VALLEY NATIONAL BANCORP
Form 10-Q
August 08, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended June 30, 2014
OR
¨ Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 1-11277

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

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

973-305-8800
(Registrant’s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (check one):
Large accelerated filer x Accelerated filer ¨

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common Stock (no par value), of which 200,585,104 shares were outstanding as of August 7, 2014.

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

| | June 30, 2014 (Unaudited) | December 31, 2013 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $266,101 | $234,253 |
| Interest bearing deposits with banks | 40,580 | 134,915 |
| Investment securities: | | |
| Held to maturity (fair value of $1,854,121 at June 30, 2014 and $1,711,427 at December 31, 2013) | 1,826,143 | 1,731,737 |
| Available for sale | 783,205 | 829,692 |
| Trading securities | 14,221 | 14,264 |
| Total investment securities | 2,623,569 | 2,575,693 |
| Loans held for sale, at fair value | 16,068 | 10,488 |
| Non-covered loans | 11,750,875 | 11,471,447 |
| Covered loans | 62,553 | 96,165 |
| Less: Allowance for loan losses | (103,053) | (113,617) |
| Net loans | 11,710,375 | 11,453,995 |
| Premises and equipment, net | 273,746 | 270,138 |
| Bank owned life insurance | 347,045 | 344,023 |
| Accrued interest receivable | 53,650 | 53,964 |
| Due from customers on acceptances outstanding | 5,162 | 5,032 |
| FDIC loss-share receivable | 20,687 | 32,757 |
| Goodwill | 428,234 | 428,234 |
| Other intangible assets, net | 32,135 | 36,130 |
| Other assets | 518,615 | 576,919 |
| Total Assets | $16,335,967 | $16,156,541 |
| Liabilities | | |
| Deposits: | | |
| Non-interest bearing | $3,581,435 | $3,717,271 |
| Interest bearing: | | |
| Savings, NOW and money market | 5,643,128 | 5,422,722 |
| Time | 2,191,489 | 2,179,269 |
| Total deposits | 11,416,052 | 11,319,262 |
| Short-term borrowings | 354,230 | 281,455 |
| Long-term borrowings | 2,797,986 | 2,792,306 |
| Junior subordinated debentures issued to capital trusts | 41,171 | 41,089 |
| Bank acceptances outstanding | 5,162 | 5,032 |
| Accrued expenses and other liabilities | 147,710 | 176,357 |
| Total Liabilities | 14,762,311 | 14,615,501 |
| Shareholders' Equity | | |
| Preferred stock (no par value, authorized 30,000,000 shares; none issued) | — | — |
| Common stock (no par value, authorized 232,023,233 shares; issued 200,477,484 shares at June 30, 2014 and 199,629,268 shares at December 31, 2013) | 70,116 | 69,941 |
| Surplus | 1,408,325 | 1,403,375 |
| Retained earnings | 125,614 | 106,340 |

| | | |
|---|---|---|
| Accumulated other comprehensive loss | (30,297 ) | (38,252 ) |
| Treasury stock, at cost (10,183 common shares at June 30, 2014 and 36,159 common shares at December 31, 2013) | (102 ) | (364 ) |
| Total Shareholders' Equity | 1,573,656 | 1,541,040 |
| Total Liabilities and Shareholders' Equity | $16,335,967 | $16,156,541 |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Interest Income | | | | |
| Interest and fees on loans | $136,338 | $133,966 | $267,417 | $266,965 |
| Interest and dividends on investment securities: | | | | |
| Taxable | 15,709 | 12,925 | 32,165 | 27,414 |
| Tax-exempt | 3,700 | 3,673 | 7,386 | 7,322 |
| Dividends | 1,390 | 1,504 | 3,180 | 3,184 |
| Interest on federal funds sold and other short-term investments | 27 | 302 | 54 | 518 |
| Total interest income | 157,164 | 152,370 | 310,202 | 305,403 |
| Interest Expense | | | | |
| Interest on deposits: | | | | |
| Savings, NOW and money market | 4,530 | 4,369 | 8,811 | 9,071 |
| Time | 6,683 | 7,794 | 13,215 | 15,905 |
| Interest on short-term borrowings | 304 | 140 | 622 | 284 |
| Interest on long-term borrowings and junior subordinated debentures | 28,228 | 30,180 | 56,111 | 60,220 |
| Total interest expense | 39,745 | 42,483 | 78,759 | 85,480 |
| Net Interest Income | 117,419 | 109,887 | 231,443 | 219,923 |
| Provision for credit losses | (5,671) | 2,552 | (1,673) | 4,321 |
| Net Interest Income After Provision for Credit Losses | 123,090 | 107,335 | 233,116 | 215,602 |
| Non-Interest Income | | | | |
| Trust and investment services | 2,244 | 2,257 | 4,686 | 4,234 |
| Insurance commissions | 4,491 | 4,062 | 8,989 | 8,052 |
| Service charges on deposit accounts | 5,636 | 5,822 | 11,387 | 11,512 |
| Gains (losses) on securities transactions, net | 7 | 41 | (1) | 3,999 |
| Trading losses, net | (34) | (270) | (43) | (2,472) |
| Fees from loan servicing | 1,786 | 1,721 | 3,456 | 3,238 |
| Gains on sales of loans, net | 679 | 14,366 | 1,592 | 29,426 |
| Gains on sales of assets, net | 276 | 678 | 128 | 410 |
| Bank owned life insurance | 1,614 | 1,424 | 3,022 | 2,765 |
| Change in FDIC loss-share receivable | (7,711) | (2,000) | (7,787) | (5,175) |
| Other | 3,422 | 4,793 | 6,503 | 8,201 |
| Total non-interest income | 12,410 | 32,894 | 31,932 | 64,190 |
| Non-Interest Expense | | | | |
| Salary and employee benefits expense | 47,094 | 47,733 | 95,182 | 98,305 |
| Net occupancy and equipment expense | 17,973 | 18,179 | 38,697 | 37,068 |
| FDIC insurance assessment | 3,393 | 5,574 | 6,680 | 8,927 |
| Amortization of other intangible assets | 2,346 | 1,927 | 4,697 | 3,530 |
| Professional and legal fees | 4,384 | 4,285 | 8,062 | 8,177 |
| Advertising | 533 | 1,850 | 1,150 | 3,652 |
| Other | 18,506 | 15,798 | 34,644 | 31,126 |
| Total non-interest expense | 94,229 | 95,346 | 189,112 | 190,785 |
| Income Before Income Taxes | 41,271 | 44,883 | 75,936 | 89,007 |

| | | | | |
|---|---|---|---|---|
| Income tax expense | 11,751 | 10,961 | 12,581 | 23,775 |
| Net Income | $29,520 | $33,922 | $63,355 | $65,232 |
| Earnings Per Common Share: | | | | |
| Basic | $0.15 | $0.17 | $0.32 | $0.33 |
| Diluted | 0.15 | 0.17 | 0.32 | 0.33 |
| Cash Dividends Declared per Common Share | 0.11 | 0.16 | 0.22 | 0.33 |
| Weighted Average Number of Common Shares Outstanding: | | | | |
| Basic | 200,472,592 | 199,244,243 | 200,301,438 | 199,085,501 |
| Diluted | 200,472,592 | 199,244,243 | 200,301,438 | 199,085,501 |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | $29,520 | $33,922 | $63,355 | $65,232 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gains and losses on available for sale securities | | | | |
| Net gains (losses) arising during the period | 7,123 | (16,353) | 14,339 | (17,040) |
| Less reclassification adjustment for net (gains) losses included in net income | (4) | (25) | 1 | (2,324) |
| Total | 7,119 | (16,378) | 14,340 | (19,364) |
| Non-credit impairment losses on available for sale securities | | | | |
| Net change in non-credit impairment losses on securities | 164 | 2,008 | 306 | 6,751 |
| Less reclassification adjustment for accretion of credit impairment losses included in net income | (64) | (43) | (179) | (109) |
| Total | 100 | 1,965 | 127 | 6,642 |
| Unrealized gains and losses on derivatives (cash flow hedges) | | | | |
| Net (losses) gains on derivatives arising during the period | (4,862) | 2,036 | (8,524) | 1,959 |
| Less reclassification adjustment for net losses included in net income | 973 | 995 | 1,938 | 2,086 |
| Total | (3,889) | 3,031 | (6,586) | 4,045 |
| Defined benefit pension plan | | | | |
| Net gains arising during the period | — | 18,784 | — | 18,769 |
| Amortization of prior service cost | — | 133 | — | 261 |
| Amortization of net loss | 37 | 471 | 74 | 936 |
| Recognition of loss due to curtailment | — | 468 | — | 468 |
| Total | 37 | 19,856 | 74 | 20,434 |
| Total other comprehensive income | 3,367 | 8,474 | 7,955 | 11,757 |
| Total comprehensive income | $32,887 | $42,396 | $71,310 | $76,989 |

See accompanying notes to consolidated financial statements.

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

| | Six Months Ended June 30, 2014 | |
|---|---|---|
| | 2014 | 2013 |
| Cash flows from operating activities: | | |
| Net income | $63,355 | $65,232 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,016 | 9,886 |
| Stock-based compensation | 3,845 | 3,327 |
| Provision for credit losses | (1,673) | 4,321 |
| Net amortization of premiums and accretion of discounts on securities and borrowings | 13,757 | 13,332 |
| Amortization of other intangible assets | 4,697 | 3,530 |
| Losses (gains) on securities transactions, net | 1 | (3,999) |
| Proceeds from sales of loans held for sale | 56,579 | 935,834 |
| Gains on sales of loans, net | (1,592) | (29,426) |
| Originations of loans held for sale | (53,568) | (846,488) |
| Gains on sales of assets, net | (128) | (410) |
| FDIC loss-share receivable (excluding reimbursements) | 7,787 | 5,175 |
| Net change in: | | |
| Trading securities | 43 | 7,987 |
| Fair value of borrowings carried at fair value | — | 2,406 |
| Cash surrender value of bank owned life insurance | (3,022) | (2,765) |
| Accrued interest receivable | 314 | (928) |
| Other assets | 37,596 | 38,758 |
| Accrued expenses and other liabilities | (32,852) | (27,077) |
| Net cash provided by operating activities | 105,155 | 178,695 |
| Cash flows from investing activities: | | |
| Net loan (originations) repayments | (243,102) | 287,940 |
| Loans purchased | (26,746) | (178,486) |
| Investment securities held to maturity: | | |
| Purchases | (279,718) | (436,005) |
| Maturities, calls and principal repayments | 185,690 | 282,888 |
| Investment securities available for sale: | | |
| Purchases | (9,180) | (283,736) |
| Sales | — | 4,309 |
| Maturities, calls and principal repayments | 77,396 | 104,679 |
| Death benefit proceeds from bank owned life insurance | — | 628 |
| Proceeds from sales of real estate property and equipment | 10,172 | 6,574 |
| Purchases of real estate property and equipment | (13,518) | (6,828) |
| Reimbursements from (payments to) the FDIC | 4,283 | (865) |
| Net cash used in investing activities | (294,723) | (218,902) |
| Cash flows from financing activities: | | |
| Net change in deposits | 96,790 | (21,396) |
| Net change in short-term borrowings | 72,775 | (29,263) |
| Repayments of long-term borrowings | — | (1,000) |
| Cash dividends paid to common shareholders | (43,995) | (64,492) |

| | | |
|---|---|---|
| Common stock issued, net | 1,511 | 3,583 |
| Net cash provided by (used in) financing activities | 127,081 | (112,568) |
| Net change in cash and cash equivalents | (62,487) | (152,775) |
| Cash and cash equivalents at beginning of year | 369,168 | 853,100 |
| Cash and cash equivalents at end of period | $306,681 | $700,325 |

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

| | Six Months Ended June 30, 2014 | 2013 |
|---|---|---|
| Supplemental disclosures of cash flow information: | | |
| Cash payments for: | | |
| Interest on deposits and borrowings | $78,549 | $84,640 |
| Federal and state income taxes | 20,102 | 6,614 |
| Supplemental schedule of non-cash investing activities: | | |
| Transfer of loans to other real estate owned | $6,340 | $13,384 |
| Transfer of loans to loans held for sale | 27,329 | — |

See accompanying notes to consolidated financial statements.

VALLEY NATIONAL BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Basis of Presentation
The unaudited consolidated financial statements of Valley National Bancorp, a New Jersey Corporation (Valley), include the accounts of its commercial bank subsidiary, Valley National Bank (the “Bank”), and all of Valley’s direct or indirect wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated. The accounting and reporting policies of Valley conform to U.S. generally accepted accounting principles (U.S. GAAP) and general practices within the financial services industry. In accordance with applicable accounting standards, Valley does not consolidate statutory trusts established for the sole purpose of issuing trust preferred securities and related trust common securities.
In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly Valley’s financial position, results of operations and cash flows at June 30, 2014 and for all periods presented have been made. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the entire fiscal year.
In preparing the unaudited consolidated financial statements in conformity with U.S. GAAP, management has made estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of financial condition and results of operations for the periods indicated. Material estimates that are particularly susceptible to change are: the allowance for loan losses; the evaluation of goodwill and other intangible assets, and investment securities for impairment; fair value measurements of assets and liabilities; and income taxes. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are deemed necessary. While management uses its best judgment, actual amounts or results could differ significantly from those estimates. The current economic environment has increased the degree of uncertainty inherent in these material estimates.
Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP and industry practice have been condensed or omitted pursuant to rules and regulations of the SEC. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Valley’s Annual Report on Form 10-K for the year ended December 31, 2013.
Note 2. Business Combinations

On May 8, 2014, Valley entered into a merger agreement to acquire 1st United Bancorp, Inc. (“1st United”) (Nasdaq: FUBC) and its wholly-owned subsidiary, 1st United Bank, with approximately $1.7 billion in assets, $1.1 billion in loans, and $1.4 billion in deposits. 1st United has a 21 branch network covering the 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 will receive 0.89 of a share of Valley common stock for each 1st United share they own, subject to adjustment in the event Valley’s average stock price falls below $8.09 or rises above $12.13 prior to closing. The transaction is valued at an estimated $312 million, based on Valley's closing stock price on May 5, 2014 (and includes the cash consideration that will be paid to 1st United stock option holders). The transaction closing is anticipated in the fourth quarter of 2014, subject to approvals from regulators, 1st United shareholder approval of the merger and Valley shareholder approval of an amendment of its certificate of incorporation to increase its authorized common shares, as well as other customary conditions.

Note 3. Earnings Per Common Share

The following table shows the calculation of both basic and diluted earnings per common share for the three and six months ended June 30, 2014 and 2013:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| | (in thousands, except for share data) | | | |
| Net income | $29,520 | $33,922 | $63,355 | $65,232 |
| Basic weighted average number of common shares outstanding | 200,472,592 | 199,244,243 | 200,301,438 | 199,085,501 |
| Diluted weighted average number of common shares outstanding | 200,472,592 | 199,244,243 | 200,301,438 | 199,085,501 |
| Earnings per common share: | | | | |
| Basic | $0.15 | $0.17 | $0.32 | $0.33 |
| Diluted | 0.15 | 0.17 | 0.32 | 0.33 |

Common stock equivalents represent the effect of outstanding common stock options and warrants to purchase Valley's common shares, excluding those with exercise prices that exceed the average market price of Valley's common stock during the periods presented and therefore would have an anti-dilutive effect on the diluted earnings per common share calculation. All of Valley's common stock equivalents were anti-dilutive as of June 30, 2014 and 2013, and therefore excluded from the diluted weighted-average number of shares outstanding presented in the above table. Anti-dilutive common stock options and warrants totaled approximately 6.6 million shares for both the three and six months ended June 30, 2014 and 7.2 million shares for both the three and six months ended June 30, 2013.

Note 4. Accumulated Other Comprehensive Loss

The following table presents the after-tax changes in the balances of each component of accumulated other comprehensive loss for the three and six months ended June 30, 2014.

| | Components of Accumulated Other Comprehensive Loss | | | | Total Accumulated Other Comprehensive Loss |
|---|---|---|---|---|---|
| | Unrealized Gains and (Losses) on Available for Sale (AFS) Securities | Non-credit Impairment Losses on AFS Securities | Unrealized Gains and (Losses) on Derivatives | Defined Benefit Pension Plan | |
| | (in thousands) | | | | |
| Balance at March 31, 2014 | $(13,634) | $(779) | $ (8,968) | $(10,283) | $(33,664) |
| Other comprehensive income before reclassifications | 7,123 | 164 | (4,862) | — | 2,425 |
| Amounts reclassified from other comprehensive income | (4) | (64) | 973 | 37 | 942 |
| Other comprehensive income, net | 7,119 | 100 | (3,889) | 37 | 3,367 |
| Balance at June 30, 2014 | $(6,515) | $(679) | $ (12,857) | $(10,246) | $(30,297) |
| | | | | | |
| Balance at December 31, 2013 | $(20,855) | $(806) | $ (6,271) | $(10,320) | $(38,252) |
| Other comprehensive income before reclassifications | 14,339 | 306 | (8,524) | — | 6,121 |
| Amounts reclassified from other comprehensive income | 1 | (179) | 1,938 | 74 | 1,834 |
| Other comprehensive income, net | 14,340 | 127 | (6,586) | 74 | 7,955 |
| Balance at June 30, 2014 | $(6,515) | $(679) | $ (12,857) | $(10,246) | $(30,297) |

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The following table presents amounts reclassified from each component of accumulated other comprehensive loss on a gross and net of tax basis for the three and six months ended June 30, 2014 and 2013.

| | Amounts Reclassified from Accumulated Other Comprehensive Loss | | | | |
|---|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | | |
| Components of Accumulated Other Comprehensive Loss | 2014 | 2013 | 2014 | 2013 | Income Statement Line Item |
| | (in thousands) | | | | |
| Unrealized gains (losses) on AFS securities before tax | $7 | $41 | $(1) | $3,999 | Gains (losses) on securities transactions, net |
| Tax effect | (3) | (16) | — | (1,675) | |
| Total net of tax | 4 | 25 | (1) | 2,324 | |
| Non-credit impairment losses on AFS securities before tax: | | | | | |
| Accretion of credit loss impairment due to an increase in expected cash flows | 110 | 75 | 308 | 188 | Interest and dividends on investment securities (taxable) |
| Tax effect | (46) | (32) | (129) | (79) | |
| Total net of tax | 64 | 43 | 179 | 109 | |
| Unrealized losses on derivatives (cash flow hedges) before tax | (1,664) | (1,714) | (3,312) | (3,594) | Interest expense |
| Tax effect | 691 | 719 | 1,374 | 1,508 | |
| Total net of tax | (973) | (995) | (1,938) | (2,086) | |
| Defined benefit pension plan: | | | | | |
| Amortization of prior service cost | — | (241) | — | (443) | * |
| Amortization of net actuarial loss | (62) | (811) | (124) | (1,605) | * |
| Recognition of loss due to curtailment | — | (750) | — | (750) | * |
| Total before tax | (62) | (1,802) | (124) | (2,798) | |
| Tax effect | 25 | 730 | 50 | 1,133 | |
| Total net of tax | (37) | (1,072) | (74) | (1,665) | |
| Total reclassifications, net of tax | $(942) | $(1,999) | $(1,834) | $(1,318) | |

* These accumulated other comprehensive loss components are included in the computation of net periodic pension cost.

Note 5. New Authoritative Accounting Guidance

Accounting Standards Update (ASU) No. 2014-12, "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period" requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU No. 2014-12 will be effective for reporting periods after January 1, 2015 and is not expected to have a significant impact on Valley's consolidated financial statements.

ASU No. 2014-11, "Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures" requires entities to account for repurchase-to-maturity transactions as secured borrowings rather than as sales with forward repurchase agreements and expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. The accounting-related changes are effective for the first interim or annual period beginning after December 15, 2014. The disclosures for certain transactions accounted for as sales are required for interim and annual periods beginning after December 15, 2014. The disclosures for

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repos, securities lending transactions, and repos-to-maturity accounted for as secured borrowings are required for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption of the ASU No. 2014-11 is prohibited. As of June 30, 2014, all of Valley's repurchase agreements were typical in nature (i.e., not repurchase-to-maturity transactions or repurchase agreements executed as a repurchase financing) and are accounted for as secured borrowings. As such, Valley's adoption of ASU No. 2014-11 is not expected to have a significant impact on its consolidated financial statements.

ASU No. 2014-04, "Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure," clarifies that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, this ASU requires interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for annual and interim periods beginning after December 15, 2014. Valley's adoption of ASU No. 2014-04 is not expected to have a significant impact on its consolidated financial statements.

ASU No. 2014-01, "Investments-Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects," amends existing guidance to permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense or benefit. For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment in accordance with Subtopic 970-323. ASU No. 2014-01 is effective for annual periods and interim reporting periods within those annual periods beginning after December 15, 2014. Early adoption is permitted. Valley's adoption of ASU No. 2014-01 is not expected to have a significant impact on its consolidated financial statements.

ASU No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This ASU applies to all entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date. ASU No. 2013-11 became effective for Valley on January 1, 2014 and did not have a significant impact on its consolidated financial statements.

Note 6. Fair Value Measurement of Assets and Liabilities

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

| | |
|---|---|
| Level 1 | Unadjusted exchange quoted prices in active markets for identical assets or liabilities, or identical liabilities traded as assets that the reporting entity has the ability to access at the measurement date. |
| Level 2 | Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly (i.e., quoted prices on similar assets), for substantially the full term of the asset or |

liability.

| | |
|---|---|
| Level 3 | Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity). |

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

The following tables present the assets and liabilities that are measured at fair value on a recurring and nonrecurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial condition at June 30, 2014 and December 31, 2013. The assets presented under "nonrecurring fair value measurements" in the table below are not measured at fair value on an ongoing basis but are subject to fair value adjustments under certain circumstances (e.g., when an impairment loss is recognized).

| | | Fair Value Measurements at Reporting Date Using: | | |
|---|---|---|---|---|
| | June 30, 2014 | 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 | $91,887 | $91,887 | $— | $— |
| U.S. government agency securities | 46,041 | — | 46,041 | — |
| Obligations of states and political subdivisions | 38,015 | — | 38,015 | — |
| Residential mortgage-backed securities | 478,132 | — | 456,630 | 21,502 |
| Trust preferred securities | 20,650 | — | 16,123 | 4,527 |
| Corporate and other debt securities | 84,536 | 27,473 | 57,063 | — |
| Equity securities | 23,944 | 2,170 | 21,774 | — |
| Total available for sale | 783,205 | 121,530 | 635,646 | 26,029 |
| Trading securities | 14,221 | — | 14,221 | |
| Loans held for sale (1) | 8,218 | — | 8,218 | — |
| Other assets (2) | 14,499 | — | 14,499 | — |
| Total assets | $820,143 | $121,530 | $672,584 | $26,029 |
| Liabilities | | | | |
| Other liabilities (2) | $26,666 | $— | $26,666 | $— |
| Total liabilities | $26,666 | $— | $26,666 | $— |
| Non-recurring fair value measurements: | | | | |
| Non-performing loans held for sale | $7,850 | $— | $7,850 | $— |
| Collateral dependent impaired loans (3) | 21,740 | — | — | 21,740 |
| Loan servicing rights | 2,314 | — | — | 2,314 |
| Foreclosed assets (4) | 12,715 | — | — | 12,715 |
| Total | $44,619 | $— | $7,850 | $36,769 |

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| | December 31, 2013 | 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 | $84,665 | $84,665 | $— | $— |
| U.S. government agency securities | 48,627 | — | 48,627 | — |
| Obligations of states and political subdivisions | 37,700 | — | 37,700 | — |
| Residential mortgage-backed securities | 508,029 | — | 483,277 | 24,752 |
| Trust preferred securities | 19,215 | — | 15,444 | 3,771 |
| Corporate and other debt securities | 83,398 | 27,273 | 56,125 | — |
| Equity securities | 48,058 | 26,905 | 21,153 | — |
| Total available for sale | 829,692 | 138,843 | 662,326 | 28,523 |
| Trading securities | 14,264 | — | 14,264 | — |
| Loans held for sale (1) | 10,488 | — | 10,488 | — |
| Other assets (2) | 15,122 | — | 15,122 | — |
| Total assets | $869,566 | $138,843 | $702,200 | $28,523 |
| Liabilities | | | | |
| Other liabilities (2) | $20,586 | $— | $20,586 | $— |
| Total liabilities | $20,586 | $— | $20,586 | $— |
| Non-recurring fair value measurements: | | | | |
| Collateral dependent impaired loans (3) | $35,700 | $— | $— | $35,700 |
| Loan servicing rights | 3,677 | — | — | 3,677 |
| Foreclosed assets (4) | 25,929 | — | — | 25,929 |
| Total | $65,306 | $— | $— | $65,306 |

(1) Loans held for sale carried at fair value (which consist of residential mortgages) had contractual unpaid principal balances totaling approximately $8.0 million and $10.4 million at June 30, 2014 and December 31, 2013, respectively.

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

(3) Excludes PCI loans.

(4) Includes covered real estate owned totaling $2.8 million and $7.6 million at June 30, 2014 and December 31, 2013, respectively.

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The changes in Level 3 assets measured at fair value on a recurring basis for the three and six months ended June 30, 2014 and 2013 are summarized below:

| | Available for Sale Securities | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| | (in thousands) | | | |
| Balance, beginning of the period | $26,911 | $77,920 | $28,523 | $71,674 |
| Total net gains for the period included in other comprehensive income | 174 | 3,406 | 222 | 11,439 |
| Settlements | (1,056) | (2,214) | (2,716) | (4,001) |
| Balance, end of the period | $26,029 | $79,112 | $26,029 | $79,112 |

No changes in unrealized losses on Level 3 securities held at June 30, 2014 and 2013 were included in earnings during the three and six months ended June 30, 2014 and 2013. There were also no transfers of assets between Level 1 and Level 2 during the three and six months ended June 30, 2014 and 2013.

There have been no material changes in the valuation methodologies used at June 30, 2014 from December 31, 2013.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

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

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

The following table presents quantitative information about Level 3 inputs used to measure the fair value of these securities at June 30, 2014:

| Security Type | Valuation Technique | Unobservable Input | Range | Weighted Average | |
|---|---|---|---|---|---|
| Private label mortgage-backed securities | Discounted cash flow | Prepayment rate | 1.30 - 44.30 | 14.4 | % |
| | | Default rate | 2.4 - 22.96 | 7.9 | |
| | | Loss severity | 40.0 - 52.90 | 48.9 | |

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

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

For two pooled securities in the Level 3 available for sale trust preferred securities category, the resulting estimated future cash flows were discounted at a yield determined by reference to similarly structured securities for which observable orderly transactions occurred. The discount rate for each security was applied using a pricing matrix based on credit, security type and maturity characteristics to determine the fair value. The fair value calculations for both securities are received from an independent valuation advisor. In validating the fair value calculation from an independent valuation advisor, Valley reviews the accuracy of the inputs and the appropriateness of the unobservable inputs utilized in the valuation to ensure the fair value calculation is reasonable from a market participant perspective.

Loans held for sale. The conforming residential mortgage loans originated for sale are reported at fair value using Level 2 inputs. The fair values were calculated utilizing quoted prices for similar assets in active markets. To determine these fair values, the mortgages held for sale are put into multiple tranches, or pools, based on the coupon rate and maturity of each mortgage. The market prices for each tranche are obtained from both Fannie Mae and Freddie Mac. The market prices represent a delivery price, which reflects the underlying price each institution would pay Valley for an immediate sale of an aggregate pool of mortgages. The market prices received from Fannie Mae and Freddie Mac are then averaged and interpolated or extrapolated, where required, to calculate the fair value of each tranche. Depending upon the time elapsed since the origination of each loan held for sale, non-performance risk and changes therein were addressed in the estimate of fair value based upon the delinquency data provided to both Fannie Mae and Freddie Mac for market pricing and changes in market credit spreads. Non-performance risk did not materially impact the fair value of mortgage loans held for sale at June 30, 2014 and December 31, 2013 based on the short duration these assets were held, and the high credit quality of these loans.

Derivatives. Derivatives are reported at fair value utilizing Level 2 inputs. The fair value of Valley's derivatives are determined using third party prices that are based on discounted cash flow analysis using observed market inputs, such as the LIBOR and Overnight Index Swap rate curves. The fair value of mortgage banking derivatives, consisting of interest rate lock commitments to fund residential mortgage loans and forward commitments for the future delivery of such loans (including certain loans held for sale at June 30, 2014), is determined based on the current market prices for similar instruments provided by Freddie Mac and Fannie Mae. 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 June 30, 2014 and December 31, 2013.

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

The following valuation techniques were used for certain non-financial assets measured at fair value on a nonrecurring basis, including non-performing loans held for sale carried at estimated fair value (less selling costs) when less than the unamortized cost, impaired loans reported at the fair value of the underlying collateral, as well as loan servicing rights, other real estate owned and other repossessed assets which are reported at fair value upon initial recognition or subsequent impairment as described below.

Non-performing loans held for sale. At June 30, 2014, non-performing loans held for sale consisted of one commercial real estate loan that was transferred to the loans held for sale account during the first quarter of 2014. The fair value of the loan was determined using Level 2 inputs, and a third party broker was engaged to solicit interest from potential purchasers. The broker coordinated loan level due diligence with interested parties and established a formal bidding process in which each participant was required to provide an indicative non-binding bid. Based on the most recent bids received for this loan, Valley established the fair market value based on both qualitative and quantitative information received from the broker. The loan was re-measured and reported at fair value of $7.9 million at June 30, 2014 resulting in a write-down of $2.3 million charged to non-interest income during the three months ended June 30, 2014.

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 certain discounting criteria. At June 30, 2014, appraisals were discounted up to 26.4 percent based on specific market data by location and property type. During the quarter ended June 30, 2014, 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 $2.2 million and $3.2 million for the three and six months ended June 30, 2014, respectively. At June 30, 2014, collateral dependent impaired loans with a total recorded investment of $23.6 million were reduced by specific valuation allowance allocations totaling $1.9 million to a reported total net carrying amount of $21.7 million.

Loan servicing rights. Fair values for each risk-stratified group of loan servicing rights are calculated using a fair value model from a third party vendor that requires inputs that are both significant to the fair value measurement and unobservable (Level 3). The fair value model is based on various assumptions, including but not limited to, prepayment speeds, internal rate of return ("discount rate"), servicing cost, ancillary income, float rate, tax rate, and inflation. The prepayment speed and the discount rate are considered two of the most significant inputs in the model. At June 30, 2014, the fair value model used prepayment speeds (stated as constant prepayment rates) from 0 percent up to 25 percent and a discount rate of 8.0 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 recognized net recoveries of impairment charges totaling $42 thousand and $142 thousand for the three and six months ended June 30, 2014, respectively.

Foreclosed assets. Certain foreclosed assets (consisting of other real estate owned and other repossessed assets), upon initial recognition and transfer from loans, are re-measured and reported at fair value through a charge-off to the allowance for loan losses based upon the fair value of the foreclosed assets. The fair value of a foreclosed asset, upon initial recognition, is typically estimated using Level 3 inputs, consisting of an appraisal that is adjusted based on certain discounting criteria, similar to the criteria used for impaired loans described above. The appraisals of of foreclosed assets discounted up to 12.0 percent at June 30, 2014. At June 30, 2014, foreclosed assets included $12.7 million of assets that were measured at fair value upon initial recognition or subsequently re-measured during the quarter ended June 30, 2014. The foreclosed assets charge-offs to the allowance for loan losses totaled $527 thousand and $2.0 million for the three and six months ended June 30, 2014, respectively. The re-measurement of foreclosed assets at fair value subsequent to their initial recognition resulted in a net loss of $75 thousand and $1.9 million within non-interest expense for the three and six months ended June 30, 2014, respectively.

Other Fair Value Disclosures

The following table presents the amount of gains and losses from fair value changes included in income before income taxes for financial assets and liabilities carried at fair value for the three and six months ended June 30, 2014 and 2013:

| Reported in Consolidated Statements of Financial Condition | Reported in Consolidated Statements of Income | Gains (Losses) on Change in Fair Value<br>Three Months Ended June 30,<br>2014 | <br><br>2013 | <br>Six Months Ended June 30,<br>2014 | <br><br>2013 |
|---|---|---|---|---|---|
| | | (in thousands) | | | |
| Assets: | | | | | |
| Trading securities | Trading losses, net | $(34) | $(36) | $(43) | $(66) |
| Loans held for sale | Gains on sales of loans, net | 679 | 14,366 | 1,592 | 29,426 |
| Liabilities: | | | | | |
| Junior subordinated debentures issued to capital trusts | Trading losses, net | — | (234) | — | (2,406) |
| | | $645 | $14,096 | $1,549 | $26,954 |

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 June 30, 2014 and December 31, 2013 were as follows:

| | Fair Value Hierarchy | June 30, 2014 Carrying Amount (in thousands) | Fair Value | December 31, 2013 Carrying Amount | Fair Value |
|---|---|---|---|---|---|
| Financial assets | | | | | |
| Cash and due from banks | Level 1 | $266,101 | $266,101 | $234,253 | $234,253 |
| Interest bearing deposits with banks | Level 1 | 40,580 | 40,580 | 134,915 | 134,915 |
| Investment securities held to maturity: | | | | | |
| U.S. Treasury securities | Level 1 | 139,192 | 149,128 | 139,255 | 144,307 |
| U.S. government agency securities | Level 2 | 14,346 | 14,718 | 4,427 | 4,365 |
| Obligations of states and political subdivisions | Level 2 | 515,402 | 530,393 | 545,886 | 543,151 |
| Residential mortgage-backed securities | Level 2 | 1,019,086 | 1,028,120 | 886,043 | 871,021 |
| Trust preferred securities | Level 2 | 98,452 | 85,886 | 103,458 | 91,489 |
| Corporate and other debt securities | Level 2 | 39,665 | 45,876 | 52,668 | 57,094 |
| Total investment securities held to maturity | | 1,826,143 | 1,854,121 | 1,731,737 | 1,711,427 |
| Net loans | Level 3 | 11,710,375 | 11,513,205 | 11,453,995 | 11,294,348 |
| Accrued interest receivable | Level 1 | 53,650 | 53,650 | 53,964 | 53,964 |
| Federal Reserve Bank and Federal Home Loan Bank stock (1) | Level 1 | 138,180 | 138,180 | 137,234 | 137,234 |
| Financial liabilities | | | | | |
| Deposits without stated maturities | Level 1 | 9,224,563 | 9,224,563 | 9,139,993 | 9,139,993 |
| Deposits with stated maturities | Level 2 | 2,191,489 | 2,254,453 | 2,179,269 | 2,206,427 |
| Short-term borrowings | Level 1 | 354,230 | 354,230 | 281,455 | 281,455 |
| Long-term borrowings | Level 2 | 2,797,986 | 3,040,487 | 2,792,306 | 3,036,953 |
| Junior subordinated debentures issued to capital trusts | Level 2 | 41,171 | 45,191 | 41,089 | 45,261 |
| Accrued interest payable (2) | Level 1 | 16,652 | 16,652 | 16,442 | 16,442 |

(1) Included in other assets.
(2) Included in accrued expenses and other liabilities.

The following methods and assumptions were used to estimate the fair value of other financial assets and financial liabilities in the table above:

Cash and due from banks and interest bearing deposits with banks. The carrying amount is considered to be a reasonable estimate of fair value because of the short maturity of these items.

Investment securities held to maturity. Fair values are based on prices 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 (Level 2 inputs). Additionally, Valley reviews the volume and level of activity for all classes of held to maturity securities and attempts to identify transactions which may not be orderly or reflective of a significant level of activity and volume. For securities meeting these criteria, the quoted prices received from either market participants or an independent pricing service

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may be adjusted, as necessary. If applicable, the adjustment to fair value is derived based on present value cash flow model projections prepared by Valley utilizing assumptions similar to those incorporated by market participants.

Loans. Fair values of non-covered loans (i.e., loans which are not subject to loss-sharing agreements with the FDIC) and covered loans (i.e., loans subject to loss-sharing agreements with the FDIC) are estimated by discounting the projected future cash flows using market discount rates that reflect the credit and interest-rate risk inherent in the loan. The discount rate is a product of both the applicable index and credit spread, subject to the estimated current new loan interest rates. The credit spread component is static for all maturities and may not necessarily reflect the value of estimating all actual cash flows re-pricing. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Accrued interest receivable and payable. The carrying amounts of accrued interest approximate their fair value due to the short-term nature of these items.

Federal Reserve Bank and Federal Home Loan Bank stock. Federal Reserve and FHLB stock are non-marketable equity securities and are reported at their redeemable carrying amounts, which approximate the fair value.

Deposits. The carrying amounts of deposits without stated maturities (i.e., non-interest bearing, savings, NOW, and money market deposits) approximate their estimated fair value. The fair value of time deposits is based on the discounted value of contractual cash flows using estimated rates currently offered for alternative funding sources of similar remaining maturity.

Short-term and long-term borrowings. The carrying amounts of certain short-term borrowings, including securities sold under agreements to repurchase (and from time to time, federal funds purchased and FHLB borrowings) approximate their fair values because they frequently re-price to a market rate. The fair values of other short-term and long-term borrowings are estimated by obtaining quoted market prices of the identical or similar financial instruments when available. When quoted prices are unavailable, the fair values of the borrowings are estimated by discounting the estimated future cash flows using current market discount rates of financial instruments with similar characteristics, terms and remaining maturity.

Junior subordinated debentures issued to capital trusts. The fair value of debentures issued to capital trusts not carried at fair value is estimated utilizing the income approach, whereby the expected cash flows, over the remaining estimated life of the security, are discounted using Valley’s credit spread over the current yield on a similar maturity of U.S. Treasury security or the three-month LIBOR for the variable rate indexed debentures (Level 2 inputs). The credit spread used to discount the expected cash flows was calculated based on the median current spreads for all fixed and variable publicly traded trust preferred securities issued by banks.

Note 7. Investment Securities

As of June 30, 2014, Valley had approximately $1.8 billion, $783.2 million, and $14.2 million in held to maturity, available for sale, and trading investment securities, respectively. 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; prolonged decline in value of equity investments; or unanticipated changes in the competitive environment could have a negative effect on Valley’s investment portfolio and may result in other-than-temporary impairment on certain investment securities in future periods. Valley’s investment portfolios include private label mortgage-backed securities, trust preferred securities principally issued by bank holding companies (including three pooled trust preferred securities), corporate bonds primarily issued by banks, and perpetual preferred and common equity securities issued by banks. These investments may pose a higher risk of future impairment charges by Valley as a result of the unpredictable nature of the U.S. economy and its potential negative effect on the future performance of the security issuers and, if applicable, the underlying mortgage loan collateral of the security. See the “Other-Than-Temporary Impairment Analysis” section below for further discussion.

Held to Maturity

The amortized cost, gross unrealized gains and losses and fair value of securities held to maturity at June 30, 2014 and December 31, 2013 were as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | | Fair Value |
|---|---|---|---|---|---|
| | (in thousands) | | | | |
| June 30, 2014 | | | | | |
| U.S. Treasury securities | $139,192 | $9,936 | $— | | $149,128 |
| U.S. government agency securities | 14,346 | 372 | — | | 14,718 |
| Obligations of states and political subdivisions: | | | | | |
| Obligations of states and state agencies | 198,610 | 7,056 | (1,291 | ) | 204,375 |
| Municipal bonds | 316,792 | 10,441 | (1,215 | ) | 326,018 |
| Total obligations of states and political subdivisions | 515,402 | 17,497 | (2,506 | ) | 530,393 |
| Residential mortgage-backed securities | 1,019,086 | 20,233 | (11,199 | ) | 1,028,120 |
| Trust preferred securities | 98,452 | 193 | (12,759 | ) | 85,886 |
| Corporate and other debt securities | 39,665 | 6,213 | (2 | ) | 45,876 |
| Total investment securities held to maturity | $1,826,143 | $54,444 | $(26,466 | ) | $1,854,121 |
| December 31, 2013 | | | | | |
| U.S. Treasury securities | $139,255 | $5,567 | $(515 | ) | $144,307 |
| U.S. government agency securities | 4,427 | — | (62 | | |