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Texas Capital Bancshares Inc.

Q1 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes - *President, Chief Executive Officer*

Julie Anderson - *Chief Financial Officer*

Jamie Britton - *Director of Investor Relations and Corporate Finance*

PRESENTATION

Operator
Welcome to the T*exas Capital Bancshares Q1 2021* Earnings Conference Call. All participants will be in a listen-only mode during the presentation. Please note this event is being recorded. If you need assistance, please signal a conference specialist by pressing the "*" key followed by "0."

I would now like to turn the call over to Jamie Britton, Director of Investor Relations and Corporate Finance. Please go ahead.

Jamie Britton
Thank you. Good afternoon and thank you for joining us for TCBI's first quarter 2021 earnings conference call. I'm Jamie Britton, Director of Investor Relations. Before we begin, please be aware this call will include forward-looking statements that are based on our current expectations of future results or events.

Forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from these statements. Our forward-looking statements are as of the date of this call and we do not assume any obligation to update or revise them. Statements made on this call should be considered together with cautionary statements and other information contained in today's earnings release, our most recent annual report on Form 10-K, and subsequent filings with the SEC. We will refer to slides during today's presentation, which can be found along with the press release in the Investor Relations' section of our website at texascapitalbank.com.

Our speakers for the call today are Rob Holmes, President and CEO and Julie Anderson, CFO. At the conclusion of our prepared remarks, our operator will facilitate a Q&A session.

And now, I will turn the call over to Rob for opening remarks. Rob…

Rob Holmes
Good afternoon, everyone. This is Rob Holmes. And I'm excited to be hosting our first quarter conference call as Texas Capital Bank's new President and CEO. Here with me, as Jamie said, is Julie Anderson, our CFO. As many of you know, I left a wonderful position running a global business at one of the best financial services firms in the world to join the team here. I believe this is evidence of the Board's true commitment to invest and build a best-in-class regional bank through a disciplined organic strategy.

With that backdrop, I would like to take a couple of minutes to speak more broadly about why I came here, what I discovered, and where we have been focused during the quarter. The why is quite simple. First, I was born and raised in Texas. I went to both college and graduate school in the state. And while I've been primarily focused outside of Texas for the last 20 plus years, I am intimately familiar with its great communities, institutions, companies, and people. There is no region with a more constructive business climate. And because of these pro-business policies

and attitude, Texas has one the largest and most diverse economies in the world with a GDP of $1.9 trillion, which puts our footprint as one of the top economies worldwide.

Companies with strongholds here are committing to even greater investments in the state and, more importantly, many others continue to enter the market with over 25 significant corporate relocations announced last year and over 15 announced so far this year. More people are moving to Texas today than any other state in the nation.

Being responsible for a complex global business focused on wholesale clients offers a unique perspective on what allows businesses to thrive. Coupling that with insights I've gained through my deep relationships with business leaders across all industries in Texas and civic leaders at both the local and state level, I have no doubt about the opportunities available in Texas today, which are extraordinary.

We have a super unique opportunity to build the flagship base in this state for businesses, institutions, and the people who run them. Doing so will enable us to engage, support, and strengthen the communities we serve in a more profound manner. We acknowledge, there have been missteps in our recent past.

The brand is indeed bruised, but the brand's promise is still very strong. I know it resonates because prior to accepting this role, I personally called many of the CEOs, business owners, and other stakeholders in the Texas ecosystem. They confirmed there's a strong mandate for Texas Capital if we can deliver on our promise. I am committed to do so.

Since I've joined, I have spoken to our bankers, prospective bankers, and talent across the enterprise. They too see the opportunity and each is excited and committed to moving forward as we build a better Texas Capital Bank. I can assure you I did not leave my last role to lead an average bank. I left for the opportunity to build something special in a place that I care about, with a team I believe in. I saw through the Texas Capital Bank before making the decision to move, and after a very busy and productive 12 weeks, both operations and our new management team are even more steadfast in our resolve to deliver.

Now let's talk about the things I've discovered since my arrival. The de-risking that the Texas Capital Bank team did for the better part of 18 months prior to my arrival deserves praise. The benefits are tangible today and position us well for the future. I know firsthand the focus of diligence it takes to operate with world-class risk management. The deliberate actions to remediate select outsized concentrations were quick, decisive, and most importantly, effective. I'm grateful for their efforts.

There is plenty of talent in Texas Capital that we are proud of. But we also have areas that we will supplement to achieve our goals and reach the position in the market we desire. That is the recognition by all of us and we have aggressively begun that journey. As I mentioned, the best bankers in the market believe in our brand and are attracted by the opportunity. And, after bringing them over, delivering on our objectives will allow us to retain them. By now, you understand my excitement about our business here in Texas. We are fortunate to have several

extremely strong national businesses as well. They are of great importance to the bank and every one of them competes very well in the markets they serve.

I would like to take a moment to touch on one of our best. I've heard from some that our mortgage warehouse business is "outsized". I was responsible for one of the largest and best mortgage warehouses in the country at my previous firm. Trust me, when I say I know what good looks like. Our people, technology, and clients across all of our mortgage finance at Texas Capital are as good or better than any competitor. You will never hear me apologize for the size or success for our mortgage finance business.

What you should criticize us about are the earnings of the rest of the bank. We are intently focused on expanding other core businesses, have already taken steps to do so. I was also pleased to discover the financial leadership teams here are well into the process of diligence in different options for managing to a better capitalized balance sheet. Some of those efforts came to fruition this quarter.

First, the issuance of $300 million in perpetual preferred shares, the largest capital raise in the history of our firm. And then, as the first regional bank to close a credit risk transfer, which transferred first loss risk in our mortgage warehouse portfolio to investors while creating a new source of funding and bringing regulatory capital treatment in line with the assets true risk profile.

Lastly, we have various functions in the bank acting with urgency, coordination, and with great discipline. However, the bank as a whole was not organized properly. Ordinary cases and routines were not practiced. Expectations were not clearly communicated and commitments to long-term strategies were not regularly adhered to. Based on these discoveries, the newly constructed leadership team and I decided to acutely focus on several fronts this quarter starting with our people. The people here have been incredibly resilient and resolute in their efforts and each one of them should be commended.

I'm the first non-founder CEO, the third CEO in a short period of time. We terminated a merger. We experienced very large losses in our loan portfolio. And like everyone else, we worked through a very difficult time both personally and professionally as COVID-19 ruined lives and put others on hold. So, in a sense, we're trying to save the best of our past and start anew. To guide this effort, I thought it critical to establish an operating committee comprised of leadership across the firm. The new operating committee's values and expectations have been established. The new level of intensity is contagious.

We are creating scale by breaking down silos, which were a tenet of past management. We are attracting some of the best talent in the market for any size financial institution, not just a regional bank. I'm sure you're aware that Nancy McDonnell and Tim Storms were my first hires. They know what to expect of me and have helped me in so many ways. But maybe most importantly, they have helped me to retain and attract talent.

Shannon Jurecka, our new CHRO, is a super important new addition. People and talent are a cornerstone going forward. I am highly discerning when it comes to the type of people we want

to attract to our platform. So far, I've been very bullish. We are looking at all of our expenses with the goal to reallocate in the areas which we need to invest. We have identified many imperatives and, as you know, each will take an investment. We have begun the process to re-underwrite every dollar of the expense base and self fund as much as possible.

We began broad efforts to continue to remediate the balance sheet, reallocate capital, and position us for growth, supported by conservative capital position, resulting with consistent quality earnings. To that end, as announced today, we decided to both monetize our MSR portfolio and wind down the correspondent lending business. While the business was upscale, profitable, and well run, it is not core to our strategy at this time.

We are excited for the employees and our clients in this channel as PHH carries this business forward, building on the foundation of success created over the past five years. We will safeguard our capital and have already implemented a new balance sheet committee. Going forward, loans will be an outcome of our relationships, not a goal. We want the bank's best-in-class management teams in our market's most important industries through the corporate lifecycle.

Our balance sheet committee ensures we're using our capital wisely to support our clients. It is not a credit approval, but the approval of the use of capital. It will ensure that we are highly disciplined in client selection, committing the appropriate amount of capital for the right opportunities. We commenced a new routine in the form of quarterly business reviews, which are deep dived into every facet of each of our businesses. Less than 100 days in the seat, we have now done this twice. Our entire operating committee in a room for days, grinding through the details of how we can build better businesses to support our clients. The findings of these reviews, coupled with our other newly established routines and cadences, will culminate our ability to share with you how we intend to further reallocate capital and resources against businesses, products, and services as part of our broader go-forward strategy.

I appreciate your time listening to these macro thoughts and areas of focus in advance of our third quarter strategic planning call. I hope you'll find this helpful, and I commit to be very candid and accessible as we move forward together.

With that, I'd like to now give it to our CFO, Julie Anderson, to comment on a solid first quarter.

Julie Anderson
Thanks, Rob. My comments will cover Slides 5 through 11. We're pleased with the solid financial performance in the first quarter and, more importantly, the actions taken during the quarter to strengthen our balance sheet and position us for the future. With respect to our operating results, total revenue for the first quarter was $239 million and, as expected, was down from the fourth quarter as a result of seasonality in the mortgage finance business but consistent with the first quarter of 2020.

Our non-interest expense was down meaningfully from the first quarter last year and flat on a linked quarter basis. We had a very modest release in reserve resulting in a small negative provision as economic conditions continue to improve. While confident in the quality of the

portfolio, we continue to be cautious and conservative in our evaluation. A few noteworthy items for the quarter I want to highlight.

Loan fees were down from the fourth quarter and we've included additional detail, which should be helpful in understanding the slight fluctuations that can be evidenced in core loan yields as a result. We continue to have PPP fees yet to be earned and expect a similar level in fees to be earned next quarter.

We participated in the second round of PPP, which net of forgiven loans, resulted in an additional $110 million in balances. As Rob mentioned, we're selling the MSR portfolio and winding down the correspondent lending business. This aligns with our strategic focus on more predictable earnings, while allowing for a reallocation of a substantial portion of the expense base into front-line talent and improved capabilities to support the C&I business. It's important to understand that there will be a lag in the revenue from these investments.

Overall credit trends continue to improve. Net charge-offs were down materially to only $6.4 million and non-accruals continue to decrease from levels experienced last year. Despite the improving economic outlook and underlying credit fundamentals, we remain disciplined and conservative with the substantial reserve built over the last 18 months. Our allowance for credit losses on loans, excluding mortgage finance loans, is 1.57%, up from 1.18% at the end of the fourth quarter 2019 and currently represents 2.5 times non-accrual loans. We did experience a slight increase in total criticized loans related to CRE and specifically hospitality exposures, which are appropriately reserved for and we feel comfortable with underlying structures, including the LTVs and the overall borrower support. Importantly, there was a slowing and negative migration from the watch category to special mention.

Our average LHI, excluding mortgage finance, was down on a linked quarter basis, but ending loans increased modestly as a result of the second round of PPP activity. Core loan yields normalized during the quarter, down from a higher fee level in the fourth quarter. It's noteworthy that our loan spreads have remained stable and even improved a bit since last year at this time as a result of continued funding cost improvement and continued growth in non-interest-bearing deposits.

We experienced another quarter of meaningful average deposit growth. We expect continued reduction in funding cost as higher cost CDs are still running off in the second quarter and we are more aggressively managing down higher cost index portfolio balances. Ultimately, longer-term value will be driven by our focus on treasury, which is evident in one of Rob's day one hire, Nancy McDonnell, who ran global treasury at a much larger institution. She is working closely with the front-line banking heads, aggressively recruiting treasury sales talent and already focusing on initiatives to enhance the treasury platform.

Net interest income was down as expected with the seasonally weaker first quarter and a normalization in loan fees after the outsized level experienced in the fourth quarter. And NIM continue to be pressured by higher liquidity. With the new CEO arriving less than 100 days ago, we paused for a bit on efforts to reposition excess cash and instead executed on capital action

needed to appropriately position the balance sheet for the future. As we finalize the strategic plan that Rob will discuss in the third quarter, you can expect us to be more acutely focused on liquidity management, which will include not only resuming the redeployment of some excess liquidity in securities, but also more aggressively managing down certain higher cost deposit category.

One final note on net interest margin. It's important to note the drop in NIM, net of the liquidity build since the fourth quarter of 2019, has been only 23 basis points compared to the over 150 basis points drop seen in fed funds. Warehouse yields continued to decline slightly linked quarter but have been extremely resilient. We would expect some continued migration in those yields in 2021. Core LHI yields, net of fee fluctuations have been fairly stable for the past four quarters, with spreads coming down only a few basis points each quarter.

First quarter non-interest income level was consistent with expectations for seasonally lower mortgage finance volume. A focus on optimizing treasury pricing and relationships benefited our deposit service charge income, and we saw our third quarter in a row of increasing wealth management and trust fee income.

Total non-interest expense for the quarter was slightly down from fourth quarter levels as reset of benefit-related expenses and incentive accruals was more than offset by reductions in servicing expense as higher long-term rates led to slower prepayment speeds and a reduction in amortization expense and a reversal of MSR impairment.

We've been transparent with the fact that hiring bankers is the priority and support of those front-line bankers who are also actively recruiting additional treasury sales and credit professional. As previously mentioned, we'll give more detail on our long-term strategy in the third quarter, which will include quantifying those investments. But it's important to understand, as Rob pointed out, that we're re-underwriting every dollar of expense and reprioritizing all initiatives and businesses, both ensuring that our investment dollars are aligned with our strategic priorities and minimizing net new spends. Rob...

Rob Holmes
Thank you, Julie. So why don't we open it for questions, Sarah, please?

QUESTIONS AND ANSWER

Operator
Thank you. To ask a question, press "*", then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, press "*", then "2." At this time, we will pause momentarily to assemble our roster.

Our first question comes from Brady Gailey with KBW. Please go ahead.

Brady Gailey
Hi. Thank you. Good afternoon, guys.

Rob Holmes
Hi, Brady.

Brady Gailey
Yes. I thought we could just start with the MSR sale. I know that unit was profitable for you all last year and looks like it was profitable in the first quarter. Julie, could you just help us understand some of the dynamics that will go away now? I think there's a couple of fee income components that goes away as well as some expense components.

Rob Holmes
Hi, Brady. Can I start with just kind of why we did it? And then, maybe Julie can help with that, if that's OK?

Brady Gailey
That'd be great.

Rob Holmes
Yes. Number one, it attracts 2.5 times of capital as a regular loan for us. We don't have a broad consumer platform to fully lever the MSR assets. And then, lastly, it could contribute to great volatility of earnings over time. So, in an effort to like to simplify the balance sheet and make it safer and earnings more consistent and help our capital position for all those reasons, I think it's a good business. We actually got it to scale, but it's not a good business for this time in the lifecycle of Texas Capital. It was a great business. So, that's why we did it. I think that will help you understand.

And then, Julie, why don't you answer the question?

Julie Anderson
Sure. Brady, that's why we provided a little extra detail in the slide deck this time, Slide 6. There is a break-out of all the different components of correspondent lending. A couple of them, you've always been able to see on the face of the financials, the net interest income component. And then there's a couple of components in non-interest income. And so, I think you've been able to see that. What you haven't had in the past is the expense component, which we've gone ahead and given you. And as I've said in my comments, we would expect to reallocate those expenses to some of the other investments that we're focused on right now.

Brady Gailey
Okay. Alright, great. And then, I also wanted to ask about loan growth. I know loans were kind of flat linked quarter, which is honestly pretty good relative to the rest of the industry. But I just want to ask, as far as loan demand, do you see it picking up at this point? A lot of people are talking about the back half of the year where we could see some nice loan growth. And then, maybe outside of like the near-term loan growth, maybe just Rob, when you think about the company, what do you think is the potential that Texas Capital could do longer-term from a loan growth point of view, considering you're in such attractive markets?

Rob Holmes
Do you want me to take…do you want to do the financials…allow me to answer the first and then if Julie has anything to clean up, she can? I think, Brady, we spoke to you on an investor call early on. You may have heard me say that loan growth will be an output of our clients' needs. We will not target loan growth. I actually think that that may have been part of the calculus that got us where we were last year. So, that's not to say that we don't aspire to have loan growth that we will…the KPI, if you will, for loan growth would be, do more with the clients that we have and also add clients to our platform. We have a very low market share of clients in Texas. And as you said and I've said many times, we couldn't find ourselves in a more constructive market. So, we'll have loan growth, but it will be an outcome of banking these clients through the corporate lifecycle.

Brady Gailey
All right. And then, finally from me, just…I know, Julie had mentioned that expenses year-over-year would be roughly flat. But at the same time, I know, Rob, you're adding a bunch of great talent. So, I just wanted an update on how you're thinking about the expense base from here?

Julie Anderson
Yes. So, Brady, I think that we'll give you more detail on that when we roll out the more comprehensive plan in the third quarter. I think what I will say is, just reiterate comments that both Rob and I made that we're re-underwriting all spend, all initiatives. And again, with the wind down of correspondent lending, we'll certainly be focused on how some of those expenses can be reallocated, so really more to come in more granular detail in the third quarter.

Rob Holmes
And Brady, I would just emphasize, the spend re-underwrite is kind of both soft and hard dollar spend, meaning running the play spend and also investing. So, it's both types.

Brady Gailey
Okay, great. Thanks for the color, guys.

Julie Anderson
Sure.

Operator
Our next question comes from Brett Rabatin with Hovde Group. Please go ahead.

Brett Rabatin
Hi. Good afternoon, everyone.

Julie Anderson
Hi, Brett.

Brett Rabatin
Good afternoon. Wanted just…Julie, a question for you, off the bat here like yourselves, like many others continue to build a mountain of cash. And it's obviously not a super attractive time to deploy a ton of the liquidity into securities that might be under water at some point. Can you just talk about the balances as you see it with deploying some of the liquidity and how you think the next few quarters might play out from that perspective? And what you might do with the balance sheet to try and mitigate the excess liquidity?

Julie Anderson
Sure, Brett. Happy to answer that. So, I think that we took a…with Rob joining us less than 100 days ago, we took a little bit of a pause on redeploying any of the excess cash. And at the same time, we had some additional growth in deposits. So, at the end of the first quarter, I will tell you that I think our cash balances were too high. I think you will see us; we're still working on the final plan for how the allocation of different asset classes are going to be on the balance sheet. But one thing that you will see us start to do a little more aggressively, we will pick up, we will again start to redeploy some into securities. As you said, I don't think we're not going to go crazy on that, but I think you'll see a little bit of additional redeployment into securities. And then...but you're also on the liability side, you are going to be more aggressively managing some of those higher cost, higher beta deposits. So, you'll see...I think you'll see a little bit more aggressive action on that in the second quarter.

And then, again, when we roll out the more holistic plan in the third quarter, I think that will help inform what we think liquidity levels are going to look like for the longer-term.

Brett Rabatin
Okay. And then, as it relates to that, Julie, would it be fair to say that you think that the margin this quarter is kind of just a one quarter blip here just from this combination of excess liquidity or how do you think about the margin from here, then obviously there's a lot of dynamics that go on that, but maybe just any thoughts around the margin?

Julie Anderson
Sure. You know what, I tried to stay away from just focusing on the margin. We focus on the different pieces of it. But again, the excess liquidity obviously continues to be a drag. So, to the extent we're able to reduce that some, that will improve the margin. There were some outsized loan fees in the fourth quarter but I think, first quarter was back to a more normal run rate. Again...and then, on the remixing on the liability side, the deposit side, that's going to continue to improve the margin.

Brett Rabatin
Okay. And then, I just have one last quick one around the increase in criticized loans that you mentioned were mostly around commercial real estate hospitality. It seems like that's a bit of an outlier for the industry. I think most folks had that movement last year as opposed to this quarter. And a lot of folks are talking about improved ADRs with hospitality. Was there a reason that these hadn't been moved previously? Can you give us any quick thoughts around why now that increase in criticized loans and hospitality?

Julie Anderson
Yes. So, I think that we've been actually pretty aggressive at downgrading for the past year. And so, the movement that we saw in the first quarter was some that were in the watch category that had already previously had been identified. So, that entire book, I think we've been pretty transparent about that, the CRE book, the hospitality fees, which is not that large of a piece. It's about...I think about $400 million overall. A meaningful percentage of that is somewhere in criticized. And this was just part of the category that moved from watch to special mention. So, we don't...we think it was what we would have expected.

Brett Rabatin
Okay. Great. Fair enough. Thanks for all the color.

Operator
Our next question comes from Jennifer Demba with Truist Securities. Please go ahead.

Jennifer Demba
Thank you. Good afternoon. A question, Rob, you said you're going to disclose more details on the strategy in the third quarter. Will that be part of the earnings call or would it be a separate event?

Rob Holmes
It will be a separate event. It will be between the second and third quarter earnings call that we dedicated solely to the strategy. I think it's too important of a reset in a call, GAAP earnings mixed in and hopefully all appreciate that focus.

Jennifer Demba
Definitely. Rob, you mentioned earlier in your monologue that the company would have an organic focus. Would acquisitions ever become part of the strategy in your mind? We know there are a lot of discussions going on the industry today.

Rob Holmes
Yes, there is. There's a lot of activity. And I'm certainly not surprised by it. There's a lot of industrial logic. But what we see, and what I mentioned in my opening remarks about...I feel like the Board, and we and I are committed to our organic strategy. There is so much more that this bank can do that we haven't done yet, product, services, markets, clients, and we don't need anybody's permission. And the organic strategy is a much lesser beta than an acquisition. So while I am wide open to ideas and thoughts and opportunities to strategic alternatives other than organic, given...especially given my background doing that for a living. I do think that the right course of action right now is just to focus on the organic go-forward path.

Jennifer Demba
Thank you.

Rob Holmes
Thank you.

Operator
Our next question comes from Ebrahim Poonawala with Bank of America. Please go ahead.

Ebrahim Poonawala
Good afternoon. I guess, Julie, just to follow-up. Appreciate not wanting to give any margin outlook, given the moving pieces. But given the impact we saw on loan fees, the PPP fees, if you could give some color just in terms of where you see NII headed relative to the first quarter levels?

Julie Anderson
So again, Ebrahim, I would just…you know, I would just take you back to the different pieces. I think, mortgage finance is seasonally lower in the first quarter. Again, we're not going to give any overall guidance on volumes but seasonally a little bit lower in the first quarter. I think there are levers there that we have to make sure that that business remains strong. I think that yields have held up really well. We could see a little bit of compression in it, but we think it's held up well.

On the core book, again, we've given a little more detail so that you can kind of parse out the different components in loan fees. I think growth in loan, I think Rob's already kind of addressed that. It will be when it…it will be when it is, and we're not sure exactly what that looks like over the next couple of quarters. And then, on deposits, I think we expect that deposit costs will continue to come down. One, we still got some brokered…higher cost brokered CDs that are rolling off, which will give us some pick up. And then, again, we're going to be a little bit more aggressive on managing some of the higher cost, higher beta deposit categories.

Ebrahim Poonawala
Got it. And, I guess, separately a question of Rob. Thanks for your prepared remarks. I think you mentioned that the brand is bruised. And I think that's not missed on anyone who has followed the bank for the last seven years. I guess, I appreciate you taking your time in terms of giving a strategic update on the bank. But what would be the message to a shareholder who's stuck with the company for the last several years in terms of as we think about when we start seeing the fruits of your strategic plan, is that by the end of this year? Is that by the first half of next year? Anything that you can at least provide qualitatively that could sort of allow someone to hang in there?

Rob Holmes
Yes. I mean, I would just say that there is an entirely different team running this bank today than this one at the past seven years, a different philosophy, a different strategy with different backgrounds. I ran a business that was multiple the size of this, global on the best financial services platform in the world with every product and service. I was responsible for businesses incorporated to Texas Capital at that platform that were multiples of size. Tim Storms, the same thing on risk, Nancy, Treasury, we're going to have some other adds soon as it relates to experience in depth and quality of management. And you supplement that with what we have

here, and the people that are still here. And I think it's a great bet. So, I'll only think you can compare seven years ago with today. And I hope what you want and you can tell me in the third quarter if you do.

Ebrahim Poonawala
Got it. Thanks for taking my questions.

Rob Holmes
Thank you.

Operator
Our next question comes from Brad Milsaps with PSC. Please go ahead.

Brad Milsaps
Hi. Good evening.

Julie Anderson
Hi, Brad.

Brad Milsaps
Hi, Julie. Hey, Rob, welcome.

Rob Holmes
Thank you.

Brad Milsaps
I just wanted to follow up on the…yes, you're welcome. On the expense discussion as it relates to the MCA business. I think the corresponding business had about $18 million expenses in the first quarter. You mentioned wanted to reallocate those. I assume that's not something that occurs sort of overnight that these would be investments that you would make over time. The $80 million annualized is more than $70 million. So, just wanted to kind of think through how quickly you see expenses ramp back up.

Julie Anderson
Yes. No, that's very fair. That would not happen overnight, it would happen over time. And again, we won't get into specifics about that until the third quarter. But yes, I mean, I think we've already alluded to some of the hiring that's already happening and the hiring that we're looking to happen. So, I think that's meaningful parts of that. But yes, again, to the speed and how that's going to look, we'll talk more about that in the third quarter. But your point is very fair that that's not going to be reinvested overnight.

Brad Milsaps
Okay. And then, secondly, I think I saw on the deck that your $3 billion or so of borrowings are going to go away in the second quarter. Are you no longer required to…by the FHLB to hold a

certain percentage of advances against the warehouse? Is that something that's changed that you do mention here that overnight borrowings may continue? But just kind of curious on how to think about that wholesale funding sources relates to your warehouse business. You obviously don't need it, but just kind of curious how to think about it.

Julie Anderson
Yes, we do. And I think we've talked about that pretty candidly before, we…because of the facility that we have, we've agreed that we will hold about 30% of the outstanding mortgage finance book. So, yes…so but that flips to…net all the term ran off in the first quarter and that flips to, the 30% is overnight money as opposed to the higher term rate.

Brad Milsaps
Okay. Got it. So you'll pick up a little bit there. Okay. That's fair enough.

Julie Anderson
Yes.

Brad Milsaps
And then, finally. Rob, just kind of a bigger picture question, when you look at Texas Capital, I understand you may not be able to answer this yet. But at $40 billion in assets, clearly the balance sheet's a bit bloated. Can you give us a sense of kind of what you feel the right-size of the bank should be kind of over the near intermediate term as you think about kind of how to approach the market from a size standpoint?

Rob Holmes
So, I would acknowledge that in my view, when I looked at the balance sheet before I started and assess is that…I don't know if I would use the word bloated, but certainly it could be rationalized and hopefully the decision to sell the MSR assets and wind down correspondent lending as evidence of our willingness to make pretty decisive decisions pretty quickly. I mean, that was decided maybe my third week here, and then it takes a while to execute. So, I would agree with you, we're going to be very disciplined about capital. I mentioned the balance sheet committee. We're going to be [indiscernible]. So, we need to be more focused and use it with great discernment, and we will manage the balance sheet appropriately going forward.

Brad Milsaps
Great. Thank you.

Rob Holmes
Thank you.

Operator
Our next question comes from Anthony Elian with JP Morgan. Please go ahead.

Anthony Elian
Hi, everyone. And welcome, Rob. A follow-up on the sale of the correspondent business. So, you reaffirmed the commitment to the other mortgage businesses. I guess, how are you thinking about these businesses more specifically mortgage finance, especially with the backdrop of higher rates as volumes could normalize lower from here?

Rob Holmes
Yes. Look, the difference with the warehouse and the MSRs, the warehouse is in a different category in terms of consistency of earnings and conservative products that we put to the warehouse, and the type of business that we do and the structure that we employ, which, remember, I was responsible for a very large warehouse in my past life. I understand this business, cold. I went through COVID with the business starting a forbearance and stuff. We have a safe and sound mortgage warehouse business. There is a number of things we can do to influence the volumes through their…through cycles. And I hope you noticed that the first quarter down, reduction is seasonal. You have to see if it's cyclical. There is certainly not out of place seasonally, but we have participations that we're talking about openly off balance sheet that we can bring on balance sheet.

We have a number of prospects, maybe to whom I've spoken with. They want to use us that are great clients that we would be proud to have, that we're talking to about bringing balances on. And there were other products, like I said we were using safe and sound products and the mortgage warehouse with the right structures, but there are products that we can expand into that does not increase risk. So…and historically, if you look at our warehouse, we're not as price sensitive as the competition. We're certainly not immune, so, we have outperformed. So, between all those things, we think we can manage it. We will be affected, but we appreciate the earnings that it contributes.

Anthony Elian
Okay. And then, Julie, I know you mentioned that it will take time for the new initiatives to show the signs of revenue impact. I guess, after you identify these new initiatives, how long will it take to start recognizing the revenue from them? Is this more of a 2021 event or likely in 2022?

Rob Holmes
Can I take that?

Julie Anderson
Yes.

Rob Holmes
I guess, it's hard to answer that. I'm not trying to be not forthcoming or candid as I promise to be. But it's hard to answer that when we haven't identified the new initiatives. So whether its roll out with that, if that's okay. And then we'll be very deliberate in giving great guidance on the ramp of those initiatives, both revenue and expense.

Anthony Elian
Okay. And then, finally from me, I know a couple of quarters ago, you guys had talked about the new deposit verticals. I know Bask Bank was one of them. I guess, where do you stand on those now? Is there an update you have? Thank you.

Rob Holmes
So, we invested in a new escrow platform and we're standing behind that. I would just say, the whole deposit vertical Bask Bank decisions and go-forward strategy will be part of a broader initiative. Look, we have some overpriced deposits on the balance sheet today, if we just speak candidly. I think, Julie mentioned, we'll be more aggressive with those. And fast and good positive vertical will be a part of that overall contemplation that we roll out in the third quarter. I mean, that the funding the bank is part of the strategy, you can't…because they're linked. So, that will be a big part of the discussion.

Anthony Elian
Great. Thank you.

Rob Holmes
You bet.

Operator
Our next question comes from Michael Rose with Raymond James. Please go ahead.

Michael Rose
Hi, good afternoon. Thanks for taking my questions. Maybe just one on credit, so you guys had a reserve release this quarter. Julie, where do you guys think just line of sight, I mean, should we expect pretty low levels of provision, assuming the economic backdrop remains relatively stable here? And do you think you can get back to day one…post-CECL day one reserve levels if things continue to improve? Thanks.

Julie Anderson
So, I think that debt, I'll make a few comments about kind of why we ended up with a small negative provision. We've benefited from the de-risking that we did in 2020. So, I thought we were ahead of all of that, lower charge-offs, lower NPAs. But you know, as I said in my comments, I mean, while economic conditions are improving, we're still going to be cautious and conservative in how we evaluate it. So, I guess, I'm not going to…we're not going to give any guidance on what we think provision is going to be going forward. We feel good about the book. We feel like that the book…the credit book is much different than it was a year ago. The composition of the criticized, the CRE, is solid. We feel good that that book has been…we have been so deliberate in client selection all along. The structure is good, so we feel good about that. But again, I think we want to reserve the right to be cautious and conservative. And my new CEO will tell you, he is very conservative with that.

Rob Holmes
Aggressively conservative.

Julie Anderson
Yes.

Michael Rose
Understood, and maybe just one bigger picture question. A lot of talk around the warehouse, a lot of talk about where you've been. Rob, you've come from a much bigger bank with many different fee lines of business. And so, I guess, that's the question, as you think about kind of intermediate term. Are there any sorts of businesses that you think might make strategic fits for you to enter in, obviously you're exiting some in the near term? But is there any just line of sight that might make sense for kind of the business bank that you seek to be as you move forward? Thanks.

Rob Holmes
Yes, you bet. So, I'll answer part of it, because that's part of a whole strategy around…I mean, the part of the whole conversation around strategy. We don't…we definitely recognize that our fee income is low compared to our peers. That'll be a focus going forward, because the obvious one we will focus on in addition to a broader strategy would be, what we've already said, which is fee times, be it a treasury business and what we're going to do there. And then, also our wealth management business, which is a really great platform that need scale. So, both those businesses you should look at going forward as contributors and then we start off the rest of the third quarter.

Michael Rose
Very helpful, and maybe just one final one from me, I'll try. I know you're not going to give any sort of margin guidance. But just given some liquidity deployment opportunity as we move forward, and just given where the margin was this quarter. Do you think NII actually just grows throughout the year from here?

Julie Anderson
Again, Michael, I kind of walk through the different pieces of that. We have levers on the mortgage finance. We're not…where yields can…we would expect that they could come down some, but we're usually not as affected as the overall market with that. Securities, we would expect to redeploy some additional excess cash into securities, which would be some pick up. And then, again, I think some of the work that we're doing on deposits. So, I guess, I'm not going to give specific guidance on exactly what it's going to look like from quarter-to-quarter, but those are the different pieces and how I think they're going to trend. Hopefully that's helpful.

Michael Rose
Yes, very helpful. Thanks. Thanks for taking my questions.

Julie Anderson
Sure.

Operator
Our next of question comes from Peter Winter with Wedbush Securities. Please go ahead.

Peter Winter
That was my question on the fee income. So, I'm all set. Thank you. Looking forward to working with you, Rob.

Rob Holmes
Yes. Thank you, Peter, me as well.

Operator
This concludes our question-and-answer session. I will now turn the conference back over to President and CEO, Rob Holmes, for any closing remarks.

CONCLUSION

Rob Holmes
Look, I just want to say I really appreciate everybody's investment of time and interest in Texas Capital. And I look forward to working with each of you and being transparent. And we're excited about the third quarter call. And everybody, stay safe. Thanks for your time.

Operator
Thank you for your participation in TCBI's Q1, 2021 earnings conference call. Please direct requests for follow up questions to julieanderson@jamie.britton@texascapitalbank.com. You may now disconnect.