased \$19.1 million and \$102.6 million for the three and nine months ended September 30, 2018 as compared to the same periods of 2017. The following table presents the components of non-interest expense for the three and nine months ended September 30, 2018 and 2017:

|   | Three Months Ended |           | Nine Months Ended |           |
|---|--------------------|-----------|-------------------|-----------|
|   | September 30,      |           | September 30,     |           |
|   | 2018               | 2017      | 2018              | 2017      |
|   | (in thousands)     |           |                   |           |
| Salary and employee benefits expense    | \$80,778           | \$69,286  | \$253,014         | \$198,777 |
| Net occupancy and equipment expense     | 26,295             | 22,756    | 81,120            | 68,400    |
| FDIC insurance assessment               | 7,421              | 4,603     | 20,963            | 14,658    |
| Amortization of other intangible assets | 4,697              | 2,498     | 13,607            | 7,596     |
| Professional and legal fees             | 6,638              | 11,110    | 29,022            | 20,107    |
| Amortization of tax credit investments  | 5,412              | 8,389     | 15,156            | 21,445    |
| Telecommunications expense              | 3,327              | 2,464     | 9,936             | 7,830     |
| Other                                   | 17,113             | 11,459    | 52,531            | 33,943    |
| Total non-interest expense              | \$151,681          | \$132,565 | \$475,349         | \$372,756 |

Salary and employee benefits expense increased \$11.5 million and \$54.2 million for the three and nine months ended September 30, 2018 as compared to the same periods of 2017. The increases were due, in part, to the additional staffing costs related to the USAB acquisition, including \$9.8 million of change in control, severance and retention expenses for the nine months ended September 30, 2018, as well as increases in both cash and stock-based



incentive compensation expense. In addition to normal increases in annual compensation, Valley has also increased its investment in technology staffing and home mortgage consultant teams over the last 12-month period.

Net occupancy and equipment expense increased \$3.5 million and \$12.7 million for the three and nine months ended September 30, 2018 as compared to the same periods of 2017 mainly due to higher technology equipment related expense and increased occupancy and other costs related to the 29-branch network acquired from USAB. The increase for the nine months ended September 30, 2018 was also driven by higher building repair expense and included \$1.1 million of USAB merger related expenses for the nine months ended September 30, 2018. Merger expenses within the category were immaterial for the third quarter of 2018.

FDIC insurance assessment increased \$2.8 million and \$6.3 million for the three and nine months ended September 30, 2018 as compared to the same periods of 2017 mainly due to the USAB acquisition and the organic growth of our balance sheet over the last 12-month period.

Amortization of other intangible assets increased \$2.2 million and \$6.0 million for the three and nine months ended September 30, 2018 as compared to the same periods in 2017. The increases were mainly due to higher amortization expense of core deposit intangibles (CDI) during the nine months of 2018 caused by \$45.9 million of such intangibles generated by the USAB acquisition. See Note 10 to the consolidated financial statements for more details.

Professional and legal fees decreased \$4.5 million and increased \$8.9 million for the three and nine months ended September 30, 2018, respectively, as compared to the same periods of 2017. The nine month increase was mainly due to litigation reserve charges of \$12.2 million and merger related expenses of \$828 thousand during the nine months ended September 30, 2018. The quarterly decrease in 2018 was largely driven by higher advisory and legal fees related to the LIFT Project and USAB acquisition incurred during the third quarter of 2017, partially offset by litigation reserve charges of \$1.7 million for the third quarter of 2018. See Note 16 to the consolidated financial statements for additional information regarding litigation matters.

Other non-interest expense increased \$5.7 million and \$18.6 million for the three and nine months ended September 30, 2018 as compared to the same periods in 2017, mainly due to moderate increases in several significant components of other expense, such as data processing, travel and entertainment, debit card and ATM expense, postage, and stationery and print expenses during the third quarter of 2018. These additional expenses were largely driven by our growth both organically and through the acquisition of USAB. Other non-interest expense also included \$1.0 million and \$6.0 million of USAB merger related expenses for the three and nine months ended September 30, 2018, largely related to data processing costs including contract termination fees and certain duplicative system costs.

#### Efficiency Ratio

The efficiency ratio measures total non-interest expense as a percentage of net interest income plus total non-interest income. We believe this non-GAAP measure provides a meaningful comparison of our operational performance and facilitates investors' assessments of business performance and trends in comparison to our peers in the banking industry. Our overall efficiency ratio, and its comparability to some of our peers, is negatively impacted by the amortization of tax credit investments, as well as infrequent charges within non-interest income and expense.

The following table presents our efficiency ratio and a reconciliation of the efficiency ratio adjusted for certain items during the three and nine months ended September 30, 2018 and 2017:

|  | Three Months Ended |            | Nine Months Ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30,      |            | September 30,     |            |
|  | 2018               | 2017       | 2018              | 2017       |
|  | (\$ in thousands)  |            |                   |            |
| Total non-interest expense                                     | \$ 151,681         | \$ 132,565 | \$ 475,349        | \$ 372,756 |
| Less: Amortization of tax credit investments (pre-tax)         | 5,412              | 8,389      | 15,156            | 21,445     |
| Less: LIFT program expenses (pre-tax)                          | —                  | 9,875      | —                 | 9,875      |
| Less: Legal expenses (litigation reserve impact only, pre-tax) | 1,684              | —          | 12,184            | —          |
| Less: Merger related expenses (pre-tax)                        | 1,304              | 1,241      | 18,080            | 1,242      |
| Total non-interest expense, adjusted                           | \$ 143,281         | \$ 113,060 | \$ 429,929        | \$ 340,194 |
| Net interest income  | \$ 216,800         | \$ 163,945 | \$ 635,150        | \$ 490,633 |
| Total non-interest income                                      | 29,038             | 26,997     | 99,358            | 81,547     |
| Add: Branch related asset impairment (pre-tax)                 | 1,821              | —          | 1,821             | —          |
| Total net interest income and non-interest income              | \$ 247,659         | \$ 190,942 | \$ 736,329        | \$ 572,180 |
| Efficiency ratio   | 61.70              | % 69.43    | % 64.72           | % 65.15    |
| Efficiency ratio, adjusted                                     | 57.85              | % 59.21    | % 58.39           | % 59.46    |

Management continuously monitors its expenses in an effort to optimize Valley's performance. Based upon these efforts and our revenue goals, we seek to achieve an adjusted efficiency ratio (as shown in the table above) in the range of 54 to 56 percent for the fourth quarter of 2018. However, we can provide no assurance that our adjusted efficiency ratio will meet our target or remain at the level reported for the third quarter of 2018.

#### Income Taxes

Effective January 1, 2018, the federal corporate income tax rate decreased from 35 percent to 21 percent under the Tax Act. Income tax expense totaled \$18.0 million for the third quarter of 2018 as compared to \$19.0 million and \$17.1 million for the second quarter of 2018 and third quarter of 2017, respectively, and \$50.2 million and \$55.9 million for the nine months ended September 30, 2018 and 2017, respectively. Our effective tax rate was 20.6 percent, 20.7 percent and 30.1 percent for the third quarter of 2018, second quarter of 2018, and third quarter of 2017, respectively, and 21.4 percent and 29.1 percent for the nine months ended September 30, 2018 and 2017, respectively.

On July 1, 2018, the State of New Jersey enacted new legislation that created a temporary surtax effective for tax years 2018 through 2021 and will require companies to file combined tax returns beginning in 2019. The New Jersey surtax did not have a material impact on our reported income tax expense for the third quarter of 2018.

U.S. GAAP requires that any change in judgment or change in measurement of a tax position taken in a prior annual period be recognized as a discrete event in the quarter in which it occurs, rather than being recognized as a change in effective tax rate for the current year. Our adherence to these tax guidelines may result in volatile effective income tax rates in future quarterly and annual periods. Factors that could impact management's judgment include changes in income, tax laws and regulations, and tax planning strategies. For the remainder of 2018, we currently estimate that our effective tax rate will range from 21 percent to 23 percent primarily reflecting the impacts of the changes in federal and state tax laws (including the New Jersey surtax effective July 1, 2018), tax-exempt income, tax-advantaged investments and general business credits. See Note 15 to the consolidated financial statements for additional information regarding our tax credit investments.



## Business Segments

We have four business segments that we monitor and report on to manage our business operations. These segments are consumer lending, commercial lending, investment management, and corporate and other adjustments. Our reportable segments have been determined based upon Valley's internal structure of operations and lines of business. Each business segment is reviewed routinely for its asset growth, contribution to income before income taxes and return on average interest earning assets and impairment (if events or circumstances indicate a possible inability to realize the carrying amount). Expenses related to the branch network, all other components of retail banking, along with the back office departments of our subsidiary bank are allocated from the corporate and other adjustments segment to each of the other three business segments. Interest expense and internal transfer expense (for general corporate expenses) are allocated to each business segment utilizing a "pool funding" methodology, which involves the allocation of uniform funding cost based on each segment's average earning assets outstanding for the period. The financial reporting for each segment contains allocations and reporting in line with our operations, which may not necessarily be comparable to any other financial institution. The accounting for each segment includes internal accounting policies designed to measure consistent and reasonable financial reporting, and may result in income and expense measurements that differ from amounts under U.S. GAAP. Furthermore, changes in management structure or allocation methodologies and procedures may result in changes in reported segment financial data.

The following tables present the financial data for each business segment for the three months ended September 30, 2018 and 2017:

|   | Three Months Ended September 30, 2018 |                    |                       |                                 |  | Total        |   |
|---|---------------------------------------|--------------------|-----------------------|---------------------------------|--|--------------|---|
|   | Consumer Lending                      | Commercial Lending | Investment Management | Corporate and Other Adjustments |  |              |   |
|   | (\$ in thousands)                     |                    |                       |                                 |  |              |   |
| Average interest earning assets                                   | \$6,264,778                           | \$17,394,412       | \$4,312,522           | \$ —                            |  | \$27,971,712 |   |
| Income (loss) before income taxes                                 | 12,684                                | 80,768             | 9,732                 | (15,578)                        |  | 87,606       |   |
| Annualized return on average interest earning assets (before tax) | 0.81                                  | % 1.86             | % 0.90                | % N/A                           |  | 1.25         | % |

|   | Three Months Ended September 30, 2017 |                    |                       |                                 |  | Total        |   |
|---|---------------------------------------|--------------------|-----------------------|---------------------------------|--|--------------|---|
|   | Consumer Lending                      | Commercial Lending | Investment Management | Corporate and Other Adjustments |  |              |   |
|   | (\$ in thousands)                     |                    |                       |                                 |  |              |   |
| Average interest earning assets                                   | \$5,226,964                           | \$12,779,310       | \$3,636,572           | \$ —                            |  | \$21,642,846 |   |
| Income (loss) before income taxes                                 | 15,609                                | 55,036             | 9,118                 | (23,026)                        |  | 56,737       |   |
| Annualized return on average interest earning assets (before tax) | 1.19                                  | % 1.72             | % 1.00                | % N/A                           |  | 1.05         | % |

## Consumer Lending

This segment, representing approximately 26.6 percent of our loan portfolio at September 30, 2018, is mainly comprised of residential mortgage loans and automobile loans, and to a lesser extent, home equity loans, secured personal lines of credit and other consumer loans (including credit card loans). The duration of the residential mortgage loan portfolio (which represented 15.6 percent of our loan portfolio at September 30, 2018) is subject to movements in the market level of interest rates and forecasted prepayment speeds. The weighted average life of the automobile loans (representing 5.3 percent of total loans at September 30, 2018) is relatively unaffected by movements in the market level of interest rates. However, the average life may be impacted by new loans as a result of the availability of credit within the automobile marketplace and consumer demand for purchasing new or used



automobiles. The consumer lending segment also includes the Wealth Management and Insurance Services Division, comprised of trust, asset management, and insurance services.

Average interest earning assets in this segment increased \$1.0 billion to \$6.3 billion for the three months ended September 30, 2018 as compared to the third quarter of 2017. The increase was largely due to loan growth from new and refinanced residential mortgage loan originations, including a higher level of non-conforming jumbo mortgages held for investment, and an increase in collateralized personal lines of credit over the last 12 months, as well as \$365.9 million and \$109.8 million of residential mortgage loans and home equity loans, respectively, acquired from USAB in January 2018.

Income before income taxes generated by the consumer lending segment decreased \$2.9 million to \$12.7 million for the third quarter of 2018 as compared to \$15.6 million for the third quarter of 2017. Non-interest expense increased \$4.2 million for the third quarter of 2018 as compared to the same quarter of 2017 mainly due to higher salaries and employee benefits expenses related to the USAB acquisition and residential mortgage commission expense. The internal transfer expense increased \$2.6 million for the third quarter of 2018 as compared to the same quarter of 2017. Non-interest income decreased \$2.2 million for the third quarter of 2018 as compared to the third quarter of 2017 mainly due to lower gains on sales of residential mortgage loans. The negative impact of the aforementioned items was partially offset by a \$6.3 million increase in the net interest income mainly driven by the increase in average loans and yield on new loans volumes.

The net interest margin on the consumer lending portfolio decreased 5 basis points to 2.69 percent for the third quarter of 2018 as compared to the same quarter one year ago mainly due to a 28 basis point increase in the costs associated with our funding sources, partially offset by a 23 basis point increase in yield on average loans. The increase in our cost of funds was primarily due to higher short-term interest rates on many of our interest bearing deposit products, including new money market and certificate of deposit initiatives, and short-term borrowings during 2018 as compared to 2017. The increase in loan yield was mainly due to higher market interest rates on new loan volumes. See the "Executive Summary" and the "Net Interest Income" sections above for more details on our deposits and other borrowings.

#### Commercial Lending

The commercial lending segment is comprised of floating rate and adjustable rate commercial and industrial loans and construction loans, as well as fixed rate owner occupied and commercial real estate loans. Due to the portfolio's interest rate characteristics, commercial lending is Valley's business segment that is most sensitive to movements in market interest rates. Commercial and industrial loans totaled approximately \$4.0 billion and represented 16.7 percent of the total loan portfolio at September 30, 2018. Commercial real estate loans and construction loans totaled \$13.7 billion and represented 56.7 percent of the total loan portfolio at September 30, 2018.

Average interest earning assets in this segment increased \$4.6 billion to \$17.4 billion for the three months ended September 30, 2018 as compared to the third quarter of 2017. This increase was mostly due to approximately \$3.2 billion of commercial PCI loans acquired from USAB and organic loan growth over the last 12 months.

For the three months ended September 30, 2018, income before income taxes for the commercial lending segment increased \$25.7 million to \$80.8 million as compared to the same quarter of 2017. Net interest income increased \$45.7 million to \$159 million for the third quarter of 2018 as compared to the same quarter in 2017 largely due to higher average balances, as well as an increase in yield on new loan originations. Internal transfer expense and non-interest expense increased \$12.1 million and \$6.5 million, respectively, during the third quarter of 2018 as compared to the same quarter in 2017 due, in part, to the USAB acquisition. The provision for credit losses increased \$4.7 million to \$5.9 million during the three months ended September 30, 2018 as compared to \$1.2 million for the third quarter of 2017 due to higher allocated reserves related to impaired loans and loan growth. See further details in the "Allowance

for Credit Losses" section in this MD&A.

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The net interest margin for this segment increased 10 basis point to 3.66 percent for the third quarter of 2018 as compared to the same period of 2017 largely due to a 38 basis point increase in the yield on average loans, partially offset by a 28 basis point increase in the cost of our funding sources.

#### Investment Management

The investment management segment generates a large portion of our income through investments in various types of securities and interest-bearing deposits with other banks. These investments are mainly comprised of fixed rate securities and, depending on our liquid cash position, federal funds sold and interest-bearing deposits with banks (primarily the Federal Reserve Bank of New York) as part of our asset/liability management strategies. The fixed rate investments are one of Valley's least sensitive assets to changes in market interest rates. However, a portion of the investment portfolio is invested in shorter-duration securities to maintain the overall asset sensitivity of our balance sheet. See the "Asset/Liability Management" section below for further analysis.

Average interest earning assets in this segment increased \$676.0 million during the third quarter of 2018 as compared to the third quarter of 2017 largely due to investment securities acquired from USAB.

For the quarter ended September 30, 2018, income before income taxes for the investment management segment increased \$614 thousand to \$9.7 million as compared to the third quarter in 2017 largely due to a \$1.2 million increase in net interest income mainly driven by the higher average investment balances and better yields on new investments purchased during the nine months ended September 30, 2018.

The net interest margin for this segment decreased 22 basis points to 1.92 percent for the third quarter of 2018 as compared to the same quarter of 2017 largely due to a 28 basis point increase in costs associated with our funding sources, partially offset by a 6 basis point increase in the yield on average investments. The increase in the yield on average investments was partly due to purchases of higher yielding securities over the last nine months and the positive impact of increased market interest rates on the variable rate portion of our securities portfolio.

#### Corporate and other adjustments

The amounts disclosed as "corporate and other adjustments" represent income and expense items not directly attributable to a specific segment, including net securities gains and losses not reported in the investment management segment above, and interest expense related to subordinated notes, as well as other infrequent charges related to bank acquisitions, litigation reserves and branch asset impairment.

The pre-tax net loss for the corporate segment decreased \$7.4 million to \$15.6 million for the three months ended September 30, 2018 as compared to the third quarter in 2017. The decrease in the net loss for this segment was mainly due to an increase in internal transfer income, partially offset by an increase in non-interest expense. Internal transfer income increased \$16.3 million to \$85.5 million for the three months ended September 30, 2018 as compared to the third quarter in 2017. The non-interest expense increased \$8.4 million to \$103.0 million for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. This increase was largely due to charges related to higher salaries and employee benefits, net occupancy and equipment, and other non-interest expenses. See further details in the "Non-Interest Expense" section above.



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The following tables present the financial data for each business segment for the nine months ended September 30, 2018 and 2017:

|   | Nine Months Ended September 30, 2018 |                    |                       |                                 |  | Total        |   |
|---|--------------------------------------|--------------------|-----------------------|---------------------------------|--|--------------|---|
|   | Consumer Lending                     | Commercial Lending | Investment Management | Corporate and Other Adjustments |  |              |   |
|   | (\$ in thousands)                    |                    |                       |                                 |  |              |   |
| Average interest earning assets                                   | \$6,058,416                          | \$16,880,690       | \$4,391,859           | \$ —                            |  | \$27,330,965 |   |
| Income (loss) before income taxes                                 | 43,444                               | 226,373            | 30,562                | (65,862)                        |  | 234,517      |   |
| Annualized return on average interest earning assets (before tax) | 0.96                                 | % 1.79             | % 0.93                | % N/A                           |  | 1.14         | % |

  

|   | Nine Months Ended September 30, 2017 |                    |                       |                                 |  | Total        |   |
|---|--------------------------------------|--------------------|-----------------------|---------------------------------|--|--------------|---|
|   | Consumer Lending                     | Commercial Lending | Investment Management | Corporate and Other Adjustments |  |              |   |
|   | (\$ in thousands)                    |                    |                       |                                 |  |              |   |
| Average interest earning assets                                   | \$5,133,132                          | \$12,543,090       | \$3,662,644           | \$ —                            |  | \$21,338,866 |   |
| Income (loss) before income taxes                                 | 46,068                               | 162,801            | 28,694                | (45,881)                        |  | 191,682      |   |
| Annualized return on average interest earning assets (before tax) | 1.20                                 | % 1.73             | % 1.04                | % N/A                           |  | 1.20         | % |

### Consumer Lending

Average interest earning assets in this segment increased \$925.3 million to \$6.1 billion for the nine months ended September 30, 2018 as compared to the same period in 2017. The increase was largely due to \$365.9 million and \$109.8 million of residential mortgage loans and home equity loans, respectively, acquired from USAB on January 1, 2018 and loan growth mainly from new and refinanced residential mortgage loan originations held for investment and collateralized personal lines of credit over the last 12 months.

Income before income taxes generated by the consumer lending segment decreased \$2.6 million to \$43.4 million for the nine months ended September 30, 2018 as compared to the same period in 2017. Non-interest expense increased \$14.8 million for the nine months ended September 30, 2018 as compared to the same period in 2017 mainly due to higher salaries and employee benefits expenses related to the USAB acquisition and the growth of our home mortgage consultant team. The internal transfer expense increased \$5.8 million for the nine months ended September 30, 2018 as compared to the same period in 2017. The provision for loan losses also increased \$1.2 million largely due to loan growth. See further detail in the "Allowance for Credit Losses" section. The negative impact of these items was partially offset by increases of \$18.0 million and \$1.2 million in net interest income and non-interest income, respectively. The increased net interest income was mostly due to higher average loans and yields on new loan volumes, while the increase in non-interest income was largely due to higher gains on sales of residential mortgage loans.

The net interest margin on the consumer lending portfolio decreased 3 basis point to 2.74 percent for the nine months ended September 30, 2018 as compared to the same period one year ago due to a 24 basis point increase in the costs associated with our funding sources, mostly offset by a 21 basis point increase in yield on average loans. The increase in our cost of funds was primarily due to higher short-term interest rates resulting from the Federal Reserve's gradual increases in short-term market interest rates during the last 12 months and intense competition for deposits mainly in our New Jersey and New York markets. The increase in loan yield was due to higher market interest rates on new loan volumes. See the "Executive Summary" and the "Net Interest Income" sections above for more details on our loans,

deposits and other borrowings.

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## Commercial Lending

Average interest earning assets in this segment increased \$4.3 billion to \$16.9 billion for the nine months ended September 30, 2018 as compared to the same period in 2017. This increase was mostly due to approximately \$3.2 billion of commercial PCI loans acquired from USAB and strong loan growth during the first nine months of 2018.

For the nine months ended September 30, 2018, income before income taxes for the commercial lending segment increased \$63.6 million to \$226.4 million as compared to the same period in 2017. Net interest income increased \$121.6 million to \$460.7 million for the nine months ended September 30, 2018 as compared to the same period in 2017 largely due to higher average balances, as well as an increase in yield on new loan originations. Non-interest income increased \$8.1 million for the nine months ended September 30, 2018 as compared to the same period in 2017 mainly due to fee income related to derivative interest rate swaps executed with commercial loan customers which totaled \$11.7 million for the nine months ended September 30, 2018 as compared to \$5.7 million for the same period in 2017. The positive impact of these items was partially offset by an increase in the internal transfer expense, non-interest expense and the provision for credit losses. Internal transfer expense and non-interest expense increased \$33.4 million and \$17.1 million, respectively, during the nine months ended September 30, 2018 as compared to the same period in 2017 due, in part, to the USAB acquisition. The provision for credit losses increased \$15.7 million to \$20.2 million during the nine months ended September 30, 2018 as compared to the same period in 2017 due to higher allocated reserves related to impaired loans and loan growth. See further details in the "Allowance for Credit Losses" section in this MD&A.

The net interest margin for this segment increased 3 basis points to 3.63 percent for the nine months ended September 30, 2018 as compared to the same period of 2017 as a 27 basis point increase in yield on average loans was partially offset by a 24 basis point increase in the cost of our funding sources.

## Investment Management

Average interest earning assets in this segment increased \$729.2 million during the nine months ended September 30, 2018 as compared to the same period in 2017. The increase was largely due to investment securities acquired from USAB and a \$61.5 million increase in average federal funds sold and other interest bearing deposits for the nine months ended September 30, 2018 as compared to the same period in 2017.

For the nine months ended September 30, 2018, income before income taxes for the investment management segment increased \$1.9 million to \$30.6 million as compared to the same period in 2017 mainly due to increases of \$5.5 million and \$1.3 million in net interest income and non-interest income, respectively, partially offset by a \$4.8 million increase in the internal transfer expense. The increase in net interest income was mainly driven by the higher average investment balances during the nine months ended September 30, 2018 as compared to the same period of 2017.

The net interest margin for this segment decreased 20 basis points to 2.00 percent for the nine months ended September 30, 2018 as compared to the same period of 2017 largely due to a 24 basis point increase in costs associated with our funding sources, partially offset by a 4 basis point increase in the yield on average investments. The increase in the yield on average investments was partly due to purchases of higher yielding securities mainly over the last nine months and the positive impact of increased market interest rates on the variable rate portion of our securities portfolio.

## Corporate and other adjustments

The pre-tax net loss for the corporate segment increased \$20.0 million to \$65.9 million for the nine months ended September 30, 2018 as compared to the same period in 2017. The increase in the net loss for this segment was mainly due to an increase in non-interest expense, partially offset by an increase in internal transfer income. The non-interest expense increased \$70.6 million to \$333.7 million for the nine months ended September 30, 2018 as compared to the

nine months ended September 30, 2017. This increase was largely due to higher salaries and employee benefits expenses related to the USAB acquisition and charges related to USAB merger expense and

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professional and legal fees for litigation reserves. See further details in the "Non-Interest Expense" section above. Internal transfer income increased \$44.0 million to \$257.7 million for the nine months ended September 30, 2018 as compared to the same period in 2017.

#### ASSET/LIABILITY MANAGEMENT

##### Interest Rate Sensitivity

Our success is largely dependent upon our ability to manage interest rate risk. Interest rate risk can be defined as the exposure of our interest rate sensitive assets and liabilities to the movement in interest rates. Our Asset/Liability Management Committee is responsible for managing such risks and establishing policies that monitor and coordinate our sources and uses of funds. Asset/Liability management is a continuous process due to the constant change in interest rate risk factors. In assessing the appropriate interest rate risk levels for us, management weighs the potential benefit of each risk management activity within the desired parameters of liquidity, capital levels and management's tolerance for exposure to income fluctuations. Many of the actions undertaken by management utilize fair value analysis and attempt to achieve consistent accounting and economic benefits for financial assets and their related funding sources. We have predominately focused on managing our interest rate risk by attempting to match the inherent risk and cash flows of financial assets and liabilities. Specifically, management employs multiple risk management activities such as optimizing the level of new residential mortgage originations retained in our mortgage portfolio through increasing or decreasing loan sales in the secondary market, product pricing levels, the desired maturity levels for new originations, the composition levels of both our interest earning assets and interest bearing liabilities, as well as several other risk management activities.

We use a simulation model to analyze net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on various interest rate scenarios over a 12-month and 24-month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and liabilities. The model incorporates certain assumptions which management believes to be reasonable regarding the impact of changing interest rates and the prepayment assumptions of certain assets and liabilities as of September 30, 2018. The model assumes immediate changes in interest rates without any proactive change in the composition or size of the balance sheet, or other future actions that management might undertake to mitigate this risk. In the model, the forecasted shape of the yield curve remains static as of September 30, 2018. The impact of interest rate derivatives, such as interest rate swaps and caps, is also included in the model.

Our simulation model is based on market interest rates and prepayment speeds prevalent in the market as of September 30, 2018. Although the size of Valley's balance sheet is forecasted to remain static as of September 30, 2018 in our model, the composition is adjusted to reflect new interest earning assets and funding originations coupled with rate spreads utilizing our actual originations during the third quarter of 2018. The model also utilizes an immediate parallel shift in the market interest rates at September 30, 2018.

The assumptions used in the net interest income simulation are inherently uncertain. Actual results may differ significantly from those presented in the table below due to the frequency and timing of changes in interest rates and changes in spreads between maturity and re-pricing categories. Overall, our net interest income is affected by changes in interest rates and cash flows from our loan and investment portfolios. We actively manage these cash flows in conjunction with our liability mix, duration and interest rates to optimize the net interest income, while structuring the balance sheet in response to actual or potential changes in interest rates. Additionally, our net interest income is impacted by the level of competition within our marketplace. Competition can negatively impact the level of interest rates attainable on loans and increase the cost of deposits, which may result in downward pressure on our net interest margin in future periods. Other factors, including, but not limited to, the slope of the yield curve and projected cash flows will impact our net interest income results and may increase or decrease the level of asset sensitivity of our balance sheet.

Convexity is a measure of how the duration of a financial instrument changes as market interest rates change. Potential movements in the convexity of bonds held in our investment portfolio, as well as the duration of the loan

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portfolio may have a positive or negative impact on our net interest income in varying interest rate environments. As a result, the increase or decrease in forecasted net interest income may not have a linear relationship to the results reflected in the table below. Management cannot provide any assurance about the actual effect of changes in interest rates on our net interest income.

The following table reflects management's expectations of the change in our net interest income over the next 12-month period in light of the aforementioned assumptions. While an instantaneous and severe shift in interest rates was used in this simulation model, we believe that any actual shift in interest rates would likely be more gradual and would therefore have a more modest impact than shown in the table below.

| Changes in Interest Rates<br>(in basis points) | Estimated Change in<br>Future Net Interest Income |                      |
|--|---|----------------------|
|  | Dollar<br>Change<br>(\$ in thousands)             | Percentage<br>Change |
| +200   | \$ 12,503   | 1.34 %               |
| +100   | 7,210   | 0.77                 |
| -100   | (24,558 )   | (2.64 )              |
| -200   | (78,772 )   | (8.45 )              |

As noted in the table above, a 100 basis point immediate increase in interest rates combined with a static balance sheet where the size, mix, and proportions of assets and liabilities remain unchanged is projected to moderately increase net interest income over the next 12 months by 0.77 percent. The Bank's sensitivity to changes in market rates declined as compared to December 31, 2017 (which projected a decrease of 0.35 percent in net interest income over a 12 month period). The change in the sensitivity of our balance sheet since December 31, 2017 was primarily due to the impact of the interest earning assets and interest bearing liabilities acquired from USAB in the first quarter of 2018. However, the net asset sensitivity of the acquired financial instruments was partially mitigated by a significant increase in short-term borrowings used for loan growth funding since March 31, 2018. Future changes including, but not limited to, deposit and borrowings strategies, the slope of the yield curve and projected cash flows will affect our net interest income results and may increase or decrease the level of net interest income sensitivity.

#### Liquidity

##### Bank Liquidity

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. A bank's liquidity reflects its ability to meet loan demand, to accommodate possible outflows in deposits and to take advantage of interest rate opportunities in the marketplace. Liquidity management is monitored by our Asset/Liability Management Committee and the Investment Committee of the Board of Directors of Valley National Bank, which review historical funding requirements, current liquidity position, sources and stability of funding, marketability of assets, options for attracting additional funds, and anticipated future funding needs, including the level of unfunded commitments. Our goal is to maintain sufficient liquidity to cover current and potential funding requirements.

The Bank has no required regulatory liquidity ratios to maintain; however, it adheres to an internal liquidity policy. The current policy maintains that we may not have a ratio of loans to deposits in excess of 125 percent or reliance on wholesale funding greater than 25 percent of total funding. The Bank was in compliance with the foregoing policies at September 30, 2018.

On the asset side of the balance sheet, the Bank has numerous sources of liquid funds in the form of cash and due from banks, interest bearing deposits with banks (including the Federal Reserve Bank of New York), investment securities held to maturity that are maturing within 90 days or would otherwise qualify as maturities if sold (i.e., 85

percent of original cost basis has been repaid), investment securities available for sale, loans held for sale, and, from time to time, federal funds sold and receivables related to unsettled securities transactions. These liquid assets

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totaled approximately \$2.2 billion, representing 8.0 percent of earning assets, at September 30, 2018 and \$2.0 billion, representing 9.3 percent of earning assets, at December 31, 2017. Of the \$2.2 billion of liquid assets at September 30, 2018, approximately \$1.1 billion of various investment securities were pledged to counterparties to support our earning asset funding strategies. We anticipate the receipt of approximately \$449 million in principal payments from securities in the total investment portfolio over the next 12 months due to normally scheduled principal repayments and expected prepayments of certain securities, primarily residential mortgage-backed securities.

Additional liquidity is derived from scheduled loan payments of principal and interest, as well as prepayments received. Loan principal payments (including loans held for sale at September 30, 2018) are projected to be approximately \$6.4 billion over the next 12 months. As a contingency plan for significant funding needs, liquidity could also be derived from the sale of conforming residential mortgages from our loan portfolio, or from the temporary curtailment of lending activities.

On the liability side of the balance sheet, we utilize multiple sources of funds to meet liquidity needs, including retail and commercial deposits, brokered and municipal deposits, and short-term and long-term borrowings. Our core deposit base, which generally excludes fully insured brokered deposits and both retail and brokered certificates of deposit over \$250 thousand, represents the largest of these sources. Average core deposits totaled approximately \$19.7 billion and \$15.4 billion for the nine months ended September 30, 2018 and for the year ended December 31, 2017, respectively, representing 72.1 percent and 71.8 percent of average earning assets for the respective periods. The level of interest bearing deposits is affected by interest rates offered, which is often influenced by our need for funds and the need to match the maturities of assets and liabilities.

Additional funding may be provided through deposit gathering networks and in the form of federal funds purchased through our well established relationships with numerous correspondent banks. While there are no firm lending commitments currently in place, management believes that we could borrow approximately \$512 million for a short term from these banks on a collective basis. The Bank is also a member of the Federal Home Loan Bank of New York (FHLB) and has the ability to borrow from them in the form of FHLB advances secured by pledges of certain eligible collateral, including but not limited to U.S. government and agency mortgage-backed securities and a blanket assignment of qualifying first lien mortgage loans, consisting of both residential mortgage and commercial real estate loans. Furthermore, we are able to obtain overnight borrowings from the Federal Reserve Bank via the discount window as a contingency for additional liquidity. At September 30, 2018, our borrowing capacity under the Federal Reserve's discount window was \$1.2 billion.

We also have access to other short-term and long-term borrowing sources to support our asset base, such as repos (i.e., securities sold under agreements to repurchase). Short-term borrowings increased approximately \$2.2 billion to \$3.0 billion at September 30, 2018 as compared to December 31, 2017 mostly due to new FHLB advances used for normal loan funding activity and liquidity purposes during the first nine months of 2018. Additionally, we assumed \$650 billion of borrowings in the USAB acquisition, consisting of FHLB borrowings and securities sold under agreements to repurchase. The change in short-term borrowings is generally driven by the levels of loan originations both for investment and sale, repayments of long-term borrowings, and our use of time deposits, fully insured brokered deposits and other short-term funding in our current liquidity/funding strategies.

#### Corporation Liquidity

Valley's recurring cash requirements primarily consist of dividends to preferred and common shareholders and interest expense on subordinated notes and junior subordinated debentures issued to capital trusts. As part of our on-going asset/liability management strategies, Valley could also use cash to repurchase shares of its outstanding common stock under its share repurchase program or redeem its callable junior subordinated debentures. These cash needs are routinely satisfied by dividends collected from the Bank. Projected cash flows from the Bank are expected to be adequate to pay preferred and common dividends, if declared, and interest expense payable to subordinated note

holders and capital trusts, given the current capital levels and current profitable operations of the bank subsidiary. In addition to dividends received from the Bank, Valley can satisfy its cash requirements by utilizing its

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own cash and potential new funds borrowed from outside sources or capital issuances. Valley also has the right to defer interest payments on the junior subordinated debentures, and therefore distributions on its trust preferred securities for consecutive quarterly periods up to five years, but not beyond the stated maturity dates, and subject to other conditions.

#### Investment Securities Portfolio

As of September 30, 2018, we had \$2.1 billion and \$1.7 billion in held to maturity and available for sale investment securities, respectively. Our total investment portfolio was comprised of U.S. Treasury securities, U.S. government agency securities, tax-exempt issuances of states and political subdivisions, residential mortgage-backed securities (including 8 private label mortgage-backed securities), single-issuer trust preferred securities principally issued by bank holding companies (including 1 pooled security) and high quality corporate bonds issued by banks at September 30, 2018. There were no securities in the name of any one issuer exceeding 10 percent of shareholders' equity, except for residential mortgage-backed securities issued by Ginnie Mae, Fannie Mae and Freddie Mac.

Among other securities, our investments in the private label mortgage-backed securities, trust preferred securities and bank issued corporate bonds may pose a higher risk of future impairment charges to us as a result of the uncertain economic environment and its potential negative effect on the future performance of the security issuers and, if applicable, the underlying mortgage loan collateral of the security.

#### Other-Than-Temporary Impairment Analysis

We may be required to record impairment charges on our investment securities if they suffer a decline in value that is considered other-than-temporary. Numerous factors, including lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect on our investment portfolio and may result in other-than temporary impairment on our investment securities in future periods. See our Annual Report on Form 10-K for the year ended December 31, 2017 for additional information regarding our impairment analysis by security type.

The investment grades in the table below reflect the most current independent analysis performed by third parties of each security as of the date presented and not necessarily the investment grades at the date of our purchase of the securities. For many securities, the rating agencies may not have performed an independent analysis of the tranches owned by us, but rather an analysis of the entire investment pool. For this and other reasons, we believe the assigned investment grades may not accurately reflect the actual credit quality of each security and should not be viewed in isolation as a measure of the quality of our investment portfolio.

The following table presents the held to maturity and available for sale investment securities portfolios by investment grades at September 30, 2018:

|  | September 30, 2018 |                        |                         | Fair Value  |
|--|--------------------|------------------------|-------------------------|-------------|
|  | Amortized Cost     | Gross Unrealized Gains | Gross Unrealized Losses |             |
| (in thousands)                                 |                    |                        |                         |             |
| Held to maturity investment grades: *          |                    |                        |                         |             |
| AAA Rated                                      | \$1,630,844        | \$ 6,165               | \$(52,508 )             | \$1,584,501 |
| AA Rated                                       | 287,690            | 3,154                  | (2,704 )                | 288,140     |
| A Rated  | 36,633             | 385                    | (440 )                  | 36,578      |
| BBB Rated                                      | 3,000              | 47                     | —                       | 3,047       |
| Non-investment grade                           | —                  | —                      | —                       | —           |
| Not rated                                      | 114,196            | 38                     | (10,146 )               | 104,088     |
| Total investment securities held to maturity   | \$2,072,363        | \$ 9,789               | \$(65,798 )             | \$2,016,354 |
| Available for sale investment grades: *        |                    |                        |                         |             |
| AAA Rated                                      | \$1,614,820        | \$ 793                 | \$(62,839 )             | \$1,552,774 |
| AA Rated                                       | 92,513             | 18                     | (2,319 )                | 90,212      |
| A Rated  | 33,739             | 109                    | (522 )                  | 33,326      |
| BBB Rated                                      | 12,273             | 1                      | (255 )                  | 12,019      |
| Non-investment grade                           | 19,219             | 324                    | (1,611 )                | 17,932      |
| Not rated                                      | 43,963             | 438                    | (1,663 )                | 42,738      |
| Total investment securities available for sale | \$1,816,527        | \$ 1,683               | \$(69,209 )             | \$1,749,001 |

Rated using external rating agencies (primarily S&P and Moody's). Ratings categories include the entire range. For \*example, "A rated" includes A+, A, and A-. Split rated securities with two ratings are categorized at the higher of the rating levels.

The unrealized losses in the AAA rated category (in the above table) in both held to maturity and available for sale investment securities are mainly related to residential mortgage-backed securities mainly issued by Ginnie Mae, Fannie Mae, and Freddie Mac. The held to maturity portfolio includes \$114.2 million in investments not rated by the rating agencies with aggregate unrealized losses of \$10.1 million at September 30, 2018. The unrealized losses for this category included \$6.2 million of unrealized losses related to four single-issuer bank trust preferred issuances with a combined amortized cost of \$36.0 million. All single-issuer trust preferred securities classified as held to maturity, including the aforementioned four securities, are paying in accordance with their terms and have no deferrals of interest or defaults. Additionally, we analyze the performance of each issuer on a quarterly basis, including a review of performance data from the issuer's most recent bank regulatory report to assess the company's credit risk and the probability of impairment of the contractual cash flows of the applicable security. Based upon our quarterly review at September 30, 2018, all of the issuers appear to meet the regulatory capital minimum requirements to be considered a "well-capitalized" financial institution and/or have maintained performance levels adequate to support the contractual cash flows of the security.

There was no other-than-temporary impairment recognized in earnings as a result of Valley's impairment analysis of its securities during the three and nine months ended September 30, 2018 and 2017 as the collateral supporting much of the investment securities has improved or performed as expected.

## Loan Portfolio

The following table reflects the composition of the loan portfolio as of the dates presented:

|                              | September 30,<br>2018 | June 30,<br>2018 | March 31,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |   |
|------------------------------|-----------------------|------------------|-------------------|----------------------|-----------------------|---|
|                              | (\$ in thousands)     |                  |                   |                      |                       |   |
| <b>Loans</b>                 |                       |                  |                   |                      |                       |   |
| Commercial and industrial    | \$4,015,280           | \$3,829,525      | \$3,631,597       | \$2,741,425          | \$2,706,912           |   |
| Commercial real estate:      |                       |                  |                   |                      |                       |   |
| Commercial real estate       | 12,251,231            | 11,913,830       | 11,706,228        | 9,496,777            | 9,351,068             |   |
| Construction                 | 1,416,259             | 1,376,732        | 1,372,508         | 851,105              | 903,640               |   |
| Total commercial real estate | 13,667,490            | 13,290,562       | 13,078,736        | 10,347,882           | 10,254,708            |   |
| Residential mortgage         | 3,782,972             | 3,528,682        | 3,321,560         | 2,859,035            | 2,941,435             |   |
| Consumer:                    |                       |                  |                   |                      |                       |   |
| Home equity                  | 521,797               | 520,849          | 549,329           | 446,280              | 448,842               |   |
| Automobile                   | 1,288,902             | 1,281,735        | 1,222,721         | 1,208,902            | 1,171,685             |   |
| Other consumer               | 834,849               | 783,363          | 748,824           | 728,056              | 677,880               |   |
| Total consumer loans         | 2,645,548             | 2,585,947        | 2,520,874         | 2,383,238            | 2,298,407             |   |
| Total loans *                | \$24,111,290          | \$23,234,716     | \$22,552,767      | \$18,331,580         | \$18,201,462          |   |
| As a percent of total loans: |                       |                  |                   |                      |                       |   |
| Commercial and industrial    | 16.7                  | % 16.5           | % 16.1            | % 15.0               | % 14.9                | % |
| Commercial real estate       | 56.7                  | % 57.2           | % 58.0            | % 56.4               | % 56.3                | % |
| Residential mortgage         | 15.6                  | % 15.2           | % 14.7            | % 15.6               | % 16.2                | % |
| Consumer loans               | 11.0                  | % 11.1           | % 11.2            | % 13.0               | % 12.6                | % |
| Total                        | 100.0                 | % 100.0          | % 100.0           | % 100.0              | % 100.0               | % |

Includes net unearned premiums and deferred loan costs of \$16.7 million, \$18.7 million, \$22.0 million, \$22.2 million \*and \$18.5 million at September 30, 2018, June 30, 2018, March 31, 2018, December 31, 2017 and September 30, 2017, respectively.

Loans increased \$876.6 million to approximately \$24.1 billion at September 30, 2018 from June 30, 2018. The increase was mainly due to strong quarter over quarter growth in total commercial real estate loans, residential mortgage loans and commercial and industrial loans. During the third quarter of 2018, Valley also originated \$124.1 million of residential mortgage loans for sale rather than held for investment. Residential mortgage loans held for sale totaled \$31.7 million and \$15.1 million at September 30, 2018 and June 30, 2018, respectively.

Total commercial and industrial loans increased \$185.8 million from June 30, 2018 to approximately \$4.0 billion at September 30, 2018, net of a normal decline in PCI loans. Exclusive of the decline in PCI loans, the non-PCI commercial and industrial loans increased by \$220.1 million, or 29.4 percent on an annualized basis during the third quarter of 2018. The increase was mostly driven by new small to middle market lending relationships within our regions established by focused calling efforts by our experienced lending teams, which includes targeted hires over the last 12 to 18 months, and to a lesser extent by increased business investment by existing relationships.

Commercial real estate loans (excluding construction loans) increased \$337.4 million from June 30, 2018 to \$12.3 billion at September 30, 2018, despite the \$160.2 million decline in the PCI loan portion of the portfolio during the third quarter of 2018. During the third quarter of 2018, non-PCI loans increased \$497.6 million, or 21.9 percent on an annualized basis. The increase in non-PCI loans was due to strong loan volumes mainly from pre-existing relationships in our Florida market area where we have taken fully advantage of Valley's higher lending capacity with former USAB customers, as well as targeted growth in New Jersey and New York. Construction loans increased \$39.5

million to \$1.4 billion at September 30, 2018 from June 30, 2018.

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Total residential mortgage loans increased \$254.3 million to approximately \$3.8 billion at September 30, 2018 from June 30, 2018 due to strong production from our home mortgage consultant team. Non-conforming (jumbo) residential mortgages originations outpaced conforming loans this quarter and resulted in a higher percentage of our production held for investment in the loan portfolio. New and refinanced residential mortgage loan originations totaled approximately \$497 million for the third quarter of 2018 as compared to \$437 million and \$307.0 million for the second quarter of 2018 and third quarter of 2017, respectively. We sold approximately \$151 million of residential mortgage loans during the third quarter of 2018.

Home equity loans totaling \$521.8 million at September 30, 2018 increased by only \$948 thousand as compared to June 30, 2018. New home equity loan volumes and customer usage of existing home equity lines of credit continue to be weak. We believe this trend may continue for the fourth quarter of 2018 due to many factors, including the Tax Act changes that limit the deductibility of mortgage interest expense for homeowners.

Automobile loans increased by \$7.2 million to \$1.3 billion at September 30, 2018 as compared to June 30, 2018. Growth slowed somewhat during the third quarter due to lower application volumes coupled with normal paydowns. Our Florida dealership network contributed \$35 million in auto loan originations, representing approximately 23 percent of Valley's total new auto loan production during the third quarter of 2018 and was relatively consistent with the linked second quarter of 2018.

Other consumer loans increased \$51.5 million, or 26.3 percent on an annualized basis to \$834.8 million at September 30, 2018 as compared to \$783.4 million at June 30, 2018 mostly due continued growth and customer usage of collateralized personal lines of credit.

Most of our lending is in northern and central New Jersey, New York City, Long Island, Florida and, to a much lesser extent, Alabama, with the exception of smaller auto and residential mortgage loan portfolios derived from other neighboring states, which could present a geographic and credit risk if there was another significant broad based economic downturn within these regions. To mitigate our geographic risks, we make efforts to maintain a diversified portfolio as to type of borrower and loan to guard against a potential downward turn in any one economic sector.

#### Purchased Credit-Impaired Loans

PCI loans increased \$3.0 billion to \$4.4 billion at September 30, 2018 from \$1.4 billion at December 31, 2017, mainly due to \$3.7 billion of PCI loans acquired from USAB on January 1, 2018, partially offset by normal repayment activity. Our PCI loans also include loans acquired in business combinations subsequent to 2011 and, to a much lesser extent, covered loans in which the Bank will share losses with the FDIC under loss-sharing agreements. Our covered loans, consisting primarily of residential mortgage and other consumer loans, totaled \$29.1 million and \$38.7 million at September 30, 2018 and December 31, 2017, respectively.

As required by U.S. GAAP, all of our PCI loans are accounted for under ASC Subtopic 310-30. This accounting guidance requires the PCI loans to be aggregated and accounted for as pools of loans based on common risk characteristics. A pool is accounted for as one asset with a single composite interest rate, aggregate fair value and expected cash flows. For PCI loan pools accounted for under ASC Subtopic 310-30, the difference between the contractually required payments due and the cash flows expected to be collected, considering the impact of prepayments, is referred to as the non-accretable difference. The contractually required payments due represent the total undiscounted amount of all uncollected principal and interest payments. Contractually required payments due may increase or decrease for a variety of reasons, e.g. when the contractual terms of the loan agreement are modified, when interest rates on variable rate loans change, or when principal and/or interest payments are received. The Bank estimates the undiscounted cash flows expected to be collected by incorporating several key assumptions, including probability of default, loss given default, and the amount of actual prepayments after the acquisition dates. The non-accretable difference, which is neither accreted into income nor recorded on our consolidated balance sheet, reflects estimated future credit losses and uncollectable contractual interest expected to be incurred over the life of the loans. The excess of the undiscounted cash flows expected at the acquisition date over the carrying amount (fair value) of the PCI loans is referred to as the accretable yield. This amount is accreted into





interest income over the remaining life of the loans, or pool of loans, using the level yield method. The accretable yield is affected by changes in interest rate indices for variable rate loans, changes in prepayment assumptions, and changes in expected principal and interest payments over the estimated lives of the loans. Prepayments affect the estimated life of PCI loans and could change the amount of interest income, and possibly principal, expected to be collected. Reclassifications of the non-accretable difference to the accretable yield may occur subsequent to the loan acquisition dates due to increases in expected cash flows of the loan pools.

At acquisition, we use a third party service provider to assist with our assessment of the contractual and estimated cash flows. During subsequent annual evaluation periods, Valley uses a third party software application to assess the contractual and estimated cash flows. Using updated loan-level information derived from Valley's main operating system, contractually required loan payments and expected cash flows for each pool level, the software reforecasts both the contractual cash flows and cash flows expected to be collected. The loan-level information used to reforecast the cash flows is subsequently aggregated on a pool basis. The expected payment data, discount rates, impairment data and changes to the accretable yield are reviewed by Valley to determine whether this information is accurate and the resulting financial statement effects are reasonable.

Similar to contractual cash flows, we reevaluate expected cash flows on a quarterly basis. Unlike contractual cash flows which are determined based on known factors, significant management assumptions are necessary in forecasting the estimated cash flows. We attempt to ensure the forecasted expectations are reasonable based on the information currently available; however, due to the uncertainties inherent in the use of estimates, actual cash flow results may differ from our forecast and the differences may be significant. To mitigate such differences, we carefully prepare and review the assumptions utilized in forecasting estimated cash flows.

On a quarterly basis, Valley analyzes the actual cash flow versus the forecasts at the loan pool level and variances are reviewed to determine their cause. In re-forecasting future estimated cash flow, Valley will adjust the credit loss expectations for loan pools, as necessary. These adjustments are based, in part, on actual loss severities recognized for each loan type, as well as changes in the probability of default. For periods in which Valley does not reforecast estimated cash flows, the prior reporting period's estimated cash flows are adjusted to reflect the actual cash received and credit events which transpired during the current reporting period.

The following table summarizes the changes in the carrying amounts of PCI loans and the accretable yield on these loans for the three and nine months ended September 30, 2018 and 2017:

|                                     | Three Months Ended September 30, |                  | 2017            |                  |
|-------------------------------------|----------------------------------|------------------|-----------------|------------------|
|                                     | 2018                             |                  | 2017            |                  |
|                                     | Carrying Amount                  | Accretable Yield | Carrying Amount | Accretable Yield |
|                                     | (in thousands)                   |                  |                 |                  |
| PCI loans:                          |                                  |                  |                 |                  |
| Balance, beginning of the period    | \$4,647,701                      | \$630,550        | \$1,541,469     | \$246,278        |
| Acquisition                         | (9,520 )                         | —                | —               | —                |
| Accretion                           | 54,367                           | (54,367 )        | 20,626          | (20,626 )        |
| Payments received                   | (262,513 )                       | —                | (90,240 )       | —                |
| Net increase in expected cash flows | —                                | 23,983           | —               | —                |
| Balance, end of the period          | \$4,430,035                      | \$600,166        | \$1,471,855     | \$225,652        |



|                                      | Nine Months Ended September 30, |                     |                    |                     |
|--------------------------------------|---------------------------------|---------------------|--------------------|---------------------|
|                                      | 2018                            |                     | 2017               |                     |
|                                      | Carrying<br>Amount              | Accretable<br>Yield | Carrying<br>Amount | Accretable<br>Yield |
|                                      | (in thousands)                  |                     |                    |                     |
| PCI loans:                           |                                 |                     |                    |                     |
| Balance, beginning of the period     | \$1,387,215                     | \$282,009           | \$1,771,502        | \$294,514           |
| Acquisition                          | 3,735,162                       | 474,208             | —                  | —                   |
| Accretion                            | 180,034                         | (180,034 )          | 68,862             | (68,862 )           |
| Payments received                    | (872,183 )                      | —                   | (364,975 )         | —                   |
| Net increase in expected cash flows  | —                               | 23,983              | —                  | —                   |
| Transfers to other real estate owned | (193 )                          | —                   | (3,534 )           | —                   |
| Balance, end of the period           | \$4,430,035                     | \$600,166           | \$1,471,855        | \$225,652           |

The net increase in expected cash flows for certain pools of loans (included in the table above) is recognized prospectively as an adjustment to the yield over the estimated remaining life of the individual pools. Based upon the most recent reforecasted cash flows during the third quarter of 2018, the net increase in accretable yield for the three and nine months ended September 30, 2018 was largely caused by a decrease in the loss expectations for certain PCI loan pools which are subsequently performing better than expected at their acquisition.

#### Non-performing Assets

Non-performing assets (excluding PCI loans) include non-accrual loans, other real estate owned (OREO) and other repossessed assets (which consist of automobiles) at September 30, 2018. Loans are generally placed on non-accrual status when they become past due in excess of 90 days as to payment of principal or interest. Exceptions to the non-accrual policy may be permitted if the loan is sufficiently collateralized and in the process of collection. OREO is acquired through foreclosure on loans secured by land or real estate. OREO and other repossessed assets are reported at the lower of cost or fair value, less cost to sell at the time of acquisition and at the lower of cost or fair value, less estimated costs to sell, thereafter. Our non-performing assets totaling \$88.7 million at September 30, 2018 decreased 8.7 percent from June 30, 2018 and increased 60.8 percent from September 30, 2017, respectively, (as shown in the table below). The \$8.4 million decrease in non-performing assets at September 30, 2018 as compared to June 30, 2018 was mainly due to decreases of \$6.1 million and \$1.9 million in non-accrual loans and OREO, respectively, during the third quarter of 2018. The increase from September 30, 2017 was mostly related to non-accrual taxi medallion loans. Non-performing assets as a percentage of total loans and non-performing assets totaled 0.37 percent at September 30, 2018 as compared to 0.42 percent at June 30, 2018. Past due loans and non-accrual loans in the table below exclude PCI loans. Under U.S. GAAP, the PCI loans (acquired at a discount that is due, in part, to credit quality) are accounted for on a pool basis and are not subject to delinquency classification in the same manner as loans originated by Valley. For details regarding performing and non-performing PCI loans, see the "Credit quality indicators" section in Note 8 to the consolidated financial statements.

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The following table sets forth by loan category accruing past due and non-performing assets on the dates indicated in conjunction with our asset quality ratios:

|   | September 30,<br>2018 | June 30,<br>2018 | March 31,<br>2017 | December 31,<br>2017 | September 30,<br>2017 |   |
|---|-----------------------|------------------|-------------------|----------------------|-----------------------|---|
|   | (\$ in thousands)     |                  |                   |                      |                       |   |
| Accruing past due loans: *                                    |                       |                  |                   |                      |                       |   |
| 30 to 59 days past due:                                       |                       |                  |                   |                      |                       |   |
| Commercial and industrial                                     | \$9,462               | \$6,780          | \$5,405           | \$3,650              | \$1,186               |   |
| Commercial real estate  | 3,387                 | 4,323            | 3,699             | 11,223               | 4,755                 |   |
| Construction  | 15,576                | 175              | 532               | 12,949               | —                     |   |
| Residential mortgage  | 10,058                | 7,961            | 6,460             | 12,669               | 7,942                 |   |
| Total Consumer  | 7,443                 | 6,573            | 5,244             | 8,409                | 5,205                 |   |
| Total 30 to 59 days past due                                  | 45,926                | 25,812           | 21,340            | 48,900               | 19,088                |   |
| 60 to 89 days past due:                                       |                       |                  |                   |                      |                       |   |
| Commercial and industrial                                     | 1,431                 | 1,533            | 804               | 544                  | 3,043                 |   |
| Commercial real estate  | 2,502                 | —                | —                 | —                    | 626                   |   |
| Construction  | 36                    | —                | 1,099             | 18,845               | 2,518                 |   |
| Residential mortgage  | 3,270                 | 1,978            | 4,081             | 7,903                | 1,604                 |   |
| Total Consumer  | 1,249                 | 860              | 1,489             | 1,199                | 1,019                 |   |
| Total 60 to 89 days past due                                  | 8,488                 | 4,371            | 7,473             | 28,491               | 8,810                 |   |
| 90 or more days past due:                                     |                       |                  |                   |                      |                       |   |
| Commercial and industrial                                     | 1,618                 | 560              | 653               | —                    | 125                   |   |
| Commercial real estate  | 27                    | 27               | 27                | 27                   | 389                   |   |
| Construction  | —                     | —                | —                 | —                    | —                     |   |
| Residential mortgage  | 1,877                 | 2,324            | 3,361             | 2,779                | 1,433                 |   |
| Total Consumer  | 282                   | 198              | 372               | 284                  | 301                   |   |
| Total 90 or more days past due                                | 3,804                 | 3,109            | 4,413             | 3,090                | 2,248                 |   |
| Total accruing past due loans                                 | \$58,218              | \$33,292         | \$33,226          | \$80,481             | \$30,146              |   |
| Non-accrual loans: *  |                       |                  |                   |                      |                       |   |
| Commercial and industrial                                     | \$52,929              | \$53,596         | \$25,112          | \$20,890             | \$11,983              |   |
| Commercial real estate  | 7,103                 | 7,452            | 8,679             | 11,328               | 13,870                |   |
| Construction  | —                     | 1,100            | 732               | 732                  | 1,116                 |   |
| Residential mortgage  | 16,083                | 19,303           | 22,694            | 12,405               | 12,974                |   |
| Total Consumer  | 2,248                 | 3,003            | 3,104             | 1,870                | 1,844                 |   |
| Total non-accrual loans                                       | 78,363                | 84,454           | 60,321            | 47,225               | 41,787                |   |
| Other real estate owned (OREO)                                | 9,863                 | 11,760           | 13,773            | 9,795                | 10,770                |   |
| Other repossessed assets                                      | 445                   | 864              | 858               | 441                  | 480                   |   |
| Non-accrual debt securities                                   | —                     | —                | —                 | —                    | 2,115                 |   |
| Total non-performing assets (NPAs)                            | \$88,671              | \$97,078         | \$74,952          | \$57,461             | \$55,152              |   |
| Performing troubled debt restructured loans                   | \$81,141              | \$83,694         | \$116,414         | \$117,176            | \$113,677             |   |
| Total non-accrual loans as a % of loans                       | 0.33                  | % 0.36           | % 0.27            | % 0.26               | % 0.23                | % |
| Total NPAs as a % of loans and NPAs                           | 0.37                  | 0.42             | 0.33              | 0.31                 | 0.30                  |   |
| Total accruing past due and non-accrual loans as a % of loans | 0.57                  | 0.51             | 0.41              | 0.70                 | 0.40                  |   |
| Allowance for loan losses as a % of non-accrual loans         | 184.99                | 164.30           | 220.26            | 255.92               | 284.70                |   |

\* Past due loans and non-accrual loans exclude PCI loans that are accounted for on a pool basis.



Loans past due 30 to 59 days increased \$20.1 million to \$45.9 million at September 30, 2018 as compared to June 30, 2018 largely due to a matured performing construction loan in the normal process of renewal totaling \$15.2 million within this past due category. Commercial and industrial loans increased \$2.7 million mainly due to a few taxi medallion loan relationships within this category at September 30, 2018 that are subsequently performing to their contractual terms.

Loans past due 60 to 89 days increased \$4.1 million to \$8.5 million at September 30, 2018 as compared to June 30, 2018 mainly due to moderate increases across most of the loan types within this delinquency category. Commercial real estate loans increased \$2.5 million mainly due to two loans included in this category at September 30, 2018.

Loans past due 90 days or more and still accruing increased \$695 thousand to \$3.8 million at September 30, 2018 as compared to \$3.1 million at June 30, 2018. All of the loans past due 90 days or more and still accruing are considered to be well secured and in the process of collection.

Non-accrual loans decreased \$6.1 million to \$78.4 million at September 30, 2018 as compared to \$84.5 million at June 30, 2018. The decrease was primarily due to improvement in loan performance and a few large loan payoffs. Non-accrual construction loans decreased \$1.1 million due to one loan reported at June 30, 2018 that paid-off during the third quarter of 2018. As a result, non-accrual loans increased to 0.33 percent of total loans at September 30, 2018 as compared to 0.36 percent of total loans at June 30, 2018.

During the third quarter of 2018, we continued to closely monitor our New York City and Chicago taxi medallion loans totaling \$123.7 million and \$8.7 million, respectively, within the commercial and industrial loan portfolio at September 30, 2018. While the vast majority of the taxi medallion loans are currently performing, negative trends in market valuations of the underlying taxi medallion collateral could impact the future performance and internal classification of this portfolio. At September 30, 2018, the medallion portfolio included impaired loans totaling \$66.5 million with related reserves of \$26.3 million within the allowance for loan losses as compared to impaired loans totaling \$64.7 million with related reserves of \$23.2 million at June 30, 2018. At September 30, 2018, the impaired medallion loans largely consisted of performing troubled debt restructured (TDR) loans classified as substandard loans, as well as \$45.7 million of non-accrual taxi cab medallion loans classified as doubtful. Our non-accrual taxi medallion loans are classified as doubtful primarily due to weakened levels of cash flow, collateral and guarantor support in relation to the loans, and not due to actual loan performance.

Valley's historical taxi medallion lending criteria had been conservative in regard to capping the loan amounts in relation to market valuations, as well as obtaining personal guarantees and other collateral in certain instances. However, the severe decline in the market valuation of taxi medallions has adversely affected the estimated fair valuation of these loans and, as a result, increased the level of our allowance for loan losses at September 30, 2018 (See the "Allowance for Credit Losses" section below). Potential further declines in the market valuation of taxi medallions could also negatively impact the future performance of this portfolio. For example, a 25 percent decline in our current estimated market value of the taxi medallions would require additional allocated reserves of \$9.7 million within the allowance for loan losses based upon the impaired taxi medallion loan balances at September 30, 2018. Additionally, Valley currently has \$29.1 million of performing non-impaired taxi medallion loans which are scheduled to mature in 2019, and \$20.7 million that mature between 2023 and 2027. If the loans with 2019 maturities became TDRs upon maturity and renewal, an additional reserve of \$8.7 million would be required based on the allowance methodology at September 30, 2018.

OREO properties decreased \$1.9 million to \$9.9 million at September 30, 2018 from \$11.8 million at June 30, 2018 primarily due to a higher volume of OREO property sales. Net gains and losses on the sale of OREO were immaterial during the nine months ended September 30, 2018. The residential mortgage and consumer loans secured by residential real estate properties for which formal foreclosure proceedings are in process totaled \$2.2 million at September 30, 2018.

TDRs represent loan modifications for customers experiencing financial difficulties where a concession has been granted. Performing TDRs (i.e., TDRs not reported as loans 90 days or more past due and still accruing or as non-accrual loans) decreased \$2.6 million to \$81.1 million at September 30, 2018 as compared to \$83.7 million at June 30,

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2018. Performing TDRs consisted of 98 loans (primarily in the commercial and industrial loan and commercial real estate portfolios) at September 30, 2018. On an aggregate basis, the \$81.1 million in performing TDRs at September 30, 2018 had a modified weighted average interest rate of approximately 5.48 percent as compared to a pre-modification weighted average interest rate of 4.81 percent. The increase in the modified weighted average interest rate of the performing TDRs as compared to the pre-modification weighted average interest rate was largely due to loans restructured at higher current market interest rates, but with extended loan terms.

#### Allowance for Credit Losses

The allowance for credit losses includes the allowance for loan losses and the reserve for unfunded commercial letters of credit. Management maintains the allowance for credit losses at a level estimated to absorb probable losses inherent in the loan portfolio and unfunded letter of credit commitments at the balance sheet dates, based on ongoing evaluations of the loan portfolio. Our methodology for evaluating the appropriateness of the allowance for loan losses includes:

- segmentation of the loan portfolio based on the major loan categories, which consist of commercial and industrial, commercial real estate (including construction), residential mortgage, and other consumer loans (including automobile and home equity loans);
- tracking the historical levels of classified loans and delinquencies;
- assessing the nature and trend of loan charge-offs;
- providing specific reserves on impaired loans; and
- evaluating the PCI loan pools for additional credit impairment subsequent to the acquisition dates.

Additionally, the qualitative factors, such as the volume of non-performing loans, concentration risks by size, type, and geography, new markets, collateral adequacy, credit policies and procedures, staffing, underwriting consistency, loan review and economic conditions are taken into consideration when evaluating the adequacy of the allowance for credit losses. The allowance for credit loss methodology and accounting policy are fully described in Part II, Item 7 and Note 1 to the consolidated financial statements in Valley's Annual Report on Form 10-K for the year ended December 31, 2017.

While management utilizes its best judgment and information available, the ultimate adequacy of the allowance for credit losses is dependent upon a variety of factors largely beyond our control, including the view of the OCC toward loan classifications, performance of the loan portfolio, and the economy. The OCC may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the allowance for loan losses when their credit evaluations differ from those of management.



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The table below summarizes the relationship among loans, loans charged-off, loan recoveries, the provision for credit losses and the allowance for credit losses for the periods indicated.

|   | Three Months Ended    |                  |                       | Nine Months Ended     |                       |   |
|---|-----------------------|------------------|-----------------------|-----------------------|-----------------------|---|
|   | September 30,<br>2018 | June 30,<br>2018 | September 30,<br>2017 | September 30,<br>2018 | September 30,<br>2017 |   |
|   | (\$ in thousands)     |                  |                       |                       |                       |   |
| Average loans outstanding   | \$23,659,190          | \$22,840,235     | \$18,006,274          | \$22,939,106          | \$17,676,222          |   |
| Beginning balance - Allowance for credit losses                               | 143,154               | 136,704          | 118,621               | 124,452               | 116,604               |   |
| Loans charged-off:  |                       |                  |                       |                       |                       |   |
| Commercial and industrial   | (833 )                | (642 )           | (265 )                | (1,606 )              | (4,889 )              |   |
| Commercial real estate  | —                     | (38 )            | —                     | (348 )                | (553 )                |   |
| Construction  | —                     | —                | —                     | —                     | —                     |   |
| Residential mortgage  | —                     | (99 )            | (129 )                | (167 )                | (488 )                |   |
| Total Consumer  | (1,150 )              | (1,422 )         | (1,335 )              | (3,783 )              | (3,467 )              |   |
| Total charge-offs   | (1,983 )              | (2,201 )         | (1,729 )              | (5,904 )              | (9,397 )              |   |
| Charged-off loans recovered:  |                       |                  |                       |                       |                       |   |
| Commercial and industrial   | 1,131                 | 819              | 2,320                 | 4,057                 | 3,480                 |   |
| Commercial real estate  | 12                    | 15               | 42                    | 396                   | 530                   |   |
| Construction  | —                     | —                | —                     | —                     | 294                   |   |
| Residential mortgage  | 9                     | 180              | 220                   | 269                   | 903                   |   |
| Total Consumer  | 600                   | 495              | 366                   | 1,563                 | 1,324                 |   |
| Total recoveries  | 1,752                 | 1,509            | 2,948                 | 6,285                 | 6,531                 |   |
| Net (charge-offs) recoveries  | (231 )                | (692 )           | 1,219                 | 381                   | (2,866 )              |   |
| Provision charged for credit losses   | 6,552                 | 7,142            | 1,640                 | 24,642                | 7,742                 |   |
| Ending balance - Allowance for credit losses                                  | \$149,475             | \$143,154        | \$121,480             | \$149,475             | \$121,480             |   |
| Components of allowance for credit losses:                                    |                       |                  |                       |                       |                       |   |
| Allowance for loan losses   | \$144,963             | \$138,762        | \$118,966             | \$144,963             | \$118,966             |   |
| Allowance for unfunded letters of credit                                      | 4,512                 | 4,392            | 2,514                 | 4,512                 | 2,514                 |   |
| Allowance for credit losses   | \$149,475             | \$143,154        | \$121,480             | \$149,475             | \$121,480             |   |
| Components of provision for credit losses:                                    |                       |                  |                       |                       |                       |   |
| Provision for losses on loans   | \$6,432               | \$6,592          | \$1,301               | \$23,726              | \$7,413               |   |
| Provision for unfunded letters of credit                                      | 120                   | 550              | 339                   | 916                   | 329                   |   |
| Provision for credit losses   | \$6,552               | \$7,142          | \$1,640               | \$24,642              | \$7,742               |   |
| Annualized ratio of net charge-offs (recoveries) to average loans outstanding | 0.00                  | % 0.01           | % (0.03 )             | % 0.00                | % 0.02                | % |
| Allowance for credit losses as a % of non-PCI loans                           | 0.76                  | 0.77             | 0.73                  | 0.76                  | 0.73                  |   |
| Allowance for credit losses as a % of total loans                             | 0.62                  | 0.62             | 0.67                  | 0.62                  | 0.67                  |   |

The overall level of loan charge-offs (as presented in the above table) has continued to be low. Net loan charge-offs totaled \$231 thousand for the third quarter of 2018 as compared to net charge-offs of \$692 thousand for the second

quarter of 2018, and \$1.2 million of net recoveries of loan charge-offs during the third quarter of 2017. During the third quarter of 2018, we recorded a \$6.6 million provision for credit losses as compared to \$7.1 million and \$1.6 million for the second quarter of 2018 and the third quarter of 2017, respectively. The provision for credit losses

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totaled \$24.6 million and \$7.7 million for the nine months ended September 30, 2018 and 2017, respectively. The elevated 2018 provision was largely due to higher reserves allocated to impaired taxi medallion loans, as well as the significant non-PCI loan growth.

The following table summarizes the allocation of the allowance for credit losses to specific loan portfolio categories and the allocations as a percentage of each loan category:

| Loan Category:                     | September 30, 2018 |           |      | June 30, 2018 |           |      | September 30, 2017 |           |      |
|------------------------------------|--------------------|-----------|------|---------------|-----------|------|--------------------|-----------|------|
|                                    | Allocation         | as a % of | Loan | Allocation    | as a % of | Loan | Allocation         | as a % of | Loan |
|                                    | (\$ in thousands)  |           |      |               |           |      |                    |           |      |
| Commercial and Industrial loans*   | \$88,509           | 2.20      | %    | \$78,649      | 2.05      | %    | \$57,203           | 2.11      | %    |
| Commercial real estate loans:      |                    |           |      |               |           |      |                    |           |      |
| Commercial real estate             | 29,093             | 0.24      | %    | 33,234        | 0.28      | %    | 36,626             | 0.39      | %    |
| Construction                       | 21,037             | 1.49      | %    | 20,578        | 1.49      | %    | 18,673             | 2.07      | %    |
| Total commercial real estate loans | 50,130             | 0.37      | %    | 53,812        | 0.40      | %    | 55,299             | 0.54      | %    |
| Residential mortgage loans         | 4,919              |           |      |               |           |      |                    |           |      |