Bank OZK

Transcript of the Third Quarter 2020 Conference Call

October 23, 2020, 10:00 am

Note: Administrative communications of the operator and other greetings and social exchanges of no substantial import have been omitted from this transcript.

Good morning, I am Tim Hicks, Chief Administrative Officer and Executive Director of Investor Relations for Bank OZK. Thank you for joining our call this morning and participating in our question and answer session. In today's Q&A session, we may make forward-looking statements about our expectations, estimates, and outlook for the future. Please refer to our earnings release, management comments and other public filings for more information on the various factors and risks that may cause actual results or outcomes to vary from those projected in, or implied by, such forward-looking statements.

Joining me on the call to take your questions are:

- George Gleason, Chairman and CEO;
- Greg McKinney, Chief Financial Officer; and
- Brannon Hamblen, President & COO of our Real Estate Specialties Group.

To make the most efficient use of the time we have for this call, we'd ask that you please limit your questions to one or two at a time and then reenter the queue for any follow-up questions if needed. We will now open up the lines for your questions.

Ken Zerbe – *Morgan Stanley*

You guys do such a great job of underwriting in the RESG portfolio. I was actually hoping you could talk instead about the credit trends in the non-RESG portfolio. Do you think that they're going to follow the same path of credit losses that most other banks are talking about, which is peaking in the middle of 2021? Or should they perform differently?

George Gleason

What I would tell you is that our RESG portfolio is our best underwritten, best documented, best collateral, best sponsorship, best structured loans there. Because of their size and complexity, they get an extraordinary level of attention and care in all aspects of the processes related to those loans.

I would tell you that our community bank lending in its various forms and our indirect lending as well, we believe, are underwritten to standards relative to the way most banks underwrite them that are favorable. So while they're not quite as low leverage or quite as thoroughly documented and serviced as our RESG loans, we think they are much better than average.

So the secret to our 24 years now of having outperformed the industry on net charge-offs every year and having averaged about 1/3 of the industry's net charge-off ratio over that last 23-year period of time as a public company is a result of the fact that not just our RESG loans, but all of our portfolios, are underwritten and serviced to a very conservative standard. So we think these portfolios will perform well in the downturn. Our aggregate portfolio was really underwritten and designed to withstand the rigors and challenges of a very adverse economic environment. So we feel like we are very well prepared for this environment.

I don't know that we have a specific expectation of when net charge-offs will peak or exactly how much they will rise because that is going to be very dependent upon government policy action, additional stimulus, COVID cases and so forth. Clearly, our deferred loans that received a pandemic modification dropped from high 6%, I believe, percentage of our portfolio at June 30, to 2.8%, I believe it was, at September 30. Tim, are those numbers correct?

Tim Hicks

Yes. The 6.9% was actually -- our highest peak was actually incurred in July. But that was the highest peak down to the 2.8% at the end of the quarter.

George Gleason

So loans are coming off both deferral, and obviously, the vast majority of those loans have just picked right back up and continued to pay and perform as we expected they would. And we would expect that the vast majority of the 2.8% remaining in deferral will continue to do so.

So at this time, we're not seeing any significant emergence of charge-offs. I'm sure will have some loans that will break in this economic environment. But our low leverage gives us a lot of confidence that our losses will continue to be very modest when we do encounter assets that have a problem.

So I don't know if second quarter or third quarter or first quarter, I don't know exactly what the high point is going to be. But I think the more important overriding bottom line is the portfolio has been designed and underwritten and booked with the idea that it would be extremely resilient and perform very well in a difficult environment. And through the first three quarters of the pandemic situation, it has performed exactly like we thought it would.

Ken Zerbe

That's very helpful. And then just the other question I had, George, I know you said that the RESG loan repayments are likely to increase in fourth quarter, and in 2021 could remain elevated as well. Why don't you think that this pandemic has caused more of a change in the behavior of the capital markets or other competitors that are taking out these loans?

George Gleason

There's a lot of capital out there, Ken. And the Federal Reserve's very aggressive action in March and April to ensure adequate liquidity in the financial system and to buy up tremendous quantities of investment grade-rated securities on the short end has created a lot of liquidity in the system and created an environment where people are having to get yield, in many situations, having to go out and take on more risk to do that.

And I think that's the beauty of our business model. We have created a business model, particularly in our RESG group, but elsewhere, where we get and have historically gotten much better than average yields while taking lower-than-average risk than our competitors, which is why for the last decade, two or three decades, really, our net charge-off ratio has been always less than our competitors' and our margins have typically been much higher than our competitors'. And you see that now with our nine basis point charge-off ratio on both purchased and non-purchased loans in the quarter just ended being much lower than many other banks are reporting. And yet, our margin in Q2 actually widened versus our competitor banks or the industry. And as of last comparable data for Q2, I think we were 93 basis points wider than the industry's margin.

So our business plan has been very thoughtfully and very carefully designed and curated over the years to truly let us get better-than-average yields with lower-than-average risk. And people who are investing who don't have that sort of well-developed business model to get yield in this environment are finding it necessary to push farther and farther out the credit risk spectrum to get spread. So we've always liked our business model. We think the current environment is really proving the quality and durability of our business model very well.

Timur Braziler – *Wells Fargo*

Maybe just starting on the appraisal commentary, excellent color in the release around updated appraisals. Maybe looking specifically at the five hotel and two office appraisals that were done in the most recent quarter, which geographies are those in? Are those geographies coming back online maybe quicker than New York is?

And I guess more broadly, can you just talk through the appraisal process? I think last quarter, you mentioned that you work with a third-party to get values kind of 12 to 18 months out. How sensitive are those values? And is that a process that's now going to be ongoing on a quarterly basis, essentially, as we get updated cash flow information?

Brannon Hamblen

As we've said in the past, as it relates to our appraisal process, it continues as it has been. And even before COVID, we were re-underwriting and re-rating every loan in the RESG portfolio at least once annually. And in the process of doing that, if we had really material degradation in circumstances, something changed around leasing or delays this side or the other, we would get an appraisal at that point.

Obviously, with the advent of COVID, there have been numerous negative impacts in markets and property types. And so the volume of new appraisals this year is up as a result of that, but it's still normal course. And with respect to where appraisals are being done, it tends to reflect where we do business. The most appraisals that have been done that our comments have reflected on, have been in our New York market. By property type, probably, most in multifamily. So the results are going to be mixed depending on any quarter, where it is and what it is, but the results are pretty similar. I think we do a good job of explaining that our loan-to-value is, in terms of moves there, is staying within a pretty tight range. And some are up, some are down. And honestly, some of the LTVs, as we've noted, are affected by principal paydowns that we collect in conjunction with loan extensions. Many of these appraisals are coming as a result of loan maturities and extensions. Obviously, 2017 was a big origination year for us. So 2020 is going to have a lot of loans coming up for extension, and so a lot of appraisals occurring at that point in time. But as we've noted in past quarters, that those extensions frequently come with principal paydowns that offset any decrease in appraised values that may occur in those situations. So we'll continue to see a lot of appraisals as we move forward in the future quarters for all those same reasons.

George Gleason

And Timur, let me add a couple of comments to Brannon's excellent color on that. First, I do want to clarify that we're using mainstream appraisal firms that are expert leaders in the industry all over the country, with a particular focus on their expertise in particular markets or particular property types. So all the major appraisal firms probably that would come to mind as being top national, top line appraisal firms, we use those. We have a separate appraisal services unit within our company that when we want an appraiser to appraise a property, we engage through that independent firm that is independent of our lending arm so our lenders have no influence or interaction in the appraisal process. So we've created our own separate structure within the company to make sure that we've got professional appraiser expertise in-house that is engaging, reviewing and making sure those appraisals meet our quality standards as well as all regulatory standards, and we're using top-quality firms.

Brannon mentioned that one of the reasons we're not seeing the kind of degradation in appraised values that you would expect given the economic condition is that with a lot of our modifications, extensions of loans, we're getting significant curtailments or paydowns on the loans. So that is, a lot of times, driven by sizing parameters that are in our loan documents, our standards for the loan that -- it was going to be less than such and such appraised value. The property comes up for renewal, it's $3 or $5 million over what that number would be, and we require curtailment as part of our renewal to keep us within the appraised loan-to-value standards that we originally expected.

And the other comment, and this is addressed in our management comments, but if you're dealing with a loan-to-value that was calculated at June 30, but it was based off an appraisal that was 3 years old, the property probably appreciated substantially in the first two and a half years of that time frame up to the COVID pandemic hitting. That was not captured because we knew values were up and we weren't reappraising it on an interim basis because we knew market conditions were healthy and improving.

But then you have the COVID pandemic hit. Values come down. Because of that, you reappraise it based on that. You're not as far from the value three years ago as you were from what would have been the value had you appraised it one or two quarters before the pandemic hit. So those factors are resulting in our loan-to-values being much closer to in line with previously reported loan-to-values than what might naturally be expected.

Timur Braziler

And then my second question, maybe shifting gears to expenses. You talked about how the new stay-at-home environment is making you adjust your thinking on branch operations, staffing, technology, et cetera. As we look ahead, what does that do to the expense growth rate?

George Gleason

Greg, you want to take a shot at that? Obviously, there are a lot of pluses and minuses. We're taking staff out in various places and adding. But Tim or Greg, you want to talk about our expectations regarding non-interest expense in the aggregate?

Greg McKinney

Yes, I can certainly do that. I think that our expense run rate in Q3 is a pretty good indication of where we think that looks like, at least in the near term. As we've talked about over the last two or three calls, we have done a lot of work trying to make our operations more efficient, more effective, make sure we've got the right people in the right places doing the right jobs and don't have people that are not fully productive as part of the team. So we have made some enhancements and improvements there over the last two or three quarters. Our new headquarters came online during the second quarter, so we've talked about that. That's a full quarter in the run rate now, so that's fully baked in to what you're seeing in Q3.

So I really think that as we look at our overhead and our thoughts around the next two or three quarters, I think Q3 is a very good starting point for that. And I would expect, at least based on what I know at this point, for Q4 and the first part of next year, to look very similar to what you see in our results here in Q3.

Catherine Mealor – *Keefe, Bruyette, & Woods, Inc.*

We've talked before about how deferrals are less relevant for you all just given the dynamic of interest reserves. But can you quantify and talk about maybe the level of loan modification that you've seen over the past couple of quarters and ones that have been restructured since the pandemic and maybe would have been considered a TDR if it weren't for the CARES Act?

George Gleason

Catherine, we are very reluctant to ever do TDRs, and we just are strongly resistant to that. So as you noticed from our 10-Qs and call reports and so forth, we have very few loans that qualify as TDRs. And if it's going to be a TDR, and the sponsorship, borrower can't modify the loan the way that's not a TDR, we're pretty much inclined to blow that loan up and move it out because I don't want to deal with it long-term as a TDR on our books.

So the CARES Act created these extensions, 90 days or a 6-month modification for deferral of payments that were not, by definition, TDRs. And a lot of banks very liberally granted those because it was a good feeling thing to do, I guess, and we were pretty resistant about doing it. Our approach was if we think a customer has not been affected by the pandemic, then they're not going to qualify for an extension under the CARES Act. They've got to be impacted to do it.

And then secondly, if we thought that they were impacted but that a 30- or 90- or 180-day extension of payments was not going to be constructive and help them work through it in a manner that would be successful, if we thought they were just going to default at 180 days out, then we just didn't grant the extension and went ahead and proactively addressed it that way.

So we've been very appropriate in the way we've addressed these. We've not done a CARES Act extensions where we thought they would not be successful in helping the customer work through what truly was a short-term situation. And we tried to not ramp them excessively to people who had not been impacted.

Now the truth of the matter is probably the vast majority of them that we granted were to people who would have paid even had we not granted it and would not have become past dues or problematic, but they were impacted; probably not to the point of defaulting, but impacted by the pandemic. So I think our portfolio quality, again, is evident in the fact that our loans rolling off from the CARES Act modifications are largely just resuming and picking up payments where they were and are continuing to pay and perform. So we hope that will continue, and we're pretty cautiously optimistic that, that will continue.

On the, I don't know, dozen or so RESG loans where we did pandemic modifications, we required on those loans -- if we were extending 2 months or 3 months or 6 months, we required the customer to put up an equal number of months of future payments in a reserve and to also rebalance any tax insurance and off-loss reserves associated with that, because if we had a customer who said, "I don't want to go back to my equity and raise additional equity for this, but I'm going to be delayed 6 months, and I need some help." We said, "Well, we'll do 3 months of extensions, but you're going to have to put up the other 3 months and rebalance the reserves so that it's not a problem." And that very thoughtful approach to the way we've handled modifications in that portfolio has meant that our customers have more skin in the game, and then putting more skin in the game has certainly demonstrated that they have a commitment to continued projects. So I think we've been very constructive and careful in the way we've done this, and we're not going to do many, if any, loans, or certainly no material loans that are going to qualify as a TDR.

Catherine Mealor

And do you have the balance of the dozen loans within RESG that you mentioned that you've done a modification for, like as you've described?

Tim Hicks

Yes. Catherine, George referred to Figure 49. It's actually 10. One of them has expired. So there's 9 that are on deferral now.

George Gleason

Sorry, I overstated it.

Catherine Mealor

That's all right. 10 versus 9, that's not too far off. And then maybe one follow-up: the credit is so good for you all right now, and I guess the main market that we're all worried about is New York. So is there any kind of color or anecdotes you can give us on some of your larger projects in that market and what you're seeing there? I think one slide that I was encouraged about was your office and bubble chart that showed some of your larger New York projects had a kind of earlier vintage and very low LTVs. But any other anecdotes about that and just the health of this portfolio in that specific market would be helpful.

George Gleason

Yes. As the bubble charts on Pages 28 and 30 show, we've got 5 hotel properties in New York and 4 office properties in the New York MSA, and those are low leverage loans as reflected on those charts. And we expect that our sponsorship is very capable on those properties, and they're high-quality properties, and that they will continue to stand behind those properties until more normal market conditions return.

New York is probably our most challenged market in the sense that it was hit early and hardest probably of any market in the country by COVID-19. And the response, whether you agree with it or not, was a very vigorous response to really shut down the city, and that is going to cause New York to be slow to rebound and take longer than cities that had a less aggressive response to shelter-in-place and shutting down economic activity are going to incur. We've got a lot of other markets that are really coming back really strong and largely recovered the vast majority or majority of the job losses and are really resuming normal activities much faster than New York. And we realize New York's more dependent upon mass transportation than a lot of the other markets, too, and that's a legitimate factor. But I think New York will recover, and we're pretty optimistic on the long-term prognosis of New York. It's just going to come back slower.

Now interestingly enough, we do a lot of condo financing. A lot of our projects in New York have continued to have sales volume even through the pandemic, continuing to sign contracts. We've got several projects that should get their certificate of occupancy issued this quarter and have large numbers of sales that should start closing as soon as the certificates of occupancy are issued to sales or under contract. So one of the reasons we're expecting elevated paydowns to really kind of resume in Q4 and continue through next year is the timing of completion of a lot of our New York projects that have significant sales contracts in place which are going to result in pretty quick paydowns once those properties CO. So it is a challenged market. We understand that. We acknowledge that. But our quality of asset sponsorship and the continued activity at a slower pace that we're seeing on those is pretty encouraging.

Michael Rose – *Raymond James & Associates*

First, I wanted to get an update on the Tahoe property. It looks like the LTV moved below 100% this quarter. It seems like there's been some sales activity. Is there any optimism that, that credit could kind of be resolved or come off of nonaccrual status, or whenever it may -- or off the watchlist, I mean, at some point over the next couple of quarters, if these trends continue? And then just, generally speaking, about any other property types that you might be concerned about.

George Gleason

Yes. Well, Michael, that property was on the special mention list until I think January or December 31 last year. Is that right, Tim?

Tim Hicks

It was sometime during last year.

George Gleason

Yes. I think it was. I think it was in the fourth quarter last year that based on the fact that we had very few lot sales going into the new year, and we were concerned about that sales velocity, we took it from special mention to substandard accrual, and it has continued to be on accrual. And this is a property that has had its fortunes dramatically improve as a result of the changes in customer behavior and expectations resulting from the pandemic. It's a golf course property in the edge of the mountains there, on a river. It's wide open spaces, big lots, lots of trees, lots of sky, lots of open air, and similar properties all over the United States have experienced a tremendous upsurge in demand in the course of the pandemic. So that has resulted in a lot of lot sales in each quarter of this year, and the lot prices have been easing up. I think they just had a record high sales price on a lot, if I got the story correct. And all of the vertical product that they have built is essentially sold or under contract and they're moving to build new vertical products. So the increase in sales velocities and the improvements in pricing have resulted in the loan-to-value on that, as of the end of this last quarter, dropping below 100%.

It continues to be substandard accrual on our books. But I would tell you, to use a phrase from the rating agencies, it's substandard accrual with a positive outlook at this point. If we continue to see the sort of improving conditions there and continued lot sales and demand for their vertical product, and that translates into sales, then we are optimistic, hopeful that, that will move from substandard accrual to special mention, and then to a pass watch and then to pass over time. So, if trends continue, we would expect to see a steady positive progression in the rating of this project.

The big prize there is if the trends continue, and they certainly appear to be in place and continuing now, but we need to see those continue longer term before we're willing to upgrade it. But positive outlook for that based on current situations.

And in the footnote there on Figure 39, we give you what contracts were in place on lots and townhomes in the last quarter and what's happened since the end of the quarter, and you can see that, at least for the moment, is all going in a very positive direction.

Michael Rose

Got it. And just as my follow-up, on the management comments, you talked about some of the restructuring and pricing in terms of what you've done in the RV and marine book. Can you give us a little bit more color there? You talked about balances inflecting perhaps in the second quarter, I believe it was. What's changed? And I know the target is to keep it between 10% to 15%. I mean, is the expectation in the change is that you expect these trends to continue in the foreseeable future and, therefore, you don't want to lose market share? Just any sort of color there would be helpful.

George Gleason

Yes. I'll tell you, our guys, we have an absolutely marvelous team running that business unit for us, and they have my great respect. And they were originating a lot of volume last year, and it was good volume and good quality and relative to what some of our competitors in the space, we're getting at good yields.

But I looked at it relative to some of our other lines of business, and frankly, we just said this is not as profitable as some of our other lines of business. We have great confidence in you guys. We think you can play a really important part in our future, but we've got to figure out how to get our premiums that we're paying to dealers down and our margins up while maintaining or even improving our credit quality.

And as part of our analytics and risk ratings and CECL around this, we had built a pretty rigorous model for evaluating risk on these credits, and we use tens of millions of consumer credit scores that were specifically dialed in on customers who had recreational equipment loans as opposed to looking at HELOCs or unsecured consumer loans or credit cards. We were really dialing in on the customers who had been in this space and that had experience. And we built the model and have back-tested that model against FICO scores. And what we've concluded, after doing a lot of study and analytics on it, is our model we built is more predictive of consumer behavior and performance and characteristics than FICO scores are. And there are a lot of things going on with FICO scores anyway that, that's another subject.

But we've concluded that we can be more focused and predictive of credit quality and get volume and get better spreads and actually take equal or lower risk in doing that. So we took enough time and sort of stepped back from the market to really test this and compare the performance of our portfolio. And with all that done now, we're ready to re-engage.

Now we are looking for better spreads and lower premiums and maintaining equal or improving credit quality. And we think that will help the performance of future originations in this portfolio quite a bit. We were out of the space for a couple of quarters. We're reengaging the space. It takes time to get your dealer network all re-engaged and going forward, but we do have positive momentum. It's going to take a while to build back our volume, but we think we're going to be producing even better quality stuff going forward than we were. And what we were doing was good. But what we're going to do, we think, is going to perform better. And yes, I'm going to miss the fact that we'll have basically a year with no growth or negative volume in this space. But thinking longer term, the key is if we can build a better mousetrap, which we think we have, and benefit from that for years to come, taking a 9-, 12-month hiatus from the market and then implementing this better improved business strategy, we think, is the right thing to do.

So that's where we are. That's more detail probably than I should have given. And probably more detail than my guys' wish I had given, but that's the bottom line.

Stephen Scouten – *Piper Sandler*

George, you referenced your -- you do have some condo exposure there in New York City. I'm wondering if you have any numbers around how much of that $3.6 billion in commitments, how much of that is in New York City, and if you have any data on the loan-to-cost in that market versus the 52% for the exposure overall?

George Gleason

Stephen I don't have that data now. We've got it, but I don't have it in my finger tips. And Brannon could probably call it up there, but we don't want to give data on the call that is not vetted before he gives it out there.

But I would tell you our New York condo exposure is very similar loan-to-value to our condo exposure in other markets, and we've got condo exposure in markets all over the country. New York is the biggest, and Miami has historically been the second biggest, although almost everything except for a couple of deals in Miami has paid off. We're trying to reload that portfolio. So New York is the biggest part of it. Loan-to-value, loan-to-cost there are very similar to what they are in other markets around the country.

Stephen Scouten

Okay. Great. And then just the only other question is really just around loan growth trends. I know you noted paydowns are expected to be maybe a little higher than 2019, so probably somewhere in the $6 billion range, give or take. Just kind of wondering within RESG, what sort of production you think might offset that. And also, if there's any kind of larger-scale opportunities that you guys think you can capitalize on with the ample capital that you guys have available to you today.

George Gleason

Stephen, what I would tell you is, yes, we hope to use the ample capital we've got to grow our portfolio and capitalize on that opportunity. I will tell you that we do expect payoffs and prepayments to be quite a bit larger in Q4, and we do think 2021 will likely be a record payoff year. So the RESG guys are keenly aware that the payoff treadmill is running full speed again. And they have got to pick up their game without, in any way, degrading our credit quality or the performance of our portfolio to continue to try to grow their book of business in light of a rigorous payoff environment. We've run on this treadmill in the past, and we've continued to maintain or grow the RESG portfolio. We would like to grow it, certainly, the next 5 quarters because we've had a bunch of payoffs pushed from the first 3 quarters of this year into the next 3 or 4 quarters. And we've got payoffs that would normally be occurring on that cycle. We're going to have payoff headwinds for 4 or 5 quarters here, and the guys are going to have to play their A-game to put on lots of high-quality volume in an environment where there are fewer transactions probably being executed for new construction and development.

But we've also historically, in the past, been able to, in times of economic turbulence, participate in a lot of restructuring and repositioning of assets that other lenders and other sponsors are getting out of, and our sponsors have been very opportunistic. So I think capitalizing on some of those opportunities is going to be important to us achieving our growth goals. No guarantees here, but as we said in the management comments, we feel pretty good about the pipeline that we've got at RESG now that we're working on for Q4 and early 2021. The guys are getting coached regularly by Brannon and Mike Moran, the leadership down at RESG, on the need to get out, hunt hard, find good opportunities on good projects that make sense even in this economy with quality sponsors. They're working hard to do that. We've got a great originations team. So we'll see how they execute. But we are cautiously optimistic about that. But your question is spot on point that, that's the big challenge now, is being able to generate quality growth that meets our standards. And I assure you, we won't generate it if it doesn't meet our standards, but quality growth that meets our standards to overcome the payoffs that are coming and generate some decent growth in average earning assets. So that's the new focus for us.

Stephen Scouten

Perfect. Great. Helpful, George. Glad to see you guys, proving out the strong credit quality once again.

Brian Martin – *Janney Montgomery Scott LLC*

Just I wanted to follow-up on that last question, just on the RESG pipeline. I guess, George, given the pandemic and the conditions that originations have been down each quarter this year, and I guess, is your expectation, given kind of what you just talked about, the kind of refocus there that maybe we get to an inflection point where you start to see that trend higher?

George Gleason

We're working hard to make that happen, Brian. Originations at RESG in Q1, as shown in Figure 9 on Page 9 of our management comments, were $1.76 billion. We went down to $1.67 billion, and Q3 was $1.4 billion. Now $1.4 billion was not a terribly bad number, but we would definitely like for that trend to be upward instead of downward. And, again, just because we've got a lot of payoffs coming. So we're going to work hard and we hope we can improve on that number. And it's just -- you just got to go execute every day, every week, every month, every quarter to do that. And the guys have demonstrated the ability to achieve those goals in the past, and they're working hard and highly motivated to do it again. So I'm absolutely confident in Brannon and Mike Moran and their leadership of the team, and absolutely confident in the capabilities of the originators. We've gotten our five origination offices for RESG around the country. And if it can be done, I think our guys will do it.

Brian Martin

Got you. Okay. And then you talked in the comments about adding some positions recently. And I guess, just wondering if you can give any color on where staffing was beefed up a little bit just as you look forward here.

George Gleason

It's too numerous to mention, all the changes and adjustments that we're making in the company probably. But from the fourth quarter of 2018 through the third quarter of 2019, I've visited every office in the company with a group of officers. So it took us almost 10 months to visit every office in the company and spoke with every employee that was present in the offices that we were in that day. So I interacted with 90% or so of the total employees in our company. And the goal of that was really just to get an absolute grassroots, ground level understanding of how we were interacting with customers and how our team was feeling about all that we were doing, and we came away with hundreds and hundreds and hundreds of recommendations for improvement that we thought made sense. And we've been working the ensuing 12 months since the conclusion of that tour that we referred to as the ‘Back To The Future Tour,’ and worked really throughout the 10 months that it was going on to implement a lot of those improvements. And that has led to a change in all of the titles and our total kind of reorganization of the staffing of our community bank. It's resulted in a lot of leadership changes and a real division of the kind of retail side of the business from the lending side of the business. And this is a process that our lending leadership and our retail banking leadership have been unanimously in agreement on, and they jointly fashioned this reorganization and redesign of our branch interactions with customers, both deposit and loan customers. And I think we are building, and have built, we've really kind of completed the last phase of that staffing reorganization just literally a few weeks ago. And I think we are building a much more efficient, much more customer-focused bank on the retail side than we've ever had before. And we've created a whole new synergy and alignment between all of our delivery channels, whether it's mobile or online or customer care centers or call centers, as many people would call them. And our retail branches and our ATM networks, all of the alignment of those different channels, has been synchronized as part of this process. And I think we are really in the process of achieving a greatly enhanced customer experience.

And we just kind of have a little -- a bleak reference in the management comments to the fact that our deposit base, the quality of it has improved tremendously, and brokered deposits at the end of the last quarter were 7.4% of deposits, and that was down from mid-teens. And our largest 10 customers used to be 16%, 18% of our total deposits, and they're mid-single digits now. And we only have one customer that we've done business with for 40-plus years that is even 2% of our total deposits, and they're just barely over 2%. And you see it in our cost of funds coming down significantly. So we think that is a huge improvement. And I'm so proud of Cindy Wolfe and Carmen McClennon and Alan Jessup, the teams who are making all those improvements in our retail bank and our community bank lending, commercial lending, in our community bank customer footprint. They're making all that a reality. And they're doing a great job, and we're having to re-staff for that. And we got a lot of people that were in the old model that can't perform in the new model, and we've had to eliminate those positions and hire people with our new model skill sets and that's much more technology and much more online and mobile and much more sales-oriented. And I just think we're doing a really good piece of work for our shareholders for the future here, and we're very excited about it.

So hopefully, we'll continue to see that increase our availability of funds and our cost of funds going forward and create more durable, long-standing customer relationships, and that's a big part of it. And then obviously, we continue to develop our technology areas, our risk and model and analytics areas. We're doing a ton of stuff because we're gathering so much more data and it puts so much governance and process around data, and we're using that so much more effectively. And the sky is the limit on the potential for that. So we're spending a lot of money on those resources. And I think that's going to generate some really good returns for us.

And I could go on and on, but we are working really hard to make sure that every aspect of our company is as world-class as our Real Estate Specialties Group and our indirect lending group and some of the things we're most known for that really have world-class, top-of-the-industry standards. We're trying to make sure that every part of the company rises to that level.

Brian Martin

Was there any change in special mention credits this quarter of note? I think you already -- you talked about the classified or the substandards already.

Tim Hicks

Brian, were you asking about substandard or special mention?

Brian Martin

Yes. I guess it looked like you gave some color on the substandard in the comments, Tim. So I guess, either way, just classifieds and criticized, if you could give any color on that just relative to last quarter, would be perfect.

Tim Hicks

Yes, absolutely. Yes, as you mentioned, we do have a trend on the substandard chart in our comments. That was an improvement quarter-over-quarter. Similarly, the special mention trend was actually a positive trend quarter-over-quarter. So we had a decent decrease quarter-over-quarter. When you look at our total loan portfolio, some of that was in our C&I book. So we were pleased to see those trends go the right way as well.

George Gleason

All right, guys. Thank you so much. We appreciate you all being on the call today. There are no further questions, so that concludes our call. We look forward to talking with you again in about 90 days. Have a great quarter.