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Regions Financial Corporation NYSE:RF

Company Conference Presentation

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Call Participants

EXECUTIVES

David Jackson Turner
Senior EVP & CFO

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

ANALYSTS

Unknown Analyst

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Presentation

Unknown Analyst

Regions Financial, RF Regions is ranked 19th in the U.S. in terms of total deposits with about $126 billion of balances and over 1,200 branches in 15 states, assets ended last quarter at $154 billion. They have the top 5 or better market share in 70% of their MSAs across the footprint. Early in the investor presentation, you can see it shows the profile evolution and the strategic actions going back to 2008, that contributed to regions, generating a top quartile ROTCE in 2022, an impressive 24% plus. And if anybody hasn't looked in the investor deck that was filed earlier this week, it always has some great data and insight into the company.

Representing Regions today on my left is David Turner, Senior Executive Vice President and Chief Financial Officer. He's also a member of Regions executive leadership team. David leads all finance operations, including financial systems, investor relations, corporate tax, accounting, M&A and others. He joined Regions back in 2005.

And then on his left, Ronnie Smith, Senior Executive Vice President and Head of Corporate Banking, which includes commercial banking, large corporate banking, capital markets, Regions business capital and other lines of business. And Ronnie began his banking career at Regions as a management trainee back in 1981.
So you guys know the format. I'll kick it off with some questions and then open it up to the audience.

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Question and Answer

Unknown Analyst

Let's start with, you had previously signaled that a higher-for-longer rate environment could lead to incrementally higher deposit betas. The market seemed surprised a few weeks ago with your updated outlook. Maybe just start there, how should we think about your near term and through the cycle deposit beta expectations?

David Jackson Turner
Senior EVP & CFO

Yes. Thanks, Jerry, for having us. Yes, we were surprised that certain investors were surprised because we had talked earlier in conferences that a higher-for-longer environment would promote a higher beta, and we had talked about that beta being in the low 40% range. Our beta this past quarter was 34%. We thought it would be about 32%. That change was driven primarily by consumer noninterest-bearing accounts being pushed into interest-bearing accounts, money market and CDs.

We think there's still more of that to come. And that could be, call it, $3 billion to $5 billion more that remixes out of noninterest bearing. So today, our noninterest-bearing percentage is 35.7%. We thought originally it would be about 35%. It's probably going to be a tad lower than that. That $3 billion to $5 billion is driven by going back to prepandemic and looking at customers that had how much cash they had in their account relative to their spend, and that was about 1.8x to 2x their monthly spend.

So if history proves right, that could be -- it's probably going to be closer to 3%. We get -- we've put in the pro forma for the margin 5% to give ourselves a little bit of cushion. That mix shift was the predominant driver of the change in the margin in the quarter from 4.04% to 3.73%. We still had -- I think we had the second highest margin still. We don't -- you can't straight line that. If you do, you'll have a pretty low margin. We think that bottoms out really at about 3 50-ish.

The other driver was we had some swaps that became -- received fixed swaps that became effective in July. It was about $6 billion. We have another $3 billion that will start this fourth quarter and then another, call it, 2.5 to 3 in the first quarter. And you -- there's a page in the deck that shows you, for the most part, the received fixed rate is about 3%. We're paying SOFR. So you can do some quick math and see that we have negative carry in those, and we're okay with that. Those are not trades. Those were put on over a year ago as insurance protection to low rates because that's our nemesis.

Yes, we give up a little bit and when we are higher for longer, but everything else is repricing higher, too. So our fixed rate repricing of $12 billion to $14 billion of fixed rate assets between securities and loans, on an average, will go on about 250 basis points higher than they are today. And that will start to overwhelm the beta in about the second half of next year.

So you're going to see our margin come down in the fourth quarter, a little bit more into the first quarter and, call it, 1 or 2 basis points maybe in the second quarter. And then we can -- then we think if our switching or $3 billion to $5 billion is right, you'll start to see growth.

Unknown Analyst

And then you indicated on the call, you expect deposits to be stable to modestly lower in the fourth quarter. What are your thoughts on 2024 in terms of deposit growth? And do you think QT has and will potentially impact your deposit balances in the industry overall?

David Jackson Turner
Senior EVP & CFO

Yes. I think as the Fed also continues to shrink the balance sheet, it has a tendency to draw deposits out of the system. It starts with the money center banks, but it then trickles down to the regional banks over time. The good news is, we're continuing to grow noninterest-bearing checking accounts, whether it be on the consumer growing operating accounts in our businesses, and that's really what matters at the end of the day.

Our loan deposit ratio is relatively low. We're not going to see a lot of loan growth in this fourth quarter and probably not going to see a lot of loan growth next year because the economy is going to continue to slow down. So you don't have the dynamic of where you're having to chase deposits to get the funding for loan growth. You can leverage. I mean you don't have to leverage that and get brokered deposits and high-cost deposits. So I think that will help maintain deposits in the system to some degree. And I think for regions, we don't see a lot of pressure on deposit outflows, if you will. I think that's stabilized since all the craziness that happened in March. So we feel good about our balances for the remainder of the year and in the 2024.

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Unknown Analyst

And you brought up loan growth. Is that attributed to the economy, higher interest rates, self-imposed or a little bit of everything? And what type of impact or the nondepository financial services companies, the kind of private credit having on the lending market?

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes. Jerry, I'll take that one. Client selectivity is critical for us, whether that's some new origination are at renewal. And so we're taking certainly the consistent approach that we've always taken, but the economic inputs that we utilize for our underwriting has changed and it creates a tightening effect if we're going to be consistent all the way through the cycle there. Are those areas that we have pointed out in the deck that you have that we consider to be higher risk in those particular areas, we do ramp up because there's been more economic headwinds in that particular group. If I were to compare our pipelines to the same time last year, we're probably down today roughly in the 45% to 50% range in our credit pipelines.

Now on the other side of the balance sheet for our clients, though, we're very pleased with what we're seeing and being able to penetrate the existing business that we have today. We've got treasury management growing at just under double digit at 9% from a customer count, about 8% from revenue growth. So we're really trying to focus in on solutions for our clients, helping them create cash that will get them to the other side of if it's a soft landing or a hard lending, cash and cash burn will be extremely important to our clients. So we're trying to look for those solutions for our clients along the way as well.

The last thing I would just mention is that as we think about the real estate side of the house, there been a lot of questions around the office portfolios. We can take a bit of a deeper dive into that. But those areas within real estate continue to surprise on being very stable within the marketplace that we serve. But we'll take that a little bit later. I'm sure we'll have some questions around that.

David Jackson Turner
Senior EVP & CFO

I had one point, and that is we're not on an RWA diet. Some people have done that to help from a capital standpoint, some have done it because of the lack of funding. And it's just very hard to fund loan growth if you're borrowing money from the FHLB only. So we are being very selective. We do realize there's opportunities to grow loans faster because of the RWA diets from some of our competitors. And we've talked internally about being real careful about that. We're not about growing loans. We're about growing relationships. So if you can get an operating account of a business and there's a loan opportunity there, that's fine. But we don't want to strap on a bunch of loans and have disproportionate growth of our loans versus our deposits.

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes. Just one other quick point on the growth piece. If you look back at the third quarter, the production that we had, the growth that we experienced, 90% came from the existing book of business. And it's not that we're not interested in new names, but to David's point, being very selective, choosing those that we had targeted before, we saw other organizations pushing relationships off the balance sheet is critically important to us.

Unknown Analyst

We kind of put it together from an NII perspective. You disclosed a lot of information to help us understand the hedging strategy and the math behind it. And we know it will help you when rates fall. You said on your call that additional swaps will be coming online. Maybe kind of walk us through how that works and just your near-term general NII outlook.

David Jackson Turner
Senior EVP & CFO

Yes. So we'll have a little bit of pressure on NII this quarter, driven from another $3 billion worth of interest rate swaps that become effective, the received fixed rate. There's a page 19 in the deck that shows you on the left side, you can see the addition of the $3 billion in the fourth quarter and surrounded $2.5 billion, $3 billion in the first quarter, received fixed rates at about 3% in paying SOFR. So you can do the quick math on that, and that's the negative carry that we'll have in the fourth quarter and into the first quarter. And we'll continue to put pressure on NII. But again, I still think our margin, while it will be down in the fourth quarter and in the first quarter and Tad in the second, we think we bottom out in that 350-ish range. And that's pretty good margin, we think, in this type of environment.

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Rates go the other way. Before higher for longer came about, we also showed you in a low rate environment that we can protect 3.60% to 4%. Anywhere in there is good for us, and we've calibrated that because it's reverse engineered to be -- to help us get the return on capital that we think we need to have over many cycles. And that's a 16% to 18% number. And forget the AOCI crazy benefit that you get today, throw that out, recalculate. And we think that a 16% to 18% return on capital and your cost of capital is in the 9, 10 range is a pretty good day's work for investors in a bank.

So our goal is to be a top returner. We don't have to be #1, but we have to be in the top quartile. Being in the top quartile gives us optionality. And if we do that, our currency also gives us optionality. We lost it a little bit because we had a pretty horrific last quarter. We're back on the horse and will be okay, and we can talk about that further. But I answered more than your question, got on the role there for a minute.

Unknown Analyst

Let's shift over to fee income, near-term expectations. Can you maybe expand on your capital markets business, thoughts there? I mean...

David Jackson Turner
Senior EVP & CFO

So yes -- so that was not one of our issues that we had this past quarter. I think that kind of hit expectations. But it's lower than we really want. We're -- from a service charge standpoint, a couple of things going on there. First, the third quarter had the full effect of the 24-hour grace that we had put in, in the second quarter. That kind of got in, call it, mid-second quarter. So we didn't have a full run rate. We now have the full run rate there.

And our customers, about 35% of those who overdraft are taking advantage of our 24-hour grace. That's a good thing for our customer. Now we lose money or don't make money as a result of it, but we still think net-net, that's the right thing to do for our customer base. The good news of all the changes we put in service charges for the consumer, we've had a bunch of growth in treasury management.

So Ronnie, why don't you talk about the growth that your teams had and then [indiscernible] cap markets to that.

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes. I mentioned just a moment ago, from a treasury management perspective, we are seeing opportunities with our existing client base to penetrate deeper. Today, we're at a 64% penetration rate with our corporate clients, taking advantage of our iTreasury platform. And as we develop new solutions for our clients, especially given the environment that many of them are facing with some of the issues around fraud and cyber risk, there are solutions that really come to a great benefit to our clients today.

So we're continuing to make progress in that particular area, I mentioned earlier in the 8% to 9% range, both in client counts and revenue count. So we're very pleased with what we're seeing in that platform and continuing to develop new products and services that set a very rapid pace within our industry.

On the capital market side, we do have a lot of headwinds blowing simply because of where the rate environment is. But we continue to be strong within our real estate capital markets group, which has been the leader for us. There's been some rationalization by our borrowers that we are going to be higher for longer, and they're taking advantage of the agency solutions that are in the marketplace.

One of the areas that has been a bit of an uphill climb for us has been around M&A, and we have advisory services that are there. We've seen a lot of that business get postponed from quarter-to-quarter just because of the uncertainty that's in the marketplace. But there are some green shoots even in that area. Our most recent acquisition of Clearsight, which is focused in the technology vertical supports our technology vertical that we've had in place for quite some time has actually seen good activity over this past quarter.

The pipeline is encouraging. We're up sharply over the same time last year. So we're starting to see some things break through. Again, I think the realization that we're going to be in this rate environment for a bit longer period of time. And so as we move forward, we'll have additional opportunities within capital markets as we move solidly into '24.

Unknown Analyst

And then sticking with fee income, debit interchange revenue going to come down again potentially. I think you quantified the amount 300 and something in the investor deck. What are your thoughts there?

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David Jackson Turner
Senior EVP & CFO

Well, we don't think there will be a change. That's my thought. I don't think they asked from a vote. But -- so we wanted to put it out there because we're a heavy debit card issuer. The Durbin Amendment hurt us disproportionately. We don't and did not -- have not seen benefits to consumers as a result of it. It's helped the merchants, the big box stores, in particular. And so we're disappointed, but the law was written, it is what it is, and it said it should be revisited and cost changed accordingly to the -- I mean, the rate changed according to the costs. And our costs come down relative to negotiating with Visa or Mastercard. We're a Visa shop.

And so there's an expectation that the rate is going to come down. Again, I don't like the rule at all, but we're going to have to comply. We don't know exactly what it's going to be. So we wanted to give you the numbers, $310 million, and you can apply whatever percentage you want. It could be 10%, it could be 20%, it could be up to 30%. So that's $100 million on a bad day, and we're going to have to adapt to overcome, just like we did when Durbin Amendment went in. So unfortunately, it is what it is. Anybody has any power to change that, I'll be welcome to help us out.

Unknown Analyst

One more question, then I'll open it up. The elevated level of expenses related to check fraud. What are you doing to resolve that? Do you think those elevated expenses persist? And will there be any impact from a regulatory perspective because of the check fraud issues?

David Jackson Turner
Senior EVP & CFO

Yes. So the end part, I don't think there's regulatory impact. I mean, we live with our regulators every day. They know exactly where we are. We tried to -- we tweak something to try to become more customer friendly in terms of the period of time that we hold a deposit because if you hold deposits too long, you start getting complaints. So there's a fine line. We opened the door too wide, bad people came rushing in, and we didn't close the door timely enough. That's on us. We thought we had it in the second quarter.

The third quarter resulted in a different type of fraud. It's called breach of warranty claim, where you don't know that the item is bad for us, about an average of 55 days. All this happened in a fairly short period of time, but we just didn't know about it. And now we put in some new technology. It wasn't overly expensive to do. We have more teams looking at it. So our costs relative to getting all that fix is not a big deal.

We think we have it dealt with. We had $53 million more than normal -- every bank has fraud every day, okay? We had $53 million more than we should have had in this third quarter, and 83% more in the second quarter. So it's $136 million of fraud this year thus far. It's -- as I say that, I want to just shoot myself, it's disappointing. We think our fraud number gets closer to normal. And we've said $25 million next quarter. Now that's higher than it's really supposed to be. We gave ourselves cushion. So we wouldn't get beat up again. And hopefully, we get that better. Even before this call, I'm calling our guys, you see anything, you see anything because I'm going to get the question. And so far, we're okay. We're okay, watching it very, very closely.

Unknown Analyst

I'll open that up to any questions in the audience.

Unknown Analyst

I've got a couple of questions. Just a quick follow-up on the check fraud. Is that an industry phenomenon? And what's driving the change, do you think? And then the second question is, I think you have $1 billion of credit card and maybe $6 billion of other consumer. Can you help me understand what's in the other consumer. I think on the deposit side, you have this great kind of deposit base of very kind of granular small deposit. So on the consumer side, what's the sort of average FICO score? What's the kind of typical kind of consumer that you're exposed to? And what's happening to those consumers?

David Jackson Turner
Senior EVP & CFO

Yes, about 5 things there. So go back to the first. What was your very first point?

Unknown Analyst

[indiscernible] check fraud. Is it an industry...

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David Jackson Turner
Senior EVP & CFO

Yes. All right. So yes, check fraud. It's -- so there -- these are very sophisticated people, crime rings that are doing this. And yes, it's an industry problem. I saw a statistic the other day that this year, fraud -- total fraud in the industry is about $24 billion this year. That's a big number. Everybody's had the problem, not to the level we have. And again, ours was driven by our change on opening the door on hold limits and the bad guys took advantage of it. What happens is they get on the dark web and they start talking to each other, and then they just overwhelm the system.

We now have better technology and awareness, and I think we'll be under better control. And I think what happens is the bad guys go and they find somebody else. So our industry is very poor at sharing when this has happened. As a matter of fact, when we issued our 8-K for the second quarter, we knew expenses were going to be up. We told everybody in advance. I got a call from 3 of my peers, it's the same thing.

So it is hitting everybody. It's just not hitting them enough where they need to have the kind of public disclosure readout because nobody wants to talk about, "hey, we've had fraud" because that invites all the bad people to come see you again. So unfortunately, it's big enough and we have to talk about it. So then you -- what other questions did you go on to?

Unknown Analyst

So it's about the consumer. What's in the consumer...

David Jackson Turner
Senior EVP & CFO

Consumer, yes. So well, let's talk about cards. You had asked about credit card. So you have to have a deposit account with us to have a credit card. Those are our customers. As a result, we haven't seen the growth in credit card balances. Some people have talked about that, that we've had issues with people having to make their payments using their credit card, and the credit card balances are growing. That's not happening for us. So we like that product, maybe my favorite product because it has a good rate. Charge-offs are below 4%, which is kind of what was in the original model. So we have really good spread and get interchange on top of that.

The other consumer is largely driven by our acquisition of EnerBank. So it's a point-of-sale lender that we acquired in '21. Is that right? '21? And we're very happy with the performance there. Loss rates are a little less than 2%. I think our yields 8-ish, something like that. And now we did have with one program, a component of a solar program that we had some -- unfortunately, this is a deferred interest or deferred payment program. What you're trying to do is give -- when you sell solar, there's a tax credit that comes with that. So the tax credit takes time to get because you have to file tax return and then you get the credit.

So the idea was you would match up that, receive that cash with a payment that's due now on your loan. And unfortunately, we've had some installer issues. We've had people that are just defaulting. And so we think that maybe we get some recoveries, we'll have to see. It's unsecured. We do have [UCC], but it's unsecured, but their solar panels attached to somebody's house. And we think when they sell the house, we'll get paid back. But we felt need to make a bigger reserve, so we provided for that in this last quarter. And you'll see those charge-offs coming through this next quarter, first quarter and the second quarter. So about 3/4 of this.

It's not hugely all that large, but it is different than what we had thought. It's a program that we inherited. We did not -- this is not our normal risk management process of having this type of program, but we inherited it when we bought Enerbank. We let it run for about a year, and we assessed it, didn't like the program, and we cut it off in '22, and we're seeing, unfortunately, the [shake down] from it here this year. So we have that done.

The rest of the portfolio is -- we feel good about its financing, HVACs and window, installs and roof on your house. So it's to homeowners. And those homeowners have a tendency to pay you back. And FICO scores on that -- what's our FICO scores guys? 780 on that portfolio as an average. So like I said, we feel pretty good about it. Did you -- you had another follow-up you start -- you asked. Did I get it?

Unknown Analyst

[indiscernible]

David Jackson Turner
Senior EVP & CFO

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For consumer? Yes. I think if you take that solar piece out, we feel pretty good about consumer. It is -- as our losses go, it's a bigger contributor to our losses. So it's about 70 basis points of loss business services underneath that. I think our total is 40 basis points. We said we would, all in, that we would be slightly higher than 35 for the year, which would imply about 40 basis points, maybe 1 point underneath that for the fourth quarter. The credit quality is still pretty good. We don't see any runaway issues on either the business side or the consumer side. There's pockets, there's a credit here or there that you got to deal with, but there's nothing systemic yet. And it's because the home -- the consumer and businesses are pretty strong, their balance sheets are still there.

We have to watch it into '24, but I suspect that our 35 to 45 basis points of charge-offs will hold through '24.

Unknown Analyst

I need to shift the discussion into something more uplifting. But Ken, why don't you go? We can do that next if Ken doesn't bring it up.

Unknown Analyst

David and Ronnie. David, on the recent call, you had talked about, obviously, this a little bit of the catch up on the beta side, which is well in, I think, well anticipated. And I just wanted to ask like that granularity that Julian referenced in the deposit base, how do you get a comfort zone that we're only going to be moving up gradually from here, you said 36 to kind of 40, if there maybe we go into the low 40s. But like every point really matters from here. And so as you look through, especially on the consumer side to watch for that last step-ups, how do you get that like real, real, real comfort that we're not going up another x above that?

David Jackson Turner
Senior EVP & CFO

Yes. So we probably worked ourselves into being so precise on the data, but it is what it is. We chose that, and we're going to live with it. So we're now talking about maybe mid-40s. I think our peers through last quarter were already at 44. And historically, we've been 5 or 6 percentage points better. We think that number is wider than that, and it's because the power of noninterest-bearing accounts is in a rising rate environment is really important. So trying to hold on to that. What I said was 35.7% noninterest-bearing, and it's critically important to us.

That is the driver -- and when I say noninterest-bearing, I'm now going deeper into consumer because it's a consumer change, Ken, to your point, that's driving the beta, it's not the business side. So we saw more switching coming out of noninterest-bearing into interest-bearing accounts. We went back account by account, prepandemic and studied the percentage of cash sitting in the consumers' account relative to their spend. And that number was about 1.8x to 2x.

And so we've now given you guidance that we think the change in noninterest-bearing to interest-bearing will be about $3 billion to $5 billion more between now and probably the middle of next year. It's driven by that math. So we can be wrong. It could be more than that, but it'd be because the consumer in mass has changed how much cash they're holding in their account. When we talk about this movement too, we're talking about people that have more -- generally more cash in their account, $75,000. Not the average consumer that has $5,100. Those folks this doesn't apply to because that $5,100 is a direct deposit and they spend the money. Direct deposit, and they spend the money.

It's the folks that keep a lot more cash. They do it for comfort. I've talked to them directly, why you why do you leave $75,000. And it's just because, I want to, and -- but they've also recognized that I can get 5%. And so why don't I take a piece of that and put it there. And I think we're going to see a bit more of that. We've given you also some beta sensitivity. I think 5 percentage points is about $40 million a year. So we're at 45 right now through the cycle. Let's see what the Fed does and see what happens. We were surprised that everybody was surprised because that beta change was telegraphed. If we were going to be higher for longer, we're going to be in the low 40s. That's up now to about the mid-40s.

Was that uplifting?

Unknown Analyst

Other questions?

Unknown Analyst

[indiscernible] give us a little bit more color in coming presentations on how you're thinking about it. But I guess, as you look into next year, how are you thinking, is it possible to see positive operating leverage in 2024 on a total basis, and maybe excluding that, can you get positive...

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David Jackson Turner
Senior EVP & CFO

Let's exclude the fraud and all the -- let's get to the normal stuff. I think having positive operating leverage was going to be virtually impossible to get. I just -- I know you've asked everybody that, and I heard a few of them. When you look at revenue, you don't have a tailwind like we did in '23 leverage. The risk is you let our expense control expenses. So we're -- but our company -- and we would love to keep it flat. We're not -- I think you'll be pleased when we're finished and it had -- a lot of things that we do today are nice to have. We're down to the [indiscernible], right? When you have a revenue challenge, like our industry is going to have next year, you're going to have to just not do some things.

Unknown Analyst

David, you said on the call, you're comfortable with your capital ratios in a strong position. You also mentioned share repurchase activity might pick up maybe after the blackout period. Could you expand on repurchase as well as just high-level capital management?

David Jackson Turner
Senior EVP & CFO

Yes. So we -- once we do our stress testing, it says we need to have 9.2% to 9.25%, 9.75% of common equity Tier 1. We settled for 9.5% just to meet in the middle. Then we had all this uncertainty with the economy. We've had all this uncertainty with Basel III end game. So we said, let's get closer to 10%. Then we said, maybe a little higher than that. We got to 10.3%. Well, now we know what Basel III end game looks like in draft form.

We don't particularly like everything that's in there. We think there's some stuff that makes -- that needs to be modified. And hopefully, we get some modification. We don't think it gets worse from here. If it changes, it gets better. And so we can now have some confidence that our 10% number is a reasonable number. That's probably still more than we need to have, but we also have to consider not just investors, but rating agencies and regulators and a whole host of people, got competition, you can't be too far away from your peer group.

So that gave us confidence that we could start with buybacks. We generate 25, 30 basis points of capital and just as everybody knows, every 10 basis points is about $100 million. So at 10.3%, we got $300 million of "excess capital." We're going to generate another $200 million, $300 million, so that's, call it, $500 million to $600 million of capital that we can buy back.

There are some people that would love for us to just leave it in there because of all the credit uncertainty. We have enough confidence to know where are going to be, which is why we started to buy our stock back.

As disappointed as we are and where our stock was after the earnings call and even where it is today, we don't use price as the mechanism to tell us when to go buy the stock back because the theory is if you optimize -- until you optimize your capital, you're not at efficient pricing. There could be some anomalies from day to day, but that's generally what happens. So we've been buying it back. And we're going to work ourselves closer to that 10% going forward.

Unknown Analyst

And Ronnie, you briefly mentioned office. You're comfortable with the portfolio and the loss content, maybe expand there as well as other buckets within CRE or watching multifamilies come up a bit over the last two days.

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes. I don't think I would describe it as comfortable with office because office has had such a dramatic cultural change over the past several year. But when you size our office exposure, we're at $1.6 billion of exposure in office that represents a little bit less than 2% of our total lending portfolio, and we have about 50% of that maturing this next year and certainly have been in contact with all of our clients throughout that period of time, just to size some of the numbers, the debt service coverage in our entire office portfolio on the average, and averages are always dangerous. But about [165] we have offices that are really performing well.

As you move down the spectrum, those that we have in the criticized classified area are averaging about 125. We have 1 identified NPL at the end of the third quarter. And so our teams have been really focused in on office. And with the sponsors, we're seeing most lean into the investment that they have made. Another geographic piece that probably makes us a bit unique in the space is that the majority of our exposure is in the Sunbelt and not in the urban markets.

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And so when you think about the demand, the Dallas-Fort Worth Metroplex is where we have our largest exposure and the majority of that exposure sits outside of the core central business district, and we continue to see really strong demand and in migration and new offices being constructed by some major firms within that particular market.

So I wouldn't say comfortable. It is front and center for us. It's receiving a lot of attention on a daily basis. And as we get closer and closer to the maturities, we'll lean into that. One other statistic I'll leave with you. We underwrote that originally at something a bit less than a 65% loan-to-value. We've put it through the stress model, working with the third-party GreenStreet, just to say, give us kind of the worst case. The average of that loan to value comes back in the 90% range at that point. And so we'll reappraise as we get closer to the maturities. But overall, we think it's a manageable number for us, and we're getting cooperation from the majority of our sponsors.

Unknown Analyst

30 seconds. So one last one. Can you do it?

Unknown Analyst

Yes. Just probably quickly on multifamily lending. I mean, it's generally a much more stable bit of CRE, but we've seen a little bit of weakness, and there's been a bit of overbuilding in your footprint. So any thoughts on that?

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Well, sure. We have $3.8 billion of multifamily that's outstanding, $300 million of that number rest within our REIT portfolio. So very high quality, and there are multiple properties that are represented in that $300 million, so call it $3.5 billion that we have outstanding and if you looked at the states that lead the areas, it's Texas and it's Florida for us. And when you get -- take one more deeper dive in the multifamily, you'll find the exposures in Houston and Dallas outweighing the rest of the Texas markets. And then when you move into Florida, Tampa and then South Florida represent the majority of that exposure.

Weakness, I might push back a little bit in our footprint on that particular statement. I would say that weakness if defined by returning to some of the practices that were prepandemic giving incentives for a few months to attract tenants in. We see that in a few of the markets, but not across the board. So I think it's all in the eye of the beholder, but we -- it feels like those that maybe we think are weaker today or just not performing at the same feverish pitch that they did at the top of the pandemic.

The dilemma about multifamily is simply this. Single-family homebuilders are not being very aggressive today. There's not a lot of inventory of existing homes on the market because people are staying in their homes with low interest rates. Multifamily is the solution, and when you have markets where you have in migration, like we do, it continues to support very strong metrics around our multifamily space. So we've got an eye on it, but so far, so good within the multifamily space today. Loan-to-value average in that portfolio gets into the mid-50 range for us. So it's been a core competency for our team for quite some time.

Unknown Analyst
With that, thanks. Please join me in thanking David and Ronnie.

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