Texas Capital Bancshares, Inc.

INVESTOR CONTACT
Jamie Britton, 214.932.6721
jamie.britton@texascapitalbank.com

MEDIA CONTACT
Shannon Wherry, 469.399.8527
shannon.wherry@texascapitalbank.com

Texas Capital Bancshares, Inc.

Q4 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes - *President, Chief Executive Officer*

Matt Scurlock - *Chief Financial Officer*

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

PRESENTATION

Operator
Welcome to TCBI's Fourth Quarter 2021 Earnings Conference Call.

It is my pleasure to now hand you over to our host, Jamie Britton. Please go ahead when you're ready, Jamie.

Jamie Britton
Good afternoon and thank you for joining us for TCBI's Fourth 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 the 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 Matt Scurlock, CFO. At the conclusion of our prepared remarks, our Operator will facilitate a Q&A session.

Now, I'll turn the call over to Rob for opening remarks.

Rob?

Rob Holmes

Good afternoon. This is Rob Holmes. Thank you for joining us today to discuss the final quarter of what has been a pivotal year for our firm. We are convinced that we have a distinct opportunity to serve best in class clients in a strong Texas market with a differentiated offering. We are building something of value, which takes time, talent, investment, and fortitude. We are fully committed to achieving our vision and making tangible progress, executing on the strategic plan I presented in September.

Before we begin, I would like to introduce our new Chief Financial Officer, Matt Scurlock, and to thank Julie Anderson one last time for more than two decades of service and steadfast commitment to Texas Capital Bank. I am very excited to have Matt step into his new role. I fully understand the importance of the appointment of a new Chief Financial Officer, as he will be a critical component in the success of our transformation. In my long history of working with hundreds of CFOs as an advisor, I have found most to be highly competent in at least one of three categories: operations, accounting, or strategy.

During the course of the past year, I have indeed challenged Matt in each, and he has proven highly competent in all three. There are many great candidates to choose from for this attractive role at this time in our company and in the market in which we serve. I am convinced that Matt is the best person to be our CFO. I am highly confident that you will find Matt to be credible and that you'll be pleased with his competency and proactive outreach to each of our constituents moving forward.

I would also like to thank the entire team at Texas Capital. Many are new to the firm and are already delivering great value. But there are also hundreds of talented people who were here before I arrived that have embraced our new expectations and strategy and have contributed greatly this past year. Together we are building Texas Capital Bank the right way. Regardless of tenure, each of you has a lot to be proud of. On behalf of the entire operating committee, I would like to express our great appreciation for your efforts and dedication during a year with a profound amount of change and compliment you on your accomplishments.

As we formally move from discovery and planning to executing and delivering, it is important to note that we benefit from good momentum and a strong foundation created over the past 12 months. We ended the year with a total capital ratio above 15%, up from 12% a year ago, and ample liquidity to support responsible growth. Due to the much-improved partnership between the businesses and risk, our credit quality has improved. As we proactively work through our legacy credit issues, it is important to note that we have realized much more than simply minimizing potential loan losses. We will also benefit from the reinvestment of that dead capital which was not generating a return into new relationships that are profitable and with target market clients.

We are still recovering from legacy, historical strategy of buying levered assets out of market, but the portfolio of legacy, trapped, poorly returning capital will mature and be reinvested consistent with our go forward strategy. It is very important to us to provide visibility into our progress versus our goals. To do that at the level we expect of ourselves, we need to enhance our internal reporting, and I'm happy to say that Matt and his team have already made significant changes which will allow us to improve our ability to report progress. To that end, we are taking a first step at providing more clarity to you this quarter and are committed to refining our detail over time.

I hope you saw the press release announcing John Cummings as our Chief Administrative Officer. John brings a wealth of broad, deep experience across all functions in many of our lines of business. John began his career at Merrill Lynch as an entry level branch trainee and advanced to leadership positions across finance, technology, banking, operations, digital platforms, and sales segments for 27 years, culminating with a position on the executive committee, reporting to the CEO. He left to re-engineer Citigroup's U.S. personal wealth management international personal bank and U.S. Citigold high net worth client banking businesses. Most recently, John served as Citigroup's managing director of wealth advisory. With John's appointment, we now have our complete senior team in place, which was one of my stated primary goals to achieve by the end of my first year, which concludes January 24.

As we communicated in our go forward strategy on September 1, 2021, we consider 2022 the true launch point. However, we made material progress against our priorities and strategic performance drivers as we closed the year. We entered this year encouraged by the progress we are already making which will

improve client relevance and result in structurally higher balanced earnings. The expansion of our products and services are on track with our strategic plan.

Our investment banking segment build is on schedule and will only accelerate with our recent FINRA approval and the launch of our new investment banking division, Texas Capital Securities. The majority of the leadership team of our investment bank is in place, working with our credit and operating risk partners to thoroughly review each of our new products and services, which will culminate in our full suite of offerings being available to our clients in the third quarter of 2022.

As you know, there are several capabilities which will be housed in our investment banking division, of which the baseline core offering is already in place. We are expanding our existing capital markets products and loans syndications platform. This investment is directly related to our new client segmented and industry focused coverage model. Greater capital markets and syndications knowledge by industry will be required to work with our different industry verticals.

Consistent with both our strategic pivot away from the loan product as our primary client offering, you will see we are now reporting investment banking and trading income as a standalone category within noninterest income, which is consistent with our peers. Our investment banking strategy is being very well received, as evidenced by multiple mandates and capital markets, as well as sell side advisory assignments. It is important to note that these advisory assignments were organically developed through the structure of our platform. One was referred by a private banker in private wealth and others by bankers in middle market banking.

Investment banking fee's contribution to total revenue is trending favorably, giving us confidence we will achieve our 10% target contribution levels, even in a more normalized rate environment. Our investment in treasury solutions expertise, products, services, and technology resulted in early, positive trends. As you know, fees can and will fluctuate through cycle as we manage earnings credit rates, but we are pitching treasury solutions from a position of strength and proficiency, resulting in new treasury relationships at an accelerating pace.

P times V revenue run rate accelerated at year end, in line with expectations. A large percentage of treasury P times V comes with a high percentage of operating deposits, which is critical. During the course of the year, operating deposits had double-digit percentage growth. As we become more relevant to more clients, becoming their primary operating bank, our reliance on higher cost index deposits with 100% beta will decrease, improving our funding cost and incrementally making us less asset sensitive over time.

As planned, in the fourth quarter we landed numerous product offerings on our treasury platform, focused on both client segments and industry specialization. In our new healthcare vertical, we have many new clients benefitting from our revenue cycle management offering. We created treasury bundles for our business banking clients, and importantly, have already improved upon them, adding more functionality for the benefit of our business banking clients. We are excited about the pipeline of the products and services plan for our treasury business during the course of this year.

One of the things we are most excited about is our digital product roadmap, which we will talk about more in the coming quarters. We are confident heading into 2022 that we are meaningfully closer to our treasury solutions fee target of 5% of total revenue by 2025. Private wealth continues to drive steady growth in both assets under management, which grew almost 50%, and in fees, which grew more than 40%. The PWA team added almost $900 million in assets under management, over 25% of which was from new clients, many of whom were referred from our expanded banking teams.

In our most aggressive year of talent acquisition in private wealth, we increased our client facing advisors by a large percentage. As noted on September 1, PWA offers a relatively mature product suite that will benefit from scale. John Cummings will quickly commence a strategic review of the business and its go to market strategy. We are confident a very good business on an already built, very good platform can be even better. Matt will provide more detail on the trends and associated drivers of non-interest income as a percentage of total revenue in the fourth quarter. I am confident we are on track to achieve our stated 15% to 20% target.

We completed our planned internal reorganization, which resulted in new client segmentation and industry specialization. Four out of our five primary business banking markets has leadership in place and bankers engaging with clients. We developed tailored treasury solutions as well as a differentiated cost-efficient credit model to address this market segment. It is important to realize this is a new segment with a new leader, with new bankers, with new clients, with new products, producing new revenue today.

The middle market banking segment has been our primary focus since our founding. As expected, it led in client acquisition and adding new bankers onto our platform. The talent pipeline remains strong. Business activity is good, and after a couple of years of inward focus, we are now intensely, externally focused. Highly talented legacy bankers, coupled with the new bankers who have very quickly contributed to new client acquisition, resulted in well over 100 new relationships this year and an increased pace in the back half.

The creation of corporate banking is complete with the leadership of each industry vertical as well as diversified in place. Each of these leaders came from larger, more complex institutions with significant and relevant experience in covering clients with a full suite of sophisticated products and services. Importantly, here is another newly formed segment with new bankers, a new leader, and new clients, with new products realizing new revenue.

The corporate banking and middle market banking segments are highly engaged with their partners and the investment bank to create a pipeline of opportunities to provide high value solutions for our clients. Moving forward, I'm excited to be personally engaged in this effort, spending as much time in the market that opportunity allows. We all know it is a very competitive environment for talent and we are unwilling to compromise. However, to date, we have enjoyed marked success in attracting client facing professionals with no regrettable losses in talent.

The number of frontline client facing professionals we have serving our markets increased 40% since the end of 2020 and we saw a 70% increase in the business banking, middle market, and corporate C&I segments. We have proven to attract great interest and talented professionals who want to build, not

preside, create and be a part of a highly constructive culture. As shown in our accompanying slides, C&I loans grew 17% year-over-year, excluding PPP, the majority of which has come in the past two quarters as a byproduct of the progress I just described. Importantly, the growth is accompanied by high quality relationship deposits, which are up 35% over the same period.

Each of these strategic priorities, treasury, wealth, investment banking, and our expanded C&I coverage models, are critical to our success and we will continue to provide updates on our progress, accomplishments, and near-term milestones each quarter going forward. As I have said to many of you, self-funding of our material investments is a very high priority. We will make progress on our investments and re-allocation of expenses a priority in our regular reporting updates. Matt will share more detail on our progress to date.

We will use this more traditional guidance to supplement this detail where appropriate; but for the elements of the bank most central to our transformation, we believe communicating the improvements in each of these areas and describing how they translate into our financials provides a clear picture and more of our progress as we execute our strategic objectives, noting financial results will lag before they begin to ramp.

Thank you for your continued interest in our firm. We are very excited about our accomplishments to date and the year ahead.

Now, I'll turn it over to our new CFO, Matt Scurlock, to discuss this quarter's results.

Matt.

Matt Scurlock

Thanks, Rob, and good afternoon. I'm thrilled to serve in this new capacity and look forward to continued partnership with colleagues across the bank as we collectively work to deliver a differentiated offering for our clients, our communities, and ultimately for you, our shareholders. Given the company's ongoing transition, we are focusing more traditional guidance on the income statement trajectories communicated previously.

Total revenue and noninterest expense in the portions of the balance sheet not directly impacted by our transformation, namely our mortgage finance loan portfolio. As Rob described, the metrics he discussed earlier are critical guideposts necessary to measure progress until more traditional bank-wide financial operating metrics increase in relevance as we exit the year. I share Rob's commitment to clarity and assure you we will continue to refine the level of detail we communicate over time. That said, with the impact of PPP lessening and one-time write-offs behind us, this quarter marks a clean jumping off point to begin evaluating the magnitude and timing of our investments relative to their ability to deliver the more sustainable, higher value revenues we know the franchise is capable of.

Let's begin on Slide 9. Our fourth quarter results signify continued progress as we invest in the talent and capabilities necessary to fulfill our strategic agenda. Net income to common was $60.8 million for the quarter, up $21.7 million quarter-over-quarter, driven by expanding revenue, a more focused expense base, and continued improvement in the credit portfolio. As a reminder, last quarter's results included a $12 million write-off, which also contributes to the quarterly change.

Total revenues grew by $10.2 million in the quarter, positively impacted by a $3.5 million increase in net interest income resulting from modest overall growth in yields and further supported by $5.9 million one-time gain on the sale of a foreclosed asset recognized in noninterest income. Underlying credit trends continued to evolve favorably, with criticized loans declining 20% quarter-over-quarter. These factors resulted in a negative provision of $10 million in the quarter versus a $5 million provision in the third. Coupled with a significantly improved capital position, the progress in our credit portfolio positions us well for a year of sustained investment, loan growth, and continued suppressed profitability near term.

We are aggressively re-allocating the expense base towards our areas of strategic focus and are meeting our plans to add frontline talent, build and deploy technology enabled products and capabilities, and ensure appropriate middle-office and back-office support through defined loading and gearing. These are foundational tenants of future scale and the path to re-establishing sustained operating leverage in late 2022 or early 2023.

Noninterest expense including the third quarter software write-offs grew by $5.6 million quarter-over-quarter and remained relatively flat year-over-year despite winding down the correspondent lending business. Salaries and benefits are up 2% quarter-over-quarter, reflecting a seasonal slowdown in hiring, but have increased almost 15% year-over-year as intended, a direct result of our shifting the expense base to match higher value, revenue generating initiatives.

Moving to Slide 10. As Rob noted, in connection with the formation and licensing of TCBI Securities, we have established a concise policy regarding the accounting for loan syndication fees and have reclassified prior period's financials to conform to this policy. Changing the classification of loan syndication fees from interest income to noninterest income was about creating clarity for investors and aligning published financials with our internal strategy. We also believe this will create better comparability between Texas Capital's results and those of other financial institutions. Additional information has been provided in the appendix of the presentation to show the immaterial impact of the reclassification.

Moving briefly to PPP. Balances declined $124.9 million from $207.3 million to $82.4 million, leaving slightly less than $2.1 million in fees to be earned. As we have said, the timing of PPP forgiveness and the associated fee recognition is unpredictable, but we expect their quarterly contribution to significantly decline in 2022.

Turning to Slide 11. We have been clear that we are not focused internally, nor do we plan to provide externally, metrics on our desired target levels of loan growth. We have also been clear that our focus is on banking best in class clients across our defined areas of industry and geographic coverage and that a

byproduct of our strategy when mature should be through cycle core growth in excess of both GDP and peers. As expected, favorable trends from the last two quarters are continuing.

Ending period C&I loans, excluding PPP, grew $669 million, or 27% annualized in the quarter. Another data point signifying the clients we want to serve in our defined markets are indeed responding to our offering. Growth was broad based with middle market and our corporate diversified group contributing strongly to the increase. This observed acceleration of loan growth over the past several quarters has driven C&I balances excluding PPP $1.5 billion, or 17% higher year-over-year.

Utilization rates improved slightly in the quarter from 48% in 3Q to 49% in 4Q but are still below our pre-COVID average of low 50%s. Client activity remained strong across all areas of industry and geographic focus and our internal pipelines continue to expand as new bankers begin to ramp, prospect and client calling disciplines improve, and we gain momentum by programmatically executing our defined strategy. As Rob described, the expanded products and services we are building are making us more relevant in our markets, and the synergies of strengthening all facets of the platform concurrently are driving the expected benefits.

Moving to real estate, outstanding commercial real estate loan balances continue to pay off at a historically rapid pace, reflecting our longstanding and deliberate weighting towards high quality, multifamily construction. This is the property type currently most favored by investors, and the project quality and reputation of our client base is resulting in more frequent and earlier project take outs than historically experienced. Twenty twenty-one commercial real estate payoffs totaled nearly $2 billion, or 49% of the total commercial real estate portfolio as of yearend 2020. Approximately 53% of the $2 billion in runoff occurred in multifamily.

A portion of the remaining runoff in that portfolio was a result of strategic exits. The 34 names targeted here constituted $367 million of yearend 2020 balances, with the vast majority, approximately 75%, coming from the hotel and senior housing portfolios. While we expect the pace of loan payoffs to remain elevated, the decrease in outstanding balances should begin to stabilize by midyear as commitments originated in 2021 start to fund and modestly increasing levels of term debt serve to counterbalance the decline in the portfolio.

Because of the actions taken to support volumes, average mortgage finance loans declined only 1% quarter-over-quarter heading into the seasonally lower first quarter and amidst the current environment's increasing tenure in corresponding, slowing market volumes. Primarily driven by mortgage finance loan activities, broker loan fees also declined modestly quarter-over-quarter, and we would expect further declines here in the first quarter.

As you know, mortgage finance is an increasingly broad and important business for us. It has and will continue to become less dependent on the mortgage warehouse alone to drive revenues as we focus on expanding our relationship into other loan, treasury, and capital markets products. That said, mortgage finance is not immune to the impact of declining industry originations expected, so we would expect portfolio balances to decline in 2022. Recent Mortgage Banker Association forecasts indicate total one to

four family mortgage originations to be down 34% from 2021 and only modestly ahead of levels last experienced in 2019.

We enter this period of expected market contraction well positioned, as deliberate actions beginning in early 2021 to enhance our mix in favor of purchase volume elevated this portion of the portfolio to 58% of our fourth quarter volume versus 47% for the industry. Because of this, we are not as sensitive to declines in refi volume and would expect the portfolio to outperform market in 2022. We are planning for full year average mortgage finance loan balances to decline in the high teens percentage range and for yields to face modest pressure as well.

Moving to Slide 12. Consistent with our strategy, quarterly average noninterest bearing deposits grew by nearly 20% from the fourth quarter of last year. Growth was broad based with corporate and middle market up 48% and 31% respectively. Reductions in quarterly average interest bearing deposits of nearly $4.9 billion from 4Q 2020 levels included the runoff of $799 million in higher priced brokerage CDs and the intentional actions taken to reduce $4 billion in higher cost, rate sensitive index deposits.

Collectively, these actions improved our ratio of quarterly average noninterest bearing deposits to total deposits to 52% at fourth quarter 2021, up from 40% at 4Q 2020. These favorable underlying trends sustained through the end of the year, with period imbalances influenced by the predictable month end outflow in mortgage finance's principal and interest balances and by mortgage finance's seasonal outflows in tax and insurance deposits, which occurs every year in the fourth quarter. As a reminder, the T&I balances begin to build again in the first quarter and will continue to grow through the year.

As we enter the year, the potential for an increase in short-term rates is met with improved funding position relative to the same point in the last cycle. Index deposits are now 24% of total deposits, remaining near historic lows, versus over 30% at the end of 2015, prior to the last tightening cycle. We have a higher mix of noninterest bearing deposits, and most importantly, we have a focused strategy to generate and sustain core operating account growth across the platform. This signifies an increasingly valuable franchise, and when coupled with liquidity levels in excess of long-term targets at this point in the rate cycle, an improved ability to more reliably realize the benefits of our asset sensitivity profile.

Turning to Slide 13, margin remained relatively flat quarter-over-quarter due to a modest improvement in traditional LHI yields, an improved balance sheet mix, and stable interest-bearing liability costs. As you may recall, we moderated our bond buying program in the third quarter, choosing to simply reinvest cash flows as opposed to locking up excess liquidity ahead of a potential tightening environment and improved loan demand. We plan to maintain this posture near term and believe we are well positioned for the quarters ahead.

Shown to the right on Slide 13 is the results of our asset sensitivity modeling which increased again this quarter. Higher average DDA levels and a modest mix to lower beta deposits in the interest-bearing portfolio were the primary drivers of the increase. But we also saw the percentage of floored loans decline, which means more of the loan portfolio will be sensitive to the initial move up in rates. Though model results are a valuable risk management tool and helpful in horizontal comparisons across the peer

set, it is important to keep in mind high level assumptions, such as the use of a static, nongrowth balance sheet.

Also, the results shown do not reflect forecast sensitivities to ramping rates, nor do they contemplate a mix shift we expect to occur with growth. It is also important to note our balance sheet positioning, especially when compared to our performance through the previous tightening cycle, which started in December of 2015. We have $5.9 billion of quarterly average liquidity above our 20% target versus $361 million below in the fourth quarter of 2015. Our deposit mix today versus six years ago has materially improved with a meaningful reduction in index deposits and we have a model better positioned to drive high-quality, low-cost funding to pair against expected growth.

We were deliberate in preparing for this occurrence, and while we will look to neutralize our asymmetric interest rate exposure over time, we are pleased with current positioning. Rob and I both discussed our noninterest income performance at length, but I would like to take a moment to note that the full year revenue growth guidance we provided on September 1 did not reflect today's more hawkish rate environment. Were we to see rate increases consistent with today's market expectations in 2022, we may see revenue growth above the communicated low to mid-single-digit target.

Turning to Page 14. As I mentioned, we are confidently moving forward with our plans to systematically align our expense base behind our strategic priorities. Adjusted for correspondent lending related expenses in the third quarter write-off, we saw an increase in expense this quarter and we are pleased to see more of our expense base attributable to salaries and benefits. This is a trend I fully expect to continue near term as we build out our coverage model, products and services, and the infrastructure needed to support them.

We continue to make meaningful progress toward our defined goal of financial resilience. Despite our modest reserve release, we remain aggressively conservative in our approach to managing the portfolio. Observable credit metrics improved again this quarter and we remain confident that legacy loans associated with the prior strategy are identified and reserved for.

Regulatory capital levels ended the year at the highest level in 20 years in an excess of both peer median and internal targets, a fact some may point to as reason to engage in share buybacks. As laid out on our September 1 strategy call, we adhered to a disciplined and analytically rigorous approach to managing our capital base in a way that we believe will drive long-term shareholder value. There could be times when that includes repatriation, but now is not that time.

The reason for our current transformation is that Texas Capital's legacy business model does not generate returns capable of earning its cost of capital through all cycles. Investing in the new products and capabilities we have identified will allow us to generate structurally higher, more sustainable earnings. Coupled with an accompanying reduction in our cost of capital, given our significantly improved balance sheet positioning, we fully expect these investments will drive expansion in incremental shareholder returns over time.

As I mentioned earlier, the investments we are making will also lead to broader client relationships and growth in the balance sheet. Benefits are already appearing, and the expected growth is materializing. Though capital levels are marginally higher than we would ideally like today, and while they could go higher with the seasonal decline in mortgage finance this quarter, we believe based on our regularly evaluated internal models we are better stewards of our shareholder's capital if we invest in our future.

Finally, turning to Page 15. Actions taken to reposition the expense base began in early 2021 with the decision to wind down correspondent lending and sell our $121 million mortgage servicing rights portfolio. The decision was dilutive to 2021 earnings, but it also unlocked approximately $70 million, or more than 10% of the run rate expense base, that was previously supporting one of our most volatile earnings sources in a business that was disconnected from our go forward strategy.

As you can see in the appendix on Slide 19, actual correspondent lending related noninterest expense for the year was slightly above $41 million, but describing the benefits of these types of decisions on a run rate basis more clearly represents the magnitude of our repositioning towards higher quality, more sustainable sources of value, and provides a more direct tie to the benefits and impacts you can expect on current and future profitability.

In addition to the correspondent lending saves, while initiating our plan to exit a portion of our higher cost index deposit portfolio, we decided to more tightly integrate several deposit focused verticals to serve our corporate banking clients. The moves generated a run rate savings of approximately $10 million to $15 million per year while also ensuring we began viewing these valuable, long-standing relationships through a lens more in line with our overall strategy.

Other saves were identified over the course of the year as well. For instance, streamlining processes to minimize costly repetition and eliminate duplicative systems in select businesses was meaningful, as was proactively managing our vendor relationships from a firm-wide vantage point in consolidating our negotiating power. As Rob has mentioned, we are sweeping every corner of our business and will continue to do so. So far we have identified over $130 million of run rate savings that has allowed us to fund over $100 million of new investment, the most important of which are investment expanded coverage in new products and services Rob outlined earlier. We are confident in our ability to continue self-funding investment, and we are committed to doing so.

At this point, the low double digit expense guidance given during our September 1 call remains intact. Were we to come in below that number, it would be the result of us self-funding more than what is needed for our planned investments, not us backing away from our ambition. As I've shared with many on this call, improving our ability to match expense directly with necessary capability and coverage to deliver scale across our business is amongst my highest priorities, as are transparency and credibility, so we fully intend to provide more of both on our progress over the coming quarters.

With that, I'll hand the call back over to Rob.

Rob Holmes

Thank you, Matt.

Why don't we, Operator, open it for about 30 minutes of questions.

Question and Answer

Operator

Thank you. Our first question today comes from Brock Vandervliet of UBS. Brock, your line is open.

Brock Vandervliet

Good afternoon. Thanks for the question.

I guess starting with the Slide 4 and the return targets, Rob and Matt, do you expect to narrow those over time, or flesh them out further at some point perhaps later in the year?

Matt Scurlock

Hi, Brock. It's Matt. Happy to take that. Appreciate the question.

We were very deliberate in setting up those return targets that we outlined for you on September 1, and as Rob and I both mentioned in our opening comments, I think more important today than traditional financial metrics are the guideposts to help you see us progress against the strategy. As we execute on plan build both in terms of capability and coverage, we will start to transition to more traditional metrics, begin to narrow or adjust the range of what we think the bank can become. But at this point, only four months after disclosing those as our target returns, we feel pretty comfortable that that is what the bank can be through cycle.

Brock Vandervliet

Okay, and just, sure. Okay, and going to Slide 15, I think that's a very interesting one. What would you say the–just trying to add a few numbers to those blocks, of course. What would you say a fair 2021 expense run rate is?

Matt Scurlock

Yes, so we took the expenses down to $600 million at the end of the year, as anticipated. This isn't intended to be a gap walk, but instead show you the amount of underlying transition. I mentioned in my comments a great way to look at it is with the $70 million of CL winddown. We've taken out actually $40 million in expense that hit the P&L in 2021; but on a run rate basis, that's $70 million through the year. We've been below the surface actively repositioning the expense base. You've seen that start to come through on the reinvestment side in terms of the product capabilities that Rob mentioned, many of which are already producing revenue, as well as the build out in frontline coverage.

If I think about the expense guidance for the year, this isn't a situation where we try to give you a range and we're worried about potentially going over it, which is not the case. Instead, we want to redeploy the savings as quickly as we can. I think that the results of this quarter are further affirmation for us that the strategy is working and we're going to aggressively invest in it throughout the year. To the extent that we can self-fund more, we're absolutely willing and open and quite eager to do that. That's how I think about Page 15.

Brock Vandervliet

Got it. Thank you.

Matt Scurlock

Thank you.

Operator

Thank you. Our next question today comes from Brady Gailey of KBW. Your line is open, Brady.

Brady Gailey

Hi. Thanks. Good afternoon, guys.

Cash remains fairly elevated. I mean, it's 27% of average earning assets in the fourth quarter. Over time, how do you think you reduce that? Is that more investing that cash into the loan book and the bond book, or is it more you still have a fairly elevated level of index deposits? I know it's come down a lot, but is it more, you know, seeing some of those deposits go and you use the cash just to kind of push out the more hot money?

Matt Scurlock

Hi, Brady. Matt. Happy to take that as well.

We disclosed on September 1 that our target long-term mix or target long-term composition between cash securities and total assets is about 20%. To use a $35 billion balance sheet, it's roughly $7 billion today. We're at $13 billion between cash and AFS, so about 36%. If you want to just target a 50/50 even split between cash and securities, the $9.5 billion we have in cash has come down about $6 billion over time to match that $3.5 billion in securities. Just by point of comparison, at this point in the last cycle we only had about 10% of the balance sheet in cash. As rates started to move, we had to raise incremental funding to match loan demand, which was obviously detrimental to the margin.

As we think about our options with excess liquidity, we're doing exactly as you described. On the liability side, we're evaluating customer deposits based on (inaudible) strategic plan, the type of deposit, the duration, the cost, and if it's a meaningful relationship for us. On the asset side, we're taking it through, of course, the steepness of the curve, monitoring any opportunities to remix the securities portfolio. At this point we're not particularly interested in adding to it or extending duration. We're in really no rush to deploy, given that we've now had a couple of quarters in a row of pretty meaningful C&I loan growth. As Rob mentioned, the pipeline there also looks good. We have ample liquidity on the balance sheet that we're going to look on both sides to rationalize, but ultimately want to maintain the support of executing the strategy.

Brady Gailey

Okay. All right, great, and then it's good to see credit quality continue to improve here. I'm just wondering, I mean, as credit quality continues to get better, I'm wondering where the reserve lands. If you back out PPP and mortgage warehouse loans, you're still at about a 1.5% reserve, which is on up there. I'm just wondering how much capital could be freed up as that reserve continues to come down. As credit gets better, where do you think that reserve lands?

Matt Scurlock

Yes, Brady, it's always difficult to forecast provision, particularly with CECL. Instead, I'll point you back to the range we gave on September 1 that we would expect between 25 and 50 basis points of through cycle charge off. If current economic conditions persist, you can likely anchor to the lower point of that range. Another variable there will certainly be loan growth. We're going to be reserving as we continue to mix cash into loans, so that could be a factor as well.

Brady Gailey

All right, great. Thanks, guys.

Operator

Thank you. Our next question today comes from Michael Rose of Raymond James. Michael, your line is open. Please proceed with your question.

Michael Rose

Hi, good afternoon. Thanks for taking my questions.

Just on Slide 13, on the revenue guide for the year, could you just help us appreciate what the breakout would be, roughly, between NII and fees, and obviously cognizant that some of the efforts that you have on the fee side are going to start to or continue to ramp through the year. But so, a greater breakdown or some color would be helpful. Thanks.

Matt Scurlock

Yes, happy to take a shot at that.

If you go to the upper righthand side of that page, we tried to give you a bit more detail this time on the underlying asset sensitivity both as modeled and then potentially as realized. If you'll bear with me for a second, I'll walk you through some of the underlying assumptions that could help you potentially think about margin.

We've got about $12.9 billion of the loan portfolio is variable. Seventy four percent of that is tied to LIBOR:

- About $7.6 billion of that is one-month,
- With $473 million tied to three-month,
- Then you've got about another $1.4 billion in the premium finance portfolio tied to 12-month that actually reprices annually, pretty even reprice schedule through the year, pretty even schedule.

Then you have about 25% tied to prime.

Of that $12.9 billion in variable, 37%, or $4.8 billion, of that is floored at 382 [bps]. That core portfolio would see a fairly significant bump in yield after about 50 basis points of Fed move, which of course in the guidance we're not incorporating any sort of pickup in rates.

That move would accelerate to about 100 points, up to about 100 basis points, at which point 85% would come off the floor. Between 50 and 100 basis points of Fed moves get you to about 85% of the book that comes off of the floors. I think that's a decent way for you to think through the existing asset sensitivity. Then if I try to break things out between them and noninterest income, we're not really looking to maximize NIM, or net interest income. We're trying to position the balance sheet in a way that supports the strategy.

A core component of the business, as Rob had described, is our ability to distribute multiple products and services into the same set of clients, ultimately becoming less dependent on the loan products and net interest income to drive growth. I think about areas we're focused on, capabilities to drive operating deposits in noninterest income, and I think you have the components that can help you think through how the margin will behave.

Rob Holmes

I'll just add a little bit, if that's okay, on the ramping of the noninterest income that you asked about during the course of the year. The number, again, I'm saying this as a positive, because we're seeing results. But we have new PFOs (phon) and product specialists with new expertise by vertical in our treasury business that simply weren't here four months ago. They're just onboarding, just meeting clients, just partnering with bankers, coming up with solutions. We launched an industry specific product. We have

new cycle management that wasn't here three months ago. New expertise in the healthcare vertical to do that.

We launched a business specific product, which is the bundle, the treasury bundle for business banking that I mentioned in my comments. We scaled the commercial collar, which we had before but we didn't use or apply appropriately across the marketplace with our clients. Now we have a very tangible, real roadmap of products and services that you'll see come on board in the first, second, third, and fourth quarter of this year to where the back half of the year will be, I would say, above parity as far as I'm concerned in treasury suite for banking.

We're really, really excited about that; but as you know, ironically this treasury sales cycle is more complex than even the loans. You make an acquired sale, and then you have to onboard that client. Then if you say you're going to sell a dollar, you only realize 80% of ramp, and that ramp can take anywhere from 18 months for a sophisticated international client, which we don't have a whole lot of, so that's maybe outside, down to several weeks or months for a simple client, to maybe a week for a business banking client. You've got lag time in the sale and then the ramp; but as we onboarded so many with so many new products, the run rate acceleration of that seems very, very encouraging.

On investment banking, we've got FINRA approval. We are online, in line with our plans, calendar plans to implement and construct that business with vendors and partners and hiring and expertise onto the platform. We have already been mandated on multiple advisory assignments with letters, and then verbally more than that. We're also been mandated on our first several debt capital market underwrites. You see really, really good momentum and trajectory.

On the private wealth side, you saw the hiring plan that we did, high double digits. Really high quality, and then John is going to do a deep dive with Alan Miller, who runs that business, and look at the entire strategy, because we do feel like we have a differentiated platform, and we're really excited about that. I don't think we need to change that, but you could see us change some other things. I think you'll see that continue to improve during the course of the year. We actually feel very good about the ramp and the trajectory, given that the amount of time that we've been making the effort.

Michael Rose

Okay, that's great color. I appreciate it. Maybe just as one follow up. When I look at Slide 4, it looks like the client facing talent additions are up. Obviously you're at 1.4x versus a 2.3 goal; but then I look at Slide 7, it looks like you're a little bit further ahead on the business middle market effort. Where are you behind? And as we think about future talent additions as we move forward, where is the catch up to that as we move forward? Thanks.

Rob Holmes

Here's the great news. I think we're ahead of our, you know, way ahead of my expectations and ahead of plan. This is a very competitive environment to hire, and I couldn't be more proud of the fact that this strategy is resonating with bankers and talent literally across the country. We've had bankers move from California. We've had them move from New York. We've had them move from competitors in market, and so we're really excited about that.

We are ahead in middle market, like you mentioned. That's our core. We've been here the longest, and we have the most exposure there, and so that's just natural. But we're ahead of plan in business banking. Corporate we're ahead of plan. We have each vertical head hired. I've run corporate banking teams globally. I've run them by industry. I'll put this corporate banking team against anyone I've managed before.

We're not just filling these seats. These are real people with real experience deep in the industries in which they come from. We're super hyper about that. We're not behind in any. We're just further ahead in some.

Michael Rose

Conceptually speaking, the fact—go ahead. Sorry.

Rob Holmes

Go ahead. No, go ahead.

Michael Rose

I was just going to say, conceptually the fact that you're ahead in some of these areas. I mean, you're not going to talk about loan growth; but conceptually given the quality of people you hired, I think you just mentioned, I think it's fair to assume that we should expect core LHI growth to accelerate through the year. Thanks.

Rob Holmes

Okay. I acquiesce. Yes. I mean that's a natural outcome. That's a natural outcome. I just, I don't want to repeat myself. It's just not our primary driver. It is part of the overall solution that our clients expect, but as I said before, like in our real estate business. If we can be more of a moving company than a warehouse,

we do better for our clients. We invite solutions to more. We increase fee income. We distribute risk. We're not just building loans on the book for loan's sake. They have to be the right client, the right use, the right risk profile. We're not stretching. I just never—that's why always has stuck with saying what we've said.

Michael Rose

Appreciate all the color. Thank you.

Operator

The next question today comes from Matt Olney of Stephens. Matt, your line is open.

Matthew Olney

Thanks for taking the question.

You mentioned the strong C&I growth, especially in the back half of the year. I'm curious about loan syndications and the tolerance to growth syndications. I think it was around 15% of the non-mortgage finance portfolio was loan syndications in the third quarter. How high could this go? And as you kind of implement your plans, do you have the fourth quarter number in front of you, you can disclose? Thanks.

Rob Holmes

We talked about investment and loan syndications. We are looking to supplement an already strong syndication desk. We're very good in certain industries. We can be better in others. Obviously, we need to build out capabilities in debt capital markets, besides just loan syndications, which we're doing as well. These bankers that have joined us on the corporate team, both diversified and by industry, have a lot of history with the product. They understand it. We are pitching lead left. We will continue to do so in loan syndications. We actually do it very, very well. We just didn't have the footprint at scale that we should have had.

As we build the footprint at scale, the syndication fees and opportunities will do nothing but grow. We're really excited about that business and the ability to ramp. Where I said back half of the year, remember that's more of a Texas Capital comment than a market comment. We are onboarding these bankers and we started a strategy midyear, right. We came up with it, then we announced it. It was fully baked and vetted and understood before we started executing it. We really haven't been at this for a very long time. Back half of the year is really for all of our businesses as bankers and TMOs and product people join the platform.

Matthew Olney

Got it. Okay, and Rob, what about the pace of investment in 2022? Will those also be loaded in the front half of the year at 1Q and 2Q?

Rob Holmes

If we're good and we do it optimally, that's what we hope to do. Last year, we had to invest in full year compensation because we're bringing people in back half of the year for some, not all, but for some of the people that we hired. We did not get a year of effort from them. Best practice would be to frontload it and we are having a lot of dialogues across the platform, but we will do what we need to do to execute the plan.

Matthew Olney

Thank you.

Rob Holmes

You bet.

Operator

Thank you. Our next question today comes from Brad Milsaps of Piper Sandler. Your line is open, Brad.

Brad Milsaps

Hi, good afternoon.

Rob Holmes

Hi, Brad.

Brad Milsaps

Thanks for taking my question. Just wanted to follow up maybe on the deposit side of the equation. Would there be anything on the way up, assuming rates do go up, that prevents you from exiting some of those remaining index relationships? Just kind of curious if there are any longer-term contracts there that would prevent you getting out as you add more core type treasury relationship, as you intend.

Matt Scurlock

No.

Brad Milsaps

Okay. Then okay and so those.

Matt Scurlock

You get a follow up off of that.

Brad Milsaps

Thanks, so those will behave just until you just run them out of the bank or are able to replace them?

Matt Scurlock

Yes, absolutely. I mean, you've heard us say it multiple times on this call and multiple times on previous calls. Growing co-operating deposits is the cornerstone of the strategy, and it's the cornerstone of the strategy for how we manage the balance sheet, how we invest on the asset side, and how we ultimately grow a stable fee income.

There is a place today in the funding mix for those deposits, but we are going to, as fast as we can, grow the operating deposits and lessen the influence of those that are 100% beta and not core to the additional parts of the platform.

Brad Milsaps

Okay, great. Then just as a follow up, Matt, I appreciate the additional color on some of the asset sensitivities related to the loan book. Was just curious, in terms of the held for sale, the mortgage finance book, would you expect those to behave like LIBOR based loans on the way up, or do you think competition is such it will make it difficult to see a lift in those rates as well?

Matt Scurlock

No, I appreciate the comment or the question on that. We tried to carve that out for you in guidance on the bottom left, or the bottom right, rather, of Page 11. We're sitting at $290 million right now on that book. Absent any movement rates we think that there will be some pressure of course since we tie it to LIBOR, so there is some modest pickup. You'll start to see rates move, but it won't be as dramatic, certainly, as it will be on the (inaudible) portfolio.

Brad Milsaps

Okay, great. Thank you, guys.

Rob Holmes

Thank you.

Operator

Thank you. The next question today comes from Brett Rabatin of Hovde Group. Your line is open.

Brett Rabatin

Hi, guys. Good afternoon. I wanted to ask about the expense guide.

Matt Scurlock

Hi, Brett.

Brett Rabatin

Hi. I wanted to ask about the expense guidance and just get an idea of what you're feeling in terms of the inflationary pressures. You mentioned that it was obviously a very competitive market. I was curious how the inflationary pressures are impacting that.

Then secondly, it sounded like at the end of the prepared comments that maybe the way to think about the expense guidance was that the low double digit is sort of an all-in encapsulating thing, and if anything it could be below that depending on how things play out. I just wanted to make sure I was reading the tea leaves on that comment correctly and then get the color on the inflationary pressures.

Rob Holmes

Why don't I start and then, Matt, I think you can finish.

I would just say on the inflation side, you know, macro with our clients, you know, we talk about every day. We think it's a real threat to the economy. We're very cognizant of it. We're planning for it. We haven't seen it as much in our expense base as I would have thought. For sure on talent, we're cognizant of it, but outside of that it looks like we're doing pretty well. Again, most of this of which we're coming to it and what you're seeing is more a result of past practices at Texas Capital versus today.

The expense savings that we're getting is from renewed rigor, analytics, cadence, routines, processes that were implemented kind of in the second quarter of this year that every single new contract and expense goes through: who can approve an expense, what's expense-able, what the process is to onboard a vendor, who focused on strategic vendor relationships, rationalizing the vendor base, third-party risk management. It's more of a comment around us more than the market environment, unfortunately still, or fortunately, depending upon your perspective.

Do you want to add anything more to that?

Matt Scurlock

Yes, just say in general on the low double-digit guidance, Brett. It's really important to know and understand that we're not just simply adding bankers onto pre-existing platform that are here solely to grow assets. We're building the very defined businesses that require front office, middle office, back office, and then very defined products and services to fit either the industry or segment that we're trying to serve.

Historically, the bank has been unable to achieve scale because it hasn't committed fully to developing these sustainable businesses, and that's what we're doing. That takes investment. The results for us to date, again, are just further encouragement that the value proposition is resonating with the clients that we ultimately want to serve. Should we come in under that guidance, it would be the outcome of us self-

funding more than we currently think we can. As I mentioned, we're certainly looking to do that, but we're not focused on trying to drive expenses lower for the sake of meeting 2022 earnings. We're really focused on allocating as much of that expense base as we possibly can against the go forward strategy.

Brett Rabatin

Okay, that's great color. Then, Rob, I'm curious. I think I believe I saw on local media here in the past quarter that you've been talking about maybe the quarter that you might achieve positive operating leverage. I didn't know if you wanted to give some thoughts on that and if that might be possible later this year.

Rob Holmes

Yes, no. I think the plan has always been, we think, first quarter of next year you'll see it. Again, Matt said, I think in his remarks, that the negative leverage may be lessened with tightening. The guidance may be a little different because we did not include that in September 1 guidance for expense or revenues. But I think the first quarter of next year is my expectation to see the shift. Which is consistent with plans.

Brett Rabatin

Okay. Appreciate the color.

Rob Holmes

You bet.

Operator

Thank you. Our final question today comes from Bill Dezellem of Tieton Capital Management. Your line is open, Bill.

Bill Dezellem

All right, thank you.

I would like to talk about criticized loans for a moment if we could. You had a nice decline sequentially, but I believe in your opening remarks you made reference to moving away from, intentionally moving away from loans with certain hotels and senior living facilities.

Would you please tie those two together, if they are related, and help us understand what's happening underneath the surface here with criticized loans.

Matt Scurlock

Yes, Bill, happy to take a shot at that.

We continue to see resolution across the portfolio, working out primarily the course for real estate loans and senior housing and hotels. We mentioned in the prepared remarks they're about $367 million over the course of the year. Notably, we haven't seen any new problems arise. We feel quite confident with the reserve level against both nonperforming as well as the criticized classified mortgage at this point.

Bill Dezellem

Is that declining criticized loans then primarily a function of working out those hotel and senior living facilities?

Matt Scurlock

Primarily.

Bill Dezellem

That's helpful.

Rob Holmes

I think there's three phases of (multiple speakers).

Bill Dezellem

Go ahead, Rob. I think there's a lag. My apologies for cutting you off.

Rob Holmes

I was just going to, yes, I think there's three kind of phases of improvement of reserves. One is special mentions improve as expected first. Then we start to get pay off and CRE sub standards and then we'll have the stubborn credits left that are fully reserved that we haven't seen move yet.

Bill Dezellem

Great, thank you. Then longer term, have you given guidance? And if not, can you give some perspective on where you'd like the efficiency ratio to fall relative to that 65% that you were at here in the Q4?

Matt Scurlock

No, Bill, we haven't given guidance on efficiency ratio, and it's likely premature to do so. To reiterate the opening comments, we are really focused on describing to you the fundamental components necessary for us to, once again, give guidance around return on tangible EPS efficiency ratio.

We're trying to build a business that delivers strong results across those more traditional metrics, but that's not going to be a 2022 activity. That at best is going to be a next year activity.

Bill Dezellem

Great, thank you. I thought I'd give you the opportunity anyhow. Appreciate the color.

Rob Holmes

Operator, we only have two more questions. I feel like we'd be rude not to take them, so we're going to go past the stated time and we'll stay for the last two.

Operator

Absolutely. The next question comes from Brandon Berman of Bank of America. Please go ahead, Brandon.

Brandon Berman

Hi. Good afternoon. Thank you for taking my question.

I just wanted to understand the sensitivity with respect to the disclosed NRS (phon) activity. On Slide 13 you assume a deposit beta of 55%. What are the changes to the disclosed sensitivity if you were to reduce that by let's say 10%, so to 45%?

Matt Scurlock

Brandon, I'm not sure I'm going to do mental math around the ALM modeling on the call. We try to break out specifically what's in the set of assumptions for you in the table. We would anticipate some level of lag in reality, of course, on repricing.

For the first 100 basis points during the last move, TCBI in general moved about 64%. The non-index seats moved about 10%. You can see that detail on the previous page, and then we've again broken out the different components for you to understand the sensitivities that are embedded in the model.

Brandon Berman

Understood, thank you.

Operator

Thank you and our final question today comes from Anthony Elian of JP Morgan. Please go ahead.

Anthony Elian

Hi. Thanks for taking the questions. Just two quick follow-ups.

In the press release, Matt you called out in other fee income there was a small one-time gain from a foreclosed asset sale. Do you have the dollar amount of this item?

Matt Scurlock

Five point nine million.

Anthony Elian

Five point nine, great. Then my follow up, looking at Slide 11, so it was another strong quarter for, of course, C&I loan growth, over about $600 million this quarter. Any specific areas that drove this, or was it broad based within C&I? Thanks.

Rob Holmes

I would say it was very broad based. It was granular. It was all core five industries of C&I. Very pleased about legacy and new bankers on the platform.

Anthony Elian

Thank you.

Operator

Thank you. We have no further questions in the queue, so I'll hand back to Rob Holmes for closing remarks.

Rob Holmes

Just thanks once again to each of you for investing the time to be with us today. Matt and Jamie are available for further questions as appropriate.

Have a great evening.

Operator

This concludes today's call. Thank you for joining.