VALLEY NATIONAL BANCORP
Form 10-Q
November 09, 2012
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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 September 30, 2012

OR

¨ **Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the transition period from ______ to ______

Commission File Number 1-11277

VALLEY NATIONAL BANCORP

(Exact name of registrant as specified in its charter)

New Jersey	**22-2477875**

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

973-305-8800

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 197,619,528 shares were outstanding as of November 6, 2012.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

VALLEY NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Unaudited)

(in thousands, except for share data)

	September 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$ 412,895	$ 372,566
Interest bearing deposits with banks	192,364	6,483
Investment securities:		
Held to maturity, fair value of $1,689,413 at September 30, 2012 and $2,027,197 at December 31, 2011	1,624,575	1,958,916
Available for sale	673,911	566,520
Trading securities	22,104	21,938
Total investment securities	2,320,590	2,547,374
Loans held for sale, at fair value	149,067	25,169
Non-covered loans	10,941,405	9,527,797
Covered loans	207,533	271,844
Less: Allowance for loan losses	(129,247)	(133,802)
Net loans	11,019,691	9,665,839
Premises and equipment, net	276,071	265,475
Bank owned life insurance	338,286	303,867
Accrued interest receivable	55,548	52,527
Due from customers on acceptances outstanding	4,474	5,903
FDIC loss-share receivable	51,938	74,390
Goodwill	420,443	317,962
Other intangible assets, net	28,872	20,818
Other assets	500,895	586,134
Total Assets	$ 15,771,134	$ 14,244,507
Liabilities		
Deposits:		
Non-interest bearing	$ 3,206,283	$ 2,781,597
Interest bearing:		
Savings, NOW and money market	4,992,748	4,390,121
Time	2,721,769	2,501,384
Total deposits	10,920,800	9,673,102
Short-term borrowings	288,865	212,849
Long-term borrowings	2,698,403	2,726,099

Junior subordinated debentures issued to capital trusts (includes fair value of $149,708 at September 30, 2012 and $160,478 at December 31, 2011 for VNB Capital Trust I)	190,594	185,598
Bank acceptances outstanding	4,474	5,903
Accrued expenses and other liabilities	154,675	174,708
Total Liabilities	14,257,811	12,978,259
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 197,446,137 shares at September 30, 2012 and 178,717,806 shares at December 31, 2011	69,402	59,955
Surplus	1,387,895	1,179,135
Retained earnings	100,253	90,011
Accumulated other comprehensive loss	(44,063)	(62,441)
Treasury stock, at cost (16,419 common shares at September 30, 2012 and 34,776 common shares at December 31, 2011)	(164)	(412)
Total Shareholders Equity	1,513,323	1,266,248
Total Liabilities and Shareholders Equity	$ 15,771,134	$ 14,244,507

* Share data reflects the five percent common stock dividend issued on May 25, 2012.

See accompanying notes to consolidated financial statements.

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VALLEY NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(in thousands, except for share data)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Interest Income				
Interest and fees on loans	$ 146,011	$ 140,303	$ 438,283	$ 409,010
Interest and dividends on investment securities:				
Taxable	15,733	26,552	54,598	84,734
Tax-exempt	3,424	3,109	9,770	8,043
Dividends	1,866	1,565	5,291	5,212
Interest on federal funds sold and other short-term investments	196	110	282	253
Total interest income	167,230	171,639	508,224	507,252
Interest Expense				
Interest on deposits:				
Savings, NOW and money market	5,051	4,961	15,095	14,722
Time	9,226	12,424	28,687	37,206
Interest on short-term borrowings	556	293	1,178	910
Interest on long-term borrowings and junior subordinated debentures	30,575	32,026	91,912	97,917
Total interest expense	45,408	49,704	136,872	150,755
Net Interest Income	121,822	121,935	371,352	356,497
Provision for credit losses	7,250	7,783	20,352	37,971
Net Interest Income After Provision for Credit Losses	114,572	114,152	351,000	318,526
Non-Interest Income				
Trust and investment services	1,947	1,769	5,705	5,744
Insurance commissions	3,228	3,416	11,947	11,496
Service charges on deposit accounts	6,513	5,616	18,545	16,908
Gains on securities transactions, net	1,496	863	2,543	20,034
Other-than-temporary impairment losses on securities	-	-	-	-
Portion recognized in other comprehensive income (before taxes)	(4,697)	-	(5,247)	(825)
Net impairment losses on securities recognized in earnings	(4,697)	-	(5,247)	(825)
Trading gains, net	6	776	627	3,110
Fees from loan servicing	1,173	989	3,481	3,356
Gains on sales of loans, net	25,055	2,890	31,362	8,060
Gains on sales of assets, net	195	179	483	382
Bank owned life insurance	1,674	1,989	5,265	5,575
Change in FDIC loss-share receivable	(390)	(1,577)	(7,502)	11,989
Other	4,296	3,293	19,912	12,696
Total non-interest income	40,496	20,203	87,121	98,525

Non-Interest Expense				
Salary and employee benefits expense	49,267	45,125	151,507	133,359
Net occupancy and equipment expense	17,466	15,656	51,731	48,309
FDIC insurance assessment	3,915	2,993	10,742	9,624
Amortization of other intangible assets	2,696	3,351	7,186	7,109
Professional and legal fees	3,471	3,666	10,440	10,459
Advertising	1,723	2,185	5,252	6,370
Other	14,681	12,326	42,419	36,981
Total non-interest expense	93,219	85,302	279,277	252,211
Income Before Income Taxes	61,849	49,053	158,844	164,840
Income tax expense	22,402	13,696	52,046	56,004
Net Income	$ 39,447	$ 35,357	$ 106,798	$ 108,836
Earnings Per Common Share*:				
Basic	0.20	0.20	0.54	0.61
Diluted	0.20	0.20	0.54	0.61
Cash Dividends Declared per Common Share*	0.16	0.16	0.49	0.49
Weighted Average Number of Common Shares Outstanding*:				
Basic	197,437,988	178,507,769	197,205,865	178,333,952
Diluted	197,437,988	178,508,382	197,206,303	178,338,310

* Share data reflects the five percent common stock dividend issued on May 25, 2012.

See accompanying notes to consolidated financial statements.

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VALLEY NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$ 39,447	$ 35,357	$ 106,798	$ 108,836
Other comprehensive (loss) income, net of tax:				
Unrealized gains and losses on available for sale securities				
Net gains (losses) arising during the period	202	(4,102)	7,323	3,784
Less reclassification adjustment for net gains included in net income	(911)	(493)	(1,519)	(12,214)
Total	(709)	(4,595)	5,804	(8,430)
Non-credit impairment losses on available for sale securities				
Net change in non-credit impairment losses on securities	(2,161)	(312)	9,497	281
Less reclassification adjustment for credit impairment losses included in net income	2,415	(68)	2,488	293
Total	254	(380)	11,985	574
Unrealized gains and losses on derivatives (cash flow hedges)				
Net losses on derivatives arising during the period	(1,219)	(9,185)	(3,389)	(12,145)
Less reclassification adjustment for net losses included in net income	1,038	353	2,657	1,042
Total	(181)	(8,832)	(732)	(11,103)
Defined benefit pension plan				
Amortization of prior service cost	102	93	308	278
Amortization of net loss	338	200	1,013	598
Total	440	293	1,321	876
Total other comprehensive (loss) income	(196)	(13,514)	18,378	(18,083)
Total comprehensive income	$ 39,251	$ 21,843	$ 125,176	$ 90,753

See accompanying notes to consolidated financial statements.

VALLEY NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Nine Months Ended September 30,	
Cash flows from operating activities:	**2012**	**2011**
Net income	$ 106,798	$ 108,836
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,463	12,067
Stock-based compensation	3,816	2,535
Provision for credit losses	20,352	37,971
Net amortization of premiums and accretion of discounts on securities and borrowings	15,333	7,636
Amortization of other intangible assets	7,186	7,109
Gains on securities transactions, net	(2,543)	(20,034)
Net impairment losses on securities recognized in earnings	5,247	825
Proceeds from sales of loans held for sale	598,885	274,032
Gains on sales of loans, net	(31,362)	(8,060)
Originations of loans held for sale	(568,330)	(241,364)
Gains on sales of assets, net	(483)	(382)
Net change in:		
FDIC loss-share receivable (excluding reimbursements)	7,502	(11,989)
Trading securities	(166)	10,448
Fair value of borrowings carried at fair value	(461)	(2,587)
Cash surrender value of bank owned life insurance	(5,265)	(5,575)
Accrued interest receivable	2,273	(3,390)
Other assets	100,700	12,217
Accrued expenses and other liabilities	(38,475)	(173)
Net cash provided by operating activities	234,470	180,122
Cash flows from investing activities:		
Net loan originations	(305,713)	(261,066)
Loans purchased	(129,659)	
Investment securities held to maturity:		
Purchases	(258,764)	(592,138)
Maturities, calls and principal repayments	582,651	427,307
Investment securities available for sale:		
Purchases	(229,037)	(463,655)
Sales	221,603	517,244
Maturities, calls and principal repayments	196,082	200,588
Death benefit proceeds from bank owned life insurance	1,689	5,389
Proceeds from sales of real estate property and equipment	5,749	4,495
Purchases of real estate property and equipment	(15,210)	(11,946)
Reimbursements from the FDIC under loss-sharing agreements	14,950	22,746
Cash and cash equivalents acquired in acquisition	117,587	
Net cash provided by (used in) investing activities	201,928	(151,036)
Cash flows from financing activities:		
Net change in deposits	(132,595)	256,725
Net change in short-term borrowings	47,016	30,256

Repayments of long-term borrowings	(27,000)	(206,000)
Redemption of junior subordinated debentures	(10,000)	
Dividends paid to common shareholders	(93,785)	(87,450)
Common stock issued, net	6,176	6,325
Net cash used in financing activities	(210,188)	(144)
Net change in cash and cash equivalents	226,210	28,942
Cash and cash equivalents at beginning of year	379,049	366,286
Cash and cash equivalents at end of period	$ 605,259	$ 395,228

See accompanying notes to consolidated financial statements.

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VALLEY NATIONAL BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(in thousands)

	Nine Months Ended September 30, 2012	2011
Supplemental disclosures of cash flow information:		
Cash payments for:		
Interest on deposits and borrowings	$ 137,138	$ 150,640
Federal and state income taxes	49,936	28,741
Supplemental schedule of non-cash investing activities:		
Transfer of loans to other real estate owned	$ 11,831	$ 7,934
Transfer of loans to loans held for sale	123,093	-
Acquisitions:		
Non-cash assets acquired:		
Investment securities available for sale	275,650	-
Loans	1,098,948	-
Premises and equipment, net	9,457	-
Accrued interest receivable	5,294	-
Goodwill	101,967	-
Other intangible assets, net	8,050	-
Other assets	67,715	-
Total non-cash assets acquired	$ 1,567,081	$ -
Liabilities assumed:		
Deposits	1,380,293	-
Short-term borrowings	29,000	-
Junior subordinated debentures issued to capital trusts	15,645	-
Other liabilities	51,312	-
Total liabilities assumed	1,476,250	-
Net non-cash assets acquired	$ 90,831	$ -
Net cash and cash equivalents acquired	$ 117,587	$ -
Common stock issued in acquisition	$ 208,418	$ -

See accompanying notes to consolidated financial statements.

VALLEY NATIONAL BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

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

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly Valley s financial position, results of operations and cash flows at September 30, 2012 and for all periods presented have been made. The results of operations for the three and nine months ended September 30, 2012 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 (including the estimated fair values recorded for acquired assets and assumed liabilities - see discussion below); 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 disclosure 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, 2011.

Effective January 1, 2012, Valley acquired State Bancorp, Inc. (State Bancorp), the holding company for State Bank of Long Island, a commercial bank. See Note 3 for further details regarding this acquisition.

On May 25, 2012, Valley paid a five percent common stock dividend to shareholders of record on May 11, 2012. All common share and per common share data presented in the consolidated financial statements and the accompanying notes below were adjusted to reflect the dividend.

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Note 2. Earnings Per Common Share

The following table shows the calculation of both basic and diluted earnings per common share for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands, except for share data)			
Net income	$ 39,447	$ 35,357	$ 106,798	$ 108,836
Basic weighted-average number of common shares outstanding	197,437,988	178,507,769	197,205,865	178,333,952
Plus: Common stock equivalents	-	613	438	4,358
Diluted weighted-average number of common shares outstanding	197,437,988	178,508,382	197,206,303	178,338,310
Earnings per common share:				
Basic	$ 0.20	$ 0.20	$ 0.54	$ 0.61
Diluted	0.20	0.20	0.54	0.61

Common stock equivalents, in the table above, 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. Anti-dilutive common stock options and warrants totaled approximately 7.6 million shares for both the three and nine months ended September 30, 2012, and 7.3 million and 7.1 million shares for the three and nine months ended September 30, 2011, respectively.

Note 3. Business Combinations

Acquisition of State Bancorp, Inc.

On January 1, 2012, Valley acquired State Bancorp, the holding company for State Bank of Long Island, a commercial bank with approximately $1.7 billion in assets, after purchase accounting adjustments, and 16 branches in Nassau, Suffolk, Queens, and Manhattan. The shareholders of State Bancorp received a fixed one- for- one exchange ratio for Valley National Bancorp common stock. The total consideration for the acquisition was $208.4 million (approximately 17.7 million shares of Valley common stock). As a condition to the closing of the merger, State Bancorp redeemed $36.8 million of its outstanding Fixed Rate Cumulative Series A Preferred Stock from the U.S. Treasury. This stock redemption was funded by a $37.0 million short-term loan from Valley to State Bancorp. The outstanding loan, included in Valley s consolidated statement of financial condition at December 31, 2011, was subsequently eliminated as of the acquisition date and is no longer outstanding.

In connection with the acquisition, Valley acquired all of the voting and common shares of State Capital Trust I and State Capital Trust II, which are wholly-owned subsidiaries established for the sole purpose of issuing trust preferred securities and related trust common securities. Valley also assumed junior subordinated debentures issued to capital trusts with combined contractual principal balances totaling $20.6 million. Valley has the right to optionally redeem the debentures and related trust preferred securities at par prior to the maturity dates of November 7, 2032 and January 23, 2034 for each respective capital trust. These capital trusts, similar to our other capital trust subsidiaries, are not consolidated for financial statement purposes.

Additionally, a warrant issued by State Bancorp (in connection with its preferred stock issuance) to the U.S. Treasury in December 2008 was assumed by Valley as of the acquisition date. The ten-year warrant to purchase up to 489 thousand of Valley common shares has an exercise price of $11.30 per share, and is exercisable on a net exercise basis. Valley has calculated an internal value for the warrants, and may negotiate their redemption with the U.S. Treasury. However, if Valley elects not to negotiate or an agreement cannot be reached with the U.S. Treasury, the warrants will likely be sold at public auction and remain outstanding.

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Merger expenses totaled $40 thousand and $1.1 million for the three and nine months ended September 30, 2012, respectively, which were largely related to data processing conversion charges that are included in other non-interest expense on the consolidated statements of income.

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

	January 1, 2012 (in thousands)
Assets acquired:	
Cash and cash equivalents	$ 117,587
Investment securities available for sale	275,650
Loans	1,098,948
Premises and equipment	9,457
Accrued interest receivable	5,294
Goodwill	101,967
Other intangible assets	8,050
Other assets	67,715
Total assets acquired	$ 1,684,668
Liabilities assumed:	
Deposits:	
Non-interest bearing	$ 371,151
Savings, NOW and money market	596,599
Time	412,543
Total deposits	1,380,293
Short-term borrowings	29,000
Junior subordinated debentures issued to capital trusts	15,645
Other liabilities	51,312
Total liabilities assumed	$ 1,476,250
Common stock issued in acquisition	$ 208,418

The fair value estimates are subject to change for up to one year after the closing date of the transaction if additional information relative to closing date fair values becomes available. As Valley continues to analyze the assets acquired and liabilities assumed, there may be adjustments to the recorded carrying values.

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 State Bancorp 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 available for sale. The estimated fair values of the investment securities available for sale were calculated utilizing Level 2 inputs. The prices for these instruments are obtained through an independent pricing service and 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, mortgage, or consumer) and credit risk rating. The estimated fair values were computed by discounting the expected cash flows from the respective portfolios. Management estimated the 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 at estimated market rates. The market rates were estimated using a buildup approach which included assumptions with respect to funding cost and funding mix, estimated servicing cost, liquidity premium, and additional spreads, if warranted, to compensate for the uncertainty inherent in the acquired loans. The methods used to estimate the Level 3 fair values of loans are extremely sensitive to the assumptions and estimates used. While management attempted to use assumptions and estimates that best reflected the acquired loan portfolios and current market conditions, a greater degree of subjectivity is inherent in these values than in those determined in active markets.

The difference between the fair value and the expected cash flows from the acquired loans will be accreted to interest income over the remaining term of the loans in accordance with Accounting Standards Codification (ASC) Subtopic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. See Note 7 for further details.

Other intangible assets. Other intangible assets 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 excluding any large relationships, for which Valley believes there is no customer related intangible asset. The fair value of the CDI stemming from any given business combination 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 are being amortized over an estimated useful life of eleven years to approximate the existing deposit relationships acquired.

Deposits. The fair values of deposit liabilities with no stated maturity (i.e., NOW and money market accounts, savings accounts, and non-interest-bearing 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 fair value of short-term borrowings approximates their contractual principal balances, as these borrowings matured in March 2012.

Junior subordinated debentures issued to capital trusts. There is no active market for the trust preferred securities issued by State Bancorp Capital Trust I and State Bancorp Capital Trust II; therefore, the fair value of junior subordinated debentures was estimated utilizing the income approach. Under the income approach, the expected cash flows over the remaining estimated life of the debentures were discounted using Valley s credit spread plus the three- month LIBOR (the contractual base index rate for these instruments). Valley s credit spread was calculated based on Valley s trust preferred securities issued by VNB Capital Trust I, which are publicly traded in an active market.

Note 4. New Authoritative Accounting Guidance

Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurements (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, was issued as a result of the effort to develop common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). While ASU No. 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands the existing disclosure requirements for fair value measurements and clarifies the existing guidance or wording changes to align with IFRS No. 13. Many of the requirements for the amendments in ASU No. 2011-04 do not result in a change in the application of the requirements in Topic 820. ASU No. 2011-04 became effective for Valley on January 1, 2012 and did not to have a significant impact on its consolidated financial statements. See Note 5 for the related disclosures.

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ASU No. 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income, requires an entity to present components of comprehensive income either in a single continuous statement of comprehensive income or in two separate consecutive statements. These amendments will make the financial statement presentation of other comprehensive income more prominent by eliminating the alternative to present comprehensive income within the statement of equity. As originally issued, ASU No. 2011-05 required entities to present reclassification adjustments out of accumulated other comprehensive income by component in the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements). This requirement was deferred by ASU No. 2011-12, Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards . ASU No. 2011-05 became effective for all interim and annual periods beginning on or after December 15, 2011 with early adoption permitted, and applied retrospectively. Valley early adopted ASU No. 2011-05 for the year ended December 31, 2011 and elected to present comprehensive income in a separate consolidated statement of comprehensive income.

ASU No. 2011-08, Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment, provides the option of performing a qualitative assessment of whether it is more likely than not that a reporting unit s fair value is less than its carrying amount, before applying the current two-step goodwill impairment test. If the conclusion is that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the entity would be required to conduct the current two-step goodwill impairment test. Otherwise, the entity would not need to apply the two-step test. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed by Valley during 2012. ASU No. 2011-08 did not have a significant impact on Valley s consolidated financial statements.

ASU No. 2012-06, Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution, addresses subsequent measurement of an indemnification asset recognized in a government-assisted acquisition of a financial institution that includes a loss-sharing agreement. When an entity recognizes an indemnification asset (in accordance with Subtopic 805-20) as a result of a government-assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs (as a result of a change in cash flows expected to be collected on the assets subject to indemnification), the entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (i.e., the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). ASU No. 2012-06 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012 with an early adoption permitted, and should be applied prospectively. ASU No. 2012-06 is not expected to have a significant impact on Valley s consolidated financial statements.

Note 5. 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).

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Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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

The following tables present the assets and liabilities that are measured at fair value on a recurring and nonrecurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial condition at September 30, 2012 and December 31, 2011. 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:		
	September 30, 2012	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. government agency securities	$ 47,577	$ -	$ 47,577	$ -
Obligations of states and political subdivisions	16,472	-	16,472	-
Residential mortgage-backed securities	470,727	-	429,227	41,500
Trust preferred securities	58,595	-	17,816	40,779
Corporate and other debt securities	31,387	28,895	2,492	-
Equity securities	49,153	27,271	21,882	-
Total available for sale	673,911	56,166	535,466	82,279
Trading securities	22,104	-	22,104	-
Loans held for sale [1]	149,067	-	149,067	-
Other assets [2]	11,918	-	11,918	-
Total assets	$ 857,000	$ 56,166	$ 718,555	$ 82,279
Liabilities				
Junior subordinated debentures issued to VNB Capital Trust I [3]	$ 149,708	$ 149,708	$ -	$ -
Other liabilities [2]	31,227	-	31,227	-
Total liabilities	$ 180,935	$ 149,708	$ 31,227	$ -
Non-recurring fair value measurements:				
Collateral dependent impaired loans [4]	$ 71,377	$ -	$ -	$ 71,377
Loan servicing rights	12,814	-	-	12,814
Foreclosed assets	25,861	-	-	25,861
Total	$ 110,052	$ -	$ -	$ 110,052

	December 31, 2011	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. government agency securities	$ 90,748	$ -	$ 90,748	$ -
Obligations of states and political subdivisions	20,214	-	20,214	-
Residential mortgage-backed securities	310,137	-	259,977	50,160
Trust preferred securities	70,425	19,576	23,698	27,151
Corporate and other debt securities	33,043	30,603	2,440	-
Equity securities	41,953	23,506	18,447	-
Total available for sale	566,520	73,685	415,524	77,311
Trading securities	21,938	-	21,938	-
Loans held for sale [(1)]	25,169	-	25,169	-
Other assets [(2)]	5,211	-	5,211	-
Total assets	$ 618,838	$ 73,685	$ 467,842	$ 77,311
Liabilities				
Junior subordinated debentures issued to VNB Capital Trust I [(3)]	$ 160,478	$ 160,478	$ -	$ -
Other liabilities [(2)]	21,854	-	21,854	-
Total liabilities	$ 182,332	$ 160,478	$ 21,854	$ -
Non-recurring fair value measurements:				
Collateral dependent impaired loans [(4)]	$ 66,854	$ -	$ -	$ 66,854
Loan servicing rights	9,078	-	-	9,078
Foreclosed assets	15,874	-	-	15,874
Total	$ 91,806	$ -	$ -	$ 91,806

(1) Loans held for sale (which consist of residential mortgages) are carried at fair value and had contractual unpaid principal balances totaling approximately $141.4 million and $24.3 million at September 30, 2012 and December 31, 2011, respectively.

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

(3) The junior subordinated debentures had contractual unpaid principal obligations totaling $146.7 million and $157.0 million at September 30, 2012 and December 31, 2011, respectively.

(4) Excludes covered loans acquired in the FDIC-assisted transactions completed in the first quarter of 2010 and other purchased credit-impaired loans acquired in the first quarter of 2012.

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The following table summarizes changes in Level 3 assets, consisting of available for sale securities, measured at fair value on a recurring basis for the three months ended September 30, 2012 and 2011:

	Three Months Ended September 30,	
	2012	2011
	(in thousands)	
Balance, beginning of the period	$ 89,091	$ 51,218
Total net (losses) gains for the period included in:		
Net income	(4,697)	-
Other comprehensive income	(150)	(489)
Settlements	(1,965)	(2,565)
Balance, end of the period	$ 82,279	$ 48,164
Change in unrealized losses for the period included in earnings for assets held at the end of the reporting period *	$ (4,697)	$ -

* Represents the net impairment losses on securities recognized in earnings for the period.

The following table summarizes changes in Level 3 assets, consisting of trading and available for sale securities, measured at fair value on a recurring basis for nine months ended September 30, 2012 and 2011:

	Nine Months Ended September 30,			
	2012		2011	
	Trading Securities	Available For Sale Securities	Trading Securities	Available For Sale Securities
	(in thousands)			
Balance, beginning of the period	$ -	$ 77,311	$ 21,903	$ 138,655
Transfers out of Level 3:				
Residential mortgage-backed securities	-	-	-	(44,771)
Trust preferred securities	-	-	(21,903)	(17,397)
Corporate and other debt securities	-	-	-	(12,914)
Equity securities	-	-	-	(9,353)
Total net (losses) gains for the period included in:				
Net income	-	(5,247)	-	(825)
Other comprehensive income	-	18,804	-	1,723
Settlements	-	(8,589)	-	(6,954)
Balance, end of the period	$ -	$ 82,279	$ -	$ 48,164
Change in unrealized losses for the period included in earnings for assets held at the end of the reporting period *	$ -	$ (5,247)	$ -	$ (825)

* Represents the net impairment losses on securities recognized in earnings for the period.

During the three and nine months ended September 30, 2012 and 2011, there were no transfers of assets between Level 1 and Level 2.

There have been no changes in the valuation methodologies used at September 30, 2012 from December 31, 2011.

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 values 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 and trust preferred 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 cash flows for trust preferred securities reflected the contractual cash flow, adjusted if necessary for potential changes in the amount or timing of cash flows due to the underlying credit worthiness of each issuer. The following table presents quantitative information about Level 3 inputs used to measure the fair value of these securities at September 30, 2012:

Security Type	Valuation Technique	Unobservable Input	Range	Weighted Average
Mortgage-backed securities	Discounted cash flow	Prepayment rate	8.9 - 29.2%	15.9%
		Default rate	4.0 - 24.9	9.1
		Loss severity	40.0 - 59.4	51.2
Single issuer trust preferred securities	Discounted cash flow	Loss severity	0.0 -100.0%	28.4%
		Market credit spreads	6.0 - 6.6	6.4
		Discount rate	6.4 - 8.3	7.5

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.

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For two single issuer trust preferred securities in the Level 3 available for sale trust preferred securities, the resulting estimated future cash flows were discounted at a yield, comprised of market rates applicable to the index of the underlying security, estimated market credit spread for similar non-rated securities and an illiquidity premium, if appropriate. The discount rate for each security was applied to three alternative cash flow scenarios, and subsequently weighted based on management s expectations. The three cash flow alternatives for each security assume a scenario with full issuer repayment, a scenario with a partial issuer repayment and a scenario with a full issuer default.

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 September 30, 2012 and December 31, 2011 based on the short duration these assets were held, and the high credit quality of these loans.

Junior subordinated debentures issued to capital trusts. The junior subordinated debentures issued to VNB Capital Trust I are reported at fair value using Level 1 inputs. The fair value was estimated using quoted prices in active markets for similar assets, specifically the quoted price of the VNB Capital Trust I preferred stock traded under ticker symbol VLYPRA on the New York Stock Exchange. The preferred stock and Valley s junior subordinated debentures issued to the Trust have identical financial terms and therefore, the preferred stock s quoted price moves in a similar manner to the estimated fair value and current settlement price of the junior subordinated debentures. The preferred stock s quoted price includes market considerations for Valley s credit and non-performance risk and is deemed to represent the transfer price that would be used if the junior subordinated debenture were assumed by a third party. Valley s potential credit risk and changes in such risk did not materially impact the fair value measurement of the junior subordinated debentures at September 30, 2012 and December 31, 2011.

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 interest rate curves and volatilities. The fair value of mortgage banking derivatives, consisting of interest rate lock commitments to fund residential mortgage loans and forward commitments for the future delivery of such loans (including certain loans held for sale at September 30, 2012), 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. On January 1, 2012, Valley made an accounting policy election to use the exception within ASU No. 2011-04 regarding the measurement of the exposure to the counterparty credit risk (i.e., calculating credit valuation adjustments on a net basis by counterparty portfolio). The credit valuation adjustments were not significant to the overall valuation of Valley s derivatives at September 30, 2012 and December 31, 2011.

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

The following valuation techniques were used for certain non-financial assets measured at fair value on a nonrecurring basis, including impaired loans reported at the fair value of the underlying collateral, loan servicing rights, other real estate owned and other repossessed assets (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 September 30, 2012, non-current appraisals were discounted up to 6.1 percent based on specific market data by location and property type. During the nine months ended September 30, 2012, 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 $4.7 million and $16.3 million for the three and nine months ended September 30, 2012, respectively. At September 30, 2012, collateral dependent impaired loans with a total recorded investment of $76.9 million were reduced by specific valuation allowance allocations totaling $5.5 million to a reported total net carrying amount of $71.4 million.

Loan servicing rights. Fair values for each risk-stratified group of loan servicing rights are calculated using a fair value model from a third party vendor that requires inputs that are both significant to the fair value measurement and unobservable (Level 3). The fair value model is based on various assumptions, including but not limited to, prepayment speeds, internal rate of return (discount rate), servicing cost, ancillary income, float rate, tax rate, and inflation. The prepayment speed and the discount rate are considered two of the most significant inputs in the model. At September 30, 2012, the fair value model used prepayment speeds (stated as constant prepayment rates) from 6.0 percent up to 27.0 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 recognized net impairment charges of $402 thousand and $382 thousand for the three and nine months ended September 30, 2012, 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. The discounts on appraisals of foreclosed assets were immaterial at September 30, 2012. During the nine months ended September 30, 2012, foreclosed assets measured at fair value upon initial recognition and subsequent re-measurement totaled $25.9 million. In connection with the measurement and the initial recognition of the foreclosed assets, Valley recognized charge-offs to the allowance for loan losses totaling $1.1 million and $5.2 million for the three and nine months ended September 30, 2012, respectively. The re-measurement of the repossessed asset at fair value subsequent to the initial recognition resulted in a loss of $270 thousand, and it was included in non-interest expense for the three and nine months ended September 30, 2012.

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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 nine months ended September 30, 2012 and 2011:

Reported in Consolidated Statements of Financial Condition	Reported in Consolidated Statements of Income	Gains (Losses) on Change in Fair Value Three Months Ended September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
		(in thousands)			
Assets:					
Available for sale securities	Net impairment losses on securities	$ (4,697)	$ -	$ (5,247)	$ (825)
Trading securities	Trading gains, net	65	136	166	523
Loans held for sale	Gains on sales of loans, net	25,055	2,890	31,362	8,060
Liabilities:					
Junior subordinated debentures issued to capital trusts	Trading gains, net	(59)	640	461	2,587
		$ 20,364	$ 3,666	$ 26,742	$ 10,345

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.

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The carrying amounts and estimated fair values of financial instruments not measured and not reported at fair value on the consolidated statements of financial condition at September 30, 2012 and December 31, 2011 were as follows:

	Fair Value Hierarchy	September 30, 2012 Carrying Amount	September 30, 2012 Fair Value	December 31, 2011 Carrying Amount	December 31, 2011 Fair Value
		(in thousands)			
Financial assets					
Cash and due from banks	Level 1	$ 412,895	$ 412,895	$ 372,566	$ 372,566
Interest bearing deposits with banks	Level 1	192,364	192,364	6,483	6,483
Investment securities held to maturity:					
U.S. Treasury securities	Level 1	99,906	116,261	100,018	113,859
Obligations of states and political subdivisions	Level 2	492,617	518,570	433,284	453,201
Residential mortgage-backed securities	Level 2	852,375	886,156	1,180,104	1,230,993
Trust preferred securities	Level 2	127,510	111,401	193,312	174,753
Corporate and other debt securities	Level 2	52,167	57,025	52,198	54,391
Total investment securities held to maturity		1,624,575	1,689,413	1,958,916	2,027,197
Net loans	Level 3	11,019,691	11,052,163	9,665,839	9,645,517
Accrued interest receivable	Level 1	55,548	55,548	52,527	52,527
Federal Reserve Bank and Federal Home Loan Bank stock(1)	Level 2	145,328	145,328	129,669	129,669
Financial liabilities					
Deposits without stated maturities	Level 1	8,199,031	8,199,031	7,171,718	7,171,718
Deposits with stated maturities	Level 2	2,721,769	2,780,264	2,501,384	2,557,119
Short-term borrowings	Level 1	288,865	288,865	212,849	215,179
Long-term borrowings	Level 2	2,698,403	3,128,748	2,726,099	3,154,150
Junior subordinated debentures issued to capital trusts	Level 2	40,886	40,858	25,120	25,620
Accrued interest payable(2)	Level 1	16,326	16,326	17,736	17,736

(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 the 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 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 repricing. 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.

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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. FRB 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 agreement 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 (excluding VNB Capital Trust I). There is no active market for the trust preferred securities issued by Valley capital trusts, except for the securities issued by VNB Capital Trust I whose related debentures are carried at fair value. Therefore, the fair value of debentures 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). Valley s credit spread was calculated based on the exchange quoted price for Valley s trust preferred securities issued by VNB Capital Trust I.

Note 6. Investment Securities

As of September 30, 2012, Valley had approximately $1.6 billion, $673.9 million, and $22.1 million in held to maturity, available for sale, and trading investment securities, respectively. 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.

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Held to Maturity

The amortized cost, gross unrealized gains and losses and fair value of securities held to maturity at September 30, 2012 and December 31, 2011 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
September 30, 2012				
U.S. Treasury securities	$ 99,906	$ 16,355	$ -	$ 116,261
Obligations of states and political subdivisions	492,617	26,030	(77)	518,570
Residential mortgage-backed securities	852,375	33,898	(117)	886,156
Trust preferred securities	127,510	1,067	(17,176)	111,401
Corporate and other debt securities	52,167	4,858	-	57,025
Total investment securities held to maturity	$ 1,624,575	$ 82,208	$ (17,370)	$ 1,689,413
December 31, 2011				
U.S. Treasury securities	$ 100,018	$ 13,841	$ -	$ 113,859
Obligations of states and political subdivisions	433,284	19,931	(14)	453,201
Residential mortgage-backed securities	1,180,104	51,041	(152)	1,230,993
Trust preferred securities	193,312	4,308	(22,867)	174,753
Corporate and other debt securities	52,198	3,799	(1,606)	54,391
Total investment securities held to maturity	$ 1,958,916	$ 92,920	$ (24,639)	$ 2,027,197

The age of unrealized losses and fair value of related securities held to maturity at September 30, 2012 and December 31, 2011 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)			
September 30, 2012						
Obligations of states and political subdivisions	$ 11,653	$ (77)	$ -	$ -	$ 11,653	$ (77)
Residential mortgage-backed securities	35,959	(117)	-	-	35,959	(117)
Trust preferred securities	9,818	(37)	80,119	(17,139)	89,937	(17,176)
Total	$ 57,430	$ (231)	$ 80,119	$ (17,139)	$ 137,549	$ (17,370)
December 31, 2011						
Obligations of states and political subdivisions	$ 1,854	$ (13)	$ 50	$ (1)	$ 1,904	$ (14)
Residential mortgage-backed securities	33,520	(152)	-	-	33,520	(152)
Trust preferred securities	35,527	(730)	55,612	(22,137)	91,139	(22,867)
Corporate and other debt securities	14,756	(192)	7,560	(1,414)	22,316	(1,606)
Total	$ 85,657	$ (1,087)	$ 63,222	$ (23,552)	$ 148,879	$ (24,639)

The total number of security positions in the securities held to maturity portfolio in an unrealized loss position at September 30, 2012 was 26 as compared to 28 at December 31, 2011.

At September 30, 2012, the unrealized losses reported for trust preferred securities mostly related to 10 single-issuer securities, issued by bank holding companies. Of the 10 trust preferred securities, 2 were investment grade, 3 were non-investment grade, and 5 were not rated. All single-issuer bank trust preferred securities classified as held to maturity are paying in accordance with their terms, have no deferrals of interest or defaults and, if applicable, the issuers meet the regulatory capital requirements to be considered well-capitalized institutions at September 30, 2012.

Management does not believe that any individual unrealized loss as of September 30, 2012 included in the table above represents other-than-temporary impairment as management mainly attributes the declines in fair value to changes in interest rates, widening credit spreads, and lack of liquidity in the market place, 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. Valley does not have the intent to sell, nor is it more likely than not that Valley will be required to sell, the securities contained in the table above before the recovery of their amortized cost basis or maturity.

As of September 30, 2012, 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 $974.7 million.

The contractual maturities of investments in debt securities held to maturity at September 30, 2012 are set forth in the table below. Maturities may differ from contractual maturities in residential mortgage-backed securities because the mortgages underlying the securities may be prepaid without any penalties. Therefore, residential mortgage-backed securities are not included in the maturity categories in the following summary.

	September 30, 2012	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year	$ 109,488	$ 109,564
Due after one year through five years	43,154	44,797
Due after five years through ten years	240,982	267,688
Due after ten years	378,576	381,208
Residential mortgage-backed securities	852,375	886,156
Total investment securities held to maturity	$ 1,624,575	$ 1,689,413

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 3.3 years at September 30, 2012.

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Available for Sale

The amortized cost, gross unrealized gains and losses and fair value of securities available for sale at September 30, 2012 and December 31, 2011 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
September 30, 2012				
U.S. government agency securities	$ 46,148	$ 1,465	$ (36)	$ 47,577
Obligations of states and political subdivisions	16,772	229	(529)	16,472
Residential mortgage-backed securities	463,489	10,460	(3,222)	470,727
Trust preferred securities*	72,336	623	(14,364)	58,595
Corporate and other debt securities	28,320	3,076	(9)	31,387
Equity securities	50,306	731	(1,884)	49,153
Total investment securities available for sale	$ 677,371	$ 16,584	$ (20,044)	$ 673,911
December 31, 2011				
U.S. government agency securities	$ 89,787	$ 1,204	$ (243)	$ 90,748
Obligations of states and political subdivisions	18,893	1,322	(1)	20,214
Residential mortgage-backed securities	304,631	10,950	(5,444)	310,137
Trust preferred securities*	106,931	78	(36,585)	70,424
Corporate and other debt securities	30,663	2,554	(173)	33,044
Equity securities	47,932	1,320	(7,299)	41,953
Total investment securities available for sale	$ 598,837	$ 17,428	$ (49,745)	$ 566,520

* Includes three pooled trust preferred securities, principally collateralized by securities issued by banks and insurance companies.

The age of unrealized losses and fair value of related securities available for sale at September 30, 2012 and December 31, 2011 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)			
September 30, 2012						
U.S. government agency securities	$ 8,534	$ (4)	$ 7,110	$ (32)	$ 15,644	$ (36)
Obligations of states and political subdivisions	10,660	(529)	-	-	10,660	(529)
Residential mortgage-backed securities	43,368	(901)	21,967	(2,321)	65,335	(3,222)
Trust preferred securities	1,173	(506)	27,669	(13,858)	28,842	(14,364)
Corporate and other debt securities	-	-	2,491	(9)	2,491	(9)
Equity securities	772	(40)	12,614	(1,844)	13,386	(1,884)
Total	$ 64,507	$ (1,980)	$ 71,851	$ (18,064)	$ 136,358	$ (20,044)
December 31, 2011						

U.S. government agency securities	$ 7,980	$ (243)	$ -	$ -	$ 7,980	$ (243)
Obligations of states and political subdivisions	141	(1)	-	-	141	(1)
Residential mortgage-backed securities	41,673	(1,655)	22,639	(3,789)	64,312	(5,444)
Trust preferred securities	23,962	(1,061)	44,758	(35,524)	68,720	(36,585)
Corporate and other debt securities	3,243	(173)	-	-	3,243	(173)
Equity securities	20,570	(4,430)	12,551	(2,869)	33,121	(7,299)
Total	$ 97,569	$ (7,563)	$ 79,948	$ (42,182)	$ 177,517	$ (49,745)

The total number of security positions in the securities available for sale portfolio in an unrealized loss position at September 30, 2012 was 55 as compared to 43 at December 31, 2011.

Of the $3.2 million unrealized losses within the residential mortgage-backed securities category of the available for sale portfolio at September 30, 2012, $1.4 million relates to three private label mortgage-backed securities that were other-than-temporarily impaired prior to September 30, 2012; for one of the securities, an additional estimated credit loss was recognized during the third quarter of 2012. The remaining $1.8 million of unrealized losses primarily relates to one investment grade private label mortgage-backed security.

The unrealized losses for trust preferred securities at September 30, 2012, in the table above relate to 3 pooled trust preferred and 12 single-issuer bank issued trust preferred securities. The unrealized losses include $5.0 million attributable to trust preferred securities issued by one bank holding company with an amortized cost of $16.5 million and a fair value of $11.5 million, and $8.1 million attributable to 3 pooled trust preferred securities with an amortized cost of $19.9 million and a fair value of $11.8 million. The trust preferred issuances by one bank holding company, initially classified as held to maturity, were found be other-than-temporarily impaired during the fourth quarter of 2011 and subsequently transferred to the available for sale portfolio at December 31, 2011. During the third quarter of 2012, Valley recognized $4.5 million of additional estimated credit impairment losses on these trust preferred securities. The three pooled trust preferred securities included one security with an unrealized loss of $6.2 million and an investment grade rating at September 30, 2012. The other two pooled trust preferred securities had non-investment grade ratings and were initially other-than-temporarily impaired in 2008 with additional estimated credit losses recognized during 2009 through 2011. See Other-Than-Temporarily Impaired Analysis section below for more details. All of the remaining single-issuer trust preferred securities are all paying in accordance with their terms and have no deferrals of interest or defaults.

The unrealized losses existing for more than twelve months for equity securities are almost entirely related to two perpetual preferred security positions with a combined $10.0 million amortized cost and a $1.8 million unrealized loss. At September 30, 2012, these perpetual preferred securities had investment grade ratings and are currently performing and paying quarterly dividends.

Management does not believe that any individual unrealized loss as of September 30, 2012 represents an other-than-temporary impairment, except for the previously discussed impaired private mortgage-backed security and trust preferred securities, as management mainly attributes the declines in value to changes in interest rates and recent market volatility and wider credit spreads, 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. Valley has no intent to sell, nor is it more likely than not that Valley will be required to sell, the securities contained in the table above before the recovery of their amortized cost basis or, if necessary, maturity.

As of September 30, 2012, 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 $356.2 million.

The contractual maturities of investment securities available for sale at September 30, 2012 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.

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	September 30, 2012	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year	$ 940	$ 958
Due after one year through five years	2,117	2,134
Due after five years through ten years	50,960	53,464
Due after ten years	109,559	97,475
Residential mortgage-backed securities	463,489	470,727
Equity securities	50,306	49,153
Total investment securities available for sale	$ 677,371	$ 673,911

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 at September 30, 2012 was 7.1 years.

Other-Than-Temporary Impairment Analysis

To determine whether a security s impairment is other-than-temporary, Valley considers several factors that include, but are not limited to the following:

The severity and duration of the decline, including the causes of the decline in fair value, such as an issuer s credit problems, interest rate fluctuations, or market volatility;

Adverse conditions specifically related to the issuer of the security, an industry, or geographic area;

Failure of the issuer of the security to make scheduled interest or principal payments;

Any changes to the rating of the security by a rating agency or, if applicable, any regulatory actions impacting the security issuer;

Recoveries or additional declines in fair value after the balance sheet date;

Our ability and intent to hold equity security investments until they recover in value, as well as the likelihood of such a recovery in the near term; and

Our intent to sell debt security investments, or if it is more likely than not that we will be required to sell such securities before recovery of their individual amortized cost basis.

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

In assessing the level of other-than-temporary impairment attributable to credit loss for debt securities, Valley compares the present value of cash flows expected to be collected with the amortized cost basis of the security. The portion of the total other-than-temporary impairment related to credit loss is recognized in earnings, while the amount related to other factors is recognized in other comprehensive income or loss. The total other-than-temporary impairment loss is presented in the consolidated statements of income, less the portion recognized in other comprehensive income or loss. Subsequent assessments may result in additional estimated credit losses on previously impaired securities. These additional estimated credit losses are recorded as reclassifications from the portion of other-than-temporary impairment previously recognized in other comprehensive income or loss to earnings in the period of such assessments. The amortized cost basis of an impaired debt security is reduced by the portion of the total impairment related to credit loss.

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For residential mortgage-backed securities, Valley estimates loss projections for each security by stressing the cash flows from the individual loans collateralizing the security using expected default rates, loss severities, and prepayment speeds, in conjunction with the underlying credit enhancement (if applicable) for each security. Based on collateral and origination vintage specific assumptions, a range of possible cash flows is identified to determine whether other-than-temporary impairment exists. See the Other-Than-Temporarily Impaired Securities section below for further details regarding the impairment of these securities.

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. Over the past several years, an increasing number of banking institutions have been required to defer trust preferred payments and various banking institutions have been put in receivership by the FDIC. 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 September 30, 2012 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.

During the fourth quarter of 2011, Valley lengthened the estimate of the timeframe over which it could reasonably anticipate receiving the expected cash flows from the trust preferred securities issued by one deferring bank holding company resulting in an $18.3 million credit impairment charge at December 31, 2011. The issuer of the trust preferred securities has deferred interest payments on these securities since late 2009 as required by an operating agreement with its bank regulators. In assessing whether a credit loss exists for the securities of the deferring issuer, Valley considers numerous other factors, including but not limited to, such factors highlighted in the bullet points above. From the dates of deferral up to and including the bank holding company s most recent regulatory filing, the bank issuer continued to accrue and capitalize the interest owed, but not remitted to its trust preferred security holders, and at the holding company level it reported cash and cash equivalents in excess of the cumulative amount of accrued but unpaid interest owed on all of its junior subordinated debentures related to trust preferred securities. Additionally, the bank subsidiary of the issuer continued to report capital ratios that were above the minimum amounts to be considered a well-capitalized financial institution in its most recent regulatory filing. However, Valley estimated a decline in the expected cash flows under one of three weighted alternative cash flow scenarios utilized to assess impairment of the securities at September 30, 2012. The cash flow scenario resulting in the decline estimates the probable cash flows based upon partial equity settlements received by shareholders of similar troubled institutions in recent merger and acquisition transactions. As a result of the decreased expected cash flow, and careful assessment of all other available factors, Valley recognized $4.5 million of additional estimated credit losses on these other-than-temporarily impaired securities in earnings for the three months ended September 30, 2012. These trust preferred securities, with a combined amortized cost of $41.8 million after credit impairment charges, had net non-credit impairment charges totaling $4.5 million (before taxes) included in accumulated other comprehensive income at September 30, 2012 and are not accruing interest. The fair value of the combined securities declined $5.3 million to $37.3 million at September 30, 2012 as compared to $42.6 million at June 30, 2012 primarily due to the reduction in expected cash flows from the securities. See Note 5 for information regarding the Level 3 valuation technique used to measure the fair value of these trust preferred securities at September 30, 2012.

For the three pooled trust preferred securities, Valley evaluates the projected cash flows from each of its tranches in the three securities to determine if they are adequate to support their future contractual principal and interest payments. Valley assesses the credit risk and probability of impairment of the contractual cash flows by projecting the default rates over the life of the security. Higher projected default rates will decrease the expected future cash flows from each security. If the projected decrease in cash flows affects the cash flows projected for the tranche held by Valley, the security would be considered to be other-than-temporarily impaired. Two of the pooled trust preferred securities were initially impaired in 2008 with additional estimated credit losses recognized during 2009 and 2011, including the $825 thousand of net impairment losses recognized during the nine months ended September 30, 2011, and are not accruing interest.

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The perpetual preferred securities, reported in equity securities, are hybrid investments that are assessed for impairment by Valley as if they were debt securities. Therefore, Valley assessed the creditworthiness of each security issuer, as well as any potential change in the anticipated cash flows of the securities as of September 30, 2012. Based on this analysis, management believes the declines in fair value of these securities are attributable to a lack of liquidity in the marketplace and are not reflective of any deterioration in the creditworthiness of the issuers.

Other-Than-Temporarily Impaired Securities

The following table provides information regarding our other-than-temporary impairment losses on securities recognized in earnings for the three and nine months ended September 30, 2012 and 2011.

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands)			
Available for sale:				
Residential mortgage-backed securities	$ 172	$ -	$ 722	$ -
Trust preferred securities	4,525	-	4,525	825
Net impairment losses on securities recognized in earnings	$ 4,697	$ -	$ 5,247	$ 825

For the three and nine months ended September 30, 2012, Valley recognized net impairment losses on residential mortgage backed securities in earnings, due to additional estimated credit losses on one of six previously impaired private label mortgage-backed securities. At September 30, 2012, the six impaired private label mortgage-backed securities had a combined amortized cost of $43.0 million and fair value of $41.5 million.

For the three and nine months ended September 30, 2012, Valley recognized net impairment losses related to the trust preferred securities issued by one bank holding company due to further credit deterioration in financial condition of the issuer. See Other-Than-Temporarily Impaired Analysis section above for further details. For the nine months ended September 30, 2011, Valley recognized net impairment losses on securities in earnings, due to additional estimated credit losses on one of the two previously impaired pooled trust preferred securities. At September 30, 2012, the impaired trust preferred securities issued by one bank holding company and the two previously impaired pooled trust preferred securities had a combined amortized cost and fair value of $47.2 million and $40.8 million, respectively, after recognition of all credit impairments.

Realized Gains and Losses

Gross gains (losses) realized on sales, maturities and other securities transactions related to investment securities included in earnings for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands)			
Sales transactions:				
Gross gains	$ 4,513	$ 450	$ 5,887	$ 19,418
Gross losses	-	-	(298)	-
	$ 4,513	$ 450	$ 5,589	$ 19,418
Maturities and other securities transactions:				
Gross gains	$ 2,242	$ 414	$ 2,261	$ 622
Gross losses	(5,259)	(1)	(5,307)	(6)
	$ (3,017)	$ 413	$ (3,046)	$ 616
Total gains on securities transactions, net	$ 1,496	$ 863	$ 2,543	$ 20,034

Valley recognized gross losses totaling $5.3 million for the third quarter of 2012 due to the early redemption of trust preferred securities issued by one bank holding company.

The following table presents the changes in the credit loss component of cumulative other-than-temporary impairment losses on debt securities classified as either held to maturity or available for sale that Valley has recognized in earnings, for which a portion of the impairment loss (non-credit factors) was recognized in other comprehensive income for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in thousands)			
Balance, beginning of period	$ 29,251	$ 11,076	$ 29,070	$ 10,500
Additions:				
Subsequent credit impairments	4,697	-	5,247	825
Reductions:				
Accretion of credit loss impairment due to an increase in expected cash flows	(590)	(109)	(959)	(358)
Balance, end of period	$ 33,358	$ 10,967	$ 33,358	$ 10,967

The credit loss component of the impairment loss represents the difference between the present value of expected future cash flows and the amortized cost basis of the security prior to considering credit losses. The beginning balance represents the credit loss component for debt securities for which other-than-temporary impairment occurred prior to each period presented. Other-than-temporary impairments recognized in earnings for credit impaired debt securities are presented as additions in two components based upon whether the current period is the first time the debt security was credit impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairment). The credit loss component is reduced if Valley sells, intends to sell or believes it will be required to sell previously credit impaired debt securities. Additionally, the credit loss component is reduced if (i) Valley receives cash flows in excess of what it expected to receive over the remaining life of the credit impaired debt security, (ii) the security matures or (iii) the security is fully written down.

Trading Securities

The fair value of trading securities (consisting of 3 single-issuer bank trust preferred securities) was $22.1 million and $21.9 million at September 30, 2012 and December 31, 2011, respectively. Interest income on trading securities totaled $442 thousand and $500 thousand for the three months ended September 30, 2012 and 2011, respectively, and $1.3 million and $1.6 million for the nine months ended September 30, 2012 and 2011, respectively.

Note 7. Loans

Purchased Credit-Impaired (PCI) loans, which include loans acquired in FDIC-assisted transactions (covered loans) subject to loss-sharing agreements, are loans acquired at a discount that is due, in part, to credit quality. The detail of the loan portfolio as of September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012			December 31, 2011		
	Non-PCI Loans	PCI Loans	Total	Non-PCI Loans	PCI Loans	Total
			(in thousands)			
Non-covered loans:						
Commercial and industrial	$ 1,847,650	$ 271,220	$ 2,118,870	$ 1,878,387	$ -	$ 1,878,387
Commercial real estate:						
Commercial real estate	3,752,963	692,375	4,445,338	3,574,089	-	3,574,089
Construction	397,292	38,647	435,939	411,003	-	411,003
Total commercial real estate loans	4,150,255	731,022	4,881,277	3,985,092	-	3,985,092
Residential mortgage	2,482,363	17,191	2,499,554	2,285,590	-	2,285,590
Consumer:						
Home equity	445,402	46,936	492,338	469,604	-	469,604
Automobile	789,248	-	789,248	772,490	-	772,490
Other consumer	159,667	451	160,118	136,634	-	136,634
Total consumer loans	1,394,317	47,387	1,441,704	1,378,728	-	1,378,728
Total non-covered loans	$ 9,874,585	$ 1,066,820	$ 10,941,405	$ 9,527,797	$ -	$ 9,527,797
Covered loans:						
Commercial and industrial	$ -	$ 51,706	$ 51,706	$ -	$ 83,742	$ 83,742
Commercial real estate	-	136,304	136,304	-	160,651	160,651
Construction	-	4,751	4,751	-	6,974	6,974
Residential mortgage	-	11,760	11,760	-	15,546	15,546
Consumer	-	3,012	3,012	-	4,931	4,931
Total covered loans	-	207,533	207,533	-	271,844	271,844
Total loans	$ 9,874,585	$ 1,274,353	$ 11,148,938	$ 9,527,797	$ 271,844	$ 9,799,641

Total non-covered loans are net of unearned discount and deferred loan fees totaling $3.8 million and $7.5 million at September 30, 2012 and December 31, 2011, respectively. The outstanding balances for non-covered PCI loans and covered loans totaled $1.1 billion and $344.9 million at September 30, 2012, respectively, and $399.6 million for covered loans at December 31, 2011.

Valley transferred $123.1 million of residential mortgage loans from loans held for investment to loans held for sale during the three months ended September 30, 2012. There were no sales of loans, other than from the held for sale loan portfolio during the three and nine months ended September 30, 2012 and 2011.

Purchased Credit-Impaired Loans (Including Covered Loans)

PCI loans are accounted for in accordance with ASC Subtopic 310-30 and are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance (i.e., the allowance for loan losses), and aggregated and accounted for as pools of loans based on common risk characteristics. The difference between the undiscounted cash flows expected at acquisition and the initial carrying amount (fair value) of the covered 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

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acquisition, or the non-accretable difference, are not recognized as a yield adjustment, as a loss accrual or a valuation allowance. Reclassifications of the non-accretable difference to the accretable yield may occur subsequent to the loan acquisition dates due to increases in expected cash flows of the loan pools.

The following table presents information regarding the estimates of the contractually required payments, the cash flows expected to be collected, and the estimated fair value of the PCI loans acquired in the State Bancorp (see Note 3) acquisition as of January 1, 2012 and PCI loans purchased from another financial institution as of March 28, 2012:

	January 1, 2012	March 28, 2012
	(in thousands)	
Contractually required principal and interest	$ 1,333,686	$ 144,357
Contractual cash flows not expected to be collected (non-accretable difference)	(66,467)	(9,111)
Expected cash flows to be collected	1,267,219	135,246
Interest component of expected cash flows (accretable yield)	(168,271)	(17,991)
Fair value of acquired loans	$ 1,098,948	$ 117,255

The following table presents changes in the accretable yield for PCI loans during the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Balance, beginning of period	$ 209,417	$ 101,517	$ 66,724	$ 101,052
Acquisitions	-	-	186,262	-
Accretion	(21,284)	(12,122)	(64,853)	(28,640)
Net reclassification from non-accretable difference	-	-	-	16,983
Balance, end of period	$ 188,133	$ 89,395	$ 188,133	$ 89,395

The net reclassification from the non-accretable difference in the table above is due to increases in expected cash flows for certain pools of covered loans and is recognized prospectively as an adjustment to the yield over the life of the individual pools.

FDIC Loss-Share Receivable

The receivable arising from the loss-sharing agreements (referred to as the FDIC loss-share receivable on our consolidated statements of financial condition) is measured separately from the covered loan portfolio because the agreements are not contractually part of the covered loans and are not transferable should the Bank choose to dispose of the covered loans.

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Changes in FDIC loss-share receivable for three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months ended September 30,		Nine Months ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Balance, beginning of the period	$ 59,741	$ 80,179	$ 74,390	$ 89,359
Discount accretion of the present value at the acquisition dates	82	146	244	437
Effect of additional cash flows on covered loans (prospective recognition)	(2,091)	(2,889)	(5,959)	(8,167)
Increase due to impairment on covered loans	-	-	-	16,932
Other reimbursable expenses	1,619	1,166	4,173	2,787
Reimbursements from the FDIC	(7,413)	-	(14,950)	(22,746)
Other	-	-	(5,960)	-
Balance, end of the period	$ 51,938	$ 78,602	$ 51,938	$ 78,602

The aggregate effect of changes in the FDIC loss-share receivable was a reduction in non-interest income of $390 thousand and $1.6 million for the three months ended September 30, 2012 and 2011, respectively, and a $7.5 million reduction and a $12.0 million increase to non-interest income for the nine months ended September 30, 2012 and 2011, respectively. The nine months of 2012 reductions in non-interest income included $6.0 million related to the FDIC s portion of the estimated losses on unused lines of credit assumed in the FDIC-assisted transactions, which have expired. Other non-interest income for the nine months ended September 30, 2012 included $7.4 million for the reversal of the estimated losses on the expired lines of credit.

Loan Portfolio Risk Elements and Credit Risk Management

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

Commercial and industrial loans. 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, a significant number 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. Short-term loans may be made on an unsecured basis based on a borrower s financial strength and past performance. Valley, in most cases, will 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 credit worthy borrowers. Unsecured commercial and industrial loans totaled $367.6 million and $337.7 million at September 30, 2012 and December 31, 2011, respectively.

Commercial real estate loans. Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans. Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real property. Loans generally involve larger principal balances and longer repayment periods as compared to commercial and industrial loans. 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.

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Construction loans. With respect to loans to developers and builders, Valley originates and manages construction loans structured on either a revolving or non-revolving basis, depending on the nature of the underlying development project. These loans 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.

Residential mortgages. Valley originates residential, first mortgage loans based on underwriting standards that generally comply with Fannie Mae and/or Freddie Mac requirements. Appraisals and valuations of real estate collateral are contracted directly with independent appraisers or from valuation services and not through appraisal management companies. 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. Residential mortgage loans include fixed and variable interest rate loans secured by one to four family homes generally located in northern and central New Jersey, the New York City metropolitan area, and eastern Pennsylvania. Valley s ability to be repaid on such loans is closely linked to the economic and real estate market conditions in this region. In deciding whether to originate each residential mortgage, Valley considers the qualifications of the borrower as well as the value of the underlying property.

Home equity loans. Home equity lending consists of both fixed and variable interest rate products. Valley mainly provides home equity loans to its residential mortgage customers within the footprint of its primary lending territory. Valley generally will not exceed a combined (i.e., first and second mortgage) loan-to-value ratio of 75 percent when originating a home equity loan.

Automobile loans. Valley uses both judgmental and scoring systems in the credit decision process for automobile loans. Automobile originations (including light truck and sport utility vehicles) are largely produced via indirect channels, originated through approved automobile dealers. Automotive collateral is generally a depreciating asset and there are times in the life of an automobile loan where the amount owed on a vehicle may exceed its collateral value. Additionally, automobile charge-offs will vary based on strength or weakness in the used vehicle market, original advance rate, when in the life cycle of a loan a default occurs and the condition of the collateral being liquidated. Where permitted by law, and subject to the limitations of the bankruptcy code, deficiency judgments are sought and acted upon to ultimately collect all money owed, even when a default resulted in a loss at collateral liquidation. Valley uses a third party to actively track collision and comprehensive risk insurance required of the borrower on the automobile and this third party provides coverage to Valley in the event of an uninsured collateral loss.

Other consumer loans. Valley s other consumer loan portfolio includes direct consumer term loans, both secured and unsecured. The other consumer loan portfolio includes minor exposures in credit card loans, personal lines of credit, personal loans and loans secured by cash surrender value of life insurance. Valley believes the aggregate risk exposure of these loans and lines of credit was not significant at September 30, 2012. Unsecured consumer loans totaled approximately $78.8 million and $66.5 million, including $8.5 million and $9.1 million of credit card loans, at September 30, 2012 and December 31, 2011, respectively.

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Credit Quality

The following tables present past due, non-accrual and current loans (excluding PCI loans, which are accounted for on a pool basis) by loan portfolio class at September 30, 2012 and December 31, 2011:

	Past Due and Non-Accrual Loans					
	30-89 Days Past Due Loans	Accruing Loans 90 Days Or More Past Due	Non-Accrual Loans	Total Past Due Loans	Current Non-PCI Loans	Total Non-PCI Loans
			(in thousands)			
September 30, 2012						
Commercial and industrial	$ 17,459	$ -	$ 12,296	$ 29,755	$ 1,817,895	$ 1,847,650
Commercial real estate:						
Commercial real estate	6,236	221	58,541	64,998	3,687,965	3,752,963
Construction	-	1,024	15,139	16,163	381,129	397,292
Total commercial real estate loans	6,236	1,245	73,680	81,161	4,069,094	4,150,255
Residential mortgage	16,961	1,051	31,564	49,576	2,432,787	2,482,363
Consumer loans:						
Home equity	466	-	2,828	3,294	442,108	445,402
Automobile	5,760	180	344	6,284	782,964	789,248
Other consumer	237	17	659	913	158,754	159,667
Total consumer loans	6,463	197	3,831	10,491	1,383,826	1,394,317
Total	$ 47,119	$ 2,493	$ 121,371	$ 170,983	$ 9,703,602	$ 9,874,585

	Past Due and Non-Accrual Loans					
	30-89 Days Past Due Loans	Accruing Loans 90 Days Or More Past Due	Non-Accrual Loans	Total Past Due Loans	Current Non-PCI Loans	Total Non-PCI Loans
			(in thousands)			
December 31, 2011						
Commercial and industrial	$ 4,347	$ 657	$ 26,648	$ 31,652	$ 1,846,735	$ 1,878,387
Commercial real estate:						
Commercial real estate	13,115	422	42,186	55,723	3,518,366	3,574,089
Construction	2,652	1,823	19,874	24,349	386,654	411,003
Total commercial real estate loans	15,767	2,245	62,060	80,072	3,905,020	3,985,092
Residential mortgage	8,496	763	31,646	40,905	2,244,685	2,285,590
Consumer loans:						
Home equity	989	13	2,700	3,702	465,902	469,604
Automobile	7,794	303	461	8,558	763,932	772,490
Other consumer	192	35	749	976	135,658	136,634
Total consumer loans	8,975	351	3,910	13,236	1,365,492	1,378,728
Total	$ 37,585	$ 4,016	$ 124,264	$ 165,865	$ 9,361,932	$ 9,527,797

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Impaired loans. Impaired loans, consisting of non-accrual commercial and industrial loans and commercial real estate loans over $250 thousand and all loans which were modified in troubled debt restructurings, are individually evaluated for impairment. PCI loans are not classified as impaired loans because they are accounted for on a pool basis. The following tables present the information about impaired loans by loan portfolio class at September 30, 2012 and December 31, 2011:

	Recorded Investment With No Related Allowance	Recorded Investment With Related Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Allowance
		(in thousands)			
September 30, 2012					
Commercial and industrial	$ 3,474	$ 39,514	$ 42,988	$ 48,081	$ 9,051
Commercial real estate:					
Commercial real estate	25,267	83,522	108,789	123,785	11,067
Construction	7,483	12,822	20,305	23,934	708
Total commercial real estate loans	32,750	96,344	129,094	147,719	11,775
Residential mortgage	7,855	18,420	26,275	28,158	3,090
Consumer loans:					
Home equity	1,642	264	1,906	2,269	15
Total consumer loans	1,642	264	1,906	2,269	15
Total	$ 45,721	$ 154,542	$ 200,263	$ 226,227	$ 23,931
December 31, 2011					
Commercial and industrial	$ 6,193	$ 48,665	$ 54,858	$ 71,111	$ 11,105
Commercial real estate:					
Commercial real estate	26,741	56,978	83,719	91,448	7,108
Construction	4,253	19,998	24,251	28,066	1,408
Total commercial real estate loans	30,994	76,976	107,970	119,514	8,516
Residential mortgage	998	20,007	21,005	22,032	3,577
Consumer loans:					
Home equity	-	242	242	242	45
Total consumer loans	-	242	242	242	45
Total	$ 38,185	$ 145,890	$ 184,075	$ 212,899	$ 23,243

The following tables present, by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(in thousands)			

Commercial and industrial	$ 43,184	$ 347	$ 37,648	$ 393
Commercial real estate:				
Commercial real estate	108,561	993	81,638	739
Construction	21,920	97	31,741	845
Total commercial real estate loans	130,481	1,090	113,379	1,584
Residential mortgage	26,325	225	18,149	188
Consumer loans:				
Home equity	1,908	2	28	-
Total consumer loans	1,908	2	28	-
Total	$ 201,898	$ 1,664	$ 169,204	$ 2,165

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	Nine Months Ended September 30, 2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(in thousands)			
Commercial and industrial	$ 49,272	$ 1,095	$ 37,986	$ 1,132
Commercial real estate:				
Commercial real estate	99,939	1,984	71,968	2,095
Construction	21,882	183	33,435	1,107
Total commercial real estate loans	121,821	2,167	105,403	3,202
Residential mortgage	22,804	599	18,251	569
Consumer loans:				
Home equity	829	9	28	1
Total consumer loans	829	9	28	1
Total	$ 194,726	$ 3,870	$ 161,668	$ 4,904

Interest income recognized on a cash basis, included in the table above was immaterial for the three and nine months ended September 30, 2012 and 2011.

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

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

Performing TDRs (not reported as non-accrual loans) totaled $109.3 million and $101.0 million as of September 30, 2012 and December 31, 2011, respectively. Non-performing TDRs totaled $34.6 million and $15.5 million as of September 30, 2012 and December 31, 2011, respectively. During the third quarter of 2012, Valley classified 26 and 18 residential mortgage and home equity loans, respectively, totaling $7.4 million as non-performing TDRs because the borrower s obligation has been discharged in bankruptcy and the borrower has not re-affirmed the debt. Of the $7.4 million in loans, approximately $3.0 million of the loans were performing in accordance with contractual loan terms at September 30, 2012. All of these loans were deemed TDRs and collateral dependent impaired loans due to the implementation of newly issued Office of the Comptroller of the Currency (OCC) guidance. To the extent that the recorded principal remains collectible, interest on such loans may be recognized on a cash basis.

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The following tables present non-PCI loans, by loan portfolio class that were modified as TDRs during the three and nine months ended September 30, 2012 and 2011. The pre-modification and post-modification outstanding recorded investments disclosed in the table below represent the loan carrying amounts immediately prior to the modification and the post modification carrying amounts at September 30, 2012 and 2011, respectively.

Troubled Debt Restructurings	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	($ in thousands)					
Commercial and industrial[1]	3	$ 11,512	$ 11,503	1	$ 12,952	$ 12,952
Commercial real estate:						
Commercial real estate	3	3,971	3,968	3	2,887	2,882
Construction	1	493	293	1	2,000	2,000
Total commercial real estate	4	4,464	4,261	4	4,887	4,882
Residential mortgage[2]	28	6,566	6,463	1	75	75
Consumer[2]	18	1,641	1,641	-	-	-
Total	53	$ 24,183	$ 23,868	6	$ 17,914	$ 17,909

Troubled Debt Restructurings	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	($ in thousands)					
Commercial and industrial[1]	16	$ 31,212	$ 27,828	17	$ 19,145	$ 18,999
Commercial real estate:						
Commercial real estate	17	39,697	39,256	6	11,927	11,856
Construction	5	7,204	3,935	2	3,350	3,314
Total commercial real estate	22	46,901	43,191	8	15,277	15,170
Residential mortgage[2]	41	10,344	8,817	4	514	506
Consumer[2]	20	1,710	1,706	-	-	-
Total	99	$ 90,167	$ 81,542	29	$ 34,936	$ 34,675

(1) Includes 8 finance leases with pre and post-modification outstanding recorded investments totaling $335 thousand and $285 thousand, respectively, for the nine months ended September 30, 2011. There were no material modifications to finance leases during 2012.

(2) Includes 26 residential mortgage and 18 home equity loans with the outstanding recorded investment (both pre and post-modification) of $5.8 million and $1.6 million respectively, that were classified as TDRs due to the OCC guidance issued in the third quarter of 2012.

The majority of the TDR concessions within the commercial and industrial and commercial real estate loan portfolios made during the three and nine months ended September 30, 2012, and 2011 involved an extension of the loan term and/or an interest rate reduction, and personal bankruptcies (defined as legal concessions in OCC guidance released in the third quarter of 2012) within the residential mortgage and consumer loan portfolios. The TDRs presented in the table above had allocated specific reserves for loan losses totaling $3.3 million and $5.4 million at September 30, 2012 and 2011, respectively. These specific reserves are included in the allowance for loan losses for loans individually evaluated for impairment disclosed in Note 8. Charge-offs resulting from loans modified as TDRs during the three and nine months ended September 30, 2012 and 2011 were immaterial.

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The following table presents non-PCI loans modified as TDRs within the previous 12 months from, and for which there was a payment default (90 days or more past due) during the three and nine months ended September 30, 2012:

Troubled Debt Restructurings Subsequently Defaulted	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	($ in thousands)			
Commercial and industrial	1	$ 979	2	$ 1,616
Commercial real estate	-	-	1	1,093
Residential mortgage	-	-	1	58
Total	1	$ 979	4	$ 2,767

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

The following table presents the risk category of loans (excluding PCI loans) by class of loans based on the most recent analysis performed at September 30, 2012 and December 31, 2011.

Credit exposure - by internally assigned risk rating	Pass	Special Mention	Substandard	Doubtful	Total
			(in thousands)		
September 30, 2012					
Commercial and industrial	$ 1,672,602	$ 64,492	$ 110,332	$ 224	$ 1,847,650
Commercial real estate	3,549,638	49,531	153,794	-	3,752,963
Construction	336,396	34,928	25,968	-	397,292
Total	$ 5,558,636	$ 148,951	$ 290,094	$ 224	$ 5,997,905
December 31, 2011					
Commercial and industrial	$ 1,669,943	$ 95,726	$ 112,186	$ 532	$ 1,878,387
Commercial real estate	3,350,475	82,612	141,002	-	3,574,089
Construction	329,848	42,845	38,114	196	411,003
Total	$ 5,350,266	$ 221,183	$ 291,302	$ 728	$ 5,863,479

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For residential mortgages, automobile, home equity and other consumer loan portfolio classes (excluding PCI loans), Valley also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in those loan classes based on payment activity as of September 30, 2012 and December 31, 2011:

Credit exposure - by payment activity	Performing Loans	Non-Performing Loans (in thousands)	Total Loans
September 30, 2012			
Residential mortgage	$ 2,450,799	$ 31,564	$ 2,482,363
Home equity	442,574	2,828	445,402
Automobile	788,904	344	789,248
Other consumer	159,008	659	159,667
Total	$ 3,841,285	$ 35,395	$ 3,876,680
December 31, 2011			
Residential mortgage	$ 2,253,944	$ 31,646	$ 2,285,590
Home equity	466,904	2,700	469,604
Automobile	772,029	461	772,490
Other consumer	135,885	749	136,634
Total	$ 3,628,762	$ 35,556	$ 3,664,318

Valley evaluates the credit quality of its PCI loan pools based on the expectation of the underlying cash flows of each pool, derived from the aging status and by payment activity of individual loans within the pool. The following table presents the recorded investment in PCI loans by class based on individual loan payment activity as of September 30, 2012 and December 31, 2011.