Bank OZK

Transcript of the Fourth Quarter 2020 Conference Call

January 22, 2021, 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 Credit & Administrative Officer 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 re-enter the queue for any follow-up questions, if needed. We will now open up the lines for your questions. Let me now ask our operator, Crystal, to remind our listeners how to cue in for questions.

Ken Zerbe - *Morgan Stanley*

First question, you obviously had fantastic NIM this quarter. So congratulations on that. But from your prepared remarks it did seem that both the purchased and non-purchased yields may have some unusual positive items this quarter. Can you just talk about how much of that NIM is sustainable on a go forward basis?

George Gleason

Ken, you're correct and we wanted to be clear in our remarks that there was a bit of lift on both pieces of that – particularly on the purchased loans. I think Tim mentioned that was about $1.7 million more than what we would consider a normal run right now. Those numbers tend to bounce around quarter-to-quarter. So what normal is is hard to determine. But our special assets guys did a great job in collecting some loans that were previously charged-off special assets and collecting interest on some loans that were previously on non-accrual status. That

really reflected their good work and that helped lift that number up to an unusually good number. And you can see on the figure in the management comments that was one of our highest net interest margin numbers in that purchased portfolio in quite a while. So there was $1.7 million, or $2 million, whatever the number, was a little bit of a lift there. And then we did have probably a bit higher level than normal, and again normal – it's hard to define what is normal. But we did have a bit higher level by a couple of million dollars – $2 million or $3 million, maybe more, in short-term extension fees and minimum interest earned on loans in the non-purchased portfolio. So that was a contributor, but there was a healthy trend in the NIM and the core spread even with those factors out. So we were we were pleased with the results.

Ken Zerbe

The other question I had was in terms of loan growth. At what point do we get past the headwinds of the elevated payoffs? I know that COVID obviously delayed some projects and I read your comments in the release it just feels like these payoffs have been a headwind for probably far longer than they should have been?

George Gleason

Well, of course, 2016 and 2017 were really large origination years, which created a lot of payoff headwinds in 2019, sort of 2 to 3 years after a lot of those big time originations. And then we had guided last year that we expected a lot of payoffs in 2020. The slowing of completion of construction projects because of shelter in place orders and the slowing of the transition financing, the bridge financing, permanent financing that takes us out clearly reduced payoffs in the second and third quarters of last year and pushed those out. We began to see quite a bit of that come back to the table in Q4.

And we'll very likely have a record level of payoffs in 2021, in part because a bunch of payoffs pushed from 2020 to 2021. And we still have normal volume that would normally pay off in 2021 as well. So we know that's the challenge for the year. We've got to work hard to find good quality, good yielding loans that meet our high standards and without sacrificing quality or pricing, see if we can continue to keep our pipelines full and originate enough to offset the payoffs and hopefully originate enough to achieve some growth in the portfolio as well. So it will be an unusually challenging year from a payout perspective in 2021 because we'll not only get what we would normally get in 2021, but we'll get some overflow from 2020 that's pandemic-related delayed overflow payoff.

So we know it's a challenge, but the encouraging thing was our RESG originations ended the year at a really good level. And even with all the noise from the pandemic in 2020, our RESG originations were a little bit better in

2020 than they were in 2019. And we have good pipelines going into the new year. So, we've got to go produce every week, every month, every quarter, and that hasn't changed.

Timur Braziler – *Wells Fargo Securities LLC*

Maybe looking at the other side of the equation and looking at the good growth you've seen in unfunded commitments over the past couple of quarters, is that indicative of sponsors getting more comfortable and re-engaging? And I guess what segments within RESG are you seeing growth come through?

Brannon Hamblen

Yes, in part, there is -- as we've come through COVID, the initial shock was strong and affected a lot of people's thinking. But as we enumerated, historically, the sponsors that we deal with and the markets that we deal in, the level of sophistication there is such that they're not going to throw the plans aside forever, COVID notwithstanding.

And we're starting to see gradually, and I don't want to overstate that, there are still projects out there that are on the sideline, but we've continued to see -- really in the Southeast, I think, is -- and we'll call it South, Southwest, is where we've seen a lot of activity. We've talked a lot about some of the major demographic trends and migrations from the Northeast in particular to the South, Southern Florida. Those trends continue to see some migration out of California into the Phoenix and Texas markets and other markets as well. So there's an underlying demand there that is still justifying a lot of new development. And I'm not going to say that everybody's full bore. They're not. There's still a number that are waiting to see how things play out. But I think some of the success that we've had, some of the growth that we've been able to achieve in a year that you wouldn't necessarily expect it is, again, tied to the fact that we're playing the long-game here. We operate for the long haul and are structuring our loans and doing deals with sponsors that support the asset quality that we feel like is coming through in our comments here.

And so we were always lending. We never stopped lending when COVID struck, and we continue to do that. And I think that reliability, the relationships involved there really undergird our ability to continue to have a strong pipeline. So I talked about geographically, the Southeast, South, Southwest has been strong. But I don't want to leave out that even in the Northeast -- we haven't been doing a lot in our New York market as we've discussed. But the guys up there have done a great job in working into other markets in the Northeast, like the Boston / Cambridge market, the D.C. market, the Baltimore market, and trying to press into some secondary markets in that world as well. So they've had good success there. We've done some, honestly, some good industrial lending up there. I know you probably noted we broke out for the first time our life sciences lending. A lot of that has

been, as you can imagine, in the Northeast and the Boston / Cambridge submarket. Very proud of what the guys have done up there on some really nice deals in that product type. It's obviously in high demand given the pandemic we're in today and others that may come in the future.

So we're -- they're pushing hard into a great product type there, and we've got other opportunities in other markets for that product type as well. So that gives you some idea of the sectors geographically and from a property type perspective. Multifamily continues to be strong, but we're trying to be very careful as we originate in that space. It has probably the most -- the highest number of developments and, in addition, competition pursuing those developments. So we'll probably continue to see strong origination there. But we're being careful to make sure it's in the right place at the right time with the right people.

George Gleason
And then you can see that in a lot of what Brannon was talking about in figure 34, which is the kind of summary recap of the distribution of loans. New York has been coming down for a number of quarters just because it's hard to find new things that make sense there. And certainly, that is a very significantly impacted COVID market. So we're probably down a $1.3 billion or so from what we were at one point in New York.

But if you look over the sixth, seventh and eighth most active geographies all at $800 million to $900 million range are Boston, Philly and D.C., which the New York office services those markets and has had a growing presence in those markets for the last several years and particularly the last year, one and half years. And then Miami, Tampa are three and nine on the list, and Phoenix is 10. So you can sort of see the emergence of these new geographies in our largest markets as migration trends and business opportunity trends are shifting. So I think our guys are doing a great job of seeing where the opportunities are and where deals are that make sense in getting there.

Timur Braziler
And then as a follow-up question, looking at the liquidity build, the cash position is about $1 billion higher year-over- year. Loan growth seems like it's going to be pressured with some of the headwinds from continued paydowns. I guess what do you guys do with that liquidity? How quickly can that be deployed? And in tying that back with margin, can the margin be sustainable with this level of liquidity, especially given some of the tailwinds that it got from these and other more or less onetime items in the fourth quarter?

George Gleason

Well, I would kind of turn that question around and say we were very pleased with the margin results that we've achieved the last couple of quarters, and particularly in the quarter just ended where we had very nice margin expansion, even holding more cash and more securities than we've probably ever held or at least among the highest volumes of cash and securities we've ever held.

So you mentioned the cash position being much higher than it was a year ago. The securities portfolio is also much higher than it was and the amount of securities pledged is much lower than it was. So, in all respects our liquidity position is very good -- very strong. And that's a positive.

Obviously, when you've got money in Fed funds at 10 basis points, more or less, and you're buying short-term, high-quality securities that are one year, 18 months or six months in duration, you're getting 20, 25, 30 basis points maybe on those if you work really hard and are lucky. That doesn't help the margin very much. So the liquidity position has weighed and will continue to weigh on our margin.

We want to keep a strong liquidity position. That's a source of strength for a bank. I don't know that we need quite as much liquidity as we have, but we're not complaining about that. So it's money that you need to keep and strength you need to have to manage your balance sheet. So it's a good question.

I wish the curve would steepen and there were things that you could be excited about investing in. But at these absolutely low level of interest rates, and the curve as relatively flat as it is, there's just not much incentive, in our view, to do anything other than stay super short and ride out this time and keep the liquidity you need to keep and are in the mediocre, little yields you can earn on it and deal with it.

Matt Olney – *Stephens Inc.*

I want to circle back on the organic loan growth discussion. And the management commentary walked through some of the major segments, whether it's RV & Marine, Community Bank or RESG. And each segment seems to have its own drivers that have some level of headwinds in them. When we take a step back, it seems like the moving parts point to total non-purchased loan growth ex PPP that could be relatively flattish in '21 versus '20. I just want to make sure I'm thinking about this right.

George Gleason

Well, I don't know that we are giving specific guidance on whether that's flattish or up a little or what. But I'll give you a little more color, Matt, that may be helpful to you. The Community Bank segment is very challenging right

now because you've got a bunch of small banks out there that are desperate for loans, and they're getting and have been really for quarters now been very aggressive on credit and very aggressive on rate. And we're going to hold our credit standards and our equity down payment standards and not give on those. And we're going to hold our minimum pricing standards, not give on that. So we always have and certainly have in the last year lost business in the Community Bank segment to other competitor banks that were just doing things a lot cheaper and a lot more aggressive on credit than we would ever be. And that's why that category of lending shrunk a little bit last year.

Likewise, we retooled our business model for our indirect unit last year. And really, we were on the sidelines for the most part for about six months or so, more or less, there. And I think that was a great decision. I feel really good about that because we used the data and the analytical capability -- we've gotten the strong capabilities of that excellent team to build a better business model, which we started kind of rolling back out in Q4. When you shut the engines off, it takes a little while to relight the engines. And then once you get the engines relit, it takes a little while to get forward momentum built up.

So we're in the process of building momentum in the RV & Marine group. And I think what you'll see there over time -- it may take a while for us to get the kind of momentum we want -- but what I think you'll see is that growing at a less rapid pace than it did in sort of the '18, '19 time frame. But I think you'll see it resume positive growth. And hopefully, that will be in the back half of 2021. And what we will be booking there -- what we are booking there now -- has lower premiums and higher spread and I think is every bit as good quality-wise. And the pandemic has pretty much revealed the high quality of what we've been doing there. But I think what we will be originating is going to be every bit as good quality-wise as what we were originating, and yet we're going to be getting better spreads and paying lower premiums for that. So it's going to be much more profitable business going forward. That unit will probably continue to have net paydowns for the next -- well, let's just say, the first half of 2021 more or less. And then I think somewhere around the middle of the year, plus or minus one month or two, we get to a point where originations probably equal payoffs. And then hopefully, we'll have some net growth from that unit in the back half of the year.

And then we've talked a lot about RESG. It was the big source of our growth in 2020. It was essentially all of our growth in 2020 and will be the biggest growth engine for us possibly in 2021. It's our best shot to have a lot of growth. And that's just simply a game of can our guys go find the deals and get the deals closed and large enough volume to cover the payoffs and achieve good positive growth. And our team there has had a history of coming through for us. Certainly, we've got a big wave of payoffs to deal with. But at the same time I'm not willing to accept the idea that those guys can't achieve the volume that we need to get some decent positive growth numbers.

Now they got to work hard, and market conditions and sponsors have got to cooperate with us in achieving that. But those guys have had a history of doing really good work. So I'm not going to sell them short and say they can't do that.

So we could have a year where we -- because of just an exceptionally high level of payoffs, we have zero loan growth. But I'm certainly not willing at this point to concede that that is the case. And we're going to work really hard to achieve the best margins we can while maintaining our quality and achieve the best growth we can.

So we're in a business where you've got to produce every day. And if you don't produce, then you're going to go backwards. And we don't want to go backwards. So we're working real hard to go forward.

Matt Olney

And then I guess as a follow-up, I also want to ask about excess capital. Overall capital levels still remain excellent at the bank. If asset growth is, call it, just less material in 2021 versus previous years, I'm curious what the updated thoughts are around a potential share buyback program that could allow the bank to deploy a portion of the excess capital?

George Gleason

That's a great question and certainly an item that is getting more and more discussion internally here. One of the reasons that we've articulated to hold significant amounts of excess capital as we have the last couple of years is to be ready for a situation where economic turbulence created opportunities. We've certainly had the economic turbulence that has resulted in some opportunities. So we had a very short window of time to capitalize on some very opportunistic purchases of securities -- but the Fed's very aggressive action closed that window shortly. And we've had the opportunity to improve pricing, which was reflected in our improving margin and core spread in the most recent quarter, core spread in the last couple of quarters and gained market share in RESG. But the big time opportunities that would allow us to utilize a lot of our surplus capital have not yet materialized and may not materialize because of the extremely rapid and aggressive monetary and fiscal policy responses to the economic downturn resulting from the pandemic. I'm not sure yet that we won't find some good opportunities to capitalize on. But the prospects for those seem to be less than one would have expected at the very outset of the pandemic. And failure of those capital uses to materialize certainly will suggest that we need to look at better ways to use some of that capital.

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

I really love your bubble charts. I think they really help to tell the picture of the diversity in your loan portfolio. And I wondered if we could turn to Figure 40 with the RESG office portfolio. And I wanted to see if you could just give us a little bit of detail on a couple of credits there. You have a few really large New York office properties, of course they are really low leverage at only 30%, but they're kind of larger with earlier vintages. And then that really large, it looks like a Los Angeles office property in the blue. So I guess, one, I just wondered if you could just give us any kind of anecdotal color on the larger exposures. And then also, it looks like there was a new office property in Dallas that was originated this year, which has a higher LTV than that average portfolio. I'm just curious if you think this is going to be a trend in some of the new originations needing to kind of move up on your leverage or if that's just credit-specific.

George Gleason

Let me talk about the Dallas bubble. And then Brannon, I'm going to throw the New York and L.A. pieces to you, and you may want to add some color on the Dallas piece.

The newly originated loan in Dallas is a loan that we made to a party that was a mezz lender on an office building loan that we had in Dallas. And the sponsorship surrendered that building to the mezz lender. So the mezz lender has taken that over. So our loan to the mezz lender on that is about a 70%, or a little higher, of new appraised value on that property. It is cash flowing, but the sponsor decided to not defend their position in that building and surrender it to the mezz. So that really speaks to the quality of the structure of our transactions.

I know some of you that are not in commercial real estate have wondered, "Wow, does having mezz lenders in a transaction enhance the bank's risk or increase the bank's risk?" And it actually lowers our risk, and that's a great example there. The sponsor I don't think disliked the asset, and sometimes sponsors have to choose what assets they're going to defend, and they surrendered that to the mezz lender. It was coming up for renewal in our world, and we were expecting substantial curtailments and paydowns because of changes in the tenancy there and how we expected that would impact the appraised value as it did.

So when the mezz lender took over the property, we originated a new loan to the mezz lender first to acquire the note. And then they very quickly moved into the ownership position on the property. And so our loan is now secured by a mortgage on the property and all the same collateral as our original loan to the sponsor. We did get about a $16 million curtailment, I think, on that, about $5 million of actual cash paydown and about $10 million or $11 million -- $9 million, $10 million or $11 million, something like it -- future funding that went away as part of that. And I think we got to improve our pricing, or at least hold it the same, and get fees associated with that

new loan. So it's a full market rate loan on full standard credit terms that we would do a new loan. The only difference is that it's higher leverage than what we would normally do a loan at. But even with that, our exposure was reduced sizably in connection with the transfer of ownership on that. So Brannon, you may want to add a little more color to that. That's probably enough on that, but you might want to address the office in New York and L.A. and elsewhere.

Brannon Hamblen
On our New York office exposures that you mentioned, we've got 4 office loans in that CBSA. And we've actually, on one of those had -- it was already very well leased at 95% -- but we had a tenant that was about a 25,000 square foot tenant actually expanded their lease by another 26,000 or 27,000 feet during the quarter. So that particular office building is in very good shape from an occupancy point of view. We've got another that is working on a lease that's not signed yet but very far advanced. That would occupy about 40% of that one. And those are our 2 largest office buildings there. We've got another 1 that's leased in the 80% range, I believe. Those are our largest New York and older vintage New York bubbles that you're seeing there on that bubble chart.

And then in L.A., the big one that sticks out there was originated early in 2020. It's a transitional execution. So right now, they're really deep in the middle of that. It will be a while before it's fully complete. And obviously, with COVID being what it is, we're happy for that time for them to work through that and then begin the lease-up process. But that's the $433 million bubble that you're seeing there on your chart.

Catherine Mealor
That's really helpful color. And then one follow-up question from the loan discussion earlier. I know this quarter was elevated, but typically don't we see elevated loan fees in periods of time where you have elevated paydowns? And so would it be fair to say that we should still see a fairly high level of loan fees this year given that we expect paydowns to be so high in 2021?

George Gleason
That's a great question, Catherine, and it's kind of a complicated scenario. A lot of what generates the loan fees on payoffs is if a loan was done for 36 months and it paid off at 24 months. And you'll recall one year or two ago, we were complaining a lot about the fact that our loans were getting paid off faster and faster and faster. Then you have unamortized loan fees -- if they're paid off well in advance of maturity -- that kick in and give you a little boost in yield at the payoff of those loans. As the pandemic has delayed construction on projects three, six months, whatever the number is, and as permanent financing has been delayed a few months on projects as well, you end up in a situation where those loan fees that you originated and deferred and amortized over the life of the

loan, you get close to the original maturity or even do a 90-day or 180-day extension because it takes a little more time to get the guys to their permanent execution. And you don't have the fees that are unamortized because they've been amortized in the income over the life of the loan. The loan has gone full term. So to the extent that the payoffs get extended, you lose some of that extra boost at the end.

Now on a lot of these loans where we're doing 90- or 180-day extensions, we do get extra fees for that. And that has contributed some extra income as well. We are, in a lot of cases, able to collect some minimum interest on loans that varies quite a bit from quarter-to-quarter and month-to-month and so forth. So I don't know that it would be fair to assume that in 2021 because we expect a lot of payoffs that that's going to result in a lot of extra juice to our net interest margin from accelerated recognition of previously deferred fees because most of those loans are going closer to full term than in the past. So there's less of that bump at the end. To the extent that we do get to do some extra term on some of those loans where they're in the process of going to the permanent market and we get to do a 90- or 180-day extension on them, that could generate some extra fees that can help us with the income situation.

So the answer to your question is it's complicated, and we're going to have to see how it plays out. I don't think it's a negative for us. I don't know that it's going to be a significant positive either.

Brian Martin – *Janney Montgomery Scott LLC*
I just wanted to find out just a little bit more on the margins, George. I think after you called out some of the, I guess, modest lift that you got from some of these onetime items this quarter, like you said, the margin still saw a nice improvement with the cost of deposits going lower and all the work you guys have done on the deposit side. Just kind of wondering once we reset that a touch lower for some of these items you called out, kind of if you can just talk a little bit about the puts and the takes of the margin going forward, especially as you continue to expect some funding cost to go lower, just kind of where the loan yields and what you're seeing there and how that may play out.

Tim Hicks
We gave you a couple of figures there to look through on our core spread on Figure 16 and then our time deposit maturity schedule on Figure 17. Obviously, we're very pleased with the level of decrease in cost of interest bearing deposits we've had the last couple of quarters -- 18 basis points of decrease this quarter was very good. We still have room to go there. I think we've got room certainly in the next few quarters. If you look at that Figure 17, both of those quarters have over 100 basis points of weighted average rate. Our weighted average rate of new and renewed time deposits in the fourth quarter was 56 basis points. So a lot of room to move down certainly in

the next couple of quarters and still in quarters two and three, maybe not as much as in Q1 and Q2. So I think that's a positive trend certainly as we look at margin and core spread.

We do -- as George mentioned earlier in the call, our reinvestment rate on our securities obviously is putting some headwind to our yield on our investment securities book. So that goes the other way a little bit. And then as you mentioned, our purchased loan yield was the highest it's been in a number of years. The difference there is we had in previous years prior to CECL, some recovery income on purchased loans that vary from quarter-to-quarter that with the adoption of CECL go into the yield. So that can bounce up and down from quarter-to-quarter -- and we had a good amount of that certainly in this past quarter.

So a lot of moving parts there, but I do think that cost of interest-bearing deposit decrease -- the opportunity that we've got in the next few quarters does provide us opportunity to continue to improve the core spread, which will certainly help from an overall net interest margin standpoint. The level of cash and securities we have and the reinvestment of those is probably the main contributor to offsetting that to some degree. And then, of course, our purchased loans are paying down 12% to 13% each quarter, and they're yielding favorable levels as well.

Brian Martin
Maybe just the only follow-up is just the new loan originations on the non-purchased side -- where are those coming in today? I guess on the RESG side, maybe more so than the other components that you talked about George?

George Gleason
I would tell you that our spread on new originations that we're booking and working on now is not quite as good as it was in 2Q of 2020 right after the pandemic started. We obviously – we were the only guys out there in the space, so we were getting better spread then than we had in a long time. But the spreads are better than what we were getting in 2Q of '19. So it's not as good as it was last year, and we'll start seeing the benefits of that spread from last year in 2021 and 2022. And the new stuff we're originating today is better than it was a couple of years ago but not as good as what we were getting 10 months ago or 9 months ago.

Brian Martin
Then just one other one for me, and I'll jump back. Was the -- Tim, the level of criticized and classified, I guess my assumption is there was not much movement in the quarter. Or can you just give any color directionally on what trends you're seeing there?

Tim Hicks

Obviously, this was very strong quarter from a credit quality standpoint. We did have a charge-off ratio of 14 basis points, which is still very, very good. In the quarter, our nonperforming assets, nonperforming loans are still very good. They ticked up -- nonperforming assets ticked up really just slightly in the quarter – but still at very low levels -- due to a couple of loans that came off of their deferral and we moved to nonperforming. One of which was a purchased loan that we got from a previous acquisition that had rolled into our non-purchased category. It was just under $10 million, a senior living facility that struggled, obviously, during the pandemic to keep occupancy and keep levels up. But very strong levels.

Our substandards really didn't move, as you saw in our chart that we've got there. It's a very stable substandard level. And you saw our deferrals come down to under 1%. And then if you look at our special mention, which we didn't give you that -- we don't have a chart on special mention, but special mention is still at very favorable levels. I think it was up just a little bit from Q3, but not much at all and still very low levels.

Stephen Scouten - *Piper Sandler*

I guess if I could start maybe thinking about expenses a little bit. You previously talked about some additional professional fees or other hires and consultants and other things that might be able to come out over time. You had really good expense results here in this quarter. I'm wondering what you're thinking the direction could be in 2021, if there's any large-scale investments that need to come or we could expect just kind of normal 3% to 5% growth, something like that.

Greg McKinney

We have been talking for a number of quarters about the use of consultants and getting some projects completed and some of that continued through the earlier to middle part of this year, but you did see that reduction in those expenses in Q4. As we've got some of that stuff wrapped up, we've been talking about the desire to really use internal resources to do a lot of those projects, and that worked for us. So we're constantly looking to move that work, internally get those consultants out of the bank. It's certainly a lot cheaper to do it with our people -- and we certainly saw the benefits of that this quarter.

There is a little bit of seasonality in our occupancy expense in the summer months, but that's not really overly significant. And then certainly, from a salary and benefit standpoint, we've talked about continuing to focus on making sure that we've got the right people in the right places doing the right jobs, and we're continuing to do that. We've made a number of changes from a staffing standpoint over the course of 2020 as we've looked to identify excess resources that we can either use elsewhere or replace those with -- or consolidate those functions

into other groups or with other resources. And then we're always going to be adding new head count as we continue to grow, expand, bring on new talent, specific talent that we need as we continue to grow and expand our bank and become a bigger bank, more efficient bank, have more capabilities and all.

So all that said, I would say that our expense rate in Q4, we were certainly pleased with that. I don't know that there's a significant ability to move that downwards, although I don't expect to see that really ramp up significantly as we look into 2021 as well. Although I will say that typically -- Q1 is where we typically see a little bit more of a bump in expenses just from the normal things from a standpoint of salary, pay raises, health insurance -- although we worked really hard this year to try to minimize the impact of that. So I would say that it's a pretty good starting point for purposes of you guys thinking about 2021.

Stephen Scouten
And then I guess just my other question, maybe more high level around RESG structure. And George, you touched on a Dallas credit where you're able to work with the mezz lender and kind of get protection there. And then I know there was some chatter in the quarter around a project in Union Square – a property in New York. And I don't know if you can speak directly to that project and some of the protections you have there. But it seems like it's an underappreciated positive for the bank, just the intensity of your loan structure, the minimum interest levels, and the interest reserves. So I don't know if you can give any more color, the amount of loans that have those sort of protections, the length of interest reserves, things like that, that might give more comfort around additional temporary issues along the way.

Brannon Hamblen
I appreciate that you appreciate the structure and the strength of the structure and what it does for us. And I do think it's an element that we'll need to continue to emphasize. But I would say that we focus a lot on these calls on growth, and I appreciate George's confidence in RESG and our ability to continue strong originations. But asset quality is always job #1. We're not going to originate in a way that sacrifices asset quality. And we've got a great team internally that is highly focused on that. And we're expanding that team to give us the best shot we have about achieving the growth but achieving it in a way that maintains the quality that we've become known for. But the groups that we do business with, and the way we structure our loans, are absolutely key to maintaining that asset quality.

And we do a good bit of business with the group that was part of the Dallas execution that George talked about earlier. We've done a good bit of business with a number of groups that have become accustomed to the

requirements of our deals -- our structures -- but are okay with that because they appreciate the execution that we provide alongside that.

And in terms of our Union Square project -- yesterday that loan that was actually sold. We actually had someone that we've done a lot of business with has been after us for quite some time actually to purchase that note. And we were successful in selling that note yesterday, actually. So the structures, the leverage, obviously, we were at a great leverage point on that transaction. And it provided the opportunity for another party that was interested in the project to come along and pay us at par. And in the process, we made some really good interest on that project while we had it.

So again, the low leverage, doing business with great parties and very strong structures has time and time again allowed us, as I have said before, to continue to lend in good times and bad.

George Gleason

And I'm going to step out here and provide a little more color on that for those that don't know -- and I don't want to get into too much detail. But that loan, we got a little attention because the borrower sponsor on that is a public entity. So they issued a communication piece as part of their public company filings that noted that we had extended the loan at 17.5% interest rate. And our strategy there was very simple. We had communicated that we were not pleased with the progress on the project and would like to be paid off, but they needed time to accomplish that. So in lieu of a fee on the renewal, we raised the interest rate with their agreement and concurrence and understanding that at the higher rate, that note would be readily sellable.

And hence, we turned around and settled and got a full par payoff. So they'll probably proceed with their business plan and may pay that loan off or may work out a deal with the lender that purchased that loan from us. So it was an agreeable execution for all parties. But it was a transaction we were just not pleased with the progress on, and that was a full par payoff, all principal, all interest, all fees, everything. So we didn't leave a $0.01 on the table, and we're never at risk. And even if the loan defaulted, we would have had no loss on it because there was sizable equity and so forth. But it was a well-executed exit of the transaction that let the sponsor have the additional time they needed, but also put the note in the form that we could readily sell it at a par takeout.

Interestingly, there was a loan a year or so ago in New York that was a condo project that we had that had lower level retail on it. And the parties ran into some initial delays, and problems getting progress on the project started as quickly as they should. They made some adjustments. We got a large paydown and reset the timeline on our loan to let them kind of restart after they got their bearings and act together on the execution required that they

pay our loan down $20 million. It was a sizable paydown and reset everything on that to a new timeline to let them kind of restart because they had wasted some of their time not getting traction initially. And that loan paid off after the first of the year in the last two weeks as well at full par payoff. And they ended up executing well on that and got the ground floor leased and the tenant. And I think the tenant is finishing out their space on all the ground floor space there. So that lease worked like it was supposed to. And they were taken out by another lender on that at a much higher loan amount than our loan amount on the project. So our knowledge and understanding of these transactions, our expertise in the area, combined with our structures and our low leverage, gives us a lot of room to exit these projects in very constructive ways in the vast majority of cases.

And we're getting a lot of paydowns in New York because we're not seeing a lot of new business in that market. In addition to those two deals, we had, I think, a $40 million or so land loan in New York payoff and several smaller New York credits that were community bank credits that were acquired as part of our Intervest acquisition have paid off. So we've had a bit of a run of New York City payoffs, probably a couple of hundred million in total since the first of the year.

Arren Cyganovich - *Citi*
In the prepared commentary that you put out last night, there was a comment about bridge and permanent lenders starting to return to the market later in the year in 2020. Are you seeing any kind of risk-taking there that might be an impediment to originations? Clearly, you had a pretty strong origination quarter in the fourth quarter. I'm just curious what you're seeing from the nonbank lenders.

Brannon Hamblen
I think generally, you can say that in commercial real estate, the trends have been that as more capital invades the market, the more that additional risk is taken and yields are pressured and things of that nature. There continues to be additional velocity there, although I will say that we're not in the world that we play in, not seeing as much pressure at the moment. It will come. And there are certain project types that are getting more attention. But there are -- a lot of that bridge capital is going to focus on higher-risk existing projects that would not normally be a large part of our business. But we're also seeing some more standard life company and bank participants become more active currently.

There is a lot of capital out there, and we've spoken to that consistently over the last several quarters that is waiting to try to take advantage of the stress. The world has held up from an asset quality point of view. I guess, I'll use that term loosely depending on where and who, but better, I think, than a lot had expected. And so the stress rates have not materialized at quite the level one might have thought. I think there's still room for that to

happen. And as I said, a lot of that bridge debt will be focused on some of those aspects of the real estate world that we might not be extremely active in. But yes, the capital at some level will be part of the challenge. George has alluded to in terms of our growth this year. But we've got a great team that's had a pretty good track record of pushing through those obstacles and originating good volume of well-structured loans with great sponsors in good markets. So we'll keep after this year and see if we can overcome those obstacles again.

George Gleason

Thank you guys all for joining the call today and for the good questions. We appreciate your interest in our company and the great questions. I look forward to being with you again about 90 days. Thank you. That concludes our call.