VALLEY NATIONAL BANCORP
Form 10-K
February 28, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
þ ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 1-11277
VALLEY NATIONAL BANCORP
(Exact name of registrant as specified in its charter)

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

973-305-8800
(Registrant’s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Stock, no par value	The Nasdaq Stock Market LLC
Non-Cumulative Perpetual Preferred Stock, Series A, no par value	The Nasdaq Stock Market LLC
Non-Cumulative Perpetual Preferred Stock, Series B, no par value	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
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 þ No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
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 þ Accelerated filer o Smaller reporting company o

Non-accelerated filer o o Emerging growth company o

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 o No þ

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $3.9 billion on June 30, 2018.

There were 331,983,842 shares of Common Stock outstanding at February 26, 2019.

Documents incorporated by reference:

Certain portions of the registrant's Definitive Proxy Statement (the "2019 Proxy Statement") for the 2019 Annual Meeting of Shareholders to be held April 17, 2019 will be incorporated by reference in Part III. The 2019 Proxy Statement will be filed within 120 days of December 31, 2018.

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PART I

Item 1. Business

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

Valley National Bancorp, headquartered in Wayne, New Jersey, is a New Jersey corporation organized in 1983 and is registered as a bank holding company with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended ("Holding Company Act"). The words "Valley," "the Company," "we," "our" and refer to Valley National Bancorp and its wholly owned subsidiaries, unless we indicate otherwise. At December 31, 2018, Valley had consolidated total assets of $31.9 billion, total net loans of $24.9 billion, total deposits of $24.5 billion and total shareholders' equity of $3.4 billion. In addition to its principal subsidiary, Valley National Bank (commonly referred to as the "Bank" in this report), Valley owns all of the voting and common shares of GCB Capital Trust III, State Bancorp Capital Trusts I and II, and Aliant Statutory Trust II at December 31, 2018 through which trust preferred securities were issued. These trusts are not consolidated subsidiaries. See Note 11 to the consolidated financial statements.

Valley National Bank is a national banking association chartered in 1927 under the laws of the United States. Currently, the Bank has 220 branches serving northern and central New Jersey, the New York City boroughs of Manhattan, Brooklyn and Queens, Long Island, Florida and Alabama. The Bank offers commercial, retail, insurance and wealth management financial services products. The Bank also provides a variety of banking services including automated teller machines, telephone and internet banking, remote deposit capture, overdraft facilities, drive-in and night deposit services, and safe deposit facilities. In addition, certain international banking services are available to customers including standby letters of credit, documentary letters of credit and related products, and certain ancillary services such as foreign exchange transactions, documentary collections, foreign wire transfers, as well as transaction accounts for non-resident aliens.

Valley National Bank's wholly-owned subsidiaries are all included in the consolidated financial statements of Valley (See Exhibit 21 at Part IV, Item 15 for a list of subsidiaries). These subsidiaries include, but are not limited to:

- an insurance agency offering property and casualty, life and health insurance;
- an asset management adviser that is a registered investment adviser with Securities and Exchange Commission (SEC);
- title insurance agencies in New York with services in New Jersey;
- subsidiaries which hold, maintain and manage investment assets for the Bank;
- a subsidiary which specializes in health care equipment lending and other commercial equipment leases; and
- a subsidiary which owns and services New York commercial loans.

The Bank's subsidiaries also include real estate investment trust subsidiaries (the REIT subsidiaries) which own real estate related investments and a REIT subsidiary, which owns some of the real estate utilized by the Bank and related real estate investments. Except for Valley's REIT subsidiaries, all subsidiaries mentioned above are directly or indirectly wholly owned by the Bank. Because each REIT must have 100 or more shareholders to qualify as a REIT, each REIT has issued less than 20 percent of its outstanding non-voting preferred stock to individuals, most of whom are current and former (non-executive officer) Bank employees. The Bank owns the remaining preferred stock and all the common stock of the REITs.

Recent Acquisitions

Valley has grown significantly in the past five years primarily through bank acquisitions that expanded our branch footprint into Florida. Recent bank transactions are discussed further below.

USAmeriBancorp, Inc. On January 1, 2018, Valley completed its acquisition of USAmeriBancorp, Inc. (USAB) headquartered in Clearwater, Florida. USAB, largely through its wholly-owned subsidiary, USAmeriBank, 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 at December 31, 2018. The acquisition represents a

significant addition to Valley's Florida presence, primarily in the Tampa Bay market. The acquisition also brought Valley to the Birmingham, Montgomery, and Tallapoosa areas in Alabama, where USAB maintained 15 of its branches. The common shareholders of USAB received 6.1 shares of Valley common stock for each USAB share they own. The total consideration for the acquisition was approximately $737 million, consisting of 64.9 million shares of Valley common stock and the outstanding USAB stock-based awards.

CNLBancshares, Inc. On December 1, 2015, Valley completed its acquisition of CNLBancshares, Inc. (CNL) and its wholly-owned subsidiary, CNLBank, headquartered in Orlando, Florida, a commercial bank with approximately $1.6 billion in assets, $825 million in loans, $1.2 billion in deposits and 16 branch offices on the date of its acquisition by Valley. The acquired branches allowed us to service Florida's west coast markets of Naples, Bonita Springs, Fort Myers and Sarasota. We also added three offices in the Jacksonville area and expanded our presence in the Orlando market. The common shareholders of CNL received 0.705 of a share of Valley common stock for each CNL share they owned prior to the merger. The total consideration for the acquisition was approximately $230 million, consisting of 20.6 million shares of Valley common stock.

1st United Bancorp, Inc. On November 1, 2014, Valley acquired 1st United Bancorp, Inc. (1st United) and its wholly-owned subsidiary, 1st United Bank, a commercial bank with approximately $1.7 billion in assets, $1.2 billion in loans, and $1.4 billion in deposits, after purchase accounting adjustments. The 1st United acquisition gave Valley its first Florida branch network consisting of 20 branch offices covering some of the most attractive urban banking markets in Florida, including locations throughout southeast Florida, the Treasure Coast, central Florida and central Gulf Coast regions. The common shareholders of 1st United received 0.89 of a share of Valley common stock for each 1st United share they owned prior to the merger. The total consideration for the acquisition was approximately $300 million, consisting of 30.7 million shares of Valley common stock and $8.9 million of cash consideration paid to 1st United stock option holders.

In connection with the 1st United acquisition, we acquired loans and other real estate owned subject to Federal Deposit Insurance Corporation (FDIC) loss-share agreements (referred to as “covered loans” and “covered OREO”, together “covered assets”). The FDIC loss-share agreements relate to three previous FDIC-assisted acquisitions completed by 1st United from 2009 to 2011. The Bank shares losses on covered assets in accordance with provisions of each loss-share agreement. The vast majority of Valley's covered loans totaling $27.6 million, or 0.1 percent of total loans, at December 31, 2018 are covered by residential mortgage related loan loss sharing agreements acquired from 1st United that will expire between 2019 and 2021.

Business Segments

Our business segments are reassessed by management, at least on an annual basis, to ensure the proper identification and reporting of our operating segments. Valley currently reports the results of its operations and manages its business through four business segments: commercial lending, consumer lending, investment management, and corporate and other adjustments. Valley’s Wealth Management Division comprised of trust, asset management and insurance services, is included in the consumer lending segment. See Note 22 to the consolidated financial statements for details of the financial performance of our business segments. We offer a variety of products and services within the commercial and consumer lending segments as described below.

Commercial Lending Segment

Commercial and industrial loans. Commercial and industrial loans totaled approximately $4.3 billion and represented 17.3 percent of the total loan portfolio at December 31, 2018. We make commercial loans to small and middle market businesses most often located in the New Jersey and New York area, as well as Florida. Loans originated from Florida accounted for approximately 28 percent of total commercial and industrial loans at December 31, 2018 as compared to 14 percent of such loans at December 31, 2017. A significant proportion of Valley’s commercial and industrial loan portfolio is granted to long-standing customers of proven ability, strong repayment performance, and high character. Underwriting standards are designed to assess the borrower’s ability to generate recurring cash flow sufficient to meet the debt service requirements of loans granted. While such recurring cash flow serves as the primary source of repayment, most of the loans are collateralized by borrower assets intended to serve as a secondary source of repayment should the need arise. Anticipated cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value, or in the case of loans secured by accounts receivable, the ability of the borrower to collect all amounts due from its customers. Our loan decisions include consideration of a borrower’s willingness to repay debts, collateral coverage, standing in the community and other forms of support. Strong consideration is given to long-term existing customers that have maintained a favorable relationship with the

Bank. Commercial loan products offered consist of term loans for equipment purchases, working capital lines of credit that assist our customers' financing of accounts receivable and inventory, and commercial mortgages for owner occupied properties. Working capital advances are generally used to finance seasonal requirements and are repaid at the end of the cycle. Short-term commercial business loans may be collateralized by a lien on accounts receivable, inventory, equipment and/or partly collateralized by real estate. Short-term loans may also be made on an unsecured basis based on a borrower's financial strength and past performance. Whenever possible, we obtain the personal guarantee of the borrower's principals to mitigate the risk. Unsecured loans, when made, are generally granted to the Bank's most creditworthy borrowers. Unsecured commercial and industrial loans totaled $580.5 million at December 31, 2018. In addition, we provide financing to the medical equipment leasing market through our leasing subsidiary, Highland Capital Corp.

The commercial portfolio also includes approximately $121.8 million and $8.4 million of New York City and Chicago taxi medallion loans at December 31, 2018, respectively, which we continue to closely monitor due to the weakness exhibited in the

taxi industry caused by strong competition from alternative ride-sharing services. At December 31, 2018, the medallion portfolio included impaired loans totaling $73.7 million with related reserves of $27.9 million within the allowance for loan losses. While most of the taxi medallion loans within the portfolio at December 31, 2018 are currently performing to their contractual terms, negative trends in the market valuations of the underlying taxi medallion collateral and a decline in borrower cash flows, among other factors, could impact the future performance of this portfolio. See the “Non-performing Assets” section of “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” (MD&A) for additional information regarding our taxi medallion loans.
Commercial real estate loans. Commercial real estate and construction loans totaled $13.9 billion and represented 55.5 percent of the total loan portfolio at December 31, 2018. We originate commercial real estate loans that are largely secured by multi-unit residential property and non-owner occupied commercial, industrial, and retail property within New Jersey, New York, Pennsylvania and Florida. Loans originated from Florida lending represented 28 percent of the total commercial real estate loans at December 31, 2018 as compared to 13 percent of such loans at December 31, 2017. Loans are generally written on an adjustable basis with rates tied to a specifically identified market rate index. Adjustment periods generally range between five to ten years and repayment is generally structured on a fully amortizing basis for terms up to thirty years. Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans but generally they involve larger principal balances and longer repayment periods as compared to commercial and industrial loans. Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real property. Repayment of most loans is dependent upon the cash flow generated from the property securing the loan or the business that occupies the property. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy and accordingly, conservative loan to value ratios are required at origination, as well as stress tested to evaluate the impact of market changes relating to key underwriting elements. The properties securing the commercial real estate portfolio represent diverse types, with most properties located within Valley’s primary markets. With respect to loans to developers and builders, we originate and manage construction loans structured on either a revolving or a non-revolving basis, depending on the nature of the underlying development project. Our construction loans totaling approximately $1.5 billion at December 31, 2018 are generally secured by the real estate to be developed and may also be secured by additional real estate to mitigate the risk. Non-revolving construction loans often involve the disbursement of substantially all committed funds with repayment substantially dependent on the successful completion and sale, or lease, of the project. Sources of repayment for these types of loans may be from pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from Valley until permanent financing is obtained elsewhere. Revolving construction loans (generally relating to single-family residential construction) are controlled with loan advances dependent upon the presale of housing units financed. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.
Consumer Lending Segment
Residential mortgage loans. Residential mortgage loans totaled $4.1 billion and represented 16.4 percent of the total loan portfolio at December 31, 2018. Our residential mortgage loans include fixed and variable interest rate loans mostly located in New Jersey, New York and Florida. Valley’s ability to be repaid on such loans is closely linked to the economic and real estate market conditions in our lending markets. We also make mortgage loans secured by homes beyond this primary geographic area; however, lending outside this primary area is generally made in support of existing customer relationships, as well as targeted purchases of loans guaranteed by third parties. Mortgage loan originations are based on underwriting standards that generally comply with Fannie Mae and/or Freddie Mac requirements. Appraisals and valuations of real estate collateral are contracted through an approved appraisal management company. The appraisal management company adheres to all regulatory requirements. The Bank’s appraisal management policy and procedure is in accordance with regulatory requirements and guidance issued by the Bank’s primary regulator. Credit scoring, using FICO® and other proprietary, credit scoring models is employed in the ultimate, judgmental credit decision by Valley’s underwriting staff. Valley does not use third party contract

underwriting services. In deciding whether to originate each residential mortgage, Valley considers the qualifications of the borrower, the value of the underlying property and other factors that we believe are predictive of future loan performance. Valley originated first mortgages include both fixed rate and adjustable rate mortgage (ARM) products with 10-year to 30-year maturities. The adjustable rate loans have a fixed-rate, fixed payment, introductory period of 5 to 10 years that is selected by the borrower. The adjustable rate residential mortgage loans totaled approximately $898 million and $218 million at December 31, 2018 and 2017, respectively. Additionally, Valley began to originate interest-only (i.e., non-amortizing) residential mortgage loans during 2017 due to demand for this type of loan product in the New York City and northern New Jersey markets. Valley's interest-only residential mortgage loans have 15-year to 30-year maturities and totaled $75.4 million (or 1.8 percent of the total residential mortgage loan portfolio) at December 31, 2018. The Bank is also a servicer of residential mortgage portfolios, and it is compensated for loan administrative services performed for mortgage servicing rights related primarily to loans originated and sold by the Bank. See Note 5 to the consolidated financial statements for further details.

Other consumer loans. Other consumer loans totaled $2.7 billion and represented 10.8 percent of the total loan portfolio at December 31, 2018. Our other consumer loan portfolio is primarily comprised of direct and indirect automobile loans, loans secured by the cash surrender value of life insurance, home equity loans and lines of credit, and to a lesser extent, secured and unsecured other consumer loans (including credit card loans). Valley is an auto lender in New Jersey, New York, Pennsylvania, Florida, Connecticut, Delaware and Alabama offering indirect auto loans secured by either new or used automobiles. Automobile originations (including light truck and sport utility vehicles) are largely produced via indirect channels, originated through approved automobile dealers. Valley acquired an immaterial amount of automobile loans from its bank acquisitions in Florida since 2014, as auto lending was not a focus of the acquired operations. However, we implemented our indirect auto lending model in Florida during 2015, and Alabama in 2018 using our New Jersey based underwriting and loan servicing platform. The relatively new Florida auto dealer network generated over $154 million and $106 million of auto loans in 2018 and 2017, respectively, while the auto loans originated from Alabama were not material in 2018. Home equity lending consists of both fixed and variable interest rate products mainly to provide home equity loans to our residential mortgage customers or take a secondary position to another lender's first lien position within the footprint of our primary lending territories. We generally will not exceed a combined (i.e., first and second mortgage) loan-to-value ratio of 80 percent when originating a home equity loan. Other consumer loans include direct consumer term loans, both secured and unsecured, but are largely comprised of personal lines of credit secured by cash surrender value of life insurance. The product is mainly originated through the Bank's retail branch network and third party financial advisors. Unsecured consumer loans totaled approximately $58.1 million, including $10.4 million of credit card loans, at December 31, 2018.

Wealth Management. Our Wealth Management and Insurance Services Division provides coordinated and integrated delivery of investment management advisory, trust services, commercial and personal insurance products, and title insurance. Asset management advisory services include investment services for individuals and small to medium sized businesses, trusts and custom -tailored investment strategies designed for various types of retirement plans. Trust services include living and testamentary trusts, investment management, custodial and escrow services, and estate administration, primarily to individuals.

Investment Management Segment

Although we are primarily focused on our lending and wealth management services, a large portion of our income is generated through investments in various types of securities, and depending on our liquid cash position, interest-bearing deposits with banks (primarily the Federal Reserve Bank of New York), as part of our asset/liability management strategies. As of December 31, 2018, our total investment securities and interest bearing deposits with banks were $3.8 billion and $177.1 million, respectively. See the "Investment Securities Portfolio" section of the MD&A and Note 4 to the consolidated financial statements for additional information concerning our investment securities.

Changes in Loan Portfolio Composition

At December 31, 2018 and 2017, approximately 74 percent of Valley's gross loans totaling $25.0 billion and $18.3 billion, respectively, consisted of commercial real estate (including construction loans), residential mortgage, and home equity loans. The remaining 26 percent at both December 31, 2018 and 2017 consisted of loans not collateralized by real estate. Valley has no internally planned changes that would significantly impact the current composition of our loan portfolio by loan type. However, we have continued to diversify the geographic concentrations in the New Jersey and New York City Metropolitan area within our loan portfolio primarily through our bank acquisitions in Florida since 2014, including our recent acquisition of USAB on January 1, 2018. Many external factors outlined in "Item 1A. Risk Factors", the "Executive Summary" section of our MD&A, and elsewhere in this report may impact our ability to maintain the current composition of our loan portfolio. See the "Loan Portfolio" section of our MD&A in this report for further discussion of our loan composition and concentration risks.

The following table presents the loan portfolio segments by state as an approximate percentage of each applicable segment and our percentage of total loans by state at December 31, 2018.

	Percentage of Loan Portfolio Segment:				
	Commercial and Industrial	Commercial Real Estate	Residential	Consumer	% of Total Loans
New Jersey	32 %	31 %	44 %	37 %	34 %
New York	27	34	24	29	31
Florida	28	28	19	15	25
Pennsylvania	1	1	2	9	2
California	1	1	6	1	2
Connecticut	1	*	1	2	1
Other	10	5	4	7	5
Total	100 %	100 %	100 %	100 %	100 %

*Represents less than one percent of the loan portfolio segment.

Risk Management

Financial institutions must manage a variety of business risks that can significantly affect their financial performance. Significant risks we confront are credit risks and asset/liability management risks, which include interest rate and liquidity risks. Credit risk is the risk of not collecting payments pursuant to the contractual terms of loan, lease and investment assets. Interest rate risk results from changes in interest rates which may impact the re-pricing of assets and liabilities in different amounts or at different dates. Liquidity risk is the risk that we will be unable to fund obligations to loan customers, depositors or other creditors at a reasonable cost.

Valley’s Board performs its risk oversight function primarily through several standing committees, including the Risk Committee, all of which report to the full Board. The Risk Committee assists the Board by, among other things, establishing an enterprise-wide risk management framework that is appropriate for Valley’s capital, business activities, size and risk appetite. The Risk Committee also reviews and recommends to the Board appropriate risk tolerances and limits for strategic, credit, interest rate, liquidity, compliance, operational (including information security risk), reputation and price risk (and ensures that risks are managed within those tolerances), and monitors compliance with applicable laws and regulations. With guidance from and oversight by the Risk Committee, management continually refines and enhances its risk management policies, procedures and monitoring programs to maintain effective risk management programs and processes.

In May 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the “EGRRCPA”) was signed into law. On July 6, 2018, the Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC) issued a joint interagency statement regarding the impact of the EGRRCPA. As a result of this statement and the EGRRCPA, Valley and the Bank are no longer subject to Dodd-Frank Act stress testing requirements. While Valley is no longer required to publish company-run annual stress tests, it continues to internally run stress tests of its capital position that are subject to review by Valley's primary regulators. Additionally, the results of the internal stress tests are considered in combination with other risk management and monitoring practices at Valley to maintain an effective risk management program.

Cyber Security

Information security is a significant operational risk for Valley. Information security includes the risk of losses resulting from cyber attacks. Valley frequently experiences attempted cyber security attacks against its systems.

However, to date, none of these incidents have resulted in material losses, known breaches of customer data or significant disruption of services to our customers. Within the past few years, we have significantly increased the resources dedicated to cyber security. We believe that further increases are likely to be required in the future, in anticipation of increases in the sophistication and persistency of cyber-attacks. We employ personnel dedicated to overseeing the infrastructure and systems necessary to defend against cyber security incidents. Senior management is regularly briefed on information and cyber security matters, preparedness and any incidents requiring a response.

Valley's Board through its Risk Committee has primary oversight responsibility for information security and receives regular updates and reporting from management on information and cyber security matters, including information related to any third-party assessments of Valley's cyber program. The Risk Committee periodically approves Valley's information security policies.

We may be required to expend significant additional resources to modify our protective measures, to investigate and remediate vulnerabilities or other exposures and if we experienced a cyber security breach of customer data, to make required notifications to customers and disclosure to government officials. As a result, cyber security and the continued development and enhancement of the controls and processes designed to protect our systems, computers, software, data and networks from attack, damage or unauthorized access is a high priority for us. While we have faith in our cyber security practices and personnel, we also know we are not immune from a costly and successful attack.

Credit Risk Management and Underwriting Approach

Credit risk management. For all loan types, we adhere 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 a Credit Committee. A reporting system supplements the review process by providing management with frequent reports concerning loan production, loan quality, concentrations of credit, loan delinquencies, non-performing, and potential problem loans. Loan portfolio diversification is an important factor utilized by us to manage the portfolio's risk across business sectors and through cyclical economic circumstances.

Our historical and current loan underwriting practice prohibits the origination of payment option adjustable residential mortgages which allow for negative interest amortization and subprime loans. Virtually all of our residential mortgage loan originations in recent years have conformed to rules requiring documentation of income, assets sufficient to close the transactions and debt to income ratios that support the borrower's ability to repay under the loan's proposed terms and conditions. These rules are applied to all loans originated for retention in our portfolio or for sale in the secondary market.

Loan underwriting and loan documentation. Loans are well documented in accordance with specific and detailed underwriting policies and verification procedures. General underwriting guidance is consistent across all loan types with possible variations in procedures and due diligence dictated by specific loan requests. Due diligence standards require acquisition and verification of sufficient financial information to determine a borrower's or guarantor's credit worthiness, capital support, capacity to repay, collateral support, and character. Credit worthiness is generally verified using personal or business credit reports from independent credit reporting agencies. Capital support is determined by acquisition of independent verifications of deposits, investments or other assets. Capacity to repay the loan is based on verifiable liquidity and earnings capacity as shown on financial statements and/or tax returns, banking activity levels, operating statements, rent rolls or independent verification of employment. Finally, collateral valuation is determined via appraisals from independent, bank-approved, certified or licensed property appraisers, valuation services, or readily available market resources.

Types of collateral. Loan collateral, when required, may consist of any one or a combination of the following asset types depending upon the loan type and intended purpose: commercial or residential real estate; general business assets including working assets such as accounts receivable, inventory, or fixed assets such as equipment or rolling stock; marketable securities or other forms of liquid assets such as bank deposits or cash surrender value of life insurance; automobiles; or other assets wherein adequate protective value can be established and/or verified by reliable outside independent appraisers. In addition to these types of collateral, we, in many cases, will obtain the personal guarantee of the borrower's principals or an affiliated corporate entity to mitigate the risk of certain commercial and industrial loans and commercial real estate loans.

Many times, we will underwrite loans to legal entities formed for the limited purpose of the business which is being financed. Credit granted to these entities and the ultimate repayment of such loans is primarily based on the cash flow

generated from the property securing the loan or the business that occupies the property. The underlying real property securing the loans is considered a secondary source of repayment, and normally such loans are also supported by guarantees of the legal entity members. Absent such guarantees or approval by our credit committee, our commercial real estate underwriting guidelines require that the loan to value ratio (at origination) should not exceed 60 percent, except for certain low risk loan categories where the loan to value ratio requirement may be higher, based on the estimated market value of the property as established by an independent licensed appraiser.

Reevaluation of collateral values. Commercial loan renewals, refinancings and other subsequent transactions that include the advancement of new funds or result in the extension of the amortization period beyond the original term, require a new or updated appraisal. Renewals, refinancings and other subsequent transactions that do not include the advancement of new funds (other than for reasonable closing costs) or, in the case of commercial loans, the extension of the amortization period beyond the original term, do not require a new appraisal unless management believes there has been a material change in market conditions or the physical aspects of the property which may negatively impact the collectability of our loan. In general, the period of time

an appraisal continues to be relevant will vary depending upon the circumstances affecting the property and the marketplace. Examples of factors that could cause material changes to reported values include the passage of time, the volatility of the local market, the availability of financing, the inventory of competing properties, new improvements to, or lack of maintenance of, the subject or competing surrounding properties, changes in zoning and environmental contamination.

Certain impaired loans are reported at the fair value of the underlying collateral (less estimated selling costs) if repayment is expected solely from the collateral and are commonly referred to as "collateral dependent impaired loans." Collateral values for such loans are typically estimated using individual appraisals performed every 12 months (or 18 months for impaired loans no greater than $1.0 million with current loan to value ratios less than 75 percent). Between scheduled appraisals, property values are monitored within the commercial portfolio by reference to recent trends in commercial property sales as published by leading industry sources. Property values are monitored within the residential mortgage portfolio by reference to available market indicators, including real estate price indices within Valley's primary lending areas.

All refinanced residential mortgage loans require new appraisals for loans held in our loan portfolio. However, certain residential mortgage loans may be originated for sale and sold without new appraisals when the investor (Fannie Mae or Freddie Mac) presents a refinance of an existing government sponsored enterprise loan without the benefit of a new appraisal. Additionally, all loan types are assessed for full or partial charge-off when they are between 90 and 120 days past due (or sooner when the borrowers' obligation has been released in bankruptcy) based upon their estimated net realizable value. See Note 1 to our consolidated financial statements for additional information concerning our loan portfolio risk elements, credit risk management and our loan charge-off policy.

Loan Renewals and Modifications

In the normal course of our lending business, we may renew loans to existing customers upon maturity of the existing loan. These renewals are granted provided that the new loan meets our standard underwriting criteria for such loan type. Additionally, on a case-by-case basis, we may extend, restructure, or otherwise modify the terms of existing loans from time to time to remain competitive and retain certain profitable customers, as well as assist 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).

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 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.

Extension of Credit to Past Due Borrowers

Loans are placed on non-accrual status generally when they become 90 days past due and the full and timely collection of principal and interest becomes uncertain. Valley's historic and current policy prohibits the advancement of additional funds on non-accrual and TDR loans, except under certain workout plans if such extension of credit is intended to mitigate losses.

Loans Originated by Third Parties

From time to time, the Bank makes purchases of commercial real estate loans and loan participations, residential mortgage loans, automobile loans, and other loan types, originated by, and sometimes serviced by, other financial institutions. The purchase decision is usually based on several factors, including current loan origination volumes, market interest rates, excess liquidity, our continuous efforts to meet the credit needs of certain borrowers under the Community Reinvestment Act, as well as other asset/liability management strategies. All of the purchased loans are selected using Valley's normal underwriting criteria at the time of purchase, or in some cases guaranteed by third

parties. Purchased commercial and industrial, and commercial real estate participation loans are generally seasoned loans with expected shorter durations. Additionally, each purchased participation loan is stress-tested by Valley to assure its credit quality.

Purchased commercial loans (including commercial and industrial and commercial real estate loans), and residential mortgage loans totaled approximately $1.5 billion and $1.1 billion, respectively, at December 31, 2018 representing 8.74 percent, and 25.74 percent of our total commercial and residential mortgage loans, respectively.

At December 31, 2018, the commercial real estate loans originated by third parties had loans past due 30 days or more totaling 1.37 percent as compared to 0.20 percent for our total commercial real estate portfolio, including all delinquencies.

Residential mortgage loans originated by third parties had loans past due 30 days or more totaling 1.64 percent of these loans at December 31, 2018 as compared to 0.49 percent for our total residential mortgage portfolio. Additionally, Valley has performed credit due diligence on the majority of the loans acquired in our bank acquisitions (disclosed under the "Recent Acquisitions" section above) in determining the estimated cash flows receivable from such loans. See the "Loan Portfolio" section of Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations of this report below for additional information.

Competition

Valley National Bank is one of the largest commercial banks headquartered in New Jersey, with its primary markets located in northern and central New Jersey, the New York City boroughs of Manhattan, Brooklyn and Queens, Long Island, Florida and Alabama. Valley ranked 18th in competitive ranking and market share based on the deposits reported by 201 FDIC-insured financial institutions in the New York, Northern New Jersey and Long Island deposit markets as of June 30, 2018. The FDIC also ranked Valley 7th, 39th, 23rd, and 15th in the states of New Jersey, New York, Florida, and Alabama, respectively, based on deposit market share as of June 30, 2018. While our FDIC rankings reflect a solid foundation in our primary markets, the market for banking and bank-related services is highly competitive and we face substantial competition in all phases of our operations. In addition to the FDIC-insured commercial banks in our principal metropolitan markets, we also compete with other providers of financial services such as savings institutions, credit unions, mutual funds, captive finance companies, mortgage companies, title agencies, asset managers, insurance companies and a growing list of other local, regional and national companies which offer various financial services. Many of these competitors may have fewer regulatory constraints, broader geographic service areas, greater capital, and, in some cases, lower cost structures.

In addition, competition has further intensified as a result of recent changes in regulation, and advances in technology and product delivery systems. We face strong competition for our borrowers, depositors, and other customers from financial technology (fintech) companies that provide innovative web-based solutions to traditional retail banking services and products. Fintech companies tend to have stronger operating efficiencies and fewer regulatory burdens than their traditional bank counterparts, including Valley. Within our markets, we also compete with some of the largest financial institutions in the world that have greater human and financial resources and are able to offer a large range of products and services at competitive rates and prices. Nevertheless, we believe we can compete effectively as a result of utilizing various strategies including our long history of local customer service and convenience as part of a relationship management culture, in conjunction with the pricing of loans and deposits. Our customers are influenced by the convenience, quality of service from our knowledgeable staff, personal contacts and attention to customer needs, as well as availability of products and services and related pricing. We provide such convenience through our banking network of 220 branches, an extensive ATM network, and our telephone and on-line banking systems. Our competitive advantage also lies in our strong community presence with over 90 years of service. This longevity is especially appealing to customers seeking a strong, stable and service-oriented bank.

We continually review our pricing, products, locations, alternative delivery channels and various acquisition prospects, and periodically engage in discussions regarding possible acquisitions to maintain and enhance our competitive position.

Personnel

At December 31, 2018, Valley National Bank and its subsidiaries employed 3,192 full-time equivalent persons. Management considers relations with its employees to be satisfactory.

Executive Officers

Name	Age at December 31, 2018	Executive Officer Since	Office
Ira Robbins	44	2009	President and Chief Executive Officer of Valley and Valley National Bank
Alan D. Eskow	70	1993	Senior Executive Vice President, Chief Financial Officer and Corporate Secretary of Valley and Valley National Bank
Dianne M. Grenz	56	2014	Senior Executive Vice President of Valley and Chief Consumer Banking Officer of Valley National Bank
Thomas A. Iadanza	60	2015	Senior Executive Vice President of Valley and Chief Lending Officer of Valley National Bank
Ronald H. Janis	70	2017	Senior Executive Vice President and General Counsel of Valley and Valley National Bank
Robert J. Bardusch	53	2016	Senior Executive Vice President of Valley and Chief Operating Officer of Valley National Bank
Kevin Chittenden	54	2016	Executive Vice President of Valley and Chief Residential Lending Officer of Valley National Bank
Bernadette M. Mueller	60	2009	Executive Vice President of Valley and Community Reinvestment Act Officer of Valley National Bank
Melissa F. Scofield	59	2015	Executive Vice President of Valley and Chief Risk Officer of Valley National Bank
Yvonne M. Surowiec	58	2017	Executive Vice President of Valley and Chief Human Resources Officer of Valley National Bank
Mark Saeger	54	2018	Executive Vice President of Valley and Chief Credit Officer of Valley National Bank
Eugene M. Fernandez	55	2018	Executive Vice President of Valley and Chief Marketing Officer of Valley National Bank
Mitchell L. Crandell	48	2007	First Senior Vice President, Chief Accounting Officer of Valley and Valley National Bank

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

Available Information

We make our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments thereto available on our website at www.valley.com without charge as soon as reasonably practicable after filing or furnishing them to the SEC. Also available on the website are Valley’s Code of Conduct and Ethics that applies to all of our employees including our executive officers and directors, Valley’s Audit Committee Charter, Valley’s Compensation and Human Resources Committee Charter, Valley’s Nominating and Corporate Governance Committee Charter, and Valley’s Corporate Governance Guidelines.

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

SUPERVISION AND REGULATION

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

Bank Holding Company Regulation

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

The Holding Company Act prohibits Valley, with certain exceptions, from acquiring direct or indirect ownership or control of five percent or more of the voting shares of any company which is not a bank and from engaging in any business other than

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

Regulation of Bank Subsidiary

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

Capital Requirements

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

In July 2013, the FRB and the OCC published final rules establishing a new comprehensive capital framework for U.S. banking organizations, referred to herein as the Basel III rules.

Under Basel III, the minimum capital ratios for us and Valley National Bank are as follows:

- 4.5 percent CET1 (common equity Tier 1) to risk-weighted assets.
- 6.0 percent Tier 1 capital (i.e., CET1 plus Additional Tier 1) to risk-weighted assets.
- 8.0 percent Total capital (i.e., Tier 1 plus Tier 2) to risk-weighted assets.
- 4.0 percent Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the "leverage ratio").

As of January 1, 2019, Basel III required us and Valley National Bank to maintain a 2.5 percent "capital conservation buffer", composed entirely of CET1, on top of the minimum risk-weighted asset ratios, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7.0 percent, (ii) Tier 1 capital to risk-weighted assets of at least 8.5 percent, and (iii) total capital to risk-weighted assets of at least 10.5 percent. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of (i) CET1 to risk-weighted assets, (ii) Tier 1 capital to risk-weighted assets or (iii) total capital to risk-weighted assets above the

respective minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and discretionary bonus payments to executive officers based on the amount of the shortfall. As of January 1, 2019, we and the Bank maintained the required capital conservation buffer of 2.5 percent.
Basel III provides for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in common equity issued by nonconsolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10 percent of CET1 or all such categories in the aggregate exceed 15 percent of CET1. The deductions and other adjustments to CET1 were previously scheduled to be phased in incrementally between January 1, 2015 and January 1, 2018. In November 2017, banking regulators announced that the phase in of certain of these adjustments for non-advanced approaches banking organizations such as Valley was frozen.

Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under Basel III, the effects of certain accumulated other comprehensive items are not excluded; however, non-advanced approaches banking organizations, including Valley and Valley National Bank, were permitted to make a one-time permanent election to continue to exclude these items effective as of January 1, 2015. We made this one-time election in the applicable bank regulatory reports as of March 31, 2015.

Basel III, with respect to us, required that our trust preferred securities be eliminated from Tier 1 capital by January 1, 2016. Accordingly, none of Valley's trust preferred securities were included in Tier 1 capital during 2018 and 2017.

With respect to Valley National Bank, Basel III also revised the "prompt corrective action" regulations pursuant to Section 38 of the FDICIA, by (i) introducing a CET1 ratio requirement at each capital quality level (other than critically undercapitalized); (ii) increasing the minimum Tier 1 capital ratio requirement for each category; and (iii) requiring a leverage ratio of 5 percent to be well-capitalized. The OCC's regulations implementing these provisions of FDICIA provide that an institution will be classified as "well capitalized" if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a CET1 ratio of at least 6.5 percent, (iv) has a Tier 1 leverage ratio of at least 5.0 percent, and (v) meets certain other requirements. An institution will be classified as "adequately capitalized" if it meets the aforementioned minimum capital ratios under Basel III. An institution will be classified as "undercapitalized" if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a CET1 ratio of less than 4.5 percent or (iv) has Tier 1 leverage ratio of less than 4.0 percent. An institution will be classified as "significantly undercapitalized" if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a CET1 ratio of less than 3.0 percent or (iv) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as "critically undercapitalized" if it has a tangible equity to total assets ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies. On January 1, 2019, the capital conservation buffer was fully phased in, and as a result, the capital ratios applicable to depository institutions under Basel III now exceed the ratios to be considered well-capitalized under the prompt corrective action regulations.

Basel III prescribes a standardized approach for calculating risk-weighted assets. Valley National Bank's capital ratios were all above the minimum levels required for it to be considered a "well capitalized" financial institution at December 31, 2018 under the "prompt corrective action" regulations in effect as of such date.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The Dodd-Frank Act was signed into law on July 21, 2010. The Dodd-Frank Act significantly changed the bank regulatory landscape and has impacted the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. Some of the effects are discussed below.

The Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB) and shifted most of the federal consumer protection rules applicable to banks and the enforcement power with respect to such rules to the CFPB.

Under the Durbin Amendment contained in the Dodd-Frank Act, the Federal Reserve adopted rules applying to banks with more than $10 billion in assets which established a maximum permissible interchange fee equal to no more than 21 cents plus 5 basis points of the transaction value for many types of debit interchange transactions. The Federal Reserve also adopted a rule to allow a debit card issuer to recover 1 cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements required by the Federal Reserve. The Federal Reserve also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product. As we exceed $10 billion in assets, we are subject to the interchange fee cap.

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "EGRRCPA") was signed into law. On July 6, 2018, the Fed, the OCC and the FDIC issued a joint interagency statement regarding the impact of the EGRRCPA. As a result of this statement and the EGRRCPA, Valley and the Bank are no longer subject to Dodd-Frank Act stress testing requirements. However, under safety and soundness requirements we will continue to

conduct stress testing of our own design.

Volcker Rule

The Volcker Rule (contained in the Dodd-Frank Act) prohibits an insured depository institution and its affiliates from: (i) engaging in “proprietary trading” and (ii) investing in or sponsoring certain types of funds (Covered Funds) subject to certain limited exceptions. The rule also effectively prohibits short-term trading strategies by any U.S. banking entity if those strategies involve instruments other than those specifically permitted for trading and prohibits the use of some hedging strategies. We identified no investments held as of December 31, 2018 that meet the definition of Covered Funds. Regulators are currently considering modifying certain aspects of the Volcker Rule.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulators and the SEC to maintain guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including us and our Bank, having at least $1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as us, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Dividend Limitations

Valley is a legal entity separate and distinct from its subsidiaries. Valley's revenues (on a parent company only basis) result in substantial part from dividends paid by the Bank. The Bank's dividend payments, without prior regulatory approval, are subject to regulatory limitations. Under the National Bank Act, without consent, a national bank may declare, in any one year, dividends only in an amount aggregating not more than the sum of its net profits for such year and its retained net profits for the preceding two years. In addition, the bank regulatory agencies have the authority to prohibit us from paying dividends if the supervising agency determines that such payment would constitute an unsafe or unsound banking practice. Among other things, consultation with the FRB supervisory staff is required in advance of our declaration or payment of a dividend to our shareholders that exceeds our earnings for the trailing four-quarter period in which the dividend is being paid.

Transactions with Related Parties

Valley National Bank's authority to extend credit to its directors, executive officers and 10 percent shareholders, as well as to entities controlled by such persons, is currently governed by the requirements of the National Bank Act, Sarbanes-Oxley Act and Regulation O of the FRB thereunder. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's Board of Directors. Under the Sarbanes-Oxley Act, Valley and its subsidiaries, other than the Bank under the authority of Regulation O, may not extend or arrange for any personal loans to its directors and executive officers.

Section 22 of the Federal Reserve Act prohibits the Bank from paying to a director, officer, attorney or employee a rate on deposits that is greater than the rate paid to other depositors on similar deposits with the Bank.

Community Reinvestment

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

“satisfactory” CRA rating in its most recent examination.
The OCC approvals of the most recent acquisitions of USAB and CNL in January 2018 and December 2015, respectively, were unconditional, however, the OCC will continue to monitor the Bank's progress with the CRA plan, and any necessary enhancements based upon new markets or otherwise, through its normal supervisory reviews. Valley National Bank's CRA plan is available for review on its website at www.valley.com.
A bank which does not have a CRA program that is deemed satisfactory by its regulator will be prevented from making acquisitions.

Corporate Governance

The Sarbanes-Oxley Act of 2002 added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting, to increase corporate responsibility and to protect investors. Among other things, the Sarbanes-Oxley Act of 2002:

- required our management to evaluate our disclosure controls and procedures and our internal control over financial reporting, and required our auditors to issue a report on our internal control over financial reporting;
- imposed on our chief executive officer and chief financial officer additional responsibilities with respect to our external financial statements, including certification of financial statements within the Annual Report on Form 10-K and Quarterly Reports on Form 10-Q by the chief executive officer and the chief financial officer;
- established independence requirements for audit committee members and outside auditors;
- created the Public Company Accounting Oversight Board which oversees public accounting firms; and
- increased various criminal penalties for violations of securities laws.

NASDAQ, where Valley common stock is listed, has corporate governance listing standards, including rules strengthening director independence requirements for boards, as well as the audit committee and the compensation committee, and requiring the adoption of charters for the compensation and audit committees.

USA PATRIOT Act

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

Regulations implementing the due diligence requirements require minimum standards to verify customer identity and maintain accurate records, encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of “concentration accounts,” and require all covered financial institutions to have in place an anti-money laundering compliance program.

The OCC, along with other banking agencies, have strictly enforced various anti-money laundering and suspicious activity reporting requirements using formal and informal enforcement tools to cause banks to comply with these provisions.

A bank which is issued a formal or informal enforcement requirement with respect to its Anti Money Laundering program will be prevented from making acquisitions.

Office of Foreign Assets Control Regulation

The U.S. Treasury Department’s OFAC administers and enforces economic and trade sanctions against targeted foreign countries and regimes, under authority of various laws, including designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. We and our Bank are responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Consumer Financial Protection Bureau Supervision

As a financial institution with more than $10 billion in assets, Valley National Bank is supervised by the CFPB for consumer protection purposes. The CFPB's regulation of Valley National Bank is focused on risks to consumers and compliance with the federal consumer financial laws and includes regular examinations of the Bank. The CFPB, along with the Department of Justice and bank regulatory authorities also seek to enforce discriminatory lending laws. In such actions, the CFPB and others have used a disparate impact analysis, which measures discriminatory results without regard to intent. Consequently, unintentional actions

by Valley could have a material adverse impact on our lending and results of operations if the actions are found to be discriminatory by our regulators.

Valley National Bank is subject to federal consumer protection statutes and regulations promulgated under those laws, including, but not limited to the following:

- Truth-In-Lending Act and Regulation Z, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act and Regulation C, requiring financial institutions to provide certain information about home mortgage and refinanced loans;
- Equal Credit Opportunity Act and Regulation B, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;
- Fair Credit Reporting Act and Regulation V, governing the provision of consumer information to credit reporting agencies and the use of consumer information; and
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies.

Valley National Bank's deposit operations are also subject to the following federal statutes and regulations, among others:

- The Truth in Savings Act and Regulation DD, which requires disclosure of deposit terms to consumers;
- Regulation CC, which relates to the availability of deposit funds to consumers;
- The Right to Financial Privacy Act, which imposes a duty to maintain the confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- Electronic Funds Transfer Act and Regulation E, governing automatic deposits to, and withdrawals from, deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

The CFPB examines Valley National Bank's compliance with such laws and the regulations under them.

Insurance of Deposit Accounts

The Bank's deposits are insured up to applicable limits by the FDIC. Under the FDIC's risk-based system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors with less risky institutions paying lower assessments on their deposits.

As required by the Dodd-Frank Act, the FDIC has adopted rules that revise the assessment base to consist of average consolidated total assets during the assessment period minus the average tangible equity during the assessment period. In addition, the rules eliminated the adjustment for secured borrowings, including Federal Home Loan Bank (FHLB) advances, and made certain other changes to the impact of unsecured borrowings and brokered deposits on an institution's deposit insurance assessment. The rules also revised the assessment rate schedule to provide initial base assessment rates ranging from 5 to 35 basis points and total base assessment rates ranging from 2.5 to 45 basis points after adjustment. The Dodd-Frank Act made permanent a $250 thousand limit for federal deposit insurance.

In 2016, the FDIC added a surcharge to the insurance assessments for banks with over $10 billion in assets, which became effective in July 2016 and continued until the Bank's December 2018 assessment invoice, which covered the assessment period from July 1, 2018 through September 30, 2018. After that invoice, the FDIC assessment no longer included a quarterly surcharge.

London Interbank Offered Rate

Central banks around the world, including the Fed, have commissioned working groups of market participants and official sector representatives with the goal of finding suitable replacements for the London Interbank Offered Rate ("LIBOR") based on observable market transactions because of the probable phase out of LIBOR. It is expected that a transition away from the widespread use of LIBOR to alternative rates will occur over the course of the next few years. Although the full impact of a transition, including the potential or actual discontinuance of LIBOR publication, remains unclear, this change may have an adverse impact on the value of, return on and trading markets for a broad array of financial products, including any LIBOR-based securities, loans and derivatives that are included in our financial assets and liabilities. A transition away from LIBOR may also require extensive changes to the contracts that govern these LIBOR-based products, as well as our systems and processes. A number of the bank's commercial loans and some residential loans are based upon LIBOR. The Bank is working on replacement language where necessary.

Item 1A. Risk Factors

An investment in our securities is subject to risks inherent to our business. The material risks and uncertainties that management believes may affect Valley are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing Valley. Additional risks and uncertainties that management is not aware of or that management currently believes are immaterial may also impair Valley's business operations. The value or market price of our securities could decline due to any of these identified or other risks, and you could lose all or part of your investment. This report is qualified in its entirety by these risk factors.

Changes in interest rates could reduce our net interest income and earnings.

Valley's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and investment securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors that are beyond Valley's control, including general economic conditions, competition, and policies of various governmental and regulatory agencies and, in particular, the policies of the FRB. Changes in interest rates driven by such factors could influence not only the interest Valley receives on loans and investment securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) Valley's ability to originate loans and obtain deposits, (ii) the fair value of Valley's financial assets, including the held to maturity and available for sale investment securities portfolios, and (iii) the average duration of Valley's interest-earning assets and liabilities. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rate indices underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk). Any substantial or unexpected change in market interest rates could have a material adverse effect on Valley's financial condition and results of operations. See additional information at the "Net Interest Income" and "Interest Rate Sensitivity" sections of our MD&A.

Our financial results and condition may be adversely impacted by changing economic conditions.

While the economy and real estate market conditions have significantly improved in recent years, a return to a recessionary economy could result in financial stress on our borrowers that would adversely affect our financial condition and results of operations. Financial institutions can be affected by changing conditions in the real estate and financial markets. Volatility in the housing markets, real estate values and unemployment levels could result in significant write-downs of asset values by financial institutions. The majority of Valley's lending is in northern and central New Jersey, the New York City metropolitan area, Florida and Alabama. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in these areas could have a material adverse impact on the quality of Valley's loan portfolio, results of operations and future growth potential. Adverse economic conditions in our market areas can reduce our rate of growth, affect our customers' ability to repay loans and adversely impact our financial condition and earnings. General economic conditions, including inflation, unemployment and money supply fluctuations, also may adversely affect our profitability.

Our investments in certain tax-advantaged projects may not generate returns as anticipated and may have an adverse impact on our results of operations.

We invest in certain tax-advantaged investments that support qualified affordable housing projects, community development and renewable energy resources. Our investments in these projects are designed to generate a return primarily through the realization of federal and state income tax credits, and other tax benefits, over specified time periods. Due diligence review is performed both prior to the initial investment and on an ongoing basis. We are subject to the risk that previously recorded tax credits, which remain subject to recapture by taxing authorities based on compliance features required to be met at the project level, may fail to meet certain government compliance requirements and may not be able to be realized. The possible inability to realize these tax credits and other tax benefits may have a negative impact on our financial results. The risk of not being able to realize the tax credits and

other tax benefits depends on many factors outside our control, including changes in the applicable tax code and the ability of the projects to be completed. We previously invested in mobile solar generators sold and managed by DC Solar and its affiliates (DC Solar). For reasons that were not known to us, DC Solar had its assets frozen in December 2018. DC Solar filed for Chapter 11 bankruptcy protection in February 2019. In February 2019, an affidavit from a Federal Bureau of Investigation (FBI) special agent stated that DC Solar was operating a fraudulent "Ponzi-like scheme" and that the majority of mobile solar generators sold to investors and managed by DC Solar and the majority of the related lease revenues claimed to have been received by DC Solar may not have existed. Certain investors in DC Solar, including us, received tax credits for making these renewable resource investments. As a result of the information provided in the FBI special agent's affidavit filed in the U.S. District Court for the Eastern District of California, we believe that, in 2019, we may be required to record an uncertain tax position liability under

Accounting Standards Codification 740, Income Taxes for a significant portion of the tax credit benefits we received in the past. We will continue to evaluate our existing tax positions, as well as new positions as they arise. However, if we are required to recognize an uncertain tax position liability in our 2019 consolidated financial statements, the uncertain tax position liability and charge-offs may have an adverse impact on our income tax liabilities, results of operations and financial condition.

The future impact of changes to the Internal Revenue Code is uncertain and may adversely affect our business.

The U.S. Congress passed significant reform of the Internal Revenue Code, known as the Tax Cuts and Jobs Act of 2017 (Tax Act) at the end of 2017. While the decline in the federal corporate tax rate from 35 percent to 21 percent lowered Valley’s income tax expense as a percentage of its taxable income in 2018 and will in subsequent years, other provisions of the Tax Act negatively impacted Valley's consolidated financial statements and it may adversely affect Valley in the future. For example, under the new provisions of the Tax Act, the Bank's FDIC insurance assessment totaling $28.3 million for the year ended December 31, 2018 was partially non-tax deductible based upon the asset size of the Bank.

The Tax Act also imposes higher limitations on the deductibility of interest and property tax expenses which may adversely impact the property values of real estate used to secure loans and create an additional tax burden for many borrowers, particularly in high tax jurisdictions such as New Jersey and New York where Valley operates. These and other federal tax changes could significantly impact the level of lending activity and the financial health of our customers. The negative impact to customers could potentially result in, among other things, an inability to repay loans or maintain deposits at Valley in states where Valley operates, especially New York and New Jersey. Any negative financial impact to our customers resulting from tax reform could adversely impact our financial condition and earnings.

The ultimate impact of the Tax Act on our business and our customers is uncertain and may be adverse.

Claims and litigation could result in significant expenses, losses and damage to our reputation.

From time to time as part of Valley’s normal course of business, customers, bankruptcy trustees, former customers, contractual counterparties, third parties and former employees make claims and take legal action against Valley based on actions or inactions of Valley. If such claims and legal actions are not resolved in a manner favorable to Valley, they may result in financial liability and/or adversely affect the market perception of Valley and its products and services. This may also impact customer demand for Valley’s products and services. Any financial liability could have a material adverse effect on Valley’s financial condition and results of operations. Any reputation damage could have a material adverse effect on Valley’s business. During 2018, Valley settled litigation matters (including one settlement subsequently approved by the courts in February 2019) resulting in a total charge of $12.2 million within professional and legal fees.

See the "Litigation" section under Note 15 to the consolidated financial statements for information regarding significant pending lawsuits.

Cyber-attacks could compromise our information or result in the data of our customers being improperly divulged, which could expose us to liability, losses and escalating operating costs.

Valley regularly collects, processes, transmits and stores confidential information regarding its customers, employees and others for whom it services loans. In some cases, this confidential or proprietary information is collected, compiled, processed, transmitted or stored by third parties on Valley’s behalf.

Information security risks have increased because of the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. Many financial institutions and companies engaged in data processing have reported significant breaches in the security of their websites or other systems, some of which have involved sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, denial-of-service, or sabotage systems, often through the introduction of computer viruses or malware, cyber-attacks and other means. Although Valley frequently experiences attempted cybersecurity attacks against its systems, to date, none of these incidents have resulted in material losses, known breaches of customer data or significant disruption of services to Valley’s customers. However, there can be no assurance that Valley will not incur such issues in the future, exposing us to significant on-going operational costs and reputational harm.

Additionally, risk exposure to cyber security matters will remain elevated or increase in the future due to, among other things, the increasing size and prominence of Valley in the financial services industry, our expansion of Internet and mobile banking tools and products based on customer needs, and the system and customer account conversions associated with the integration of merger targets.

In managing our cyber risks, when entering a new vendor relationship, we review and gage the cyber security risk of such third-party service providers. A successful attack on one of our third-party service providers could adversely affect our business and result in the disclosure or misuse of our confidential information. While we believe we are taking reasonable, risk-based precautions to manage the risk of cyber-attacks against third party service providers, there can be no assurance that our third-party service providers will not suffer a cyber-attack that exposes us to significant operational costs and damages.

While we believe we have risk based technology reasonably capable of discovering cyber-attacks, and personnel who are qualified to monitor our technology and systems to detect cyber-attacks, we can offer no assurance that we will be able to identify and prevent cyber-attacks when they occur. Significant damage may occur if Valley fails to identify, or there is a delay in identifying, a cyber-attack on our systems, or those of our third-party service providers.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could adversely affect our asset quality and profitability for those loans secured by real property and increase the number of defaults and the level of losses within our loan portfolio.

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2018, approximately 74 percent of our total loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and could deteriorate in value during the time the credit is extended. A downturn in the real estate market in our primary market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and shareholders' equity could be adversely affected. The declines in home or commercial real estate prices in the New Jersey, New York and Florida markets we primarily serve, along with the reduced availability of mortgage credit, also may result in increases in delinquencies and losses in our loan portfolios. Unexpected decreases in home or commercial real estate prices coupled with slow economic growth and elevated levels of unemployment could drive losses beyond those which are provided for in our allowance for loan losses. In that event, our earnings could be adversely affected.

The secondary market for residential mortgage loans, for the most part, is limited to conforming Fannie Mae and Freddie Mac loans. The effects of this limited mortgage market combined with another correction in residential real estate market prices and reduced levels of home sales, could result in price reductions in home values, adversely affecting the value of collateral securing mortgage loans held, mortgage loan originations and gains on sale of mortgage loans. Declines in real estate values and home sales volumes, and financial stress on borrowers as a result of job losses or other factors, could have further adverse effects on borrowers that result in higher delinquencies and greater charge-offs in future periods, which could adversely affect our financial condition or results of operations. For additional risks related to our sales of residential mortgages in the secondary market, see the "We may incur future losses in connection with repurchases and indemnification payments related to mortgages that we have sold into the secondary market" risk factor below.

Net gains on sales of residential mortgage loans are a significant component of our non-interest income and could fluctuate in future periods.

Net gains on sales of residential mortgage loans represented approximately 15 percent and 19 percent of our non-interest income for the years ended December 31, 2018 and 2017, respectively. Our ability or decision to sell a portion of our mortgage loan production in the secondary market is dependent upon, amongst other factors, the levels of market interest rates, consumer demand marketable loans, our sales and pricing strategies, the economy and our need to maintain the appropriate level of interest rate risk on our balance sheet. A change in one or more of these or other factors could significantly impact our ability to sell mortgage loans in the future and adversely impact the level of our non-interest income and financial results.

Higher charge-offs and weak credit conditions could require us to increase our allowance for credit losses through a provision charge to earnings.

We maintain an allowance for credit losses based on our assessment of credit losses inherent in our loan portfolio (including unfunded credit commitments). The process for determining the amount of the allowance is critical to our financial results and conditions. It requires difficult, subjective and complex judgments about the future, including the impact of national and regional economic conditions on the ability of our borrowers to repay their loans. If our judgment proves to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio. Deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an

increase in the allowance for loan losses. Additionally, bank regulators review the classification of our loans in their examination of us and we may be required in the future to change the classification on certain of our loans, which may require us to increase our provision for loan losses or loan charge-offs. If actual net charge-offs were to exceed Valley's allowance, its earnings would be negatively impacted by additional provisions for loan losses. Any increase in our allowance for loan losses or loan charge-offs as required by the OCC or otherwise could have an adverse effect on our results of operations or financial condition.

An increase in our non-performing assets may reduce our interest income and increase our net loan charge-offs, provision for loan losses, and operating expenses.

Our non-accrual loans increased from 0.22 percent of total loans at December 31, 2016 to 0.35 percent of total loans at December 31, 2018 largely due to a significant increase in non-accrual taxi medallion loans within our commercial and industrial loan portfolio since 2016. While most of the taxi medallion loans are currently performing to their contractual terms, continued negative trends in the market valuations of the underlying taxi medallion collateral caused by ride-sharing services could impact the future performance of such loans, the level of our loan charge-offs and the provision for loan loans. Additionally, a downturn in economic or real estate market conditions could result in increased charge-offs to our allowance for loan losses and lost interest income relating to non-performing loans. Non-performing assets (including non-accrual loans, other real estate owned, and other repossessed assets) totaled $98.6 million at December 31, 2018. These non-performing assets can adversely affect our net income mainly through decreased interest income and increased operating expenses incurred to maintain such assets or loss charges related to subsequent declines in the estimated fair value of foreclosed assets. Adverse changes in the value of our non-performing assets, or the underlying collateral, or in the borrowers' performance or financial conditions could adversely affect our business, results of operations and financial condition. There can be no assurance that we will not experience increases in non-performing loans in the future, or that our non-performing assets will not result in lower financial returns in the future.

We may be required to increase our allowance for credit losses as a result of changes to an accounting standard.

In 2016, the FASB released a new standard for determining the amount of the allowance for credit losses. The new standard will be effective for Valley for reporting periods beginning January 1, 2020. The new credit loss model will be a significant change from the standard in place today, as it requires the allowance for credit losses to be calculated based on current expected credit losses (commonly referred to as the "CECL model") rather than losses inherent in the portfolio as of a point in time. When adopted, the CECL model will likely increase our allowance for credit losses, which could materially affect our financial condition and future results of operations. The extent of the increase and its impact to our financial condition is under evaluation but will ultimately depend upon the nature and characteristics of Valley's portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date; therefore, the potential financial impact is currently unknown.

The loss of or decrease in lower-cost funding sources within our deposit base, including our inability to achieve deposit retention targets under our branch transformation strategy, may adversely impact our net interest income and net income.

Checking and savings, NOW, and money market deposit account balances and other forms of customer deposits can decrease when customers perceive alternative investments, such as the stock market or money market or fixed income mutual funds, as providing a better risk/return tradeoff. Additionally, our customers largely bank with us because of our local customer service and convenience. For a certain percentage customers, this convenience could be negatively impacted by recent branch consolidation activity undergone as part of our branch transformation strategy. If customers move money out of bank deposits and into other investments, Valley could lose a low cost source of funds, increasing its funding costs and reducing Valley's net interest income and net income.

We may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose us to additional liability and could have a material adverse effect on us.

We are required to comply with anti-money laundering, anti-terrorism and other laws and regulations in the United States. These laws and regulations require us, among other things, to adopt and enforce "know-your-customer" policies and procedures and to report suspicious and large transactions to applicable regulatory authorities. These laws and regulations have become increasingly complex and detailed, require improved systems and sophisticated monitoring and compliance personnel and have become the subject of enhanced government supervision.

While we have adopted policies and procedures aimed at detecting and preventing the use of our banking network for money laundering and related activities, those policies and procedures may not completely eliminate instances in which we may be used by customers to engage in money laundering and other illegal or improper activities. To the extent we fail to fully comply with applicable laws and regulations, the OCC, along with other banking agencies, have

the authority to impose fines and other penalties and sanctions on us. In addition, our business and reputation could suffer if customers use our banking network for money laundering or illegal or improper purposes.

Our controls and procedures may fail or be circumvented, which may result in a material adverse effect on our business, results of operations and financial condition.

Management periodically reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the

controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

As disclosed in “Item 9A - Controls and Procedures,” a material weakness was identified in our internal control over financial reporting as of December 31, 2017 resulting from Valley not assigning the appropriate levels of responsibility and authority to its Ethics and Compliance group to identify and evaluate the severity and financial reporting implications of allegations of non-compliance with laws and regulations, Company policies and procedures and other complaints. Additionally, Valley did not establish controls over required communications of such matters to senior management or others within the organization and to those charged with governance to enable them to conduct or monitor the investigation and resolution of such matters on a timely basis. Based on this material weakness, management concluded that our disclosure controls and procedures were not effective as of December 31, 2017. During the first quarter of 2018, Valley initiated remediation efforts. Management reviewed the design and operation of the controls and made enhancements to the proper identification and escalation of allegations of non-compliance with laws and regulations, Company policies and procedures and other complaints that require the attention of senior management and those charged with governance. During the third quarter of 2018, management completed the implementation of such enhancements and the new controls and procedures were placed in operation. Management evaluated these new controls and procedures and determined that the Company’s internal control over financial reporting was effective as of December 31, 2018.

We could incur future goodwill impairment.

If our estimates of the fair value of our goodwill change as a result of changes in our business or other factors, we may determine a goodwill impairment charge is necessary. Estimates of the fair value of goodwill are determined using several factors and assumptions, including, but not limited to, industry pricing multiples and estimated cash flows. Based upon Valley’s 2018 and 2017 goodwill impairment testing, the fair values of its four reporting units, wealth management, consumer lending, commercial lending, and investment management, were in excess of their carrying values. If the fair values of the four reporting units were less than their book value of the total common shareholders’ equity for an extended period of time, Valley would consider this and other factors, including the anticipated cash flows of each of the reporting units, to determine whether goodwill is impaired. No assurance can be given that we will not record an impairment loss on goodwill in the future and any such impairment loss could have a material adverse effect on our results of operations and financial condition. At December 31, 2018, our goodwill totaled $1.1 billion. See Note 8 to the consolidated financial statements for additional information.

We may reduce or eliminate the cash dividend on our common stock, which could adversely affect the market price of our common stock.

Holders of our common stock are only entitled to receive such cash dividends as our Board of Directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and may reduce or eliminate our common stock cash dividend in the future depending upon our results of operations, financial condition or other metrics. This could adversely affect the market price of our common stock. Additionally, as a bank holding company, our ability to declare and pay dividends is dependent on federal regulatory policies and regulations including the supervisory policies and guidelines of the OCC and the FRB regarding capital adequacy and dividends. Among other things, consultation of the FRB supervisory staff is required in advance of our declaration or payment of a dividend that exceeds our earnings for a four-quarter period in which the dividend is being paid.

If our subsidiaries are unable to make dividends and distributions to us, we may be unable to make dividend payments to our preferred and common shareholders or interest payments on our long-term borrowings and junior subordinated debentures issued to capital trusts.

We are a separate and distinct legal entity from our banking and non-banking subsidiaries and depend on dividends, distributions, and other payments from the Bank and its non-banking subsidiaries to fund cash dividend payments on our preferred and common stock and to fund most payments on our other obligations. Regulations relating to capital requirements affect the ability of the Bank to pay dividends and other distributions to us and to make loans to us.

Additionally, if our subsidiaries' earnings are not sufficient to make dividend payments to us while maintaining adequate capital levels, we may not be able to make dividend payments to our preferred and common shareholders or interest payments on our long-term borrowings and junior subordinated debentures issued to capital trusts. Furthermore, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors.

Extensive regulation and supervision have a negative impact on our ability to compete in a cost-effective manner and may subject us to material compliance costs and penalties.

Valley, primarily through its principal subsidiary and certain non-bank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds

and the banking system as a whole. Many laws and regulations affect Valley's lending practices, capital structure, investment practices, dividend policy and growth, among other things. They encourage Valley to ensure a satisfactory level of lending in defined areas and establish and maintain comprehensive programs relating to anti-money laundering and customer identification. Congress, state legislatures, and federal and state regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect Valley in substantial and unpredictable ways. Such changes could subject Valley to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on Valley's business, financial condition and results of operations. Valley's compliance with certain of these laws will be considered by banking regulators when reviewing bank merger and bank holding company acquisitions.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose community investment and nondiscriminatory lending requirements on financial institutions. The Consumer Financial Protection Bureau, the Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act or other fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions, restrictions on expansion and restrictions on entering new business lines. Private parties also may challenge an institution's performance under fair lending laws in litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

Future acquisitions may dilute shareholder value, especially tangible book value per share.

We regularly evaluate opportunities to acquire other financial institutions. As a result, merger and acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt, or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of our tangible book value per common share may occur in connection with any future acquisitions.

Future offerings of common stock, preferred stock, debt or other securities may adversely affect the market price of our stock and dilute the holdings of existing shareholders.

In the future, we may increase our capital resources or, if our or the Bank's actual or projected capital ratios fall below or near the current (Basel III) regulatory required minimums, we or the Bank could be forced to raise additional capital by making additional offerings of common stock, preferred stock or debt securities. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution. Upon liquidation, holders of our debt securities and shares of preferred stock, and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock. In December 2016, Valley issued 9.24 million shares of common stock and used the proceeds for growth in the Bank's loan portfolio, as well as other general corporate purposes. In August 2017, Valley issued 4.0 million shares of non-cumulative perpetual stock with a dividend at issuance of 5.50 percent and a liquidation preference of $25 per share. See Note 18 to the consolidated financial statements for more details on our common and preferred stock.

Changes in accounting policies or accounting standards could cause us to change the manner in which we report our financial results and condition in adverse ways and could subject us to additional costs and expenses.

Valley's accounting policies are fundamental to understanding its financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of Valley's assets or liabilities and financial results. Valley identified its accounting policies regarding the allowance for loan losses, purchased

credit-impaired loans, goodwill and other intangible assets, and income taxes to be critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain. Under each of these policies, it is possible that materially different amounts would be reported under different conditions, using different assumptions, or as new information becomes available.

From time to time, the FASB and the SEC change their guidance governing the form and content of Valley's external financial statements. In addition, accounting standard setters and those who interpret U.S. generally accepted accounting principles (U.S. GAAP), such as the FASB, SEC, banking regulators and Valley's independent registered public accounting firm, may change or even reverse their previous interpretations or positions on how these standards should be applied. Such changes are expected to continue and may accelerate dependent upon the FASB and International Accounting Standards Board commitments to achieving convergence between U.S. GAAP and International Financial Reporting Standards. Changes in U.S. GAAP and changes in current

interpretations are beyond Valley’s control, can be hard to predict and could materially impact how Valley reports its financial results and condition. In certain cases, Valley could be required to apply new or revised guidance retroactively or apply existing guidance differently (also retroactively) which may result in Valley restating prior period financial statements for material amounts. Additionally, significant changes to U.S. GAAP may require costly technology changes, additional training and personnel, and other expenses that will negatively impact our results of operations.

We may be unable to adequately manage our liquidity risk, which could affect our ability to meet our obligations as they become due, capitalize on growth opportunities, or pay regular dividends on our common stock.

Liquidity risk is the potential that Valley will be unable to meet its obligations as they come due, capitalize on growth opportunities as they arise, or pay regular dividends on our common stock because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances.

Liquidity is required to fund various obligations, including credit commitments to borrowers, mortgage and other loan originations, withdrawals by depositors, repayment of borrowings, dividends to shareholders, operating expenses and capital expenditures. Liquidity is derived primarily from retail deposit growth and retention; principal and interest payments on loans; principal and interest payments on investment securities; sale, maturity and prepayment of investment securities; net cash provided from operations; and access to other funding sources, such as the FHLB and certain brokered deposit channels established by the Bank.

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could have a detrimental impact to our access to liquidity sources include a decrease in the level of our business activity due to persistent weakness, or downturn, in the economy or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not necessarily specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

Our market share and income may be adversely affected by our inability to successfully compete against larger and more diverse financial service providers and digital fintech start-up firms.

Valley faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources than Valley to deal with the potential negative changes in the financial markets and regulatory landscape. Valley competes with other providers of financial services such as commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, title agencies, asset managers, insurance companies, and a large list of other local, regional and national institutions which offer financial services. Additionally, the financial services industry is facing a wave of digital disruption from fintech companies that provide innovative web-based solutions to traditional retail banking services and products. Fintech companies tend to have stronger operating efficiencies and fewer regulatory burdens than their traditional bank counterparts, including Valley.

Mergers and acquisitions of financial institutions within New Jersey, the New York Metropolitan area and Florida may also occur given the current difficult banking environment and add more competitive pressure to a substantial portion of our marketplace. Our profitability depends upon our continued ability to successfully compete in our market area. If Valley is unable to compete effectively, it may lose market share and its income generated from loans, deposits, and other financial products may decline.

Our ability to make opportunistic acquisitions is subject to significant risks, including the risk that regulators will not provide the requisite approvals.

We may make opportunistic whole or partial acquisitions of other banks, branches, financial institutions, or related businesses from time to time that we expect may further our business strategy. Any possible acquisition will be subject to regulatory approval, and there can be no assurance that we will be able to obtain such approval in a timely manner or at all. Even if we obtain regulatory approval, these acquisitions could involve numerous risks, including lower than expected performance or higher than expected costs, difficulties related to integration, diversion of management's attention from other business activities, changes in relationships with customers, and the potential loss of key employees. In addition, we may not be successful in identifying acquisition candidates, integrating acquired

institutions, or preventing deposit erosion or loan quality deterioration at acquired institutions. Competition for acquisitions can be highly competitive, and we may not be able to acquire other institutions on attractive terms. There can be no assurance that we will be successful in completing or will even pursue future acquisitions, or if such transactions are completed, that we will be successful in integrating acquired businesses into operations. Ability to grow may be limited if we choose not to pursue or are unable to successfully make acquisitions in the future.

Failure to successfully implement our growth strategies could cause us to incur substantial costs and expenses which may not be recouped and adversely affect our future profitability.

From time to time, Valley may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. Valley may invest significant time and resources to develop and market new lines of business and/or products and services. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved, and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting customer preferences, may also impact the successful implementation of a new line of business or a new product or service. Additionally, any new line of business and/or new product or service could have a significant impact on the effectiveness of Valley's system of internal controls. Failure to successfully manage these risks could have a material adverse effect on Valley's business, results of operations and financial condition.

We may not keep pace with technological change within the financial services industry, negatively affecting our ability to remain competitive and profitable.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Valley's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in Valley's operations. Many of Valley's competitors have substantially greater resources to invest in technological improvements. Valley may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on Valley's business and, in turn, Valley's financial condition and results of operations.

We rely on our systems, employees and certain service providers, and if our system fails, our operations could be disrupted.

We face the risk that the design of our controls and procedures, including those to mitigate the risk of fraud by employees or outsiders, may prove to be inadequate or are circumvented, thereby causing delays in detection of errors or inaccuracies in data and information. We regularly review and update our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

We may also be subject to disruptions of our systems arising from events that are wholly or partially beyond our control (including, for example, electrical or telecommunications outages), which may give rise to losses in service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as us) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. We maintain a system of comprehensive policies and a control framework designed to monitor vendor risks including, among other things, (i) changes in the vendor's organizational structure or internal controls, (ii) changes in the vendor's financial condition, (iii) changes in the vendor's support for existing products and services and (iv) changes in the vendor's strategic focus. While we believe these policies and procedures help to mitigate risk, the failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements could be disruptive to our operations, which could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

We may not be able to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities in which we engage can be intense and we may not be able to hire people or to retain them. The unexpected loss of services of one or more of our key personnel, including, but not limited to, the executive officers disclosed in Item 1 of this Annual Report, could have a material adverse impact on our business because we would lose the employees’ skills, knowledge of the market, and years of industry experience and may have difficulty promptly finding qualified replacement personnel.

Severe weather, acts of terrorism and other external events could significantly impact our ability to conduct our business.

A significant portion of our primary markets is located near coastal waters which could generate naturally occurring severe weather, or in response to climate change, that could have a significant impact on our ability to conduct business. Many areas in New Jersey, New York, Florida and Alabama in which our branches operate are subject to severe flooding from time to time and significant weather related disruptions may become common events in the future. Heavy storms and hurricanes can also cause

severe property damage and result in business closures, negatively impacting both the financial health of retail and commercial customers and our ability to operate our business. The risk of significant disruption and potential losses from future storm activity exists in all of our primary markets.

Additionally, New York City and New Jersey remain central targets for potential acts of terrorism against the United States. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. Although we have established and regularly test disaster recovery policies and procedures, the occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

We are subject to environmental liability risk associated with lending activities which could have a material adverse effect on our financial condition and results of operations.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review prior to originating certain commercial real estate loans, as well as before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

We may incur future losses in connection with repurchases and indemnification payments related to mortgages that we have sold into the secondary market.

We engage in the origination of residential mortgages for sale into the secondary market, while typically retaining the loan servicing. In connection with such sales, we make representations and warranties, which, if breached, may require us to repurchase such loans, substitute other loans or indemnify the purchasers of such loans for actual losses incurred in respect of such loans. The aggregate principal balances of residential mortgage loans serviced by the Bank for others approximated $3.2 billion and $2.8 billion at December 31, 2018 and 2017, respectively. Over the past several years, we have experienced a nominal amount of repurchase requests, and only a few of which have actually resulted in repurchases by Valley (only five and two loan repurchases in 2018 and 2017, respectively). None of the loan repurchases resulted in material loss. As of December 31, 2018, no reserves pertaining to loans sold were established on our financial statements. While we currently believe our repurchase risk remains low based upon our careful loan underwriting and documentation standards, it is possible that requests to repurchase loans could occur in the future and such requests may have a negative financial impact on us.

Possible replacement of the LIBOR benchmark interest rate may have an impact on Valley's business, financial condition or results of operations.

On July 27, 2017, the Financial Conduct Authority (FCA), a regulator of financial services firms in the United Kingdom, announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021. The FCA and the submitting LIBOR banks have indicated they will support the LIBOR indices through 2021 to allow for an orderly transition to an alternative reference rate. In the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee of the Federal Reserve Board. Other financial services regulators and industry groups are evaluating the possible phase-out of LIBOR and the development of alternate reference rate indices or reference rates. Many of Valley's assets and liabilities are indexed to LIBOR. We are evaluating the potential impact of the possible replacement of the LIBOR benchmark interest rate, but are not able to predict whether LIBOR will cease to be available after 2021, whether the alternative rates the Federal Reserve Board proposes to publish will become market benchmarks in place of LIBOR, or what the impact of such a transition will have on Valley's business, financial condition, or results of operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We conduct our business at 220 retail banking centers locations in northern and central New Jersey, the New York City boroughs of Manhattan, Brooklyn and Queens, Long Island, Florida and Alabama. We own 120 of our banking center facilities and several non-branch operating facilities. The other properties are leased for various terms.

The following table summarizes our retail banking centers in each state:

	Number of banking centers	% of Total
New Jersey		
Northern	99	45.0
Central	25	11.4
Total New Jersey	124	56.4
New York		
Manhattan	12	5.5
Long Island	12	5.5
Brooklyn	9	4.1
Queens	5	2.3
Total New York	38	17.3
Florida	43	19.5
Alabama	15	6.8
Total	220	100.0 %

Our principal business office is located at 1455 Valley Road, Wayne, New Jersey. Including our principal business office, we own five office buildings in Wayne, New Jersey and one building in Chestnut Ridge, New York, which are used for various operations of Valley National Bank and its subsidiaries. Our New York City corporate headquarters are located at One Penn Plaza in Manhattan and are primarily used as a central hub for New York based lending activities of senior executives and other commercial lenders. We also lease six non-bank office facilities in Florida, used for operational, executive and lending purposes.

On January 1, 2018, the acquisition of USAB added 14 banking centers in Florida, mostly in the Tampa Bay area, and 15 banking centers in the Birmingham, Montgomery and Tallapoosa areas of Alabama.

During the second half of 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. During 2018, we identified several branches within New Jersey and New York that did not meet certain internal performance measures. Of those identified, we closed 7 branches in 2018 and closed or will close 13 additional branches during the first quarter of 2019.

The total net book value of our premises and equipment (including land, buildings, leasehold improvements and furniture and equipment) was $341.6 million at December 31, 2018. We believe that all of our properties and equipment are well maintained, in good operating condition and adequate for all of our present and anticipated needs. During February 2019, we entered into an agreement for the sale-leaseback of 29 of our currently owned properties. The transaction is expected to close in the first or second quarter of 2019, and is subject to change or termination due to buyer due diligence on the identified properties. See the "Recent Event" section of the MD&A and Note 23 to the consolidated financial statements for more information.

Item 3. Legal Proceedings

In the normal course of business, we may be a party to various outstanding legal proceedings and claims. In the opinion of management, our financial condition, results of operations, and liquidity should not be materially affected by the outcome of such legal proceedings and claims. See Note 15 to the consolidated financial statements for further details.

PART II

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

Our common stock is traded on the NASDAQ under the ticker symbol “VLY”. There were 7,330 shareholders of record as of December 31, 2018.

Performance Graph

The following graph compares the cumulative total return on a hypothetical $100 investment made on December 31, 2013 in: (a) Valley’s common stock; (b) the KBW Regional Banking Index (KRX) and (c) the Standard and Poor’s (S&P) 500 Stock Index. The graph is calculated assuming that all dividends are reinvested during the relevant periods. The graph shows how a $100 investment would increase or decrease in value over time based on dividends (stock or cash) and increases or decreases in the market price of the stock.

	12/13	12/14	12/15	12/16	12/17	12/18
Valley	$100.00	$100.30	$106.44	$131.50	$131.61	$108.20
KBW Regional Banking Index (KRX)	100.00	102.43	108.56	151.04	153.77	126.88
S&P 500	100.00	113.68	115.24	129.02	157.17	150.27

Issuer Repurchase of Equity Securities

The following table presents the purchases of equity securities by the issuer and affiliated purchasers during the three months ended December 31, 2018:

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans(2)	Maximum Number of Shares that May Yet Be Purchased Under the Plans (2)
October 1, 2018 to October 31, 2018	1,821	$ 10.56	—	4,112,465
November 1, 2018 to November 30, 2018	41,478	10.02	—	4,112,465
December 1, 2018 to December 31, 2018	62,839	9.32	—	4,112,465
Total	106,138		—	

(1) Represents repurchases made in connection with the vesting of employee stock awards.

(2) On January 17, 2007, Valley publicly announced its intention to repurchase up to 4.7 million outstanding common shares in the open market or in privately negotiated transactions. The repurchase plan has no stated expiration date. No repurchase plans or programs expired or terminated during the three months ended December 31, 2018.

Equity Compensation Plan Information
The information set forth in Item 12 of Part III of this Annual Report under the heading “Equity Compensation Plan Information” is incorporated by reference herein.

Item 6. Selected Financial Data

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

	As of or for the Years Ended December 31,				
	2018	2017	2016	2015	2014
	($ in thousands, except for share data)				
Summary of Operations:					
Interest income—tax equivalent basis [1]	$1,164,967	$842,457	$770,270	$705,879	$642,334
Interest expense	302,045	174,107	148,774	156,754	161,846
Net interest income—tax equivalent basis [1]	862,922	668,350	621,496	549,125	480,488
Less: tax equivalent adjustment	5,719	8,303	8,382	7,866	7,933
Net interest income	857,203	660,047	613,114	541,259	472,555
Provision for credit losses	32,501	9,942	11,869	8,101	1,884
Net interest income after provisions for credit losses	824,702	650,105	601,245	533,158	470,671
Non-interest income:					
(Losses) gains on securities transactions, net	(2,342)	(20)	777	2,487	745
Gains on sales of loans, net	20,515	20,814	22,030	4,245	1,731
(Losses) gains on sales of assets, net	(2,402)	(95)	1,358	2,776	18,087
Other non-interest income	118,281	91,007	84,095	83,304	59,255
Total non-interest income	134,052	111,706	108,260	92,812	79,818
Non-interest expense:					
Loss on extinguishment of debt	—	—	315	51,129	10,132
Amortization of tax credit investments	24,200	41,747	34,744	27,312	24,196
Other non-interest expense	604,861	467,326	441,066	420,634	368,927
Total non-interest expense	629,061	509,073	476,125	499,075	403,255
Income before income taxes	329,693	252,738	233,380	126,895	147,234
Income tax expense	68,265	90,831	65,234	23,938	31,062
Net income	261,428	161,907	168,146	102,957	116,172
Dividends on preferred stock	12,688	9,449	7,188	3,813	—
Net income available to common shareholders	$248,740	$152,458	$160,958	$99,144	$116,172
Per Common Share:					
Earnings per share:					
Basic	$0.75	$0.58	$0.63	$0.42	$0.56
Diluted	0.75	0.58	0.63	0.42	0.56
Dividends declared	0.44	0.44	0.44	0.44	0.44
Book value	9.48	8.79	8.59	8.26	8.03
Tangible book value [2]	5.97	6.01	5.80	5.36	$5.38
Weighted average shares outstanding:					
Basic	331,258,964	264,038,123	254,841,571	234,405,909	205,716,293
Diluted	332,693,718	264,889,007	255,268,336	234,437,000	205,716,293
Ratios:					
Return on average assets	0.86 %	0.69 %	0.76 %	0.53 %	0.69 %
Return on average shareholders' equity	7.91	6.55	7.46	5.26	7.18
	12.21	9.32	11.07	7.66	10.26

Return on average tangible shareholders' equity[3]					
Average shareholders' equity to average assets	10.93	10.53	10.08	10.08	9.62
Tangible common equity to tangible assets [4]	6.45	6.83	6.91	6.52	6.87
Efficiency ratio [5]	63.46	65.96	66.00	78.71	73.00
Dividend payout	58.67	75.86	69.80	105.00	78.40
Tier 1 leverage capital [6]	7.57	8.03	7.74	7.90	7.46
Common equity Tier 1 capital [6]	8.43	9.22	9.27	9.01	N/A
Tier 1 risk-based capital [6]	9.30	10.41	9.90	9.72	9.73
Total risk-based capital [6]	11.34	12.61	12.15	12.02	11.42
Financial Condition:					
Assets	$31,863,088	$24,002,306	$22,864,439	$21,612,616	$18,792,491
Net loans	24,883,610	18,210,724	17,121,684	15,936,929	13,371,560
Deposits	24,452,974	18,153,462	17,730,708	16,253,551	14,034,116
Shareholders' equity	3,350,454	2,533,165	2,377,156	2,207,091	1,863,017

See Notes to the Selected Financial Data that follow.

Notes to Selected Financial Data

(1) In this report a number of amounts related to net interest income and net interest margin are presented on a tax equivalent basis using a federal tax rate of 21 percent for 2018 and 35 percent for 2017, 2016, 2015 and 2014. Valley believes that this presentation provides comparability of net interest income and net interest margin arising from both taxable and tax-exempt sources and is consistent with industry practice and SEC rules.

(2) This Annual Report on Form 10-K contains supplemental financial information which has been determined by methods other than 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.

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

	At December 31,				
	2018	2017	2016	2015	2014
	($ in thousands, except for share data)				
Common shares outstanding	331,431,217	264,468,851	263,638,830	253,787,561	232,110,975
Shareholders' equity	$3,350,454	$2,533,165	$2,377,156	$2,207,091	$1,863,017
Less: Preferred stock	209,691	209,691	111,590	111,590	—
Less: Goodwill and other intangible assets	1,161,655	733,144	736,121	735,221	614,667
Tangible common shareholders' equity	$1,979,108	$1,590,330	$1,529,445	$1,360,280	$1,248,350
Tangible book value per common share	$5.97	$6.01	$5.80	$5.36	$5.38

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

	Years Ended December 31,				
	2018	2017	2016	2015	2014
	($ in thousands)				
Net income	$261,428	$161,907	$168,146	$102,957	$116,172
Average shareholders' equity	$3,304,531	$2,471,751	$2,253,570	$1,958,757	$1,618,965
Less: Average goodwill and other intangible assets	1,163,397	734,200	734,520	614,084	486,769
Average tangible shareholders' equity	$2,141,134	$1,737,551	$1,519,050	$1,344,673	$1,132,196
Return on average tangible shareholders' equity	12.21 %	9.32 %	11.07 %	7.66 %	10.26 %

(4) Tangible common shareholders' equity to tangible assets, which is a non-GAAP measure, is computed by dividing tangible shareholders' equity (shareholders' equity less goodwill and other intangible assets) by tangible assets, as follows:

	At December 31,				
	2018	2017	2016	2015	2014
			($ in thousands)		
Tangible common shareholders' equity	$1,979,108	$1,590,330	$1,529,445	$1,360,280	$1,248,350
Total assets	$31,863,088	$24,002,306	$22,864,439	$21,612,616	$18,792,491
Less: Goodwill and other intangible assets	1,161,655	733,144	736,121	735,221	614,667

Tangible assets	$30,701,433	$23,269,162	$22,128,318	$20,877,395	$18,177,824
Tangible common shareholders' equity to tangible assets	6.45 %	6.83 %	6.91 %	6.52 %	6.87 %

(5) The efficiency ratio measures total non-interest expense as a percentage of net interest income plus total non-interest income.

(6) Capital positions and ratios as of December 31, 2018, 2017, 2016 and 2015 were calculated under Basel III rules which became effective January 1, 2015.

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

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

Cautionary Statement Concerning Forward-Looking Statements

This Annual Report on Form 10-K, both in the MD&A and elsewhere, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management's confidence and strategies and management's expectations about new and existing programs and products, acquisitions, relationships, opportunities, taxation, technology, market conditions and economic expectations. These statements may be identified by such forward-looking terminology as "should," "expect," "believe," "view," "opportunity," "allow," "continues," "reflects," "typically," "usually," "anticipate," or similar statements or 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 listed under the "Risk Factors" section in Part1, Item 1A of this Annual Report on Form 10-K 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 key employees;
- the inability to grow customer deposits to keep pace with loan growth;
- an increase in our allowance for credit losses due to higher than expected loan losses within one or more segments of our loan portfolio;
- 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;
- the effect of the partial U.S. Government shutdown on levels of economic activity in the markets in which we operate and on levels of end market demand in the economy in general;
- 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;
- 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;
- 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;

- 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

Our accounting and reporting policies conform, in all material respects, to U.S. GAAP. In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of financial condition and results of operations for the periods indicated. Actual results could differ materially from those estimates.

Valley's accounting policies are fundamental to understanding management's discussion and analysis of its financial condition and results of operations. Our significant accounting policies are presented in Note 1 to the consolidated financial statements. We identified our policies for the allowance for loan losses, purchased credit-impaired loans, 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.

The judgments used by management in applying the critical accounting policies discussed below may be affected by significant changes in the economic environment, which may result in changes to future financial results. Specifically, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in material changes in the allowance for loan losses in future periods, and the inability to collect on outstanding loans could result in increased loan losses. In addition, the valuation of certain collateral dependent impaired loans (including New York City taxi cab medallion loan valuations based on the estimated value of the underlying medallions) could be adversely impacted by illiquidity or dislocation in certain markets, resulting in depressed market valuations of the underlying collateral, thus leading to additional provisions for loan losses.

Allowance for Loan Losses. The allowance for credit losses includes the allowance for loan losses and the reserve for unfunded commercial letters of credit and represents management's estimate of credit losses inherent in the loan portfolio at the balance sheet date. The determination of the appropriate level of the allowance is based on periodic evaluations of the loan portfolios. There are numerous components that enter into the evaluation of the allowance for loan losses, which includes a quantitative analysis, as well as a qualitative review of its results. The qualitative review is subjective and requires a significant amount of judgment. Various banking regulators, as an integral part of their examination process, also review the allowance for loan losses. Such regulators 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. Additionally, our allowance for credit losses methodology includes loan portfolio evaluations at the portfolio segment level, which consists of the commercial and industrial, commercial real estate, construction, residential mortgage, home equity, automobile and other consumer loan portfolios.

The allowance for loan losses consists of the following:

- specific reserves for individually impaired loans;
- reserves for adversely classified loans, and higher risk rated loans that are not impaired loans;
- reserves for other loans that are not impaired; and, if applicable,
- reserves for impairment of purchased credit-impaired (PCI) loans subsequent to their acquisition date.

Our reserves on classified and non-classified loans also include reserves based on general economic conditions and other qualitative risk factors both internal and external to Valley, including changes in loan portfolio volume, the composition and concentrations of credit, new market initiatives, and the impact of competition on loan structuring and pricing.

Reserves for PCI loans within the Allowance for Loan Losses

We evaluated the acquired PCI loans and elected to account for them in accordance with Accounting Standards Codification (ASC) Subtopic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," since all of these loans were acquired at a discount attributable, at least in part, to credit quality. The PCI loans are initially recorded at their estimated fair values segregated into pools of loans sharing common risk characteristics. The fair values include estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows.

The PCI loans are subject to our internal credit review. If and when unexpected credit deterioration occurs at the loan pool level subsequent to the acquisition date, a provision for credit losses for the PCI loans will be charged to earnings for the full amount of the decline in expected cash flows for the pool. Under the accounting guidance of ASC Subtopic 310-30, for acquired credit impaired loans, the allowance for loan losses on (or reserves for) PCI loans is measured at each financial reporting date based on future expected cash flows. This assessment and measurement are performed at the pool level and not at the individual loan level. Accordingly, decreases in expected cash flows resulting from further credit deterioration on a pool of acquired PCI

loan pools as of such measurement date compared to those originally estimated are recognized by recording a provision and allowance for loan losses on PCI loans. Subsequent increases in the expected cash flows of the loans in that pool would first reduce any allowance for loan losses on PCI loans; and any excess will be accreted for prospectively as a yield adjustment. Valley had no allowance reserves related to PCI loans at December 31, 2018 and 2017.

Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this MD&A.

Changes in Our Allowance for Loan Losses

Valley considers it difficult to quantify the impact of changes in forecast on its allowance for loan losses. However, management believes the following discussion may enable investors to better understand the variables that drive the allowance for loan losses, which amounted to $151.9 million at December 31, 2018.

For impaired credits, if the present value of expected cash flows were 10 percent higher or lower, the allowance would have decreased $3.3 million or increased $4.8 million, respectively, at December 31, 2018. If the fair value of the collateral (for collateral dependent loans) was 10 percent higher or lower, the allowance would have decreased $4.3 million or increased $4.7 million, respectively, at December 31, 2018.

The internal risk rating assigned to each non-classified credit is an important variable in determining the allowance. If each non-classified credit were rated one grade worse (special mention rate), the allowance would have increased by approximately $24.9 million as of December 31, 2018. Additionally, if the loss factors used to calculate the allowance for non-classified loans were 10 percent higher or lower, the allowance would have increased or decreased by approximately $11.0 million, respectively, at December 31, 2018. Moreover, if the expected loss rate applied to classified loans were to increase or decrease by 10 percent, the allowance would have been $930 thousand higher or lower, respectively, at December 31, 2018.

Purchased Credit-Impaired Loans. Purchased credit-impaired (PCI) loans are loans acquired at a discount (that is due, in part, to credit quality). Valley's PCI loan portfolio totaling $4.2 billion at December 31, 2018 primarily consists of loans acquired in business combinations subsequent to 2011. The PCI loans 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. We estimate 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 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.” 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. 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 our estimate of the expected cash flows of the loan pools.

On a quarterly basis, the Bank periodically evaluates the remaining contractual required payments due and estimates of cash flows expected to be collected for the underlying loans of each PCI loan pool. These evaluations require the continued use of key assumptions and estimates 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.

PCI loans that may have been classified as non-performing loans by an acquired bank are no longer classified as non-performing because these loans are accounted for on a pooled basis. Management’s judgment is required in

classifying loans in pools as performing loans, and is dependent on having a reasonable expectation about the timing and amount of the pool cash flows to be collected, even if certain loans within the pool are contractually past due.
See Notes 1 and 5 to the consolidated financial statements, and "Loan Portfolio" section included in this MD&A for further PCI loan details, including net increases and decreases in expected cash flows subsequent to the applicable PCI loan acquisition dates impacting the accretable yield in 2018 and 2017.
Goodwill and Other Intangible Assets. We record all assets, liabilities, and non-controlling interests in the acquiree in purchase acquisitions, including goodwill and other intangible assets, at fair value as of the acquisition date, and expense all acquisition related costs as incurred as required by ASC Topic 805, “Business Combinations.” Goodwill totaling $1.1 billion at December 31, 2018 is not amortized but is subject to annual tests for impairment or more often, if events or circumstances indicate

it may be impaired. Other intangible assets totaling $77.0 million at December 31, 2018 are amortized over their estimated useful lives and are subject to impairment tests if events or circumstances indicate a possible inability to realize the carrying amount. Such evaluation of other intangible assets is based on undiscounted cash flow projections. The initial recording of goodwill and other intangible assets requires subjective judgments concerning estimates of the fair value of the acquired assets and assumed liabilities.

Currently, the goodwill impairment analysis is generally a two-step test. During 2018, Valley elected to perform step one of the two-step goodwill impairment test for all of its reporting units but may choose to perform an optional qualitative assessment allowable for one or more units in future periods to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Step one compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired; however, if the carrying amount of the reporting unit exceeds its fair value, an additional step must be performed. That additional step compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, i.e., by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step above, over the aggregate estimated fair values of the individual assets, liabilities, and identifiable intangibles, as if the reporting unit was being acquired in a business combination at the impairment test date. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The loss establishes a new basis in the goodwill and subsequent reversal of goodwill impairment losses is not permitted.

Fair value may be determined using market prices, comparison to similar assets, market multiples, discounted cash flow analysis and other determinants. Estimated cash flows may extend far into the future and, by their nature, are difficult to determine over an extended timeframe. Factors that may materially affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures and technology, and changes in discount rates, terminal values, and specific industry or market sector conditions. To assist in assessing the impact of potential goodwill or other intangible assets impairment charges at December 31, 2018, the impact of a five percent impairment charge on these intangible assets would result in a reduction in pre-tax income of approximately $58.1 million. See Note 8 to the consolidated financial statements for additional information regarding goodwill and other intangible assets.

Income Taxes. We are subject to the income tax laws of the U.S., its states and municipalities. The income tax laws of the jurisdictions in which we operate are complex and subject to different interpretations by the taxpayer and the relevant government taxing authorities. In establishing a provision for income tax expense, we must make judgments and interpretations about the application of these inherently complex tax laws to our business activities, as well as the timing of when certain items may affect taxable income.

Our interpretations may be subject to review during examination by taxing authorities and disputes may arise over the respective tax positions. We attempt to resolve these disputes during the tax examination and audit process and ultimately through the court systems when applicable. We monitor relevant tax authorities and revise our estimate of accrued income taxes due to changes in income tax laws and their interpretation by the courts and regulatory authorities on a quarterly basis. Revisions of our estimate of accrued income taxes also may result from our own income tax planning and from the resolution of income tax controversies. Such revisions in our estimates may be material to our operating results for any given quarter.

The provision for income taxes is composed of current and deferred taxes. Deferred taxes arise from differences between assets and liabilities measured for financial reporting versus income tax return purposes. Deferred tax assets are recognized if, in management's judgment, their realizability is determined to be more likely than not. We perform regular reviews to ascertain the realizability of our deferred tax assets. These reviews include management's estimates and assumptions regarding future taxable income, which also incorporate various tax planning strategies. In connection with these reviews, if we determine that a portion of the deferred tax asset is not realizable, a valuation allowance is established. As of December 31, 2018 and 2017, management determined it is more likely than not that Valley will realize its net deferred tax assets, except for a valuation allowance of $733 thousand established at

December 31, 2018. However, in the fourth quarter of 2017 we re-measured and reduced our deferred tax assets by $15.4 million for the estimated impact of the Tax Act, which decreased our federal income tax rate from 35 percent to 21 percent effective January 1, 2018. During 2018, we recognized a $2.3 million tax benefit related to the adjustment of the Tax Act provisional amounts in our final 2017 tax returns completed in the fourth quarter of 2018. During 2017, we also reduced our state deferred tax assets by $4.5 million to reflect the effect of our organic and acquisition-based expansion primarily in Florida on our existing state deferred tax assets. During 2018 and 2017, the charge to our income tax expense related to the reduction of such deferred tax assets was immaterial. The $2.3 million and $19.9 million in total adjustments were reflected as credits and charges, respectively, to our income tax expense for 2018 and 2017, respectively.

Historically, we maintained a reserve related to certain tax positions that management believes contain an element of uncertainty. An uncertain tax position is measured based on the largest amount of benefit that management believes is more likely than not to be realized. During the fourth quarter of 2018, income tax expense included a net tax benefit of $3.3 million related

to the elimination of our remaining reserve for unrecognized tax benefits caused by the expiration of the statute of limitations for certain tax positions.
See Notes 1 and 13 to the consolidated financial statements and the “Income Taxes” section in this MD&A for an additional discussion on the accounting for income taxes.
New Authoritative Accounting Guidance. See Note 1 of the consolidated financial statements for a description of recent accounting pronouncements including the dates of adoption and the anticipated effect on our results of operations and financial condition.
Executive Summary
Company Overview. At December 31, 2018, Valley had consolidated total assets of $31.9 billion, total net loans of $24.9 billion, total deposits of $24.5 billion and total shareholders’ equity of $3.4 billion. Our commercial bank operations after the acquisition of USAmeriBancorp, Inc (see below) include branch office locations in northern and central New Jersey, the New York City boroughs of Manhattan, Brooklyn and Queens, Long Island, Florida and Alabama. Of our current 220 branch network, 56 percent, 17 percent, 20 percent and 7 percent of the branches are located in New Jersey, New York, Florida and Alabama, respectively. Despite our current and past branch consolidation activity, we have grown both in asset size and locations significantly over the past several years primarily through bank acquisitions.

USAmeriBancorp, Inc. On January 1, 2018, Valley completed its acquisition of USAmeriBancorp, Inc. (USAB) headquartered in Clearwater, Florida. USAB, largely through its wholly-owned subsidiary, USAmeriBank, 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 as of December 31, 2018. The acquisition represents a significant addition to Valley’s Florida franchise, and meaningfully enhanced its presence in the Tampa Bay market, which is Florida’s second largest metropolitan area by population. 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 own. The total consideration for the acquisition was approximately $737.2 million, and the transaction resulted in $394.0 million of goodwill and $45.9 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 the second half of 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 2018, we identified several branches within New Jersey and New York that did not meet certain internal performance measures. Of those identified, we closed 7 branches in 2018 and closed or will close 13 additional branches during the first quarter of 2019. The estimated annual operating expense savings from the 20 branch closures is expected to be approximately $9 million. We recognized severance costs and branch asset impairment charges of $2.7 million and $1.8 million, respectively, related to the branch closures and branch staff reductions in 2018.
For the remaining branch network, we continue to monitor the operating performance of each branch and implement tailored action plans focused on improving profitability and deposit levels for those branches that underperform.

While we expect the repositioning, renovations and consolidation to be mostly complete by the end of 2020, it is important to recognize the evolving retail banking landscape combined with our 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 fully phased-in by June 30, 2019.

As of December 31, 2018, Valley had completed LIFT enhancements that will result in cost reductions greater than 83 percent of the $22 million annual goal. 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. During the fourth quarter of 2017, we incurred a $18.5 million charge due to the impact of the Tax Cuts and Jobs Act (Tax Act) signed into law by the President on December 22, 2017. Of the $18.5 million charge, $15.4 million relates to the estimated tax expense from the re-measurement of net deferred tax assets and the remaining $3.1 million is after-tax losses from adjustments to low income housing and tax-advantaged renewable energy investments included in non-interest expense. Effective January 1, 2018, our Federal income tax rate decreased from 35 percent to 21 percent under the Tax Act. See the "Non-Interest Expense" and "Income Taxes" sections below for more details.

Recent Event. During February 2019, we announced that the Bank entered into an agreement for the sale-leaseback of 29 of its currently owned properties. The properties, consisting of 1 corporate location and 28 branches, are expected to be sold for an aggregate cash purchase price of approximately $107 million. Valley expects to realize a pre-tax gain of approximately $81 million net of transaction related expenses. The transaction is expected to close in the first or second quarter of 2019 and is subject to change or termination due to current buyer due diligence on the identified properties.

In addition, Valley announced its plan to eliminate approximately 60 corporate positions as a part of continuous efforts to improve operating efficiencies. The annualized salary and benefit expense associated with these eliminations is expected to be in excess of $5 million, excluding severance charges. Valley expects to implement the majority of cost saves by the end of the second quarter of 2019.

Other Matters. We have previously invested in mobile solar generators sold and managed by DC Solar, which were included in other assets on the balance sheet and separately disclosed in Note 14 of the consolidated financial statements. For reasons that were not known to us, DC Solar had its assets frozen in December 2018. DC Solar filed for Chapter 11 bankruptcy protection in February 2019. In February 2019, an affidavit from an FBI special agent stated that DC Solar was operating a fraudulent "Ponzi-like scheme" and that the majority of mobile solar generators sold to investors and managed by DC Solar and the majority of the related lease revenues claimed to have been received by DC Solar may not have existed. Certain investors in DC Solar, including us, received tax credits for making these renewable resource investments. We claimed tax credit benefits of approximately $22.8 million in our consolidated financial statements between 2013 through 2015. If the allegations set forth in the declaration filed by the FBI are proven to be accurate, up to the entire amount of the tax credits claimed by us could potentially be disallowed. Based on the information known as of the date of this Annual Report on the Form 10-K, we believe that this has not met the more-likely-than-not criterion to record an uncertain tax position liability. As a result of the information in the FBI declaration, we are evaluating whether or not an unrecognized tax liability exists under ASC 740 for an uncertain tax position in 2019 for at least part, if not potentially all, of the tax credit benefits that we claimed. If we are required to recognize an uncertain tax position liability in our 2019 consolidated financial statements, the uncertain tax position liability and charge-offs may have an adverse impact on our income tax liabilities, results of operations and financial condition. For additional information on the risks of our investments in tax-advantaged investments, see Item 1A. Risk Factors.

Annual Results. Net income totaled $261.4 million, or $0.75 per diluted common share, for the year ended December 31, 2018 compared to $161.9 million in 2017, or $0.58 per diluted common share. The increase in net income was largely due to: (i) a $197.2 million, or 29.9 percent, increase in our net interest income driven by a $5.5 billion increase in average loan balances, partially offset by interest expense related to higher short-term interest rates and a $4.9 billion increase in average interest bearing liabilities as compared to 2017, (ii) a $22.3 million increase in non-interest income partly due to higher service charges on deposit accounts and other income related to our USAB acquisition and a $6.5 million gain on the sale of Visa Class B shares in 2018, (iii) a $22.6 million decrease in income

tax expense largely due to the net impact of the Tax Act, partially offset by (iv) a $120.0 million, or 23.6 percent, increase in total non-interest expense largely due to increased operational size from the USAB acquisition, as well as an increase of $14.8 million in USAB merger expenses, $12.2 million in legal expense related to litigation reserves, higher costs related to Branch Transformation, re-branding and technology, and (v) a $22.6 million increase in our provision for credit losses. 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 2018 annual results.

Operating Environment. U.S. economic growth accelerated, and labor market conditions strengthened in 2018. Real gross domestic product expanded 3.0 percent for 2018, compared to 2.2 and 1.6 percent in 2017 and 2016, respectively.

During 2018, the Federal Reserve gradually increased the target range for the federal funds rate four times throughout the year. As a result, the target range increased from 1.25 percent to 1.50 percent as of January 1, 2018 to 2.25 percent to 2.50 percent

at December 31, 2018. The Federal Open Market Committee left the target range for the federal funds rate unchanged at their January 2019 meeting and noted it would be patient and look at incoming data to determine if additional interest rate increases would be appropriate in the future.
The 10-year U.S. Treasury note yield ended the fourth quarter of 2018 at 2.69 percent, 29 basis points higher compared with December 31, 2017. However, the spread between the 2-year and 10-year U.S. Treasury note yields ended the fourth quarter of 2018 at 0.15 percent, 8 basis points lower than September 30, 2018 and 41 basis points lower compared with December 31, 2017.
For all commercial banks in the U.S., loan growth accelerated in 2018 to 5.2 percent compared to 4.1 percent in 2017. Alternatively, deposit growth decelerated from 4.2 percent in 2017 to 4.1 percent in 2018. Core deposit growth continues to be challenged by traditional rate driven market competition, attractive investment options due to a strong economy, as well as the rapid adoption of non-traditional digital banking platforms by more consumers.
See further discussion of our loans, deposits and the impact of the current economic and interest rate environments as highlighted throughout the remaining MD&A discussion below.
Loans. Total loans increased by $6.7 billion to $25.0 billion at December 31, 2018 from December 31, 2017, net of residential mortgage loans sold during 2018. Adjusted for $3.7 billion of loans acquired from USAB on January 1, 2018, total loans grew by 13.4 percent in 2018 due to strong demand in most loan categories. For 2019, we have established a goal to grow our overall loan portfolio in the range of 6 to 8 percent. However, there can be no assurance that we will achieve such levels given the potential for unforeseen changes in the market and other conditions. 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. At December 31, 2018, our PCI loan portfolio totaled $4.2 billion, or 16.7 percent of our total loan portfolio, and includes all of the loans acquired from USAB on January 1, 2018.
Total non-PCI loan portfolio delinquencies (including loans past due 30 days or more and non-accrual loans) as a percentage of total loans were 0.62 percent and 0.70 percent at December 31, 2018 and 2017, respectively. Total accruing past due loans decreased to $67.7 million at December 31, 2018 from $80.5 million at December 31, 2017 mostly due to normal period-end fluctuations in early stage delinquencies and a few large matured performing commercial real estate and construction loans in the normal process of renewal reported at December 31, 2017.
Non-accrual loans totaled $88.4 million, or 0.35 percent of our entire loan portfolio of $25.0 billion, at December 31, 2018 as compared to $47.2 million, or 0.26 percent of total loans, at December 31, 2017. The increase in non-accruals was largely due to a $49.2 million increase in the commercial and industrial loan category caused by taxi cab medallion loans internally downgraded to doubtful, partially offset by a $9.0 million decline in commercial real estate loans. Overall, our non-performing assets increased by 71.6 percent to $98.6 million at December 31, 2018 as compared to $57.5 million at December 31, 2017 primarily due to the increase in non-accrual loans.
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, due to the potential for future credit deterioration caused by the unpredictable future strength of the U.S. economy and the housing and labor markets, management cannot provide assurance that our non-performing assets will remain at, or increase from, the levels reported as of December 31, 2018. See the “Non-performing Assets” section below for further analysis of our asset quality.
Investments. During the year ended December 31, 2018, we recognized net losses on securities transactions of $2.3 million as compared to net losses totaling $20 thousand in 2017 and net gains of $777 thousand in 2016. The 2018 net losses were partly related to the sale of all the private label mortgage-backed securities classified as available for sale in our investment portfolio during the fourth quarter. See further details in the “Investment Securities Portfolio” section below and Note 4 to the consolidated financial statements.
Deposits and Other Borrowings. Our mix of total deposits slightly shifted to time deposits during 2018 as compared to 2017 largely due to the greater use of brokered time deposits in the second half of 2018. Non-interest bearing deposits

represented approximately 28 percent of total average deposits for the year ended December 31, 2018, while savings, NOW and money market accounts were 49 percent and time deposits were 23 percent. Average non-interest bearing deposits increased $1.0 billion to approximately $6.2 billion for the year ended December 31, 2018 as compared to 2017 due, in large part, to $887.1 million of deposits assumed from USAB and our continuous efforts to encourage new and existing loan borrowers to maintain deposit accounts at Valley. Average savings, NOW and money market account balances increased $2.2 billion to $11.1 billion in 2018 largely due to $1.7 billion of deposits assumed from USAB and several retail and business account initiatives. Average time deposits also increased $1.8 billion to $5.1 billion in 2018 due to (i) $999.6 million of deposits assumed from USAB, (ii) increased use of brokered CDs as an alternative to more costly FHLB borrowings with shorter or similar maturities and (iii) successful retail

deposit gathering efforts. Ending balances of brokered money market deposit accounts and brokered time deposits totaled $1.1 billion and $2.1 billion, respectively, at December 31, 2018 as compared to $1.4 billion and $71.1 million, respectively, at December 31, 2017.

Average short-term borrowings increased $702.0 million to $2.2 billion for 2018 as compared to 2017 largely due to new FHLB advances used for funding of loan growth and balancing the appropriate mix of short- and long-term funding in the current interest rate environment. Valley also assumed $650.0 million of very short duration borrowings from USAB on January 1, 2018.

Average long-term borrowings increased $226.3 million to approximately $2.1 billion for 2018 as compared to 2017 largely due to an increase in average FHLB advances to fund loan growth during 2018, and to a lesser extent $100.5 million of borrowings assumed from USAB. See further discussion of our average interest bearing liabilities under the "Net Interest Income" section below.

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. The net interest margin on a fully tax equivalent basis is calculated by dividing tax equivalent net interest income by average interest earning assets and is a key measurement used in the banking industry to measure income from interest earning assets. During 2018, Valley elected to reclassify fee income related to derivative interest rate swaps executed with commercial loan customers totaling $16.4 million from interest and fees on loans to other non-interest income within the presentation of its net interest margin below and the 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.

Annual Period 2018. Net interest income on a tax equivalent basis increased by $194.6 million to $862.9 million for 2018 as compared to 2017. The increase was mainly driven by a $5.5 billion increase in average loan balances and a 31 basis point increase in loan yield, partially offset by interest expense related to a $4.9 billion increase in average interest bearing liabilities and a 36 basis point increase in the cost of such liabilities as compared to 2017. See further discussion of the changes in our average interest earning assets and interest bearing liabilities below.

The net interest margin on a tax equivalent basis was 3.11 percent for the year ended December 31, 2018 and remained unchanged as compared to 2017. However, the yield on average interest earning assets increased 29 basis points mainly attributable to the increased yield on average loans. The yield on average loans increased 31 basis points to 4.43 percent for 2018 as compared to 4.12 percent in 2017 largely due to new and renewed loan volumes and higher market interest rates in 2018. Our average non-taxable investment portfolio yield decreased 45 basis points during 2018 as compared to one year ago due to a lower tax equivalent yield caused by the Tax Act, partially offset by higher market rates on securities acquired and purchased in 2018. Offsetting the increase in the yield on average interest earning assets, the cost of average interest bearing liabilities increased 36 basis points to 1.47 percent for 2018. The increase in the overall cost as compared to 2017 was mainly driven by increases of 36, 89 and 32 basis points in our cost of average savings, NOW and money market deposit accounts; short-term borrowings; and time deposits, respectively, in 2018. The increases were largely due to a gradual increase in short-term market interest rates during 2018 that were influenced by five individual increases of 0.25 percent in the federal funds target rate from mid-December 2017 to mid-December 2018 by the FOMC, as well as strong market competition for customer deposits. The annual average of the daily effective federal funds rate increased 83 basis points to 1.83 percent for 2018 from 1.00 percent in 2017.

Our earning asset portfolio is comprised of both fixed-rate and adjustable-rate loans and investments. Many of our earning assets are priced based upon the prevailing treasury rates, the Valley prime rate (set by Valley management based on various internal and external factors) or on the U.S. prime interest rate as published in The Wall Street Journal. On average, the 10-year treasury rate increased from 2.33 percent in 2017 to 2.91 percent in 2018, positively impacting our yield on average loans as new and renewed fixed-rate loans originated in 2018. Additionally, the U.S. prime rate increased to 5.50 percent from 5.25 percent in mid-December 2017 and has increased five times since mid-December 2017 in conjunction with the increase in the targeted federal funds rate. The higher U.S. prime rate,

and our increase in the Valley prime rate to 6.375 percent from 6.125 percent during December 2018, will have an immediate positive impact on the yield of our U.S. and Valley prime rate based loan portfolios for 2019 as compared to 2018. Should the treasury rates remain at or increase above current levels, this will also have a positive, but more gradual, effect on our interest income based on our ability to originate new and renewed fixed rate loans.

Average interest earning assets totaling $27.7 billion for the year ended December 31, 2018 increased $6.2 billion, or 28.9 percent, as compared to 2017. Average loan balances increased $5.5 billion to $23.3 billion in 2018 and drove the majority of the $299.5 million increase in the interest income on a tax equivalent basis for loans as compared to 2017. The growth in average loans during 2018 was due to $3.7 billion of loans acquired from USAB on January 1, 2018, strong loan demand in all commercial loan categories and greater retention of residential mortgage loan production. Much of the new loan production in the commercial area came from additional business with current customer relationships, including opportunities to expand the former USAB

lending limits with customers in our new Tampa Bay market. Average investment securities increased $663.8 million to approximately $4.1 billion in 2018 due to $522.6 million of securities acquired from USAB, as well as a moderate expansion of residential mortgage-backed securities held in the taxable portfolio. Average federal funds sold and other interest bearing deposits increased $29.3 million to $218.9 million for the year ended December 31, 2018 as compared to 2017 mostly due to slightly higher levels of overnight liquidity held primarily caused by fluctuations in the timing of new loan originations.

Average interest bearing liabilities increased $4.9 billion to $20.5 billion for the year ended December 31, 2018 from the same period in 2017 due to increases in all of our funding categories. Average savings, NOW and money market accounts increased $2.2 billion mostly due to $1.7 billion of such deposits assumed from USAB and retail money market account gathering initiatives during 2018, partially offset by slightly lower utilization of brokered money market account balances in our loan growth funding strategy and other liquidity needs in 2018. Average time deposits increased $1.8 billion to $5.1 billion for 2018 as compared to 2017 mainly due to $999.6 million of CDs assumed from USAB, retail CDs strategies executed in 2018 and increased use of brokered CDs in the second half of 2018. Average short-term and long-term borrowings increased $702.0 million and $226.3 million in 2018, respectively, as compared to 2017 due, in part, to a higher level of FHLB borrowings used to fund new loan and investment activities, and, to a lesser extent, $650.0 million and $100.5 million, respectively, of such borrowings assumed from USAB. See the "Fourth Quarter of 2018" section below for more information regarding changes in our interest bearing liabilities during 2018.

Fourth Quarter of 2018. Net interest income on a tax equivalent basis totaling $223.4 million for the fourth quarter of 2018 increased $52.0 million and $5.3 million as compared to the fourth quarter of 2017 and third quarter of 2018, respectively. The increase as compared to the fourth quarter of 2017 was largely due to the acquisition of USAB on January 1, 2018 and loan growth during 2018. Interest income on a tax equivalent basis increased $17.6 million to $316.0 million for the fourth quarter of 2018 as compared to the third quarter of 2018, largely due to an increase of $871.7 million in average loans and a 11 basis point increase in the yield on average loans. Interest expense of $92.5 million for the three months ended December 31, 2018 increased $12.3 million from the third quarter of 2018 largely due to higher interest rates on many of our interest bearing deposit products and FHLB borrowings, and a $756.9 million increase in average interest-bearing liabilities. The increase in average interest-bearing liabilities was largely driven by both brokered and retail time deposit gathering initiatives, partially offset by lower short-term and long-term FHLB borrowings.

The net interest margin on a tax equivalent basis of 3.10 percent for the fourth quarter of 2018 decreased 3 basis points and 2 basis points from 3.13 percent and 3.12 percent for the fourth quarter of 2017 and third quarter of 2018, respectively. The yield on average interest earning assets increased by 12 basis points on a linked quarter basis due to the higher yields on average loans and investment securities. The yield on average loans increased to 4.61 percent for the fourth quarter of 2018 from 4.50 percent for the third quarter of 2018, mostly due to the high volume of new loan originations at current market rates. The increased yield on average investment securities was partly caused by a decrease in premium amortization on residential mortgage-backed securities, due to lower prepayments on such financial instruments. The cost of average interest bearing liabilities increased by 17 basis points to 1.72 percent for the fourth quarter of 2018 as compared to the linked third quarter of 2018. The increase was due to a 23 basis point increase in both the cost of average interest bearing deposits and short-term borrowings, largely driven by higher market interest rates. The cost of average long-term borrowings also increased 21 basis points as compared to the third quarter of 2018 largely due to the change in the composition of such borrowings caused by the maturity and repayment of lower cost borrowings in the second half of 2018. Our cost of total average deposits was 1.07 percent for the fourth quarter of 2018 as compared to 0.88 percent for the three months ended September 30, 2018.

Looking forward, we expect moderate compression pressure on our net interest margin for the first quarter of 2019 due to the potential narrowing of the spread between short and long-term interest rates and two less days during the quarter. For the full year of 2019, we anticipate net interest income growth of approximately 5 to 7 percent. However, our net interest margin and net interest income could both experience an unexpected material decline as compared to the fourth 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 each of the three years ended December 31, 2018, 2017 and 2016:

ANALYSIS OF AVERAGE ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY AND
NET INTEREST INCOME ON A TAX EQUIVALENT BASIS

	2018			2017			2016		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	($ in thousands)								
Assets									
Interest earning assets:									
Loans [(1)(2)]	$23,340,330	$1,033,996	4.43%	$17,819,003	$734,485	4.12%	$16,400,745	$680,892	4.15%
Taxable investments [(3)]	3,409,687	100,515	2.95	2,910,390	82,488	2.83	2,536,197	64,349	2.54
Tax-exempt investments [(1)(3)]	733,956	27,220	3.71	569,469	23,691	4.16	604,188	23,903	3.96
Interest bearing deposits with banks	218,938	3,236	1.48	189,636	1,793	0.95	288,182	1,126	0.39
Total interest earning assets	27,702,911	1,164,967	4.21	21,488,498	842,457	3.92	19,829,312	770,270	3.88
Allowance for loan losses	(136,775)			(117,529)			(109,084)		
Cash and due from banks	278,181			236,297			291,021		
Other assets	2,431,537			1,886,035			2,032,704		
Unrealized losses on securities available for sale, net	(46,578)			(14,503)			921		
Total assets	$30,229,276			$23,478,798			$22,044,874		
Liabilities and Shareholders' Equity									
Interest bearing liabilities:									
Savings, NOW and money market deposits	$11,093,136	$108,394	0.98%	$8,934,335	$55,300	0.62%	$8,563,208	$39,787	0.46%
Time deposits	5,131,167	81,959	1.60	3,329,693	42,546	1.28	3,104,307	37,775	1.22
Total interest bearing deposits	16,224,303	190,353	1.17	12,264,028	97,846	0.80	11,667,515	77,562	0.66
	2,187,998	45,930	2.10	1,486,001	18,034	1.21	1,246,790	12,022	0.96

Short-term borrowings									
Long-term borrowings [4]	2,116,619	65,762	3.11	1,890,288	58,227	3.08	1,610,576	59,190	3.68
Total interest bearing liabilities	20,528,920	302,045	1.47	15,640,317	174,107	1.11	14,524,881	148,774	1.02
Non-interest bearing deposits	6,193,839			5,192,087			5,067,124		
Other liabilities	201,986			174,643			199,299		
Shareholders' equity	3,304,531			2,471,751			2,253,570		
Total liabilities and shareholders' equity	$30,229,276			$23,478,798			$22,044,874		
Net interest income/interest rate spread [5]		862,922	2.74%		668,350	2.81%		621,496	2.86%
Tax equivalent adjustment		(5,719)			(8,303)			(8,382)	
Net interest income, as reported		$857,203			$660,047			$613,114	
Net interest margin [6]			3.09%			3.07%			3.09%
Tax equivalent effect			0.02			0.04			0.04%
Net interest margin on a fully tax equivalent basis [6]			3.11%			3.11%			3.13%

(1) Interest income is presented on a tax equivalent basis using a 21 percent federal tax rate for 2018, and a 35 percent federal tax rate for both 2017 and 2016, 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 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.

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 Valley 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

	Years Ended December 31, 2018 Compared to 2017			2017 Compared to 2016		
	Change Due to Volume	Change Due to Rate	Total Change	Change Due to Volume	Change Due to Rate	Total Change
	(in thousands)					
Interest income:						
Loans*	$241,292	$58,219	$299,511	$59,125	$(2,302)	$56,823
Taxable investments	14,611	3,416	18,027	10,114	8,025	18,139
Tax-exempt investments*	6,303	(2,774)	3,529	(1,411)	1,199	(212)
Federal funds sold and other interest bearing deposits	311	1,132	1,443	(491)	1,158	667
Total increase in interest income	262,517	59,993	322,510	67,337	8,080	75,417
Interest expense:						
Savings, NOW and money market deposits	15,640	37,454	53,094	1,790	13,723	15,513
Time deposits	26,955	12,458	39,413	2,824	1,947	4,771
Short-term borrowings	10,962	16,934	27,896	2,561	3,451	6,012
Long-term borrowings and junior subordinated debentures	7,028	507	7,535	9,418	(10,381)	(963)
Total increase in interest expense	60,585	67,353	127,938	16,593	8,740	25,333
Increase (decrease) in net interest income	$201,932	$(7,360)	$194,572	$50,744	$(660)	$50,084

* Interest income is presented on a tax equivalent basis using a 21 percent federal tax rate for 2018, and a 35 percent federal tax rate for both 2017 and 2016, respectively.

Non-Interest Income

Non-interest income represented 10.4 percent and 11.8 percent of total interest income plus non-interest income for 2018 and 2017, respectively. For the year ended December 31, 2018, non-interest income increased $22.3 million as compared to the year ended December 31, 2017.

The following table presents the components of non-interest income for the years ended December 31, 2018, 2017, and 2016:

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Trust and investment services	$12,633	$11,538	$10,345
Insurance commissions	15,213	18,156	19,106
Service charges on deposit accounts	26,817	21,529	20,879
(Losses) gains on securities transactions, net	(2,342)	(20)	777
Fees from loan servicing	9,319	7,384	6,441
Gains on sales of loans, net	20,515	20,814	22,030
Bank owned life insurance	8,691	7,338	6,694

Other	43,206	24,967	21,988
Total non-interest income	$134,052	$111,706	$108,260

Trusts and investment services income increased $1.1 million for the year ended December 31, 2018 as compared to 2017 mainly due to higher investment and advisory fees resulting from increased assets under management during 2018. The increase in assets under management was largely due to higher market valuations and asset appreciation during 2018.
Insurance commissions decreased $2.9 million for the year ended December 31, 2018 from $18.2 million in 2017 mainly due to lower volumes of business generated by the Bank's insurance agency subsidiary.
Service charges on deposit accounts increased $5.3 million for the year ended December 31, 2018 as compared to 2017 mostly driven by the acquisition of USAB on January 1, 2018.
Net losses on securities transactions increased $2.3 million for the year ended December 31, 2018 as compared to 2017. The higher level of net losses was partly due to the sale of all of our private label mortgage-backed securities classified as available for sale for an aggregate net loss of $1.5 million during the fourth quarter of 2018, as well as the sale of equity securities previously classified as available for sale and certain municipal securities acquired from USAB.
Fees from loan servicing increased $1.9 million for the year ended December 31, 2018 from $18.2 million in 2017 mainly due to additional fees from mortgage servicing rights of loans originated and sold by us during the last 12 months. The aggregate principal balances of residential mortgage loans serviced by us for others increased approximately $300 million to $3.2 billion, at December 31, 2018 from $2.8 billion at December 31, 2017.
Net gains on sales of loans remained relatively unchanged for the year ended December 31, 2018 as compared to 2017 despite a lower volume of loans sold during 2018, mainly due to higher spreads (margins) on individual loan sales as compared to 2017. During 2018, we sold $675.9 million of residential mortgages originated for sale as compared to $800.9 million of residential mortgage loans sold during 2017. Residential mortgage loan originations (including both new and refinanced loans) increased 82.4 percent to $1.7 billion for the year ended December 31, 2018 as compared to $955.7 million in 2017. 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 held for sale carried at fair value at each period end. The net gains in the fair value of loans held for sale totaled $211 thousand and $782 thousand in 2018 and 2017, respectively. See further discussions of our residential mortgage loan origination activity under “Loans” in the "Executive Summary" section of this MD&A above and the fair valuation of our loans held for sale at Note 3 of the consolidated financial statements.
Other non-interest income increased $18.2 million for the year ended December 31, 2018 from 2017 partly due to (i) a $8.1 million increase in fee income related to derivative interest rate swaps executed with commercial lending customers, (ii) a $6.5 million gain realized on the sale of our Visa Class B shares during the fourth quarter of 2018 and (iii) additional other income generated from the USAB acquisition. Swap fee income totaled $16.4 million and $8.3 million for the years ended December 31, 2018 and 2017, respectively. Partially offsetting these items, we also recognized branch asset impairment charges of $1.8 million related to branch closures during the third quarter of 2018.

Non-Interest Expense

Non-interest expense increased $120.0 million to $629.1 million for the year ended December 31, 2018 as compared to 2017. The following table presents the components of non-interest expense for the years ended December 31, 2018, 2017 and 2016:

	Years Ended December 31,		
	2018	2017	2016
		(in thousands)	
Salary and employee benefits expense	$333,816	$ 263,337	$243,222
Net occupancy and equipment expense	108,763	92,243	87,140
FDIC insurance assessment	28,266	19,821	20,100
Amortization of other intangible assets	18,416	10,016	11,327
Professional and legal fees	34,141	25,834	17,755
Amortization of tax credit investments	24,200	41,747	34,744

Telecommunication expense	12,102	9,921	10,021
Other	69,357	46,154	51,816
Total non-interest expense	$629,061	$ 509,073	$476,125

Salary and employee benefits expense increased by $70.5 million for the year ended December 31, 2018 as compared to 2017 largely due to (i) normal increases in annual compensation and incentives (including additional staffing related to the USAB

acquisition), (ii) expansion of our technology and home mortgage consultant teams, (iii) $9.8 million of change in control, severance and retention expenses related to the USAB acquisition, and (iv) $2.7 million of severance costs related to our Branch Transformation strategy during the fourth quarter of 2018. Stock-based compensation expense increased $7.0 million to $18.8 million for the year ended December 31, 2018 as compared to 2017.

Net occupancy and equipment expenses increased $16.5 million for the year ended December 31, 2018 as compared to 2017 largely due to costs related to the 29-branch network acquired from USAB and higher technology equipment related expense. Repair and maintenance, and depreciation expense increased $11.0 million and $2.7 million for the year ended December 31, 2018, respectively, as compared to 2017. USAB merger related expenses within the category totaled $856 thousand for the year ended December 31, 2018.

The FDIC insurance assessment increased $8.4 million for the year ended December 31, 2018 from the year ended December 31, 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 $8.4 million for the year ended December 31, 2018 as compared to 2017 mainly due to an increase of $7.5 million in amortization expense of core deposit intangibles (CDI) during 2018. The increase in the amortization of CDI was driven by the recognition of $45.9 million of CDI in the USAB acquisition (see Note 8 to the consolidated financial statements for more details). Higher amortization expense of loan servicing rights, caused by additional loan servicing rights recorded over the last twelve-month period, also contributed to the increase in 2018.

Professional and legal fees increased $8.3 million for the year ended December 31, 2018 as compared to 2017, largely due to litigation reserve charges of $12.2 million and merger related expenses of $837 thousand during 2018. These increases were partially offset by lower consulting and advisory fees for the year ended December 31, 2018 as compared to 2017, which included additional fees related to the LIFT Project and USAB acquisition.

Amortization of tax credit investments decreased $17.5 million for the year ended December 31, 2018 as compared to 2017 mostly due to normal differences in the timing and amount of such investments and recognition of the related tax credits, as well as a $4.3 million charge during the fourth quarter of 2017 related to the impairment of tax credit investments caused by the Tax Act. Tax credit investments, while negatively impacting the level of our operating expenses and efficiency ratio, directly reduce our income tax expense and effective tax rate. See Note 14 to the consolidated financial statements for additional information.

Other non-interest expense increased $23.2 million for the year ended December 31, 2018 as compared to 2017 partly due to increases of $5.9 million and $5.6 million in data processing fees and USAB merger related expense during 2018, respectively. During 2018, we also experienced moderate increases in several other significant components of other expense, such as travel and entertainment, debit card and ATM expense, postage, and stationary and print expenses. These additional expenses were largely driven by our growth both organically and through the acquisition of USAB. Advertising expense included in this category increased $3.8 million to $5.7 million for the year ended December 31, 2018 as compared to 2017 mostly due to focused campaigns in the new Florida markets, as well as the more recent Valley re-branding efforts.

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 mostly by the amortization of tax credit investments, merger related expenses, litigation expenses, severance costs, and gains and losses on securities transactions. See table below for more details.

The following table presents our efficiency ratio and a reconciliation of the efficiency ratio adjusted for such items during the years ended December 31, 2018, 2017 and 2016:

	Years Ended December 31,		
	2018	2017	2016
	($ in thousands)		
Total non-interest expense, as reported	$629,061	$509,073	$476,125
Less: Amortization of tax credit investments (pre-tax)	24,200	41,747	34,744
Less: LIFT program expenses (pre-tax) (1)	—	9,875	—
Less: Merger related expenses (pre-tax) (2)	17,445	2,620	—
Less: Severance expense (branch transformation only, pre-tax)	2,662	—	—
Less: Legal expenses (litigation reserve impact only, pre-tax)	12,184	—	—
Total non-interest expense, as adjusted	$572,570	$454,831	$441,381
Net interest income	857,203	660,047	613,114
Total non-interest income, as reported	134,052	111,706	108,260
Add: Branch related asset impairment (pre-tax) (3)	1,821	—	—
Add: Losses (gains) on securities transactions, net (pre-tax)	2,342	20	(777)
Less: Gain on the sale of Visa Class B shares (pre-tax)	6,530	—	—
Total non-interest income, as adjusted	$131,685	$111,726	$107,483
Gross operating income, as adjusted	$988,888	$771,773	$720,597
Efficiency ratio	63.46%	65.96%	66.00%
Efficiency ratio, adjusted	57.90%	58.93%	61.25%

(1) LIFT program expenses are primarily within professional and legal fees and salary and employee benefits expense.
(2) Merger related expenses are primarily within salary and employee benefits and other expense.
(3) Branch related asset impairment is included in net losses on sale of assets within non-interest income.

See the "Results of Operations—2017 Compared to 2016" section later in this MD&A for the discussion and analysis of changes in our non-interest expense from 2016 to 2017.

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 was $68.3 million for the year ended December 31, 2018, reflecting an effective tax rate of 20.7 percent, as compared to $90.8 million for the year ended 2017, reflecting an effective tax rate of 35.9 percent. The decrease in both income tax expense and the effective tax rate in 2018 as compared to 2017 was primarily caused by the lower 2018 federal tax rate and a $15.4 million charge recognized in the fourth quarter of 2017 resulting from the re-measurement of Valley's estimated net deferred tax asset as of December 31, 2017 under the Tax Act. The income tax expense and effective tax rate for 2018 also reflect a net tax benefit of $3.3 million related to the reduction in our reserve for unrecognized tax benefits due to the expiration of the statute of limitations for certain tax positions. 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 surtax did not have a material impact on our reported income tax expense for the year ended December 31, 2018. The New Jersey surtax equals 2.5 percent for the years 2018 and 2019 and decreases to 1.5 percent for 2020 and 2021.

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. Based on the current information available, we anticipate that our effective tax rate will range from 22 percent to 24 percent for 2019, primarily reflecting the estimated 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 additional information regarding our income taxes under our "Critical Accounting Policies and Estimates" section above, as well as Note 13 to the consolidated financial statements.
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 segments' 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. See Note 22 to the consolidated financial statements for the segments' financial data.
Consumer lending. The consumer lending segment is mainly comprised of residential mortgage loans, automobile loans, secured personal lines of credit and home equity loans and represented in the aggregate 27.2 percent of the total loan portfolio at December 31, 2018. The duration of the residential mortgage loan portfolio (which represented 16.4 percent of our total loan portfolio at December 31, 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 December 31, 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 Division, comprised of trust, asset management, insurance services, and asset-based lending support services.
Average interest earning assets in this segment increased $1.0 billion to $6.2 billion for the year ended December 31, 2018 as compared to 2017. The increase was mainly attributable to organic residential mortgage loan growth driven by our home mortgage consulting team, as well as $365.9 million and $109.8 million of residential mortgage loans and home equity loans, respectively, acquired from USAB on January 1, 2018. Automobile loans and other consumer loans (mainly consisting of secured personal lines) also grew by 9.2 percent and 18.3 percent, respectively, over the last 12 months.
Income before income taxes generated by the consumer lending segment decreased $6.2 million to $57.3 million for the year ended December 31, 2018 as compared to $63.5 million for the year ended December 31, 2017. The decrease was largely attributable to increases in non-interest expense and internal transfer expense, partially offset by an increase in net interest income. Non-interest expense increased $20.3 million as compared to 2017 due, in part, to higher salary and employee benefits expense related to the USAB acquisition and additional compensation related to

our growing home mortgage consultant team. The internal transfer expense increased $9.2 million, as compared to 2017. The negative impact of these items was partially offset by an increase of $27.7 million in net interest income, mostly due to higher average loans and yields on new loan volumes, partially offset by higher funding costs.

The net interest margin on the consumer lending portfolio was 2.77 percent for the years ended December 31, 2017 and December 31, 2018. The 2018 margin remained unchanged from 2017 due to a 27 basis point increase in the yield on average loans that was fully offset by a 27 basis point increase in the costs associated with our funding sources. The increased loan yield was due to higher market interest rates on new loan volumes. The increased cost of funds was primarily due to increased short-term interest rates resulting from the Federal Reserve's gradual increase in short-term market interest rates during 2018 and intense

competition for deposits mainly in our New Jersey and New York markets. See the "Executive Summary" and the "Net Interest Income" sections above for more details on our loans, deposits and other borrowings.
The return on average interest earning assets before income taxes for the consumer lending segment was 0.92 percent for 2018 compared to 1.23 percent for 2017.
Commercial lending. The commercial lending segment is mainly comprised of floating rate and adjustable rate commercial and industrial 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 $4.3 billion and represented 17.3 percent of the total loan portfolio at December 31, 2018. Commercial real estate loans and construction loans totaled $13.9 billion and represented 55.5 percent of the total loan portfolio at December 31, 2018. Average interest earning assets in this segment increased $4.5 billion to $17.1 billion for the year ended December 31, 2018 as compared to 2017. The increase was primarily attributable to approximately $3.2 billion of commercial PCI loans acquired from USAB and strong loan growth during the last 12 months.
For the year ended December 31, 2018, income before income taxes for the commercial lending segment increased $85.1 million to $308.5 million as compared to 2017. Net interest income increased $165.0 million to $621.7 million for the year ended December 31, 2018 as compared to 2017 largely due to the aforementioned increase in average loan balances, as well as an increase in yield on new loan originations. Non-interest income increased $10.9 million for the year ended December 31, 2018 as compared to 2017 mainly due to fee income related to derivative interest rate swaps executed with commercial loan customers which totaled $16.4 million for the year ended December 31, 2018 as compared to $8.3 million 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. The provision for credit losses increased $20.2 million to $27.0 million for the year ended December 31, 2018 as compared to 2017 (See details in the "Allowance for Credit Losses" section of this MD&A). The internal transfer expense and non-interest expense increased $46.6 million and $24.0 million, respectively, for the year ended December 31, 2018 as compared to 2017, due, in part, to the USAB acquisition.
The net interest margin for this segment increased 2 basis points to 3.63 percent during 2018 as a result of a 29 basis point increase in the yield on average loans, partially offset by a 27 basis point increase in the cost of our funding sources as compared to 2017.
The return on average interest earning assets before income taxes for this segment was 1.80 percent for 2018 compared to 1.77 percent for the prior year period.

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, interest-bearing deposits with banks (primarily the FRB 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 increased $693.1 million to $4.4 billion for the year ended December 31, 2018 as compared to 2017 mostly due to investment securities acquired from USAB and some additional investment in residential mortgage-backed securities. Average other interest bearing deposits also increased $29.3 million to $218.9 million for the year ended December 31, 2018 as compared to 2017.
For the year ended December 31, 2018, income before income taxes for the investment management segment increased $529 thousand to $38.9 million as compared to 2017 primarily due to a $5.6 million increase in net interest income and a $946 thousand increase in non-interest income, partially offset by a $6.0 million increase in the internal transfer expense. The increase in net interest income was mainly driven by higher average investment balances during the year ended December 31, 2018 as compared to 2017.

The net interest margin for this segment decreased 21 basis points to 1.97 percent during the year ended December 31, 2018 as compared to 2017 as a result of a 27 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 and the positive impact of increased market interest rates on the variable rate portion of our securities portfolio.

The return on average interest earning assets before income taxes for this segment was 0.89 percent for 2018 compared to 1.05 percent for 2017.

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, interest expense related to subordinated notes, as well as income and expense from derivative financial instruments.

The pre-tax net loss for the corporate segment increased $2.5 million for the year ended December 31, 2018 to $75.0 million as compared to $72.5 million in 2017. The higher net loss during 2018 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 $75.7 million to $440.2 million for the year ended December 31, 2018 as compared to 2017 largely due to higher salaries and employee benefits expenses related to the USAB acquisition, USAB merger expense and professional and legal fees related to litigation reserves. See further details in the "Non-Interest Expense" section in this MD&A. Internal transfer income increased $61.7 million to $344.9 million for the year ended December 31, 2018 as compared to the prior year.

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 attempts 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 December 31, 2018. The model assumes changes in interest rates without any proactive change in the composition or size of the balance sheet by management. In the model, the forecasted shape of the yield curve remains static as of December 31, 2018. The impact of interest rate derivatives, such as interest rate swaps, is also included in the model.

Our simulation model is based on market interest rates and prepayment speeds prevalent in the market as of December 31, 2018. Although the size of Valley’s balance sheet is forecasted to remain static as of December 31, 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 2018. The model utilizes an immediate parallel shift in the market interest rates at December 31, 2018.

The assumptions used in the net interest income simulation are inherently uncertain. Actual results may differ significantly from those presented in the table above, 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 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 above. 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.

	Estimated Change in Future Net Interest Income	
Changes in Interest Rates	Dollar Change	Percentage Change
(in basis points)	($ in thousands)	
+200	$ 16,547	1.82 %
+100	9,410	1.04
- 100	(4,473)	(0.49)
- 200	(27,716)	(3.06)

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 1.04 percent. The Bank's asset sensitivity to changes in market rates increased 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 funding loan growth during 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.

The following table sets forth the amounts of interest earning assets and interest bearing liabilities that were outstanding at December 31, 2018 and their associated fair values. The expected cash flows are categorized based on each financial instrument's anticipated maturity or interest rate reset date in each of the future periods presented.

INTEREST RATE SENSITIVITY ANALYSIS

	Rate	2019	2020	2021	2022	2023	Thereafter	Total Balance	Fair Value
	($ in thousands)								
Interest sensitive assets:									
Interest bearing deposits with banks	2.35%	$177,088	$—	$—	$—	$—	$—	$177,088	$177,088
Investment securities held to maturity	3.52	437,470	274,955	262,828	215,431	188,457	689,105	2,068,246	2,034,943
Investment securities available for sale	2.85	135,166	285,461	234,334	258,821	148,426	687,336	1,749,544	1,749,544
Loans held for sale, at fair value	4.65	35,155	—	—	—	—	—	35,155	35,155
Loans	4.49	10,559,163	3,056,634	2,703,476	2,312,576	2,106,710	4,296,910	25,035,469	24,068,755
Total interest sensitive assets	4.31%	$11,344,042	$3,617,050	$3,200,638	$2,786,828	$2,443,593	$5,673,351	$29,065,502	$28,065,485
Interest sensitive liabilities:									
Deposits:									
Savings, NOW and money market	0.78%	$11,213,495	$—	$—	$—	$—	$—	$11,213,495	$11,213,495
Time	2.10	4,987,313	1,551,066	163,059	176,727	143,287	42,532	7,063,984	7,005,573
Short-term borrowings	2.45	2,118,914	—	—	—	—	—	2,118,914	2,091,892
Long-term borrowings	3.30	244,666	25,000	840,000	250,000	194,602	100,000	1,654,268	1,751,194
Junior subordinated debentures	5.10	55,370	—	—	—	—	—	55,370	55,692
Total interest sensitive liabilities	1.56%	$18,619,758	$1,576,066	$1,003,059	$426,727	$337,889	$142,532	$22,106,031	$22,117,846
Interest sensitivity		$(7,275,716)	$2,040,984	$2,197,579	$2,360,101	$2,105,704	$5,530,819	$6,959,471	$5,947,639

gap								
Ratio of interest sensitive assets to interest sensitive liabilities	0.61:1	2.29:1	3.19:1	6.53:1	7.23:1	39.80:1	1.31:1	1.27:1

The above table provides an approximation of the projected re-pricing of assets and liabilities at December 31, 2018 on the basis of contractual maturities, adjusted for anticipated prepayments of principal (including anticipated call dates on long-term borrowings and junior subordinated debentures), and scheduled rate adjustments. The prepayment experience reflected herein is based on historical experience combined with market consensus expectations derived from independent external sources. The actual repayments of these instruments could vary substantially if future prepayments differ from historical experience or current market expectations. While all non-maturity deposit liabilities are reflected in the 2018 column in the table above, management controls the re-pricing of the vast majority of the interest-bearing instruments within these liabilities.

Our cash flow derivatives are designed to protect us from upward movement in interest rates on certain deposits and other borrowings. The interest rate sensitivity table reflects the sensitivity at current interest rates. As a result, the notional amount of our derivatives is not included in the table. We use various assumptions to estimate fair values. See Note 3 of the consolidated financial statements for further discussion of fair value measurements.

The total gap re-pricing within one year as of December 31, 2018 was a negative $7.3 billion, representing a ratio of interest sensitive assets to interest sensitive liabilities of 0.61:1. The total gap re-pricing position, as reported in the table above, reflects the projected interest rate sensitivity of our principal cash flows based on market conditions as of December 31, 2018. As the market level of interest rates and associated prepayment speeds move, the total gap re-pricing position will change accordingly, but not likely in a linear relationship. Management does not view our one-year gap position as of December 31, 2018 as presenting an unusually high risk potential, although no assurances can be given that we are not at risk from interest rate increases or decreases.

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 30 percent of total funding. The Bank was in compliance with the foregoing policies at December 31, 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 totaled approximately $2.3 billion, representing 8.0 percent of earning assets, at December 31, 2018 and $2.0 billion, representing 9.3 percent of earning assets, at December 31, 2017. Of the $2.3 billion of liquid assets at December 31, 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 $747 million in principal 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 December 31, 2018) are projected to be approximately $5.9 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. Core deposits averaged approximately $18.1 billion and $15.4 billion for the years ended December 31, 2018 and 2017, respectively, representing 65.3 percent and 71.8 percent of average earning assets at December 31, 2018 and 2017, respectively. 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.

The following table lists, by maturity, all certificates of deposit of $250 thousand and over at December 31, 2018:

	2018
	(in thousands)
Less than three months	$ 268,842
Three to six months	249,448
Six to twelve months	288,064
More than twelve months	303,048
Total	$ 1,109,402

Additional funding may be provided from short-term liquidity borrowings through deposit gathering networks and in the form of federal funds purchased obtained through our well established relationships with several correspondent banks. While there are no firm lending commitments currently in place, management believes that we could borrow approximately $512 million for a short time from these banks on a collective basis. The Bank is also a member of the Federal Home Loan Bank of New York 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 December 31, 2018, our borrowing capacity under the Federal Reserve Bank's discount window was approximately $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 (consisting of FHLB advances, repos, and from time to time, federal funds purchased) increased $1.4 billion to $2.1 billion at December 31, 2018 as compared to $748.6 million at December 31, 2017 mostly due to new FHLB advances used for normal loan funding activity and liquidity purposes. 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.

Average short-term FHLB advances exceeded 30 percent of total shareholders' equity at December 31, 2018 and 2017, respectively. The following table sets forth information regarding Valley's short-term FHLB advances at the dates and for the years ended December 31, 2018 and 2017:

	2018	2017
	($ in thousands)	
FHLB advances:		
Average balance outstanding	$1,828,751	$1,196,507
Maximum outstanding at any month-end during the period	2,607,000	1,907,000
Balance outstanding at end of period	1,732,000	427,000
Weighted average interest rate during the period	1.00 %	1.07 %
Weighted average interest rate at the end of the period	2.44	1.34

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 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

The primary purpose of the investment portfolio is to provide a source of earnings, be a source of liquidity, and serve as a tool for managing interest rate risk. The decision to purchase or sell securities is based upon the current assessment of long and short-term economic and financial conditions, including the interest rate environment and other statement of financial condition components. See additional information under "Interest Rate Sensitivity", "Liquidity" and "Capital Adequacy" sections elsewhere in this MD&A.

As of December 31, 2018, our investment portfolio was comprised of U.S. Treasury securities, U.S. government agency securities, taxable and tax-exempt issues of states and political subdivisions, residential mortgage-backed securities, single-issuer trust preferred securities principally issued by bank holding companies and high quality corporate bonds. 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. Securities with limited marketability and/or restrictions, such as Federal Home Loan Bank and Federal Reserve Bank stocks, are carried at cost and are included in other assets.

Among other securities, our investments in trust preferred securities and corporate bonds (including some issued by banks) 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.

Investment securities at December 31, 2018, 2017 and 2016 were as follows:

	2018	2017	2016
	(in thousands)		
Held to maturity			
U.S. Treasury securities	$138,517	$138,676	$138,830
U.S. government agency securities	8,721	9,859	11,329
Obligations of states and political subdivisions:			
Obligations of states and state agencies	341,702	244,272	252,185
Municipal bonds	243,954	221,606	314,405
Total obligations of states and political subdivisions	585,656	465,878	566,590
Residential mortgage-backed securities	1,266,770	1,131,945	1,112,460
Trust preferred securities	37,332	49,824	59,804
Corporate and other debt securities	31,250	46,509	36,559
Total investment securities held to maturity (amortized cost)	$2,068,246	$1,842,691	$1,925,572
Available for sale			
U.S. Treasury securities	$49,306	$49,642	$49,591
U.S. government agency securities	36,277	42,505	23,041
Obligations of states and political subdivisions:			
Obligations of states and state agencies	97,113	38,219	40,342
Municipal bonds	99,979	74,665	79,425
Total obligations of states and political subdivisions	197,092	112,884	119,767
Residential mortgage-backed securities	1,429,782	1,223,295	1,015,542
Trust preferred securities	—	3,214	8,009
Corporate and other debt securities	37,087	51,164	60,565
Total debt securities	1,749,544	1,482,704	1,276,515
Equity securities	—	11,201	20,858
Total investment securities available for sale (fair value)	$1,749,544	$1,493,905	$1,297,373
Total investment securities	$3,817,790	$3,336,596	$3,222,945

As of December 31, 2018, total investments increased $481.2 million or 14.4 percent as compared to 2017 largely due to an increase in residential mortgage-backed securities classified as held for maturity and available for sale totaling a combined $341.3 million, and a $204.0 million combined increase in obligations of states and state agencies classified as held to maturity and available for sale. These increases were mainly driven by investment securities acquired from USAB. See Note 2 to the consolidated financial statements for additional information.

At December 31, 2018, we had $1.3 billion and $1.4 billion of residential mortgage-backed securities classified as held to maturity and available for sale, respectively. Approximately 71 percent and 69 percent of these residential mortgage-backed securities, respectively, were issued and guaranteed by Ginnie Mae. The remainder of our outstanding residential mortgage-backed security balances at December 31, 2018 were issued by either Freddie Mac or Fannie Mae.

The following table presents the remaining contractual maturities (unadjusted for any expected prepayments) with the corresponding weighted-average yields of held to maturity and available for sale debt securities at December 31, 2018:

	0-1 year		1-5 years		5-10 years		Over 10 years		Total	
	Amount (1)	Yield (2)	Amount (1)	Yield (2)	Amount (1)	Yield (2)	Amount (1)	Yield (2)	Amount (1)	Yield (2)
	($ in thousands)									
Held to maturity										
U.S. Treasury securities	$—	— %	$108,966	2.90%	$29,551	3.06%	$—	— %	$138,517	2.93%
U.S. government agency securities	—	—	—	—	—	—	8,721	2.53	8,721	2.53
Obligations of states and political subdivisions: (3)										
Obligations of states and state agencies	8,125	1.59	48,680	5.07	135,071	4.64	149,826	3.60	341,702	4.17
Municipal bonds	11,293	4.16	105,492	4.03	76,861	3.92	50,308	6.12	243,954	4.43
Total obligations of states and political subdivisions	19,418	3.08	154,172	4.36	211,932	4.38	200,134	4.23	585,656	4.28
Residential mortgage-backed securities (4)	—	—	5,197	3.19	23,047	3.03	1,238,526	2.92	1,266,770	2.92
Trust preferred securities	—	—	—	—	1,353	8.23	35,979	4.86	37,332	4.98
Corporate and other debt securities	2,000	2.37	11,250	2.77	18,000	4.64	—	—	31,250	3.82
Total	$21,418	3.02%	$279,585	3.70%	$283,883	4.17%	$1,483,360	3.14%	$2,068,246	3.36%
Available for sale										
U.S. Treasury securities	$—	— %	$49,306	1.60%	$—	— %	$—	— %	$49,306	1.60%
U.S. government agency securities	—	—	2,850	1.64	—	—	33,427	3.18	36,277	3.06
Obligations of states and political subdivisions: (3)										
Obligations of states and state agencies	2,002	2.28	18,484	3.36	24,091	4.39	52,536	4.24	97,113	4.07
Municipal bonds	2,640	2.71	37,502	2.69	30,372	4.49	29,465	4.80	99,979	3.86
Total obligations of states and political subdivisions	4,642	2.52	55,986	2.91	54,463	4.45	82,001	4.44	197,092	3.96
Residential mortgage-backed securities (4)	15	5.08	9,039	2.38	80,570	2.74	1,340,158	2.84	1,429,782	2.83
Corporate and other debt securities	—	—	14,910	2.92	22,177	4.55	—	—	37,087	3.89
Total	$4,657	2.53%	$132,091	2.36%	$157,210	3.59%	$1,455,586	2.94%	$1,749,544	2.95%

(1) Held to maturity amounts are presented at amortized costs, stated at cost less principal reductions, if any, and adjusted for accretion of discounts and amortization of premiums. Available for sale amounts are presented at fair value.

(2) Average yields are calculated on a yield-to-maturity basis.

(3) Average yields on obligations of states and political subdivisions are generally tax-exempt and calculated on a tax-equivalent basis using a statutory federal income tax rate of 21 percent.

(4) Residential mortgage-backed securities are shown using stated final maturity.

The residential mortgage-backed securities portfolio is a significant source of our liquidity through the monthly cash flow of principal and interest. Mortgage-backed securities, like all securities, are sensitive to change in the interest rate environment, increasing and decreasing in value as interest rates fall and rise. As interest rates fall, the potential increase in prepayments can reduce the yield on the mortgage-backed securities portfolio, and reinvestment of the proceeds will be at lower yields. Conversely, rising interest rates may reduce cash flows from prepayments and extend anticipated duration of these assets. We monitor the changes in interest rates, cash flows and duration, in accordance with our investment policies. Management seeks out investment securities with an attractive spread over our cost of funds.

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. For debt securities, the primary consideration in determining whether impairment is other-than-temporary is whether or not Valley expects to collect all contractual cash flows.

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 December 31, 2018.

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Held to maturity investment grades:*				
AAA Rated	$1,628,611	$ 9,684	$(36,504)	$1,601,791
AA Rated	285,607	4,113	(1,698)	288,022
A Rated	36,606	366	(353)	36,619
BBB Rated	3,000	60	—	3,060
Non-investment grade	—	—	—	—
Not rated	114,422	213	(9,184)	105,451
Total investment securities held to maturity	$2,068,246	$ 14,436	$(47,739)	$2,034,943
Available for sale investment grades:*				
AAA Rated	$1,616,252	$ 1,725	$(43,851)	$1,574,126
AA Rated	88,204	42	(1,705)	86,541
A Rated	21,227	27	(412)	20,842
BBB Rated	17,982	127	(367)	17,742
Non-investment grade	10,436	—	(1,267)	9,169
Not rated	42,303	74	(1,253)	41,124
Total investment securities available for sale	$1,796,404	$ 1,995	$(48,855)	$1,749,544

* Rated using external rating agencies (primarily S&P and Moody’s). Ratings categories include 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 $114.4 million in investments not rated by the rating agencies with aggregate unrealized losses of $9.2 million at December 31, 2018. The unrealized losses for this category included $5.9 million of unrealized losses related to 4 single-issuer bank trust preferred issuances with a combined amortized cost of $36 million. All single-issuer bank 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 December 31, 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 years ended December 31, 2018, 2017 and 2016 as the collateral supporting much of the investment securities has improved or performed as expected. During the fourth quarter of 2018, we sold all of our private label mortgage-backed securities classified as available for sale, including securities that were previously impaired and rated non-investment grade, for an aggregate net loss of $1.5 million.

Loan Portfolio

The following table reflects the composition of the loan portfolio for the years indicated.

	At December 31,				
	2018	2017	2016	2015	2014
	($ in thousands)				
Commercial and industrial	$4,331,032	$2,741,425	$2,638,195	$2,540,491	$2,251,111
Commercial real estate:					
Commercial real estate	12,407,275	9,496,777	8,719,667	7,424,636	6,160,881
Construction	1,488,132	851,105	824,946	754,947	533,134
Total commercial real estate	13,895,407	10,347,882	9,544,613	8,179,583	6,694,015
Residential mortgage	4,111,400	2,859,035	2,867,918	3,130,541	2,576,372
Consumer:					
Home equity	517,089	446,280	469,009	511,203	497,247
Automobile	1,319,571	1,208,902	1,139,227	1,239,313	1,144,831
Other consumer	860,970	728,056	577,141	441,976	310,337
Total consumer loans	2,697,630	2,383,238	2,185,377	2,192,492	1,952,415
Total loans *	$25,035,469	$18,331,580	$17,236,103	$16,043,107	$13,473,913
As a percent of total loans:					
Commercial and industrial	17.3 %	15.0 %	15.3 %	15.8 %	16.7 %
Commercial real estate	55.5	56.4	55.4	51.0	49.7
Residential mortgage	16.4	15.6	16.6	19.5	19.1
Consumer loans	10.8	13.0	12.7	13.7	14.5
Total	100 %	100 %	100 %	100 %	100 %

* Total loans are net of unearned premiums and deferred loan costs of $21.5 million, $22.2 million, $15.3 million and $3.5 million at December 31, 2018, 2017, 2016 and 2015, respectively, as compared to unearned discounts and deferred loan fees of $9.0 million at December 31, 2014.

Total loans increased by $6.7 billion to $25.0 billion at December 31, 2018 from December 31, 2017, net of residential mortgage loans sold during 2018. Adjusted for $3.7 billion of loans acquired from USAB on January 1, 2018, total loans grew by 13.4 percent in 2018 due to strong demand in most loan categories discussed further below. During 2018, Valley also originated $406.1 million of residential mortgage loans for sale rather than investment. Loans held for sale totaled $35.2 million and $15.1 million at December 31, 2018 and 2017, respectively. See additional information regarding our residential mortgage loan activities below.

Our loan portfolio includes PCI loans, which are loans acquired at a discount that is due, in part, to credit quality. At December 31, 2018, our PCI loan portfolio increased $2.8 billion to $4.2 billion as compared to December 31, 2017 primarily due to the PCI loan classification of all the loans acquired from USAB on January 1, 2018.

Commercial and industrial loans totaled $4.3 billion at December 31, 2018 and increased by $1.6 billion from December 31, 2017 mainly due to a $1.0 billion increase from December 31, 2017 in the non-PCI loan portfolio, and $583 million of PCI loans acquired from USAB. The increase in non-PCI loans was due to strong organic growth mostly driven by new small to middle market lending relationships within our regions established by focused calling efforts by our experienced lending teams. We have enhanced the commercial teams through targeted hires over the last 12 to 18 months. The growth is also partly due to our lending teams in the new Florida markets, and, to a lesser extent, increased new business investment by pre-existing Valley relationships. While we are optimistic about the first quarter of 2019 and current loan pipeline, we do expect some leveling off of loan growth as compared to 2018 due to a number of factors, including a competitive marketplace for strong borrowers, lower business investment, a decline in the initial expansion opportunities with existing customers in the Tampa, Florida market, as well as normal PCI and other loan repayments.

Commercial real estate loans (excluding construction loans) increased $2.9 billion to $12.4 billion at December 31, 2018 from December 31, 2017 mainly due to $1.7 billion of PCI loans acquired from USAB and a $1.4 billion increase in non-PCI loan portfolio from December 31, 2017, partly offset by normal PCI loan repayments. The increase in non-PCI loans was primarily due to strong organic loan volumes generated across a broad-based segment of borrowers within the commercial real estate portfolio mainly from pre-exiting relationships in our Florida market area where we have taken full advantage of Valley's higher lending

capacity with former USAB customers, as well as targeted growth in New Jersey and New York. Construction loans totaled $1.5 billion at December 31, 2018 and increased $637.0 million from December 31, 2017 partly due to $338 million of PCI loans acquired from USAB. The remaining net increase was mainly driven by organic growth in the new Florida markets, as well as advances on existing construction projects.

Residential mortgage loans totaled $4.1 billion at December 31, 2018 and increased by $1.3 billion from December 31, 2017 due to strong production from our home mortgage consultant team over the past 12 months. Our new and refinanced residential mortgage loan originations increased 82.4 percent to $1.7 billion for the year ended December 31, 2018 as compared to $955.7 million in 2017. Of the $1.7 billion in total originations, $262 million represented Florida residential mortgage loans. During 2018, Valley sold $676 million of residential mortgages originated for sale as compared to approximately $801 million of mortgages sold during the year ended December 31, 2017. We retain mortgage originations based on credit criteria and loan to value levels, the composition of our interest earning assets and interest bearing liabilities and our ability to manage the interest rate risk associated with certain levels of these instruments. From time to time, we purchase residential mortgage loans originated by, and sometimes serviced by, other financial institutions based on several factors, including current loan origination volumes, market interest rates, excess liquidity, CRA and other asset/liability management strategies. Purchased residential mortgage loans are generally selected using Valley’s normal underwriting criteria at the time of purchase and are sometimes partially or fully guaranteed by third parties or insured by government agencies such as the Federal Housing Administration (FHA). During 2018, Valley purchased approximately $105 million of 1-4 family loans, qualifying for CRA purposes.

Our residential mortgage production declined approximately 12 percent in the fourth quarter of 2018 as compared to the linked third quarter of 2018. However, we have seen good loan application volumes in the early stages of the first quarter of 2019 and the current economy and market interest rates for residential mortgages have remained favorable for consumer demand.

Consumer loans totaled $2.7 billion at December 31, 2018 and increased $314.4 million from December 31, 2017 mainly due to growth in automobile and secured personal lines of credit. Automobile loans increased $110.7 million to $1.3 billion at December 31, 2018 from December 31, 2017 primarily due to higher indirect auto application activity during the second half of 2018. Additionally, our Florida dealership network contributed over $155 million in auto loan originations, representing approximately 24 percent of Valley's total new auto loan production for 2018 as compared to $106 million, or 19 percent, of total originations in 2017. While we're optimistic that this positive trend in new loan production will continue into the first quarter of 2019, we can provide no assurance that our auto loans will not decline in future periods. Other consumer loans increased $132.9 million to $861.0 million at December 31, 2018 as compared to 2017 largely due to continued strong growth and customer usage of collateralized personal lines of credit that allow the customer to manage their liquidity needs by accessing the cash value of their whole life insurance policy. Home equity loans increased only $70.8 million in 2018 from $446.3 million at December 31, 2017 mainly due to $91.2 million loans acquired from USAB, partially offset by normal repayment activity. The non-PCI loans slightly declined year over year, as new home equity loan volumes and customer usage of existing home equity lines of credit continued to be weak in 2018. We believe this trend may continue for the first quarter of 2019 due to many factors, including the Tax Act changes that limit the deductibility of mortgage interest expense for homeowners.

Despite the overall strong organic loan growth experienced in 2018, we expect this trend to moderately slowdown in both commercial and consumer lending activities in 2019. However, we will continue to focus on new niche commercial loan programs to increase the overall yield of our loan portfolio and provide supplemental growth opportunities. For 2019, we anticipate overall loan portfolio growth in the range of 6 to 8 percent. However, there can be no assurance that we will achieve such levels, or balances will not decline from December 31, 2018 given the potential for unforeseen changes in consumer confidence, the economy and other market conditions.

Most of our lending is in northern and central New Jersey, New York City, Long Island, and Florida, with the exception of smaller auto and residential mortgage loan portfolios derived primarily from other neighboring states of New Jersey, 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. Geographically, we may make further inroads into our primary lending markets through bank acquisitions, such as our recent acquisition of USAB, as well as select de novo branch efforts or adding lending staff.

The following table reflects the contractual maturity distribution of the commercial and industrial and construction loans within our loan portfolio as of December 31, 2018:

	One Year or Less	One to Five Years	Over Five Years	Total
	(in thousands)			
Commercial and industrial—fixed-rate	$570,642	$747,242	$953,144	$2,271,028
Commercial and industrial—adjustable-rate	517,618	677,808	864,578	2,060,004
Construction—fixed-rate	228,724	89,687	40,526	358,937
Construction—adjustable-rate	719,553	282,150	127,492	1,129,195
	$2,036,537	$1,796,887	$1,985,740	$5,819,164

We may renew loans at maturity when requested by a customer. In such instances, we generally conduct a review which includes an analysis of the borrower’s financial condition and, if applicable, a review of the adequacy of collateral via a new appraisal from an independent, bank approved, certified or licensed property appraiser or readily available market resources. A rollover of the loan at maturity may require a principal reduction or other modified terms.

Purchased Credit-Impaired Loans (Including Covered Loans)

PCI loans increased $2.8 billion to $4.2 billion at December 31, 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 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 of residential mortgage and other consumer loans totaled $27.6 million at December 31, 2018.

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 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 tables summarize the changes in the carrying amounts of PCI loans and the accretable yield on these loans for the years ended December 31, 2018 and 2017.

	2018		2017	
	Carrying Amount	Accretable Yield	Carrying Amount	Accretable Yield
	(in thousands)			
Balance, beginning of the period	$1,387,215	$282,009	$1,771,502	$294,514
Acquisition	3,736,984	559,907	—	—
Accretion	235,741	(235,741)	89,770	(89,770)
Payments received	(1,169,661)	—	(470,523)	—
Net increase in expected cash flows	—	269,783	—	77,265
Transfers to other real estate owned	(193)	—	(3,534)	—
Balance, end of the period	$4,190,086	$875,958	$1,387,215	$282,009

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. The net increase in the expected cash flows totaling approximately $269.8 million for the year ended December 31, 2018 was largely due to higher interest rates and increased construction loan balances (mainly acquired from USAB) captured in the cash flow reforecast in the fourth quarter of 2018. The net increase in the expected cash flows totaling $77.3 million for the year ended December 31, 2017 was largely due to a decrease in the expected losses for certain PCI loan pools during the fourth quarter of 2017.

Non-performing Assets

Non-performing assets (NPAs), which exclude non-performing PCI loans, include non-accrual loans, other real estate owned (OREO) and other repossessed assets (which consist of automobiles) at December 31, 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 fair value, less estimated costs to sell, or cost thereafter. The non-performing assets totaling $98.6 million at December 31, 2018 increased 71.6 percent over the last 12-month period (as shown in the table below) primarily due to higher non-accrual commercial and industrial loans, which included $58.4 million of non-accrual taxi medallion loans at December 31, 2018 as compared to $14.2 million of such loans at December 31, 2017. NPAs as a percentage of total loans and NPAs totaled 0.39 percent and 0.31 percent at December 31, 2018 and 2017, respectively. Despite the year over year increase largely driven by the taxi medallion loan portfolio, we believe the total NPAs has remained relatively low as a percentage of the total loan portfolio and NPAs over the past five years. The moderate level of NPAs is reflective of our consistent approach to the loan underwriting criteria for both Valley originated loans and loans purchased from third parties. 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 5 to the consolidated financial statements.

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:

	At December 31,				
	2018	2017	2016	2015	2014
	($ in thousands)				
Accruing past due loans [1]					
30 to 59 days past due					
Commercial and industrial	$13,085	$3,650	$6,705	$3,920	$1,630
Commercial real estate	9,521	11,223	5,894	2,684	8,938
Construction	2,829	12,949	6,077	1,876	448
Residential mortgage	16,576	12,669	12,005	6,681	6,200
Total Consumer	9,740	8,409	4,197	3,348	2,982
Total 30 to 59 days past due	51,751	48,900	34,878	18,509	20,198
60 to 89 days past due					
Commercial and industrial	3,768	544	5,010	524	1,102
Commercial real estate	530	—	8,642	—	113
Construction	—	18,845	—	2,799	—
Residential mortgage	2,458	7,903	3,564	1,626	3,575
Total Consumer	1,386	1,199	1,147	626	764
Total 60 to 89 days past due	8,142	28,491	18,363	5,575	5,554
90 or more days past due					
Commercial and industrial	6,156	—	142	213	226
Commercial real estate	27	27	474	131	49
Construction	—	—	1,106	—	3,988
Residential mortgage	1,288	2,779	1,541	1,504	1,063
Total Consumer	341	284	209	208	152
Total 90 or more days past due	7,812	3,090	3,472	2,056	5,478
Total accruing past due loans	$67,705	$80,481	$56,713	$26,140	$31,230
Non-accrual loans [1]					
Commercial and industrial	$70,096	$20,890	$8,465	$10,913	$8,467
Commercial real estate	2,372	11,328	15,079	24,888	22,098
Construction	356	732	715	6,163	5,223
Residential mortgage	12,917	12,405	12,075	17,930	17,760
Total Consumer	2,655	1,870	1,174	2,206	2,209
Total non-accrual loans	88,396	47,225	37,508	62,100	55,757
Non-performing loans held for sale	—	—	—	—	7,130
Other real estate owned (OREO) [2]	9,491	9,795	9,612	13,563	14,249
Other repossessed assets	744	441	384	437	1,232
Non-accrual debt securities	—	—	1,935	2,142	4,729
Total non-performing assets	$98,631	$57,461	$49,439	$78,242	$83,097
Performing troubled debt restructured loans	$77,216	$117,176	$85,166	$77,627	$97,743
Total non-accrual loans as a % of loans	0.35 %	0.26 %	0.22 %	0.39 %	0.41 %
Total NPAs as a % of loans and NPAs	0.39	0.31	0.29	0.49	0.61
Total accruing past due and non-accrual loans as a % of loans	0.62	0.70	0.55	0.55	0.65
Allowance for loan losses as a % of non-accrual loans	171.79	255.92	305.05	170.98	183.57

(1) Past due loans and non-accrual loans exclude PCI loans that are accounted for on a pool basis.

(2) This table excludes covered OREO properties subject to loss-sharing agreements with the FDIC totaling $558 thousand, $5.0 million and $9.2 million at December 31, 2016, 2015, and 2014, respectively. There were no covered OREO properties at December 31, 2018 and 2017.

Loans past due 30 to 59 days increased $2.9 million to $51.8 million at December 31, 2018 as compared to $48.9 million at December 31, 2017, mostly due to an increase in commercial and industrial loan delinquencies, partially offset by decreases in construction loan and commercial real estate loan delinquencies. Commercial and industrial loan delinquencies increased $9.4 million as compared to December 31, 2017 partly due to two loan relationships in the normal process of renewal totaling $6.0 million at December 31, 2018. Construction loans within this delinquency category decreased $10.1 million to $2.8 million at December 31, 2018 as compared to one year ago mainly due to two loan relationships reported at December 31, 2017 of which both were subsequently brought current to their contractual terms.

Loans past due 60 to 89 days decreased $20.3 million to $8.1 million at December 31, 2018 as compared to December 31, 2017 largely due to an $18.8 million decrease in construction loan delinquencies. This decrease was mainly due to four loan relationships in the normal process of renewal or collection that were included in this loan category at December 31, 2017.

Loans 90 days or more past due and still accruing increased $4.7 million to $7.8 million at December 31, 2018 as compared to December 31, 2017. Commercial and industrial loan delinquencies increased $6.2 million mainly due to one large loan relationship in the process of collection included in this category at December 31, 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 increased $41.2 million to $88.4 million at December 31, 2018 as compared to December 31, 2017 mainly due to an increase in taxi medallion loans within the commercial and industrial loan category. Non-accrual taxi medallion loans increased $44.3 million to $58.5 million at December 31, 2018 as compared to $14.2 million at December 31, 2017 mainly due to continued weakness in the New York City taxi industry. The majority of the non-accrual taxi medallion loans were previously performing troubled debt restructured (TDR) loans and included in our impaired loans at both December 31, 2018 and 2017. See further discussion of our taxi medallion loan portfolio below.

Although the timing of collection is uncertain, management believes that most of the non-accrual loans at December 31, 2018, are well secured and largely collectible based on, in part, our quarterly review of impaired loans and the valuation of the underlying collateral, if applicable. Our impaired loans (mainly consisting of non-accrual commercial and industrial loans and commercial real estate loans over $250 thousand and all troubled debt restructured loans) totaled $156.6 million at December 31, 2018 and had $33.0 million in related specific reserves included in our total allowance for loan losses. If interest on non-accrual loans had been accrued in accordance with the original contractual terms, such interest income would have amounted to approximately $3.6 million, $2.5 million and $2.1 million for the years ended December 31, 2018, 2017 and 2016, respectively; none of these amounts were included in interest income during these periods.

During 2018, we continued to closely monitor the performance of our New York City (NYC) and Chicago taxi medallion loans totaling $121.8 million and $8.4 million, respectively, within the commercial and industrial loan portfolio at December 31, 2018. While most of the taxi medallion loans are currently performing to their contractual terms, continued negative trends in the market valuations of the underlying taxi medallion collateral due to competing car service providers and other external factors could impact the future performance and internal classification of this portfolio. At December 31, 2018, the medallion portfolio included impaired loans totaling $73.7 million with related reserves of $27.9 million within the allowance for loan losses as compared to impaired loans totaling $63.9 million with related reserves of $9.1 million at December 31, 2017. At December 31, 2018, the impaired medallion loans largely consisted of $58.5 million of non-accrual taxi cab medallion loans classified as doubtful, as well as performing troubled debt restructured (TDR) loans classified as substandard loans.

Valley's historical taxi medallion lending criteria was conservative in regard to capping the loan amounts in relation to the prevailing market valuations at the time of origination, as well as obtaining personal guarantees and other collateral in certain instances. However, the severe decline in the market valuation of taxi medallions over the last several years has adversely affected the estimated fair valuation of these loans and, as a result, increased the level of our allowance for loan losses at December 31, 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 $10.6 million within the allowance for loan losses based upon the impaired taxi medallion loan balances at December 31, 2018. Additionally, Valley currently has $22.5 million of performing non-impaired taxi medallion loans which are scheduled to mature in 2019, and $18.3 million that mature between 2023 and 2027. If the loans with 2019 maturities were renewed and became TDRs, an additional reserve of $8.6 million would be required based on the allowance methodology at December 31, 2018.

OREO (which consists of 52 commercial and residential properties) decreased $304 thousand to $9.5 million at December 31, 2018 as compared to $9.8 million at December 31, 2017. See additional information regarding OREO and other repossessed assets, including our foreclosed asset activity, in Notes 1 and 3 to the consolidated financial statements.

Troubled debt restructured loans (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 $40.0 million to $77.2 million at December 31, 2018 as compared to $117.2 million at December 31, 2017 mainly due to the taxi medallion loans migrating to non-accrual loan status during 2018. Performing TDRs consisted of 119 loans and 141 loans (primarily in the commercial and industrial loan and commercial real estate portfolios) at December 31, 2018 and 2017, respectively. On an aggregate basis, the $77.2 million in performing TDRs at December 31, 2018 had a modified weighted average interest rate of approximately 5.37 percent as compared to a pre-modification weighted average interest rate of 4.70 percent. See Note 5 to the consolidated financial statements for additional disclosures regarding our TDRs. 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.

Potential Problem Loans

Although we believe that substantially all risk elements at December 31, 2018 have been disclosed in the categories presented above, it is possible that for a variety of reasons, including economic conditions, certain borrowers may be unable to comply with the contractual repayment terms on certain real estate and commercial loans. As part of the analysis of the loan portfolio, management determined that there were approximately $142.8 million and $146.0 million in potential problem loans (consisting mostly of commercial and industrial loans) at December 31, 2018 and 2017, respectively. Potential problem loans were not classified as non-accrual loans in the non-performing asset table above. Potential problem loans are defined as performing loans for which management has concerns about the ability of such borrowers to comply with the loan repayment terms and which may result in a non-performing loan. Our decision to include performing loans in potential problem loans does not necessarily mean that management expects losses to occur, but that management recognizes potential problem loans carry a higher probability of default. At December 31, 2018, the potential problem loans consisted of various types of performing commercial credits internally risk rated substandard, including taxi medallion loans, because the loans exhibited well-defined weaknesses and required additional attention by management. See further discussion regarding our internal loan classification system at Note 5 to the consolidated financial statements. There can be no assurance that Valley has identified all of its potential problem loans at December 31, 2018.

Asset Quality and Risk Elements

Lending is one of the most important functions performed by Valley and, by its very nature, lending is also the most complicated, risky and profitable part of our business. For our commercial loan portfolio, comprised of commercial and industrial loans, commercial real estate loans, and construction loans, a separate credit department is responsible for risk assessment and periodically evaluating overall creditworthiness of a borrower. Additionally, efforts are made to limit concentrations of credit so as to minimize the impact of a downturn in any one economic sector. We believe our loan portfolio is diversified as to type of borrower and loan. However, loans collateralized by real estate, including $3.4 billion of PCI loans, represent approximately 74 percent of total loans at December 31, 2018. Most of the loans collateralized by real estate are in northern and central New Jersey, New York City and Florida presenting a geographical credit risk if there was a further significant broad-based deterioration in economic conditions within these regions (see Part I, Item 1A. Risk Factors - "Our financial results and condition may be adversely impacted by changing economic conditions").

Consumer loans are comprised of residential mortgage loans, home equity loans, automobile loans and other consumer loans. Residential mortgage loans are secured by 1-4 family properties mostly located in New Jersey, New York and Florida. We do provide mortgage loans secured by homes beyond this primary geographic area; however,

lending outside this primary area has generally consisted of loans made in support of existing customer relationships, as well as targeted purchases of certain loans guaranteed by third parties. Our mortgage loan originations are comprised of both jumbo (i.e., loans with balances above conventional conforming loan limits) and conventional loans based on underwriting standards that generally comply with Fannie Mae and/or Freddie Mac requirements. The weighted average loan-to-value ratio of all residential mortgage originations in 2018 was 70 percent while FICO® (independent objective criteria measuring the creditworthiness of a borrower) scores averaged 748. Home equity and automobile loans are secured loans and are made based on an evaluation of the collateral and the borrower's creditworthiness. In addition to our primary markets, automobile loans are mostly originated in several other contiguous states. Due to the level of our underwriting standards applied to all loans, management believes the out of market loans generally present no more risk than those made within the market. However, each loan or group of loans made outside of our primary markets poses different geographic risks based upon the economy of that particular region.

Management realizes that some degree of risk must be expected in the normal course of lending activities. Allowances are maintained to absorb such loan losses inherent in the portfolio. The allowance for credit losses and related provision are an expression of management's evaluation of the credit portfolio and economic climate.

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, 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 loan losses consists of four elements: (i) specific reserves for individually impaired credits, (ii) reserves for adversely classified, or higher risk rated, loans that are not impaired, (iii) reserves for other loans based on historical loss factors (using the appropriate loss look-back and loss emergence periods) adjusted for both internal and external qualitative risk factors to Valley, including the aforementioned factors, as well as changes in both organic and purchased loan portfolio volumes, the composition and concentrations of credit, new market initiatives, and the impact of competition on loan structuring and pricing, and (iv) an allowance for PCI loan pools impaired subsequent to the acquisition date, if applicable.

The Credit Risk Management Department individually evaluates non-accrual (non-homogeneous) loans within the commercial and industrial loan and commercial real estate loan portfolio segments over $250 thousand and troubled debt restructured loans within all the loan portfolio segments for impairment based on the underlying anticipated method of payment consisting of either the expected future cash flows or the related collateral. If payment is expected solely based on the underlying collateral, an appraisal is completed to assess the fair value of the collateral. Collateral dependent impaired loan balances are written down to the current fair value (less estimated selling costs) of each loan's underlying collateral resulting in an immediate charge-off to the allowance, excluding any consideration for personal guarantees that may be pursued in the Bank's collection process. (See the "Assets and Liabilities Measured at Fair Value on Non-recurring Basis" section of Note 3 to the consolidated financial statements for further details). If repayment is based upon future expected cash flows, the present value of the expected future cash flows discounted at the loan's original effective interest rate is compared to the carrying value of the loan, and any shortfall is recorded as a specific valuation allowance in the allowance for credit losses. At December 31, 2018, a $33.0 million specific valuation allowance was included in the allowance for credit losses related to $156.6 million of impaired loans that had such an allowance. See Note 5 to the consolidated financial statements for more details regarding impaired loans.

The allowance allocations for non-classified loans within all of our loan portfolio segments are calculated by applying historical loss factors by specific loan types to the applicable outstanding loans and unfunded commitments. Loss factors are based on the Bank's historical loss experience over a look-back period determined to provide the appropriate amount of data to accurately estimate expected losses as of period end. Additionally, management assesses the loss emergence period for the expected losses of each loan segment and adjusts each historical loss factor accordingly. The loss emergence period is the estimated time from the date of a loss event (such as a personal bankruptcy) to the actual recognition of the loss (typically via the first full or partial loan charge-off) and is

determined based upon a study of our past loss experience by loan segment. The loss factors may also be adjusted for significant changes in the current loan portfolio quality that, in management's judgment, affect the collectability of the portfolio as of the evaluation date.

The following table summarizes the relationship among loans, loans charged-off, loan recoveries, the provision for credit losses and the allowance for credit losses for the years indicated:

	Years Ended December 31,				
	2018	2017	2016	2015	2014
	($ in thousands)				
Average loans outstanding	$23,340,330	$17,819,003	$16,400,745	$14,447,020	$12,081,683
Beginning balance—Allowance for credit losses	$124,452	$116,604	$108,367	$104,287	$117,112
Loans charged-off:					
Commercial and industrial	(2,515)	(5,421)	(5,990)	(7,928)	(12,722)
Commercial real estate	(348)	(559)	(650)	(1,864)	(4,894)
Construction	—	—	—	(926)	(4,576)
Residential mortgage	(223)	(530)	(866)	(813)	(1,004)
Total Consumer	(4,977)	(4,564)	(3,463)	(3,441)	(3,702)
Total loan charge-offs	(8,063)	(11,074)	(10,969)	(14,972)	(26,898)
Charged-off loans recovered:					
Commercial and industrial	4,623	4,736	2,852	7,233	6,874
Commercial real estate	417	552	2,047	846	2,198
Construction	—	873	10	913	912
Residential mortgage	272	1,016	774	421	248
Total Consumer	2,093	1,803	1,654	1,538	1,957
Total loan recoveries	7,405	8,980	7,337	10,951	12,189
Net charge-offs	(658)	(2,094)	(3,632)	(4,021)	(14,709)
Provision charged for credit losses	32,501	9,942	11,869	8,101	1,884
Ending balance—Allowance for credit losses	$156,295	$124,452	$116,604	$108,367	$104,287
Components of allowance for credit losses:					
Allowance for loan losses	$151,859	$120,856	$114,419	$106,178	$102,353
Allowance for unfunded letters of credit	4,436	3,596	2,185	2,189	1,934
Allowance for credit losses	$156,295	$124,452	$116,604	$108,367	$104,287
Components of provision for credit losses:					
Provision for loan losses *	$31,661	$8,531	$11,873	$7,846	$3,445
Provision for unfunded letters of credit	840	1,411	(4)	255	(1,561)
Provision for credit losses	$32,501	$9,942	$11,869	$8,101	$1,884
Ratio of net charge-offs during the period to average loans outstanding	0.00%	0.01%	0.02%	0.03%	0.12%
Allowance for credit losses as a % of non-PCI loans	0.75	0.73	0.75	0.79	0.89
Allowance for credit losses as a % of total loans	0.62	0.68	0.68	0.68	0.77

* Includes a negative (credit) provision for covered loans totaling $5.9 million for 2014. There was no provision for covered loans in 2018, 2017, 2016, and 2015.

Our net loan charge-offs decreased $1.4 million to $658 thousand in 2018 as compared to $2.1 million in 2017. The improvement in net loan charge-offs as compared to the year ended December 31, 2017 was due, in part, to lower commercial and industrial loan gross charge-offs during 2018.
Net charge-offs have steadily declined over the last four years and have remained relatively low over the last five years as compared to many of our peers. During this five-year period, our net charge-offs were at a high of 0.12 percent of average loans

during 2014 and a low of 0.00 percent of average loans during 2018. The lower level of our net loan charge-offs during 2018 was largely as a result of the continued solid performance of our loan portfolio, strong collections and a favorable economic environment. While we have a positive outlook for the future performance of the loan portfolio and the economy, there can be no assurance that our levels of net charge-offs will not deteriorate in 2019, especially given the relatively modest levels realized in the past five years.

Despite the low level of net loan charge-offs, the provision for credit losses increased $22.6 million to $32.5 million in 2018 as compared to 2017 largely due to strong loan growth and higher allocated reserves for impaired loans (mostly related to taxi medallion loans within commercial and industrial loans).

The following table summarizes the allocation of the allowance for credit losses to specific loan portfolio categories for the past five years:

	2018		2017		2016		2015		2014	
	Allowance Allocation	Percent of Loan Category to total loans	Allowance Allocation	Percent of Loan Category to total loans	Allowance Allocation	Percent of Loan Category to total loans	Allowance Allocation	Percent of Loan Category to total loans	Allowance Allocation	Percent of Loan Category to total loans
	($ in thousands)									
Loan Category:										
Commercial and industrial*	$95,392	17.3 %	$60,828	15.0 %	$53,005	15.3 %	$50,956	15.8 %	$45,610	16.7 %
Commercial real estate:										
Commercial real estate	26,482	49.6	36,293	51.8	36,405	50.6	32,037	46.3	27,426	45.7
Construction	23,168	5.9	18,661	4.6	19,446	4.8	15,969	4.7	15,414	4.0
Residential mortgage	5,041	16.4	3,605	15.6	3,702	16.6	4,625	19.5	5,093	19.1
Total Consumer	6,212	10.8	5,065	13.0	4,046	12.7	4,780	13.7	5,179	14.5
Unallocated	—	—	—	—	—		—	—	5,565	—
Total allowance for credit losses	$156,295	100 %	$124,452	100 %	$116,604	100 %	$108,367	100 %	$104,287	100 %

* Includes the allowance for unfunded letters of credit.

The allowance for credit losses, comprised of our allowance for loan losses and reserve for unfunded letters of credit, as a percentage of total loans was 0.62 percent at December 31, 2018 and 0.68 percent at December 31, 2017. Our allowance allocations for losses at December 31, 2018 increased across most loan categories mainly due strong organic loan growth. The increased allowance allocation for the commercial and industrial loans category (see table above) at December 31, 2018 was also partly due to higher specific reserves for impaired taxi medallion loans. At December 31, 2018, the allowance allocation for commercial real estate loans declined to $26.5 million from $36.3 million at December 31, 2017 mainly due to a continued decline in historical loss rates over the prolonged current economic cycle. Additionally, our estimate of the allowance for credit losses at December 31, 2018 was impacted by the level of net charge-offs and internally classified loans, assumptions based on the current economic environment, as well as other qualitative factors.

Our allowance for credit losses as a percentage of total non-PCI loans (excluding PCI loans with carrying values totaling approximately $4.2 billion) was 0.75 percent at December 31, 2018 as compared to 0.73 percent at December 31, 2017. PCI loans, largely acquired through prior bank acquisitions, are accounted for on a pool basis and initially recorded net of fair valuation discounts related to credit which may be used to absorb future losses on such loans before any allowance for loan losses is recognized subsequent to acquisition. Due to the adequacy of such

discounts, there were no allowance reserves related to PCI loans at December 31, 2018 and 2017. See Notes 1 and 6 to the consolidated financial statements for additional information regarding our allowance for loan losses.
Prior to December 31, 2015, the allowance also contained reserves identified as the unallocated portion in the table above to cover inherent losses within a given loan category which have not been otherwise reviewed or measured on an individual basis. Such reserves represented management's attempt to ensure that the overall allowance reflected a margin for imprecision and the uncertainty that is inherent in estimates of probable credit losses. During 2015, Valley refined and enhanced its assessment of the adequacy of the allowance for loan losses. As a result, Valley no longer has an "unallocated" segment in its allowance for credit losses, as the risks and uncertainties meant to be captured by the unallocated allowance have been included in the qualitative framework for the respective portfolios at December 31, 2018, 2017, 2016 and 2015. As such, the unallocated allowance has in essence been reallocated to the certain portfolios based on the risks and uncertainties it was meant to capture.

Loan Repurchase Contingencies

We engage in the origination of residential mortgages for sale into the secondary market. During 2016, loan sales increased significantly from 2015 and 2014 as refinance activity once again strengthened due to a favorably low interest rate environment for most of the year. While refinance activity declined in 2017, Valley expanded its efforts in the purchased home loan market and expanded its team of home mortgage consultants. As a result of these efforts combined with portfolio loan sales, loan sales totaled approximately $676 million and $801 million for 2018 and 2017, respectively.

In connection with loan sales, we make representations and warranties, which, if breached, may require us to repurchase such loans, substitute other loans or indemnify the purchasers of such loans for actual losses incurred due to such loans. However, the performance of our loans sold has been historically strong due to our strict underwriting standards and procedures. Over the past several years, we have experienced a nominal amount of repurchase requests, only a few of which have actually resulted in repurchases by Valley (only five loan repurchases in 2018 and two loan repurchase in 2017). None of the loan repurchases resulted in material loss. Accordingly, no reserves pertaining to loans sold were established on our consolidated financial statements at December 31, 2018 and 2017. See Item 1A. Risk Factors - "We may incur future losses in connection with repurchases and indemnification payments related to mortgages that we have sold into the secondary market" of this Annual Report for additional information.

Capital Adequacy

A significant measure of the strength of a financial institution is its shareholders' equity. At December 31, 2018 and 2017, shareholders' equity totaled approximately $3.4 billion and $2.5 billion, or 10.5 percent and 10.6 percent of total assets, respectively. During 2018, total shareholders' equity increased by $817.3 million primarily due to (i) the additional capital of $737.2 million issued in the USAB acquisition, (ii) net income of $261.4 million, (iii) a $17.2 million increase attributable to the effect of our stock incentive plan, and (iv) net proceeds of $1.0 million from the reissuance of treasury stock and issuance of authorized common shares issued under our dividend reinvestment plan totaling 87 thousand shares. The positive changes were partially offset by (i) cash dividends declared on common and preferred stock totaling a combined $159.0 million, (ii) $23.4 million of other comprehensive losses, and (iii) a $17.1 million net cumulative effect adjustment to retained earnings for the adoption of new accounting guidance as of January 1, 2018.

Valley and Valley National Bank are subject to the regulatory capital requirements administered by the Federal Reserve Bank and the OCC. Quantitative measures established by regulation to ensure capital adequacy require Valley and Valley National Bank to maintain minimum amounts and ratios of common equity Tier 1 capital, total and Tier 1 capital to risk-weighted assets, and Tier 1 capital to average assets, as defined in the regulations.

Effective January 1, 2015, Valley implemented the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Basel III final rules require a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5 percent, Tier 1 capital to risk-weighted assets of 6.0 percent, ratio of total capital to risk-weighted assets of 8.0 percent, and minimum leverage ratio of 4.0 percent. The rule changes included the implementation of a new capital conservation buffer that is added to the minimum requirements for capital adequacy purposes. The capital conservation buffer was subject to a three-year phase-in period that started on January 1, 2016, at 0.625 percent of risk-weighted assets and increases each subsequent year by 0.625 percent until reaching its final level of 2.5 percent, which was fully phased-in on January 1, 2019. As of December 31, 2018 and 2017, Valley and Valley National Bank exceeded all capital adequacy requirements with the capital conservation buffer under the Basel III Capital Rules. See Note 17 for Valley's and Valley National Bank's regulatory capital positions and capital ratios at December 31, 2018 and 2017.

Typically, our primary source of capital growth is through retention of earnings. Our rate of earnings retention is derived by dividing undistributed earnings per common share by earnings (or net income available to common stockholders) per common share. Our retention ratio was 41.3 percent and 24.1 percent for the years ended December 31, 2018 and 2017, respectively. Our retention ratio increased from the year ended December 31, 2017, however it was negatively impacted by infrequent charges, including legal expenses related to litigation reserves, USAB merger expense, branch asset impairment and severance costs related to our Branch Transformation strategy.

Our retention ratio is expected to improve in 2019 due to, among other factors, higher earnings from continued loan growth and further implementation of our LIFT and Branch Transformation initiatives.
Cash dividends declared amounted to $0.44 per common share for both years ended December 31, 2018 and 2017. The Board is committed to examining and weighing relevant facts and considerations, including its commitment to shareholder value, each time it makes a cash dividend decision. The Federal Reserve has cautioned all bank holding companies about distributing dividends which may reduce the level of capital or not allow capital to grow in light of the increased capital levels as required under the Basel III rules. Prior to the date of this filing, Valley has received no objection or adverse guidance from the FRB or the OCC regarding the current level of its quarterly common stock dividend.

Valley maintains an effective shelf registration statement with the SEC that allows us to periodically offer and sell in one or more offerings, individually or in any combination, our common stock, preferred stock and other non-equity securities. The shelf registration statement provides Valley with capital raising flexibility and enables Valley to promptly access the capital markets in order to pursue growth opportunities that may become available in the future and permits Valley to comply with any changes in the regulatory environment that call for increased capital requirements. Valley's ability, and any decision to issue and sell securities pursuant to the shelf registration statement, is subject to market conditions and Valley's capital needs at such time. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both. Such offerings may be necessary in the future due to several reasons beyond management's control, including numerous external factors that could negatively impact the strength of the U.S. economy or our ability to maintain or increase the level of our net income. See Note 18 to the consolidated financial statements for additional information on Valley's stock issuances.

Contractual Obligations and Off-Balance Sheet Arrangements

Contractual Obligations and Commitments. In the ordinary course of operations, Valley enters into various financial obligations, including contractual obligations that may require future cash payments. As a financial services provider, we routinely enter into commitments to extend credit, including loan commitments, standby and commercial letters of credit. Such commitments are subject to the same credit policies and approval process accorded to loans made by the Bank. See Note 15 of the consolidated financial statements for additional information.

The following table summarizes Valley's contractual obligations and other commitments to make future payments as of December 31, 2018. Payments for deposits, borrowings and debentures do not include interest. Payments related to leases, capital expenditures, other purchase obligations and commitments to sell loans are based on actual payments specified in the underlying contracts. Commitments to extend credit and standby letters of credit are presented at contractual amounts; however, since many of these commitments are expected to expire unused or only partially used based upon our historical experience, the total amounts of these commitments do not necessarily reflect future cash requirements.

	Note to Financial Statements	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
				(in thousands)		
Contractual obligations:						
Time deposits	Note 9	$4,987,313	$1,714,126	$ 320,014	$42,531	$7,063,984
Long-term borrowings [1]	Note 10	255,000	865,000	375,000	160,000	1,655,000
Junior subordinated debentures issued to capital trusts [1]	Note 11	—	—	—	60,827	60,827
Operating leases	Note 15	29,093	58,304	52,626	262,200	402,223
Capital expenditures		51,526	—	—	—	51,526
Other purchase obligations [2]		44,357	1,488	44	—	45,889
Total		$5,367,289	$2,638,918	$ 747,684	$525,558	$9,279,449
Other commitments:						
Commitments to extend credit	Note 15	$3,709,389	$1,623,627	$ 508,858	$805,257	$6,647,131
Standby letters of credit	Note 15	210,685	41,803	37,377	27,076	316,941
Commitments to sell loans	Note 15	58,897	—	—	—	58,897
Total		$3,978,971	$1,665,430	$ 546,235	$832,333	$7,022,969

[1] Amounts presented consist of the contractual principal balances. Carrying values and call dates are set forth in Notes 10 and 11 to the consolidated financial statements for long-term borrowings and junior subordinated

debentures issued to capital trusts, respectively.

(2) This category primarily consists of contractual obligations for communication and technology costs.

Valley also has obligations under its pension benefit plans, not included in the above table, as further described in Note 12 of the consolidated financial statements.

Derivative Instruments and Hedging Activities. We are exposed to certain risks arising from both our business operations and economic conditions. We principally manage our exposures to a wide variety of business and operational risks through management of our core business activities. We manage economic risks, including interest rate and liquidity risks, primarily by managing the amount, sources, and duration of our assets and liabilities and, from time to time, the use of derivative financial

instruments. Specifically, we enter 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. Our derivative financial instruments are used to manage differences in the amount, timing, and duration of our known or expected cash receipts and our known or expected cash payments mainly related to certain variable-rate borrowings and fixed-rate loan assets. Valley also 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. See Note 15 to the consolidated financial statements for quantitative information on our derivative financial instruments and hedging activities.

Trust Preferred Securities. In addition to the commitments and derivative financial instruments of the types described above, our off-balance sheet arrangements include a $1.8 million ownership interest in the common securities of our statutory trusts to issue trust preferred securities at December 31, 2018. See Note 11 of the consolidated financial statements for additional information on our statutory trusts and the related junior subordinated debentures and trust preferred securities.

Results of Operations—2017 Compared to 2016

Net interest income on a tax equivalent basis increased by $50.1 million to $676.6 million for 2017 compared with $626.5 million for 2016. The increase was mainly driven by a $1.4 billion increase in average loan balances, partially offset by interest expense related to a $1.1 billion increase in average interest bearing liabilities as compared to 2016. Average interest earning assets totaling $21.5 billion for the year ended December 31, 2017 increased $1.7 billion, or 8.4 percent, as compared to 2016. Average loan balances increased $1.4 billion to $17.8 billion in 2017 and drove the $56.8 million increase in the interest income on a tax equivalent basis for loans as compared to 2016. The growth in average loans during 2017 was fueled mostly by solid demand for commercial real estate loans and secured personal lines of credit throughout the year, supplemented by $411 million of purchased loans primarily consisting of participations in multi-family loans and whole 1-4 family loans that were a mix of qualifying and non-qualifying CRA loans. Average investment securities increased $339.5 million to approximately $3.5 billion in 2017 due to moderate expansion of the taxable portfolio mostly within the residential mortgage-backed securities classified as available for sale category. Average federal funds sold and other interest bearing deposits decreased $98.5 million to $189.6 million for the year ended December 31, 2017 as compared to 2016 mostly due to lower levels of overnight liquidity held primarily by fluctuations in the timing of new loan originations and loan purchases.

Average interest bearing liabilities increased $1.1 billion to $15.6 billion for the year ended December 31, 2017 from the same period in 2016 due to increases in several funding categories. Average savings, NOW and money market accounts increased $371.1 million mostly due to retail money market account gathering initiatives during the second half of 2017 partially offset by slightly lower utilization of brokered money market account balances in our loan growth funding strategy and other liquidity needs in 2017. Average time deposits increased $225.4 million to $3.3 billion for 2017 as compared to 2016 mainly due to similar retail certificate of deposit strategies executed in the second half of 2017. Average short-term and long-term borrowings increased $239.2 million and $279.7 million in 2017, respectively, as compared to 2016 due, in part, to a higher level of FHLB borrowings used to fund new loan and investment activities, partially offset by declines in both short and long-term securities sold under agreements to repurchase.

Non-interest income represented 10.9 percent and 11.9 percent of total interest income plus non-interest income for 2017 and 2016, respectively. For the year ended December 31, 2017, non-interest income increased $216 thousand as compared to 2016 mainly due to increases in net gains on sales of loans, trust and investment services income, and fees from loans servicing, partially offset by lower insurance commissions.

Net gains on sales of loans decreased $1.2 million for the year ended December 31, 2017 as compared to 2016 largely due to lower spreads (or margins) on individual loan sales despite a higher volume of residential mortgage loans sold

during 2017.

Trusts and investment services income increased $1.2 million for the year ended December 31, 2017 as compared to 2016 mainly due to higher investment and advisory fees resulting from increased assets under management during 2017. The increase in assets under management was largely due to higher market valuations and asset appreciation during 2017.

Fees from loan servicing increased $943 thousand for the year ended December 31, 2017 as compared to $6.4 million in 2016 mainly due to the high volume of loans originated for sale and significantly higher sales volumes during 2017. Valley retains loan servicing on the majority of its loans originated and sold in the secondary market.

The increases in non-interest income were partially offset by a decrease in insurance commissions totaling $950 thousand for the year ended December 31, 2017 from $19.1 million in 2016 mainly due to lower volumes of business generated by the Bank's insurance agency subsidiary.

Non-interest expense increased $32.9 million to $509.1 million for the year ended December 31, 2017 as compared to 2016. The increase was mainly attributable to increases in salaries and employee benefits, professional and legal fees, amortization of tax credit investments, and net occupancy and equipment expenses.

Salary and employee benefits expense increased by $18.7 million for the year ended December 31, 2017 due to increased salaries and cash incentive compensation (both paid and accrued) for the year ended December 31, 2017. The increases were largely due to normal increases in annual compensation and incentives, expansion of our technology and home mortgage consultant teams, stock-based compensation expense as well as severance costs totaling $3.8 million related to our LIFT initiative recognized during the third quarter of 2017. Professional and legal fees also increased $8.1 million for the year ended December 31, 2017 as compared to 2016 largely due to advisory and legal fees related to our LIFT program and the acquisition of USAB during 2017. In addition, amortization of tax credit investments increased $7.0 million for the year ended December 31, 2017 as compared to 2016 mostly due to a $4.3 million charge related to the impairment of tax credit investments caused by the Tax Act, as well as normal differences in the timing and amount of such investments and recognition of the related tax credits. Lastly, net occupancy and equipment expenses increased $5.1 million for the year ended December 31, 2017 as compared to 2016 largely due to higher technology equipment related expense.

Income tax expense was $90.8 million for the year ended December 31, 2017, reflecting an effective tax rate of 35.9 percent, as compared to $65.2 million for the year ended 2016, reflecting an effective tax rate of 28.0 percent. The increase in both income tax expense and the effective tax rate in 2017 was primarily caused by the estimated impact of the Tax Act, consisting of an $15.4 million charge resulting from the re-measurement of Valley's estimated net deferred tax asset as of December 31, 2017.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

For information regarding Quantitative and Qualitative Disclosures About Market Risk, see Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Interest Rate Sensitivity.”

Item 8. Financial Statements and Supplementary Data

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2018	2017
	(in thousands except for share data)	
Assets		
Cash and due from banks	$251,541	$243,310
Interest bearing deposits with banks	177,088	172,800
Investment securities:		
Held to maturity (fair value of $2,034,943 at December 31, 2018 and $1,837,620 at December 31, 2017)	2,068,246	1,842,691
Available for sale	1,749,544	1,493,905
Total investment securities	3,817,790	3,336,596
Loans held for sale, at fair value	35,155	15,119
Loans	25,035,469	18,331,580
Less: Allowance for loan losses	(151,859)	(120,856)
Net loans	24,883,610	18,210,724
Premises and equipment, net	341,630	287,705
Bank owned life insurance	439,602	386,079
Accrued interest receivable	95,296	73,990
Goodwill	1,084,665	690,637
Other intangible assets, net	76,990	42,507
Other assets	659,721	542,839
Total Assets	$31,863,088	$24,002,306
Liabilities		
Deposits:		
Non-interest bearing	$6,175,495	$5,224,928
Interest bearing:		
Savings, NOW and money market	11,213,495	9,365,013
Time	7,063,984	3,563,521
Total deposits	24,452,974	18,153,462
Short-term borrowings	2,118,914	748,628
Long-term borrowings	1,654,268	2,315,819
Junior subordinated debentures issued to capital trusts	55,370	41,774
Accrued expenses and other liabilities	231,108	209,458
Total Liabilities	28,512,634	21,469,141
Shareholders' Equity		
Preferred stock, no par value; authorized 50,000,000 shares:		
Series A (4,600,000 shares issued at December 31, 2018 and December 31, 2017)	111,590	111,590
Series B (4,000,000 shares issued at December 31, 2018 and December 31, 2017)	98,101	98,101
Common stock (no par value, authorized 450,000,000 shares; issued 331,634,951 shares at December 31, 2018 and 264,498,643 shares at December 31, 2017)	116,240	92,727
Surplus	2,796,499	2,060,356
Retained earnings	299,642	216,733
Accumulated other comprehensive loss	(69,431)	(46,005)

Treasury stock, at cost (203,734 shares at December 31, 2018 and 29,792 shares at December 31, 2017)	(2,187)	(337)
Total Shareholders' Equity	3,350,454	2,533,165
Total Liabilities and Shareholders' Equity	$31,863,088	$24,002,306

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2018	2017	2016
	(in thousands, except for share data)		
Interest Income			
Interest and fees on loans	$1,033,993	$ 734,474	$ 680,876
Interest and dividends on investment securities:			
Taxable	87,306	72,676	58,143
Tax-exempt	21,504	15,399	15,537
Dividends	13,209	9,812	6,206
Interest on other short-term investments	3,236	1,793	1,126
Total interest income	1,159,248	834,154	761,888
Interest Expense			
Interest on deposits:			
Savings, NOW and money market	108,394	55,300	39,787
Time	81,959	42,546	37,775
Interest on short-term borrowings	45,930	18,034	12,022
Interest on long-term borrowings and junior subordinated debentures	65,762	58,227	59,190
Total interest expense	302,045	174,107	148,774
Net Interest Income	857,203	660,047	613,114
Provision for credit losses	32,501	9,942	11,869
Net Interest Income After Provision for Credit Losses	824,702	650,105	601,245
Non-Interest Income			
Trust and investment services	12,633	11,538	10,345
Insurance commissions	15,213	18,156	19,106
Service charges on deposit accounts	26,817	21,529	20,879
(Losses) gains on securities transactions, net	(2,342)	(20)	777
Fees from loan servicing	9,319	7,384	6,441
Gains on sales of loans, net	20,515	20,814	22,030
Bank owned life insurance	8,691	7,338	6,694
Other	43,206	24,967	21,988
Total non-interest income	134,052	111,706	108,260
Non-Interest Expense			
Salary and employee benefits expense	333,816	263,337	243,222
Net occupancy and equipment expense	108,763	92,243	87,140
FDIC insurance assessment	28,266	19,821	20,100
Amortization of other intangible assets	18,416	10,016	11,327
Professional and legal fees	34,141	25,834	17,755
Amortization of tax credit investments	24,200	41,747	34,744
Telecommunication expenses	12,102	9,921	10,021
Other	69,357	46,154	51,816
Total non-interest expense	629,061	509,073	476,125
Income Before Income Taxes	329,693	252,738	233,380
Income tax expense	68,265	90,831	65,234
Net Income	261,428	161,907	168,146
Dividends on preferred stock	12,688	9,449	7,188
Net Income Available to Common Shareholders	$248,740	$ 152,458	$ 160,958
Earnings Per Common Share:			

Basic	$0.75	$0.58	$0.63
Diluted	0.75	0.58	0.63
Cash Dividends Declared Per Common Share	0.44	0.44	0.44
Weighted Average Number of Common Shares Outstanding:			
Basic	331,258,964	264,038,123	254,841,571
Diluted	332,693,718	264,889,007	255,268,336

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Net income	$261,428	$161,907	$168,146
Other comprehensive (loss) income, net of tax:			
Unrealized gains and losses on securities available for sale			
Net (losses) gains arising during the period	(22,932)	352	(4,293)
Less reclassification adjustment for net losses (gains) included in net income	1,857	11	(465)
Total	(21,075)	363	(4,758)
Non-credit impairment losses on available for sale and held to maturity securities			
Net change in non-credit impairment losses on securities	—	498	417
Less reclassification adjustment for accretion of credit impairment losses included in net income	380	(167)	(539)
Total	380	331	(122)
Unrealized gains and losses on derivatives (cash flow hedges)			
Net gains (losses) on derivatives arising during the period	1,874	576	(2,461)
Less reclassification adjustment for net losses included in net income	2,494	5,028	7,641
Total	4,368	5,604	5,180
Defined benefit pension plan			
Net (losses) gains arising during the period	(7,151)	(2,722)	3,298
Amortization of prior service cost	146	191	(181)
Amortization of net loss	447	248	185
Total	(6,558)	(2,283)	3,302
Total other comprehensive (loss) income	(22,885)	4,015	3,602
Total comprehensive income	$238,543	$165,922	$171,748

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

		Common Stock				Accumulated		
	Preferred Stock	Shares	Amount	Surplus	Retained Earnings	Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
	($ in thousands)							
Balance - December 31, 2015	$111,590	253,788	$88,626	$1,927,399	$125,171	$(45,695)	$—	$2,207,091
Net income	—	—	—	—	168,146	—	—	168,146
Other comprehensive income, net of tax	—	—	—	—	—	3,602	—	3,602
Cash dividends declared on preferred stock	—	—	—	—	(7,188)	—	—	(7,188)
Cash dividends declared on common stock	—	—	—	—	(113,212)	—	—	(113,212)
Effect of stock incentive plan, net	—	57	365	10,737	(143)	—	(3,894)	7,065
Common stock issued	—	9,794	3,362	106,265	(20)	—	2,045	111,652
Balance - December 31, 2016	111,590	263,639	92,353	2,044,401	172,754	(42,093)	(1,849)	2,377,156
Reclassification due to the adoption of ASU No. 2018-02	—	—	—	—	7,927	(7,927)	—	—
Net income	—	—	—	—	161,907	—	—	161,907
Other comprehensive income, net of tax	—	—	—	—	—	4,015	—	4,015
Preferred stock issued	98,101	—	—	—	—	—	—	98,101
Cash dividends declared on preferred stock	—	—	—	—	(9,449)	—	—	(9,449)
Cash dividends declared on common stock	—	—	—	—	(116,332)	—	—	(116,332)
Effect of stock incentive plan, net	—	117	229	11,297	(18)	—	(1,948)	9,560
Common stock issued	—	713	145	4,658	(56)	—	3,460	8,207
Balance - December 31, 2017	209,691	264,469	92,727	2,060,356	216,733	(46,005)	(337)	2,533,165
Reclassification due to the adoption of ASU No. 2016-01	—	—	—	—	480	(480)	—	—
Reclassification due to the adoption of ASU No. 2017-12	—	—	—	—	61	(61)	—	—
Adjustment due to the adoption of ASU No. 2016-16	—	—	—	—	(17,611)	—	—	(17,611)
Balance - January 1, 2018	209,691	264,469	92,727	2,060,356	199,663	(46,546)	(337)	2,305,863
Net income	—	—	—	—	261,428	—	—	261,428
Other comprehensive loss, net of tax	—	—	—	—	—	(22,885)	—	(22,885)
Cash dividends declared on preferred stock	—	—	—	—	(12,688)	—	—	(12,688)
Cash dividends declared on common stock	—	—	—	—	(146,346)	—	—	(146,346)
	—	1,955	771	21,022	(2,415)	—	(2,198)	17,180

Effect of stock incentive plan, net								
Common stock issued	—	65,007	22,742	715,121	—	—	348	738,211
Balance - December 31, 2018	$209,691	331,431	$116,240	$2,796,499	$299,642	$(69,431)	$(2,187)	$3,350,454

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Cash flows from operating activities:			
Net income	$261,428	$161,907	$168,146
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	27,554	24,845	24,431
Stock-based compensation	19,472	12,204	10,032
Provision for credit losses	32,501	9,942	11,869
Net amortization of premiums and accretion of discounts on securities and borrowings	38,454	46,346	24,310
Amortization of other intangible assets	18,416	10,016	11,327
Losses (gains) on securities transactions, net	2,342	20	(777)
Proceeds from sales of loans held for sale	687,983	813,855	572,439
Gains on sales of loans, net	(20,515)	(20,814)	(22,030)
Originations of loans held for sale	(406,087)	(444,290)	(425,713)
Losses (gains) on sales of assets, net	2,402	95	(1,358)
Net deferred income tax (benefit) expense	(11,780)	76,848	27,154
Net change in:			
Fair value of borrowings hedged by derivative transactions	—	—	6,158
Cash surrender value of bank owned life insurance	(8,691)	(7,338)	(6,694)
Accrued interest receivable	(9,183)	(7,174)	(3,262)
Other assets	(33,145)	(57,353)	47,458
Accrued expenses and other liabilities	(7,562)	121	(24,313)
Net cash provided by operating activities	593,589	619,230	419,177
Cash flows from investing activities:			
Net loan originations and purchases	(3,257,939)	(1,418,073)	(1,379,431)
Investment securities held to maturity:			
Purchases	(264,721)	(220,356)	(669,157)
Maturities, calls and principal repayments	241,077	290,929	325,766
Investment securities available for sale:			
Purchases	(289,554)	(411,788)	(679,530)
Sales	44,377	2,727	4,782
Maturities, calls and principal repayments	255,031	204,684	867,998
Death benefit proceeds from bank owned life insurance	4,220	13,089	2,406
Proceeds from sales of real estate property and equipment	7,786	9,357	20,560
Purchases of real estate property and equipment	(26,440)	(18,117)	(20,707)
Cash and cash equivalents acquired in acquisitions	156,612	—	—
Net cash used in investing activities	$(3,129,551)	$(1,547,548)	$(1,527,313)

CONSOLIDATED STATEMENTS OF CASH FLOWS—(Continued)

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Cash flows from financing activities:			
Net change in deposits	$2,734,669	$422,754	$1,477,157
Net change in short-term borrowings	720,307	(332,332)	3,969
Proceeds from issuance of long-term borrowings, net	—	1,065,000	385,000
Repayments of long-term borrowings	(750,682)	(185,000)	(769,182)
Proceeds from issuance of preferred stock, net	—	98,101	—
Cash dividends paid to preferred shareholders	(15,859)	(6,277)	(7,188)
Cash dividends paid to common shareholders	(138,857)	(115,881)	(111,813)
Purchase of common shares to treasury	(3,801)	(2,645)	(3,191)
Common stock issued, net	2,704	8,207	112,085
Net cash provided by financing activities	2,548,481	951,927	1,086,837
Net change in cash and cash equivalents	12,519	23,609	(21,299)
Cash and cash equivalents at beginning of year	416,110	392,501	413,800
Cash and cash equivalents at end of year	$428,629	$416,110	$392,501
Supplemental disclosures of cash flow information:			
Cash payments for:			
Interest on deposits and borrowings	$290,444	$170,614	$151,209
Federal and state income taxes	53,587	29,013	26,564
Supplemental schedule of non-cash investing activities:			
Transfer of loans to other real estate owned	$743	$7,301	$8,089
Loans transferred to loans held for sale	289,633	313,201	174,501
Acquisition:			
Non-cash assets acquired:			
Investment securities held to maturity	$214,217	$—	$—
Investment securities available for sale	308,385	—	—
Loans	3,736,984	—	—
Premises and equipment	62,066	—	—
Bank owned life insurance	49,052	—	—
Accrued interest receivable	12,123	—	—
Goodwill	394,028	—	—
Other intangible assets	45,906	—	—
Other assets	100,059	—	—
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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Note 1)

Business

Valley National Bancorp, a New Jersey Corporation (Valley), is a bank holding company whose principal wholly-owned subsidiary is Valley National Bank (the "Bank"), a national banking association providing a full range of commercial, retail and trust and investment services largely through its offices and ATM network throughout northern and central New Jersey, the New York City boroughs of Manhattan, Brooklyn and Queens, Long Island, Florida and Alabama. The Bank is subject to intense competition from other financial services companies and is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by certain regulatory authorities.

Valley National Bank's subsidiaries are all included in the consolidated financial statements of Valley. These subsidiaries include, but are not limited to:

- an insurance agency offering property and casualty, life and health insurance;
- an asset management adviser that is a registered investment adviser with Securities and Exchange Commission (SEC);
- title insurance agencies in New York with services in New Jersey;
- subsidiaries which hold, maintain and manage investment assets for the Bank;
- a subsidiary which specializes in health care equipment lending and other commercial equipment leases; and
- a subsidiary which owns and services New York commercial loans.

The Bank's subsidiaries also include real estate investment trust subsidiaries (the "REIT" subsidiaries) which own real estate related investments and a REIT subsidiary which owns some of the real estate utilized by the Bank and related real estate investments. Except for Valley's REIT subsidiaries, all subsidiaries mentioned above are directly or indirectly wholly-owned by the Bank. Because each REIT subsidiary must have 100 or more shareholders to qualify as a REIT, each REIT subsidiary has issued less than 20 percent of its outstanding non-voting preferred stock to individuals, most of whom are non-senior management Bank employees. The Bank owns the remaining preferred stock and all the common stock of the REITs.

Basis of Presentation

The consolidated financial statements of Valley include the accounts of its commercial bank subsidiary, Valley National 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. See Note 11 for more details. Certain prior period amounts have been reclassified to conform to the current presentation.

In preparing the 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, purchased credit-impaired loans, the evaluation of goodwill and other intangible assets for impairment, and income taxes. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the consolidated financial statements in the period they are deemed necessary. While management uses its best judgment, actual amounts or results could differ significantly from those estimates. The current economic environment has increased the degree of uncertainty inherent in these material estimates.

Effective January 1, 2018, Valley acquired USAmeriBancorp, Inc. and its wholly-owned subsidiary, USAmeriBank. See Note 2 for further details regarding this acquisition.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest bearing deposits in other banks (including the Federal Reserve Bank of New York) and, from time to time, overnight federal funds sold. The Bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. These reserve balances totaled $120.7 million and $122.0 million at

December 31, 2018 and 2017, respectively.

Investment Securities

Investment securities are classified at the time of purchase based on management's intention, as securities held-to-maturity or securities available-for-sale. Investment securities classified as held-to-maturity are those that management has the positive intent and ability to hold until maturity. Investment securities held-to-maturity are carried at amortized cost, adjusted for amortization of premiums and accretion of discounts using the level-yield method over the contractual term of the securities, adjusted for actual prepayments, or to call date if the security was purchased at premium. Investment securities classified as available-for-sale are carried at fair value with unrealized holding gains and losses reported as a component of other comprehensive income or loss, net of tax. Realized gains or losses on the available-for-sale securities are recognized by the specific identification method and are included in net gains on securities transactions. Security transactions are recorded on a trade-date basis. Investments in Federal Home Loan Bank and Federal Reserve Bank stock, which have limited marketability, are carried at cost in other assets.

Quarterly, Valley evaluates its investment securities classified as held to maturity and available for sale for other-than-temporary impairment. Valley's evaluation of other-than-temporary impairment considers factors that include, among others, the causes of the decline in fair value, such as credit problems, interest rate fluctuations, or market volatility; and the severity and duration of the decline. For debt securities, the primary consideration in determining whether impairment is other-than-temporary is whether or not it is probable that current and/or future contractual cash flows have been or may be impaired. Valley also assesses the intent and ability to hold the securities (as well as the likelihood of a near-term recovery), and the intent to sell the securities and whether it is more likely than not that we will be required to sell the securities before the recovery of their amortized cost basis. In assessing the level of other-than-temporary impairment attributable to credit loss, Valley compares the present value of cash flows expected to be collected with the amortized cost basis of the security. If a determination is made that a debt security is other-than-temporarily impaired, Valley will estimate the amount of the unrealized loss that is attributable to credit and all other non-credit related factors. The credit related component will be recognized as an other-than-temporary impairment charge in non-interest income. The non-credit related component will be recorded as an adjustment to accumulated other comprehensive income (loss), net of tax. When a debt security becomes other-than-temporarily impaired, its amortized cost basis is reduced to reflect the portion of the total impairment related to credit loss. There was no other-than-temporary impairment recognized in earnings as a result of Valley's impairment analysis of its securities during 2018, 2017 and 2016. See the "Other-Than-Temporary Impairment Analysis" section of Note 4 for further discussion.

Interest income on investments includes amortization of purchase premiums and discounts. Valley discontinues the recognition of interest on debt securities if the securities meet both of the following criteria: (i) regularly scheduled interest payments have not been paid or have been deferred by the issuer, and (ii) full collection of all contractual principal and interest payments is not deemed to be the most likely outcome, resulting in the recognition of other-than-temporary impairment of the security.

Loans Held for Sale

Loans held for sale generally consist of residential mortgage loans originated and intended for sale in the secondary market and are carried at their estimated fair value on an instrument-by-instrument basis as permitted by the fair value option election under U.S. GAAP. Changes in fair value are recognized in non-interest income in the accompanying consolidated statements of income as a component of net gains on sales of loans. Origination fees and costs related to loans originated for sale (and carried at fair value) are recognized as earned and as incurred. Loans held for sale are generally sold with loan servicing rights retained by Valley. Gains recognized on loan sales include the value assigned to the rights to service the loan. See "Loan Servicing Rights" section below.

Loans and Loan Fees

Loans are reported at their outstanding principal balance net of any unearned income, charge-offs, unamortized deferred fees and costs on originated loans and premium or discounts on purchased loans, except for purchased credit-impaired loans. Loan origination and commitment fees, net of related costs are deferred and amortized as an adjustment of loan yield over the estimated life of the loans approximating the effective interest method.

Loans are deemed to be past due when the contractually required principal and interest payments have not been received as they become due. Loans are placed on non-accrual status generally, when they become 90 days past due and the full and timely collection of principal and interest becomes uncertain. When a loan is placed on non-accrual status, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Payments received on non-accrual loans are generally applied against principal. A loan in which the borrowers' obligation has not been released in bankruptcy courts may be restored to an accruing basis when it becomes well secured and is in the process of collection, or all past due amounts become current under the loan agreement and collectability is no longer doubtful.

Purchased Credit-Impaired Loans

Purchased credit-impaired (PCI) loans are loans acquired at a discount (that is due, in part, to credit quality). Valley's PCI loan portfolio primarily consists of loans acquired in business combinations subsequent to 2011 and $27.6 million of mainly residential mortgage loans subject to loss sharing agreements (referred to as "covered loans") with the FDIC. The PCI loans are initially recorded at fair value (as determined by the present value of expected future cash flows) with no allowance for loan losses. Interest income on PCI loans has been accounted for based on the acquired loans' expected cash flows. The PCI loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. A pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flow.

The difference between the undiscounted cash flows expected at acquisition and the investment in the 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 "nonaccretable difference," are not recognized as a yield adjustment or as a loss accrual or an allowance for loan losses. Increases in expected cash flows subsequent to the acquisition are recognized prospectively through adjustment of the yield on the pool over its remaining life, while decreases in expected cash flows are recognized as impairment through a loss provision and an increase in the allowance for loan losses. Therefore, the allowance for loan losses on these impaired pools reflect only losses incurred after the acquisition (representing the present value of all cash flows that were expected at acquisition but currently are not expected to be received). Valley had no allowance reserves related to PCI loans at December 31, 2018 and 2017.

On a quarterly basis, the Bank periodically evaluates the remaining contractual required payments due and estimates of cash flows expected to be collected for the underlying loans of each PCI loan pool. These evaluations require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Changes in the contractual required payments due and estimated cash flows expected to be collected may result in changes in the accretable yield and non-accretable difference or reclassifications between accretable yield and the non-accretable difference. For the pools with better than expected cash flows, the forecasted increase is recorded as an additional accretable yield that is recognized as a prospective increase to our interest income on loans and the FDIC loss-share receivable, if applicable, is prospectively reduced by the guaranteed portion of the additional cash flows expected to be received, with a corresponding reduction to non-interest income. See Note 5 for additional information.

PCI loans that may have been classified as non-performing loans by an acquired bank are no longer classified as non-performing because these loans are accounted for on a pooled basis. Management's judgment is required in classifying loans in pools as performing loans, and is dependent on having a reasonable expectation about the timing and amount of the pool cash flows to be collected, even if certain loans within the pool are contractually past due.

Allowance for Credit Losses

The allowance for credit losses (the "allowance") is increased through provisions charged against current earnings and additionally by crediting amounts of recoveries received, if any, on previously charged-off loans. The allowance is reduced by charge-offs on loans or unfunded letters of credit which are determined to be a loss, in accordance with established policies, when all efforts of collection have been exhausted.

The allowance is maintained at a level estimated to absorb probable credit losses inherent in the loan portfolio as well as other credit risk related charge-offs. The allowance is based on ongoing evaluations of the probable estimated losses inherent in the non-PCI loan portfolio and off-balance sheet unfunded letters of credit, as well as reserves for impairment of PCI loans subsequent to their acquisition date. As discussed under the "Purchased Credit-Impaired Loans" section above, Valley had no allowance reserves related to PCI loans at December 31, 2018 and 2017. The Bank's methodology for evaluating the appropriateness of the allowance includes grouping the non-covered loan portfolio into loan segments based on common risk characteristics, tracking the historical levels of classified loans and delinquencies, estimating the appropriate loss look-back and loss emergence periods related to historical losses for each loan segment, providing specific reserves on impaired loans, and assigning incremental reserves where necessary based upon qualitative and economic outlook factors including numerous variables, such as the nature and trends of recent loan charge-offs. Additionally, 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.

The allowance for loan losses consists of four elements: (i) specific reserves for individually impaired credits, (ii) reserves for adversely classified, or higher risk rated, loans that are not impaired, (iii) reserves for other loans based on historical loss factors (using the appropriate loss look-back and loss emergence periods) adjusted for both internal and external qualitative risk factors to Valley, including the aforementioned factors, as well as changes in both organic and purchased loan portfolio volumes, the composition and concentrations of credit, new market initiatives, and the impact of competition on loan structuring and pricing, and (iv) an allowance for PCI loan pools impaired subsequent to the acquisition date, if applicable.

The Credit Risk Management Department individually evaluates non-accrual (non-homogeneous) commercial and industrial loans and commercial real estate loans over $250 thousand and all troubled debt restructured loans. The value of an impaired loan is measured based upon the underlying anticipated method of payment consisting of either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral, if the loan is collateral dependent, and its payment is expected solely based on the underlying collateral. If the value of an impaired loan is less than its carrying amount, impairment is recognized through a provision to the allowance for loan losses. Collateral dependent impaired loan balances are written down to the estimated current fair value (less estimated selling costs) of each loan's underlying collateral resulting in an immediate charge-off to the allowance, excluding any consideration for personal guarantees that may be pursued in the Bank's collection process. If repayment is based upon future expected cash flows, the present value of the expected future cash flows discounted at the loan's original effective interest rate is compared to the carrying value of the loan, and any shortfall is recorded as a specific valuation allowance in the allowance for loan losses. Accrual of interest is discontinued on an impaired loan when management believes, after considering collection efforts and other factors, the borrower's financial condition is such that collection of all principal and interest is doubtful. Cash collections from non-accrual loans are generally credited to the loan balance, and no interest income is recognized on these loans until the principal balance has been determined to be fully collectible. Residential mortgage loans and consumer loans usually consist of smaller balance homogeneous loans that are collectively evaluated for impairment, and are specifically excluded from the impaired loan portfolio, except where the loan is classified as a troubled debt restructured loan.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of the loans. Loans are evaluated based on an internal credit risk rating system for the commercial and industrial loan and commercial real estate loan portfolio segments and non-performing loan status for the residential and consumer loan portfolio segments. Loans are risk-rated based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial and industrial loans and commercial real estate loans, and evaluated by the Loan Review Department on a test basis. Loans with a grade that is below "Pass" grade are adversely classified. See Note 5 for details. Any change in the credit risk grade of adversely classified performing and/or non-performing loans affects the amount of the related allowance. Once a loan is adversely classified, the assigned relationship manager and/or a special assets officer in conjunction with the Credit Risk Management Department analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically assign a valuation allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things. Loans identified as losses by management are charged-off. Commercial loans are generally assessed for full or partial charge-off to the net realizable value for collateral dependent loans when a loan is between 90 or 120 days past due or sooner if it is probable that a loan may not be fully collectable. Residential loans and home equity loans are generally charged-off to net realizable value when the loan is 120 days past due (or sooner when the borrowers' obligation has been released in bankruptcy). Automobile loans are fully charged-off when the loan is 120 days past due or partially charged-off to the net realizable value of collateral, if the collateral is recovered prior to such time. Unsecured consumer loans are generally fully charged-off when the loan is 150 days past due.

The allowance allocations for other loans (i.e., risk rated loans that are not adversely classified and loans that are not risk rated) are calculated by applying historical loss factors for each loan portfolio segment to the applicable outstanding loan portfolio balances. Loss factors are calculated using statistical analysis supplemented by management judgment. The statistical analysis considers historical default rates, historical loss severity in the event of default, and the average loss emergence period for each loan portfolio segment. The management analysis includes an evaluation of loan portfolio volumes, the composition and concentrations of credit, credit quality and current delinquency trends.

See Notes 5 and 6 for Valley's loan credit quality and additional allowance disclosures.

Premises and Equipment, Net

Premises and equipment are stated at cost less accumulated depreciation computed using the straight-line method over the estimated useful lives of the related assets. Estimated useful lives range from 3 years for capitalized software to up to 40 years for buildings. Leasehold improvements are amortized over the term of the lease or estimated useful life of the asset, whichever is shorter. Major improvements are capitalized, while repairs and maintenance costs are charged to operations as incurred. Upon retirement or disposition, any gain or loss is credited or charged to operations. See Note 7 for further details.

Bank Owned Life Insurance

Valley owns bank owned life insurance (BOLI) to help offset the cost of employee benefits. BOLI is recorded at its cash surrender value. Valley's BOLI is invested primarily in U.S. Treasury securities and residential mortgage-backed securities issued by government sponsored enterprises and Ginnie Mae. The majority of the underlying investment portfolio is managed by one

independent investment firm. The change in the cash surrender value is included as a component of non-interest income and is exempt from federal and state income taxes as long as the policies are held until the death of the insured individuals.

Other Real Estate Owned

Valley acquires other real estate owned (OREO) through foreclosure on loans secured by real estate. OREO is reported at the lower of cost or fair value, as established by a current appraisal (less estimated costs to sell), and is included in other assets. Any write-downs at the date of foreclosure are charged to the allowance for loan losses. Expenses incurred to maintain these properties, unrealized losses resulting from valuation write-downs after the date of foreclosure, and realized gains and losses upon sale of the properties are included in other non-interest expense. OREO totaled $9.5 million and $9.8 million at December 31, 2018 and 2017, respectively. OREO included foreclosed residential real estate properties totaling $852 thousand and $7.3 million at December 31, 2018 and 2017, respectively. Residential mortgage and consumer loans secured by residential real estate properties for which formal foreclosure proceedings are in process totaled $1.8 million and $3.8 million at December 31, 2018 and 2017, respectively.

Goodwill

Intangible assets resulting from acquisitions under the acquisition method of accounting consist of goodwill and other intangible assets (see “Other Intangible Assets” below). Goodwill is not amortized and is subject to an annual assessment for impairment. Currently, the goodwill impairment analysis is generally a two-step test. However, Valley may choose to perform an optional qualitative assessment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test for one or more units in future periods. During 2018 and 2017, Valley elected to perform step one of the two-step goodwill impairment test for all of its reporting units.

Goodwill is allocated to Valley’s reporting unit, which is a business segment or one level below, at the date goodwill is actually recorded. If the carrying value of a reporting unit exceeds its estimated fair value, a second step in the analysis is performed to determine the amount of impairment, if any. The second step compares the implied fair value of the reporting unit’s goodwill with the carrying amount of that goodwill. If the carrying value of a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded equal to the excess amount in the current period earnings. Valley reviews goodwill annually or more frequently if a triggering event indicates impairment may have occurred, to determine potential impairment by determining if the fair value of the reporting unit has fallen below the carrying value.

Other Intangible Assets

Other intangible assets primarily consist of loan servicing rights (largely generated from loan servicing retained by the Bank on residential mortgage loan originations sold in the secondary market to government sponsored enterprises), core deposits (the portion of an acquisition purchase price which represents value assigned to the existing deposit base) and customer lists obtained through acquisitions. Other intangible assets are amortized using various methods over their estimated lives and are periodically evaluated for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impairment is deemed to exist, an adjustment is recorded to earnings in the current period for the difference between the fair value of the asset and its carrying amount. See further details regarding loan servicing rights below.

Loan Servicing Rights

Loan servicing rights are recorded when originated mortgage loans are sold with servicing rights retained, or when servicing rights are purchased. Valley initially records the loan servicing rights at fair value. Subsequently, the loan servicing rights are carried at the lower of unamortized cost or market (i.e., fair value). The fair values of the loan servicing rights are determined using a method which utilizes servicing income, discount rates, prepayment speeds and default rates specifically relative to Valley’s portfolio for originated mortgage servicing rights.

The unamortized costs associated with acquiring loan servicing rights, net of any valuation allowances, are included in other intangible assets in the consolidated statements of financial condition and 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. A valuation allowance is established through an impairment charge to earnings to the extent the unamortized cost of a stratified group of loan servicing rights exceeds its estimated fair value. Increases in the fair value of impaired loan servicing rights are recognized as a reduction of the valuation allowance, but not in excess of such allowance. The amortization of loan servicing rights is recorded in non-interest income.

Stock-Based Compensation

Compensation expense for stock options and restricted stock awards (i.e., non-vested stock awards) is based on the fair value of the award on the date of the grant and is recognized ratably over the service period of the award. Under Valley’s long-term incentive compensation plans, award grantees that are eligible for retirement do not have a service period requirement. Compensation expense for these awards is recognized immediately in earnings. The service period for non-retirement eligible employees is the shorter of the stated vesting period of the award or the period until the employee’s retirement eligibility date. The fair value of each option granted is estimated using a binomial option pricing model. The fair value of restricted stock awards is based upon the last sale price reported for Valley’s common stock on the date of grant or the last sale price reported preceding such date, except for performance-based restricted stock and restricted stock unit awards with a market condition. The grant date fair value of a performance-based restricted stock or restricted stock unit award that vests based on a market condition is determined by a third party specialist using a Monte Carlo valuation model. See Note 12 for additional information.

Fair Value Measurements

In general, fair values of financial instruments are based upon quoted market prices, where available. When observable market prices and parameters are not fully available, management uses valuation techniques based upon internal and third party models requiring more management judgment to estimate the appropriate fair value measurements. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value, including adjustments based on internal cash flow model projections that utilize assumptions similar to those incorporated by market participants. Other adjustments may include amounts to reflect counterparty credit quality and Valley’s creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. See Note 3 for additional information.

Revenue Recognition

On January 1, 2018, Valley adopted Accounting Standards Update 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 Accounting Standards Codification (ASC) Topic 606. 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 revenues, reported separately within total non-interest income on the consolidated statements of income, are within the scope of ASC Topic 606:

Trust and investment 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.

Income Taxes

Valley uses the asset and liability method to provide income taxes on all transactions recorded in the consolidated financial statements. This method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities for book and tax purposes. Accordingly, a deferred tax asset or liability for each temporary difference is determined based on the enacted tax rates that will be in effect when the underlying items of income and expense are expected to be realized.

Valley’s expense for income taxes includes the current and deferred portions of that expense. Deferred tax assets are recognized if, in management's judgment, their realizability is determined to be more likely than not. A valuation allowance is established to reduce deferred tax assets to the amount we expect to realize. Deferred income tax expense or benefit results from differences between assets and liabilities measured for financial reporting versus income-tax return purposes. The effect on deferred taxes of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. See Note 13 for details regarding the impact of the Tax Cuts and Jobs Act enacted by the U.S. government on December 22, 2017.

Valley maintains a reserve related to certain tax positions that management believes contain an element of uncertainty. An uncertain tax position is measured based on the largest amount of benefit that management believes is more likely than not to be realized. Periodically, Valley evaluates each of its tax positions and strategies to determine whether the reserve continues to be appropriate.

Comprehensive Income

Comprehensive income or loss is defined as the change in equity of a business entity during a period due to transactions and other events and circumstances, excluding those resulting from investments by and distributions to shareholders. Comprehensive income consists of net income and other comprehensive income or loss. Valley’s components of other comprehensive income or loss, net of deferred tax, include: (i) unrealized gains and losses on securities available for sale (including the non-credit portion of other-than-temporary impairment charges relating to these securities); (ii) unrealized gains and losses on derivatives used in cash flow hedging relationships; and (iii) the pension benefit adjustment for the unfunded portion of its various employee, officer, and director pension plans. Income tax effects are released from accumulated other comprehensive income on an individual unit of account basis. Valley presents comprehensive income and its components in the consolidated statements of comprehensive income for all periods presented. See Note 19 for additional disclosures.

Earnings Per Common Share

In Valley's computation of the earnings per common share, the numerator of both the basic and diluted earnings per common share is net income available to common shareholders (which is equal to net income less dividends on preferred stock). The weighted average number of common shares outstanding used in the denominator for basic earnings per common share is increased to determine the denominator used for diluted earnings per common share by the effect of potentially dilutive common stock equivalents utilizing the treasury stock method.

The following table shows the calculation of both basic and diluted earnings per common share for the years ended December 31, 2018, 2017 and 2016:

	2018	2017	2016
	(in thousands, except for share data)		
Net income available to common shareholders	$248,740	$ 152,458	$ 160,958
Basic weighted-average number of common shares outstanding	331,258,964	264,038,123	254,841,571
Plus: Common stock equivalents	1,434,754	850,884	426,765
Diluted weighted-average number of common shares outstanding	332,693,718	264,889,007	255,268,336
Earnings per common share:			
Basic	$0.75	$ 0.58	$ 0.63
Diluted	0.75	0.58	0.63

Common stock equivalents represent the dilutive effect of additional common shares issuable upon the assumed vesting or exercise, if applicable, of performance-based restricted stock units, common stock options and warrants to purchase Valley’s common shares. Common stock options 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. Average outstanding anti-dilutive warrants and, to a lesser extent, common stock options equaled approximately 2.1 million, 3.1 million, and 4.0 million of common shares for the years ended December 31, 2018, 2017 and 2016, respectively. All of the outstanding warrants expired unexercised in the fourth quarter of 2018. See Note 18 for details.

Preferred and Common Stock Dividends

Valley issued 4.6 million shares and 4.0 million shares of non-cumulative perpetual preferred stock in June 2015 and August 2017, respectively, which were initially recorded at fair value (see Note 18 for additional details on the preferred stock issuances). The preferred shares are senior to Valley common stock, whereas the current year dividends must be paid before Valley can pay dividends to its common stockholders. Preferred dividends declared are deducted from net income for computing income available to common stockholders and earnings per common share computations.

Cash dividends to both preferred and common stockholders are payable and accrued when declared by Valley's Board of Directors.

Treasury Stock

Treasury stock is recorded using the cost method and accordingly is presented as a reduction of shareholders’ equity.

Derivative Instruments and Hedging Activities

As part of its asset/liability management strategies and to accommodate commercial borrowers, Valley has used interest rate swaps and caps to hedge variability in cash flows or fair values caused by changes in interest rates. Valley also uses derivatives not designated as hedges for non-speculative purposes to manage its exposure to interest rate movements related to a service for commercial lending customers, risk participation agreements sharing the risk of default on the interest rate swaps for certain purchased or sold loan participations, mortgage banking activities consisting of customer interest rate lock commitments and forward contracts to sell residential mortgage loans, and hybrid instruments, consisting of market linked certificates of deposit with an embedded swap contract. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Valley records all derivatives as assets or liabilities at fair value on the consolidated statements of financial condition.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income or loss and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in earnings. On a quarterly basis, Valley assesses the effectiveness of each hedging relationship by comparing the changes in cash flows or fair value of the derivative hedging instrument with the changes in cash flows or fair value of the designated hedged item or transaction. If a hedging relationship is terminated due to ineffectiveness, and the derivative instrument is not re-designated to a new hedging relationship, the subsequent change in fair value of such instrument is charged directly to earnings.

Derivatives not designated as hedges do not meet the hedge accounting requirements under U.S. GAAP. Changes in fair value of derivatives not designated in hedging relationships are recorded directly in earnings. Valley calculates the credit valuation adjustments to the fair value of derivatives designated as fair value hedges on a net basis by counterparty portfolio, as an accounting policy election under the provisions of ASU No. 2011-04.

New Authoritative Accounting Guidance

New Accounting Guidance Adopted in 2018

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, issued in August 2018, 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 during the third quarter of 2018. The adoption resulted in the removal of the 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 previously presented in Note 3 due to the immaterial amount of such assets

(which were also subsequently sold during the fourth quarter of 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 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 19).

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 previous U.S. GAAP, the tax effects of intercompany sales were deferred until the transferred asset is sold to a third party or otherwise recovered through amortization. This was an exception to the accounting for income taxes that generally requires recognition of current and deferred income taxes. Effective January 1, 2018, ASU No. 2016-16 eliminated the exception for intercompany sales of assets. ASU No. 2016-16 was applied using the modified retrospective method, and, as a result, Valley recorded a $17.6 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 3). 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. The guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other U.S. GAAP. Valley adopted the guidance on January 1, 2018 using the

modified retrospective method, however, Valley did not record a cumulative-effect adjustment to opening retained earnings at the adoption date because it found no material changes related to the timing or amount of revenue recognition. Consequently, the new revenue recognition standard did not have a material impact on Valley’s consolidated financial statements. Valley has also concluded that additional disaggregation of revenue categories that are within the scope of the new guidance is not necessary. See the "Revenue Recognition" section of Note 1 above for additional information.
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 into before and after the adoption date. During the fourth quarter of 2018, Valley adopted ASU No. 2018-15 on a prospective basis. The adoption of ASU No. 2018-15 did not have a significant impact on Valley's consolidated financial statements.

New Accounting Guidance to be Adopted in the First Quarter of 2019

ASU No. 2016-02, "Leases (Topic 842)" and subsequent related updates require lessees to recognize leases on balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use model that requires lessees to recognize a right of use (ROU) asset and related lease liability for all leases with a term longer than 12 months. 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. Leases will continue to be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement. Topic 842 became effective for Valley for reporting periods after January 1, 2019 and it had a material effect on our financial statements related to the recognition of new ROU assets and lease liabilities and significant new disclosures about leasing activities. The new standard also provides several optional practical expedients in transition and accounting policy elections. Valley elected the "package of practical expedients," the practical expedient to not separate lease and non-lease components, and the short-term lease recognition exemption accounting policy election.

Valley initially applied Topic 842 at the adoption date and recognized 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". Upon adoption, Valley recorded a right of use asset of approximately $216 million (net of the reversal of the current deferred rent liability) and lease obligation of approximately $241 million as of January 1, 2019. The recognized right of use asset 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 during the first quarter of 2019. Valley applied the hindsight practical expedient and concluded that several lease terms should be reduced. As a result, Valley will adjust the initial recognition of the carrying amount of ROU asset and lease obligation and record an adjustment to the opening balance of retained earnings as of January 1, 2019 totaling $6.2 million. 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.

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 will not have a significant impact on Valley's consolidated financial statements.

New Accounting Guidance Not Yet Adopted

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 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.

BUSINESS COMBINATIONS (Note 2)

USAmeriBancorp, Inc.

On January 1, 2018, Valley completed its acquisition of USAmeriBancorp, Inc. (USAB) headquartered in Clearwater, Florida. USAB, largely through its wholly-owned subsidiary, USAmeriBank, 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 at December 31, 2018. The acquisition represents a significant addition to Valley's Florida presence, primarily in the Tampa Bay market. The acquisition also brought Valley to the Birmingham, Montgomery, and Tallapoosa areas in Alabama, where USAB maintained 15 of its branches. The common shareholders of USAB received 6.1 shares of Valley common stock for each USAB share they own. The total consideration for the acquisition was approximately $737 million, consisting of 64.9 million shares of Valley common stock and the outstanding USAB stock-based awards.

Merger expenses totaled $17.4 million for the year ended December 31, 2018, which primarily related to salary and employee benefits and other expenses are included in non-interest expense on the consolidated statements of income.

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

	January 1, 2018 (in thousands)
Assets acquired:	
Cash and cash equivalents	$156,612
Investment securities held to maturity	214,217
Investment securities available for sale	308,385
Loans	3,736,984
Premises and equipment	62,066
Bank owned life insurance	49,052
Accrued interest receivable	12,123
Goodwill	394,028
Other intangible assets	45,906
Other assets:	
Deferred taxes	10,623
Other real estate owned	4,073
FHLB and FRB stock	38,809
Tax credit investments	20,138
Other	26,416
Total other assets	100,059
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. Valley revised the estimated fair values of the acquired assets as of the acquisition date due to additional acquisition date information obtained during the second half of 2018. 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 $5.8 million net increase in goodwill (see Note 8 for amount of goodwill as allocated to Valley's business segments).

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 ASC Subtopic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality." See Note 5 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. See Note 10 for further details.

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. See Note 11 for further details.

FAIR VALUE MEASUREMENT OF ASSETS AND LIABILITIES (Note 3)

Accounting Standards Codification (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 Basis and Non-Recurring Basis

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

		Fair Value Measurements at Reporting Date Using:		
	December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Recurring fair value measurements:				
Assets				
Investment securities:				
Available for sale:				
U.S. Treasury securities	$49,306	$49,306	$—	$ —
U.S. government agency securities	36,277	—	36,277	—
Obligations of states and political subdivisions	197,092	—	197,092	—
Residential mortgage-backed securities	1,429,782	—	1,429,782	—
Corporate and other debt securities	37,087	—	37,087	—
Total available for sale	1,749,544	49,306	1,700,238	—
Loans held for sale [(1)]	35,155	—	35,155	—
Other assets [(2)]	48,979	—	48,979	—
Total assets	$1,833,678	$49,306	$1,784,372	$ —
Liabilities				
Other liabilities [(2)]	$23,681	$—	$23,681	$ —
Total liabilities	$23,681	$—	$23,681	$ —
Non-recurring fair value measurements:				
Collateral dependent impaired loans [(3)]	$45,245	$—	$—	$ 45,245
Loan servicing rights	273	—	—	273
Foreclosed assets	5,673	—	—	5,673
Total	$51,191	$—	$—	$ 51,191

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

(1) Represents residential mortgage loans held for sale that are carried at fair value and had contractual unpaid principal balances totaling approximately $34.6 million and $14.8 million at December 31, 2018 and 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 of the valuation techniques described below apply to the unpaid principal balance excluding any accrued interest or dividends at the measurement date. Interest income and expense are recorded within the consolidated statements of income depending on the nature of the instrument using the effective interest method based on acquired discount or premium.

Available for sale securities. All U.S. Treasury securities, certain corporate and other debt securities, and certain preferred equity securities are reported at fair value utilizing Level 1 inputs. The majority of other investment

securities are reported at fair value utilizing Level 2 inputs. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom Valley has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions, among other things. Management reviews the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data. In addition, Valley reviews the volume and level of activity for all available for sale securities and attempts to identify transactions which may not be orderly or reflective of a significant level of activity and volume.

For certain private mortgage-backed securities reported at December 31, 2017, Valley prepared present value cash flow models derived from unobservable market information (Level 3 inputs). During the fourth quarter of 2018, Valley sold all of the its Level 3 available for sale securities, including 4 private label mortgage-backed securities.
Loans held for sale. 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. 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. Non-performance risk did not materially impact the fair value of mortgage loans held for sale at December 31, 2018 and 2017 based on the short duration these assets were held and the 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 analyses 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 December 31, 2018 and 2017), is determined based on the current market prices for similar instruments. 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 December 31, 2018 and 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 non-recurring 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 are significantly adjusted based on customized discounting criteria. At December 31, 2018, certain appraisals may be discounted based on specific market data by location and property type. During 2018 and 2017, 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. The collateral dependent loan charge-offs to the allowance for loan losses totaled $638 thousand and $2.1 million for the years ended December 31, 2018 and 2017, respectively. These collateral dependent impaired loans with a total recorded investment of $73.7 million and $57.5 million at December 31, 2018 and 2017, respectively, were reduced by specific valuation allowance allocations totaling $28.5 million and $9.1 million to a reported total net carrying amount of $45.2 million and $48.4 million at December 31, 2018 and 2017, respectively.
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 December 31, 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 impairment charges on its loan servicing rights totaling $388 thousand and $429 thousand the years ended December 31, 2018 and 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 customized discounting criteria, similar to the criteria used for impaired loans described above. There were no adjustments to the appraisals of foreclosed assets at December 31, 2018. During the years ended December 31, 2018 and 2017, foreclosed assets measured at fair value upon initial recognition or subsequent re-measurement totaled $5.7 million and $3.5 million, respectively. The charge-offs of foreclosed assets to the allowance for loan losses totaled $2.0 million and $1.9 million for the years ended December 31, 2018 and 2017, respectively. The re-measurement of foreclosed assets at fair value subsequent to their initial recognition resulted in losses of $390 thousand, $361 thousand and $1.0 million included in non-interest expense for the years ended December 31, 2018, 2017 and 2016, respectively.

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 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 December 31, 2018 and 2017 were as follows:

		December 31,			
		2018		2017	
	Fair Value Hierarchy	Carrying Amount	Fair Value	Carrying Amount	Fair Value
		(in thousands)			
Financial assets					
Cash and due from banks	Level 1	$251,541	$251,541	$234,310	$234,310
Interest bearing deposits with banks	Level 1	177,088	177,088	172,800	172,800
Investment securities held to maturity:					
U.S. Treasury securities	Level 1	138,517	142,049	138,676	145,257
U.S. government agency securities	Level 2	8,721	8,641	9,859	9,981
Obligations of states and political subdivisions	Level 2	585,656	586,033	465,878	477,479
Residential mortgage-backed securities	Level 2	1,266,770	1,235,605	1,131,945	1,118,044
Trust preferred securities	Level 2	37,332	31,486	49,824	40,088
Corporate and other debt securities	Level 2	31,250	31,129	46,509	46,771
Total investment securities held to maturity		2,068,246	2,034,943	1,842,691	1,837,620
Net loans	Level 3	24,883,610	24,068,755	18,210,724	17,562,153
Accrued interest receivable	Level 1	95,296	95,296	73,990	73,990
Federal Reserve Bank and Federal Home Loan Bank stock [(1)]	Level 1	232,080	232,080	178,668	178,668
Financial liabilities					
Deposits without stated maturities	Level 1	17,388,990	17,388,990	14,589,941	14,589,941
Deposits with stated maturities	Level 2	7,063,984	7,005,573	3,563,521	3,465,373
Short-term borrowings	Level 1	2,118,914	2,091,892	748,628	679,316
Long-term borrowings	Level 2	1,654,268	1,751,194	2,315,819	2,453,797
Junior subordinated debentures issued to capital trusts	Level 2	55,370	55,692	41,774	37,289
Accrued interest payable [(2)]	Level 1	25,762	25,762	14,161	14,161

(1) Included in other assets.

(2) Included in accrued expenses and other liabilities.

INVESTMENT SECURITIES (Note 4)

Held to Maturity

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
December 31, 2018				
U.S. Treasury securities	$138,517	$ 3,532	$—	$142,049
U.S. government agency securities	8,721	55	(135)	8,641
Obligations of states and political subdivisions:				
Obligations of states and state agencies	341,702	4,332	(5,735)	340,299
Municipal bonds	243,954	3,141	(1,361)	245,734
Total obligations of states and political subdivisions	585,656	7,473	(7,096)	586,033
Residential mortgage-backed securities	1,266,770	3,203	(34,368)	1,235,605
Trust preferred securities	37,332	77	(5,923)	31,486
Corporate and other debt securities	31,250	96	(217)	31,129
Total investment securities held to maturity	$2,068,246	$ 14,436	$(47,739)	$2,034,943
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 December 31, 2018 and 2017 were as follows:

	Less than Twelve Months		More than Twelve Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
December 31, 2018						
U.S. government agency securities	$—	$—	$6,074	$(135)	$6,074	$(135)
Obligations of states and political subdivisions:						
Obligations of states and state agencies	16,098	(266)	138,437	(5,469)	154,535	(5,735)
Municipal bonds	3,335	(37)	60,078	(1,324)	63,413	(1,361)
Total obligations of states and political subdivisions	19,433	(303)	198,515	(6,793)	217,948	(7,096)
Residential mortgage-backed securities	72,240	(852)	846,671	(33,516)	918,911	(34,368)
Trust preferred securities	—	—	30,055	(5,923)	30,055	(5,923)
Corporate and other debt securities	9,948	(52)	4,835	(165)	14,783	(217)
Total	$101,621	$(1,207)	$1,086,150	$(46,532)	$1,187,771	$(47,739)
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 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 held to maturity portfolio in an unrealized loss position at December 31, 2018 was 378 as compared to 152 at December 31, 2017.

The unrealized losses existing for more than twelve months within the residential mortgage-backed securities category of the held to maturity portfolio at December 31, 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 December 31, 2018 primarily related to four non-rated single-issuer 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 December 31, 2018.

As of December 31, 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 $1.3 billion.

The contractual maturities of investments in debt securities held to maturity at December 31, 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.

	December 31, 2018	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year	$21,418	$21,459
Due after one year through five years	274,389	278,051
Due after five years through ten years	260,835	267,813
Due after ten years	244,834	232,015
Residential mortgage-backed securities	1,266,770	1,235,605
Total investment securities held to maturity	$2,068,246	$2,034,943

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 7.7 years at December 31, 2018.

Available for Sale

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
December 31, 2018				
U.S. Treasury securities	$50,975	$ —	$(1,669)	$49,306
U.S. government agency securities	36,844	71	(638)	36,277
Obligations of states and political subdivisions:				
Obligations of states and state agencies	100,777	18	(3,682)	97,113
Municipal bonds	101,207	209	(1,437)	99,979
Total obligations of states and political subdivisions	201,984	227	(5,119)	197,092
Residential mortgage-backed securities	1,469,059	1,484	(40,761)	1,429,782
Corporate and other debt securities	37,542	213	(668)	37,087
Total investment securities available for sale	$1,796,404	$ 1,995	$(48,855)	$1,749,544
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 December 31, 2018 and 2017 were as follows:

	Less than Twelve Months		More than Twelve Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
December 31, 2018						
U.S. Treasury securities	$—	$—	$49,306	$(1,669)	$49,306	$(1,669)
U.S. government agency securities	2,120	(20)	26,775	(618)	28,895	(638)
Obligations of states and political subdivisions:						
Obligations of states and state agencies	17,560	(95)	75,718	(3,587)	93,278	(3,682)
Municipal bonds	5,018	(106)	70,286	(1,331)	75,304	(1,437)
Total obligations of states and political subdivisions	22,578	(201)	146,004	(4,918)	168,582	(5,119)
Residential mortgage-backed securities	119,645	(668)	1,221,942	(40,093)	1,341,587	(40,761)
Corporate and other debt securities	12,339	(161)	12,397	(507)	24,736	(668)
Total	$156,682	$(1,050)	$1,456,424	$(47,805)	$1,613,106	$(48,855)
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 December 31, 2018 was 545 as compared to 327 at December 31, 2017.

The unrealized losses more than twelve months for the residential mortgage-backed securities category of the available for sale portfolio at December 31, 2018 largely related to several investment grade securities mainly issued by Ginnie Mae, Fannie Mae, and Freddie Mac.

As of December 31, 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 investments securities available for sale at December 31, 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.

	December 31, 2018	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year	$4,666	$4,643
Due after one year through five years	125,825	123,051
Due after five years through ten years	78,305	76,640
Due after ten years	118,549	115,428
Residential mortgage-backed securities	1,469,059	1,429,782
Total investment securities available for sale	$1,796,404	$1,749,544

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 7.8 years at December 31, 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 trust preferred securities and corporate bonds (including 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.

For the single-issuer trust preferred securities and corporate and other debt securities, Valley reviews each portfolio to determine if all the securities are paying in accordance with their terms and have no deferrals of interest or defaults. A deferral event by a bank holding company for which Valley holds trust preferred securities may require the recognition of an other-than-temporary impairment charge if Valley determines that it is more likely than not that all contractual interest and principal cash flows may not be collected. Among other factors, the probability of the collection of all interest and principal determined by Valley in its impairment analysis declines if there is an increase in the estimated deferral period of the issuer. Additionally, a FDIC receivership for any single-issuer would result in an impairment and significant loss. Including the other factors outlined above, Valley analyzes the performance of the issuers on a quarterly basis, including a review of performance data from the issuers’ most recent bank regulatory report, if applicable, to assess their credit risk and the probability of impairment of the contractual cash flows of the applicable security. All of the issuers had capital ratios at December 31, 2018 that were at or above the minimum amounts to be considered a “well-capitalized” financial institution, if applicable, and/or have maintained performance levels adequate to support the contractual cash flows of the trust preferred securities.

At December 31, 2018, approximately 40.6 percent of the $782.7 million carrying value of obligations of states and political subdivisions were issued by the states of (or municipalities within) New Jersey, Utah, Texas, and Maryland. The obligations of states and political subdivisions mainly consist of general obligation bonds and, to lesser extent, special revenue bonds which had an aggregated amortized cost and fair value of $198.8 million and $193.1 million, respectively, at December 31, 2018. Special revenue bonds were largely issued by the Utah and Minnesota and other state housing authorities, as well Port Authority of New York and New Jersey. As part of Valley’s pre-purchase analysis and on-going quarterly assessment of impairment of the obligations of states and political subdivisions, our

Credit Risk Management Department conducts a financial analysis and risk rating assessment of each security issuer based on the issuer's most recently issued financial statements and other publicly available information. Substantially all of these investments are investment grade. As of December 31, 2018, these securities are expected to perform in accordance with their contractual terms and, as a result, Valley expects to recover the entire amortized cost basis of these securities.
There were no other-than-temporary impairment losses on securities recognized in earnings for the years ended December 31, 2018 and 2017. Management does not believe that any individual unrealized loss as of December 31, 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.
Realized Gains and Losses
Gross gains and losses realized on sales, maturities and other securities transactions included in earnings for the years ended December 31, 2018, 2017 and 2016 were as follows:

	2018	2017	2016
	(in thousands)		
Sales transactions:			
Gross gains	$1,769	$—	$271
Gross losses	(3,881)	(25)	(58)
	$(2,112)	$(25)	$213
Maturities and other securities transactions:			
Gross gains	$42	$43	$615
Gross losses	(272)	(38)	(51)
	$(230)	$5	$564
(Losses) gains on securities transactions, net	$(2,342)	$(20)	$777

Net losses on sales transactions in 2018 (as presented in the table above) primarily related to the sales of equity securities previously classified as available for sale, certain municipal securities acquired from USAB and all of Valley's private label mortgage-backed securities classified as available for sale, including securities that were previously impaired.
LOANS (Note 5)
The detail of the loan portfolio as of December 31, 2018 and 2017 was as follows:

	December 31, 2018			December 31, 2017		
	Non-PCI Loans	PCI Loans*	Total	Non-PCI Loans	PCI Loans*	Total
	(in thousands)					
Loans:						
Commercial and industrial	$3,590,375	$740,657	$4,331,032	$2,549,065	$192,360	$2,741,425
Commercial real estate:						
Commercial real estate	9,912,309	2,494,966	12,407,275	8,561,851	934,926	9,496,777
Construction	1,122,348	365,784	1,488,132	809,964	41,141	851,105
Total commercial real estate loans	11,034,657	2,860,750	13,895,407	9,371,815	976,067	10,347,882
Residential mortgage	3,682,984	428,416	4,111,400	2,717,744	141,291	2,859,035
Consumer:						
Home equity	371,340	145,749	517,089	373,631	72,649	