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Texas Capital Bancshares, Inc.

Q1 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes - *President, Chief Executive Officer*

Matt Scurlock - *Chief Financial Officer*

Jocelyn Kukulka - *Director of Investor Relations*

PRESENTATION

Operator
Good afternoon. Thank you for attending today's TCBI Q1 2022 Earnings Call.

All lines will be muted during the presentation portion of the call, with an opportunity for questions and answers at the end.

I would now like to pass the conference over to Jocelyn Kukulka with TCBI. Please go ahead.

Jocelyn Kukulka

Good afternoon, and thank you for joining us for TCBI's First Quarter 2022 Earnings Conference Call. I'm Jocelyn Kukulka, Head 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 first quarter, of which concludes the first six months in the transformation of our firm. We noted on the last call that 2022 marks a clear transition from discovery and planning to executing on what we believe is our distinct opportunity to deliver a differentiated offering to best-in-class clients in our home markets.

The strategy outlined on September 1 of last year is resonating with both clients and talent that we want to attract, and our resolve has only strengthened as we purposefully and aggressively reallocate both our capital and expense base to take advantage of the market opportunities we are uniquely positioned to serve.

We continue to address the well noted imbalances in our legacy model by steadily progressing against our defined strategic performance metrics that, when realized, will enable us to generate structurally higher, more sustainable earnings through expected interest rate and credit cycles. Observed short-term earnings vulnerability to changes in the long end of the curve further evidences why we are rapidly pivoting our business model by adding the right talent and equipping support model with the products and services necessary to being increasingly relevant to our clients.

Supported by the actions taken last year to improve the balance sheet and reposition our expense base, we are moving quickly to accomplish both objectives. We have now increased frontline talent by over 60%. One notable area of investment includes C&I, where we have more than doubled the number of client-facing bankers, allotting them to specifically newly formed market segments and industry verticals. Our bankers are increasingly enabled by the right, middle and back office support model, focused on delivering new product and service capabilities, while modernizing and improving the client experience.

Material progress was evident again this quarter across, one, Treasury Solutions, two, Private Wealth, and, three, Investment Banking, and we expect to deliver new capabilities in each over the next two quarters that will significantly improve the product offering. Importantly, encouraging results are beginning to materialize, as both realized client acquisition and product and balance sheet-related pipelines have increased each over the last few quarters.

First, let's discuss Treasury Solutions. We have been clear, both in our word and in our material actions, that we are focused on becoming more relevant to more clients by serving their needs, to become their primary operating bank. We have also been clear about our belief that doing so requires tailoring expertise, products and service to defined market segments, which we simply have not had in the past.

On our January earnings call, we described two new purpose-built product offerings, a digitally-enabled, healthcare-specific revenue cycle management product and new business banking treasury bundles, both of which are in market, producing new revenue, generated by new bankers with new clients. We also noted, consistent with our September 1 strategy update, that we would be accelerating progress on both our new digital product roadmap and new digital client experience, using the competitive advantage inherent in our branch-like network to focus resources on owning the technology-enabled client experience across products, with a focus on simplified, intuitive interactions and client-enablement. This has allowed us to build for what our customers want, not what they have had.

Unique amongst our competitors, we are not burdened by a legacy M&A infrastructure, allowing our greatly improved Technology Team a simplistic platform on which to build solutions for our clients. This quarter, our Technology and Operations Teams released the first version of our internally-developed digital commercial onboarding platform. As with all new technologies, the rollout will be moderated, and the initial version will require Relationship Managers to assist new clients when onboarding commercial DDA and savings accounts. We are meeting our original deadlines and on track to deliver full self-service capability to our commercial clients by the end of the year. The new platform reduces total onboarding time through an entirely digital experience, lowering risk, limiting internal handoffs and enabling our clients to move at the pace of their business. As a result of this focus, client acquisition and pipelines for

future growth have accelerated over the last four quarters in this important category, and the rollout of the digital client journey is expected to only accelerate future market penetration.

I'd like to now address Private Wealth. Last quarter, we announced the final member of our Operating Committee, John Cummings, who assumed, among other responsibilities, our Consumer lines of business, Consumer Banking and Private Wealth. John and his team have spent the last 90 days conducting a strategic review of the Private Wealth business and its go-to-market strategy, ultimately confirming the potential to accelerate growth in an already performing, but subscale, business. We continue to experience strong organic flows, with more than half coming from new clients. Net organic flows over the last 12 months were $586 million, or 81% of total AUM growth. This is a trend we would expect to accelerate as recently added frontline talent begins maturing on the platform. We will continue to add client-facing advisors to support opportunities distinctive to our markets and business model.

Finally, Investment Banking. After receiving FINRA approval in the fourth quarter of last year, our Investment Banking segment build is on schedule. Despite a recent broad market contraction due to geopolitical and economic uncertainty, our capital markets and advisory business continues to be well received and will be a critical part in the broader solutions to benefit our clients.

It is important to remember that we are not building capabilities to chase market trends or generate short-term earnings. We are building capabilities that make our Company more relevant and viable to our clients throughout their corporate lifecycle.

We are happy to report that, over the course of Q1, we closed our first underwritten capital markets transaction and our M&A Team won multiple new mandates to advise our clients on sell-side transactions. As expected, these advisory assignments were organically developed through referring bankers in our C&I and Private Wealth segments, evidencing strong engagement with our clients and meaningful collaboration with Relationship Managers across the firm.

The last 90 days were marked by continued progress advancing both operational infrastructure and functional expertise necessary to deliver our first set of sales and trading base capabilities into the market this quarter.

When discussing the strategic rationale for an investment bank, as a component of our full-service offering, we often point to two things, the quality of our current and prospective commercial banking relationships and the imminence of our mortgage finance business, the latter of which is an early focus of these product capabilities. As a result, we expect to launch two new offerings this quarter, specifically helping our clients manage pipeline and interest rate risk and gestation finance and TBA, or to be announced, MBS markets. Consistent with our strategy, these services allow us to deepen relationships with existing clients and offer a more complete solution to our prospects, as we provide a one-stop-shop solution for their mortgage finance needs. As a result, even though the mortgage market, overall, has contracted due to the recent rate environment, we do expect our expanded products and services will allow us to capture market share and enhance our profitability this year.

This quarter, we also expect to launch trading and corporate debt securities and corporate loans, which will complement our existing syndicated finance business and offer our corporate and middle market clients to access institutional capital markets from our Dallas-based trading floor. We expect to continue making investments over the balance of this quarter and next, enabling trading and mortgage whole loans and corporate equity securities. We now know the progress we've achieved to date, coupled with the sheer opportunity created and ability to attract market-leading talent to Texas Capital. We are happy that the opportunity to build a sales and trading platform in Texas has provided a sense of partnership and ownership that resonates with known, experienced, senior market leaders which move through Dallas from leading desks in New York.

We continue to expand our existing capital markets products, rates and loan syndications platform to complement our new client-segmented and industry-focused coverage model. As a result of market conditions in Q1, we have primarily seen the benefit of these changes in mandated and qualified late-stage pipelines. We expect to make continued investments in talent to further build product and industry expertise dedicated to our covered markets and verticals. Our capital markets and loan syndication businesses will also benefit from the distribution capabilities coming online this quarter and lead left capabilities we expect to deliver later this year.

The platform we are building will be a critical complement to our core banking franchise, and, over time, serve to further diversify current sensitivities in our revenue base. Although Investment Banking fees were down linked quarter, we remain confident we will achieve our 10% target contribution levels, even in a more normalized rate environment. Matt will provide more detail on the trends and associated drivers of non-interest income as a percentage of total revenue in the first quarter, but I am confident we are building the capabilities required to achieve our stated 15% to 20% target.

After completing our comprehensive internal reorganization last year, we continue to build our C&I business across client segmentation and industry specialization. While not exclusive to C&I, core disciplines, such as our Balance Sheet Committee, are proving effective at socializing the required focus on, one, client selection, two, capital allocation, and, three, partnership across the firm. These routines connect our strategy directly to our actions and ensure banker-like client teams can proceed confidently with their clients and prospects.

Business banking leadership is now in place across our five primary Texas markets and we continue to add both client-facing and credit talent to support robust, early client demand. Our tailored Treasury Solutions, as well as a differentiated cost-efficient credit model, are performing as expected, and we see both realized revenue and pipeline growing across product types each week. Formally created in September of last year, this entirely new segment will continue to produce new revenue with new clients, using newly developed products and a new service model. I have been particularly pleased with a marked improvement in the middle market banking segment across geographies.

We said in our last earnings call that after a couple of years of inward focus, we were now intensely externally focused, a fact that I continued to observe up close this quarter, while spending nearly a third of my time in our markets with our bankers, directly engaged with our clients and prospects. We are fortunate to have a foundation of well-respected bankers that were here before I arrived. They are

currently banking some of the best clients in their markets. Their collective commitment to the firm's go-forward, client-centric vision was a core part of the foundation for us to rapidly expand to other segments within their geographic areas of focus, and is a noted reason for our early success.

The Corporate Banking Leadership Team is complete, with each industry vertical lead now in place. Here is another newly formed segment with new leaders, new bankers, new clients, with new products, realizing new revenue. In fact, nearly 50% of the group's revenue producers joined Texas Capital in the last seven months. 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.

Given the firm's current unacceptable market share, we believe our opportunity is outsized, and as an early indicator of our ability to grow market share and expand our client base, C&I loans grew again this quarter and are up 23% year-over-year. Much of this growth is accompanied by high-quality, relationship-based commercial deposits, which were up 14% over the same period, and supported by a solid pipeline.

Each of the strategic priorities discussed, Treasury, Wealth, Investment Banking, and our expanded core commercial C&I coverage models, are critical to our success to building the only full-service financial services firm headquartered in the state. We remain committed to reinvesting in organic growth in order to achieve our vision, which will create a more valuable firm for our shareholders. Our ability to confidently reinvest is contingent on a balance sheet appropriately positioned to deliver returns through cycle. Given the rapidly evolving rate environment, we continue to evaluate options to accelerate the balance sheet transformation, insulating the Bank's strategy from changing market conditions. This discipline and risk strategy has been missing in the past.

Given the size of the opportunity before us, our preferred use of capital remains supporting the capability build and anticipated organic growth outlined in the strategic plan. However, the operating environment has changed significantly since our last earnings call and the impact of declining mortgage finance volumes, coupled with the potential for significant rate increases, could create opportunities for excess capital deployment. Put simply, capital levels are poised to benefit from reduced balance sheet usage and increased earnings potential.

Our current CET1 ratio of 11.46% positions us strongly against peers, and, coupled with the current valuation, the Board of Directors has authorized a $150 million share repurchase program, representing approximately 5% of the outstanding shares. Consistent with our experience and disciplined capital management and sound corporate governance standards, a share repurchase program creates optionality and will allow for opportunistic repurchases when we believe that the valuation is dislocated from the long-term value generated by high-quality organic growth.

We will continue to provide updates on our progress, accomplishments and near-term milestones each quarter going forward. Thank you for your continued interest and support in our firm. We are excited about our accomplishments to date and the year ahead.

Now, I'll turn it over to Matt to discuss the quarter's results in detail. Matt?

Matt Scurlock

Thanks, Rob, and good afternoon.

Let's begin on Slide 9.

First quarter results depict an expense and capital base increasingly focused on supporting our defined strategic objectives, while also highlighting the known sensitivities of our current balance sheet and timing differences associated with changes in the interest rate environment.

Net income to common was $35.3 million for the quarter, down $25.5 million quarter-over-quarter, driven primarily by the 27% decline in average mortgage finance loans, as the sharp rise in mortgage rate accelerated the industry's anticipated full year market contraction into Q1.

Total revenue was down $21.7 million in the quarter, or $15.8 million when removing the $5.9 million one-time gain that occurred in the fourth quarter of last year. Results were negatively impacted by a $14.5 million decrease in interest income associated with the decline in mortgage finance loans, which is partially offset by continued redeployment of excess cash into higher earning assets. Benefits to earnings associated with our deliberate multi-quarter increase in asset sensitivity at this point await further realization of the forward curve.

Non-interest expense continues to grow as expected, and I'm pleased with our progress redeploying savings realized last year into higher value initiatives that will create future scale. Salaries and benefits increased by 14% year-over-year, while total non-interest expense increased only 2%, reflecting our success in self-funding the noted growth in talent and technology-enabled capabilities necessary to deliver the critical early stages of our transformation.

Multi-quarter credit trends remain favorable, with criticized loans declining 18% quarter-over-year and 50% year-over-year, driving a negative provision of $2 million in the quarter, compared to a negative $10 million provision in the fourth quarter of last year.

As part of the Bank's proactive interest rate risk management strategy, $1 billion of longer duration securities were transferred into held-to-maturity from available-for-sale at the beginning of March. Even with the transfer, the steady rise in the long end of the treasury yield curve throughout the quarter resulted in a linked quarter increased negative AOCI position of $158 million.

Moving to Slide 10, ending period C&I loans, excluding PPP, increased again this quarter, up $414 million, or 16% annualized, signifying early benefits of expanded coverage, improving calling disciplines and focused execution on our defined strategy. This observed continuation of loan growth over the past several quarters has driven C&I balances, excluding PPP, $2 billion, or 23%, higher year-over-year. Notably, the number of businesses and bankers coming online continues to expand, supported by maturing front, middle and back office alignment on client selection, go-to-market strategy and available product solutions. Growth continues to come primarily from new relationships, as utilization rates moved only slightly higher in the quarter to 50%, still below our pre-COVID average of low 50s. PPP payoffs

continue with a total remaining balance of $22.7 million, leaving approximately $300,000 in fees to be earned, which we expect to realize this quarter.

Moving to real estate, we noted on the fourth quarter call that while we expected the pace of loan payoffs to remain elevated, we anticipated they would retreat from record levels, at a minimum allowing originations to keep pace with payoffs by mid-year. Consistent with our expectations, period end real estate balances grew by $166 million, or 14% annualized, in the quarter, reflecting modestly increasing production levels as payoffs reverted down to a 36% annualized rate, versus the 49% experienced in 2021. Consistent with our longstanding strategy, the majority of new origination volume was in multi-family, reflecting both our deep experience in the space and preference for this property type, given observed performance through credit and interest rate cycles.

The balance sheet and earnings momentum created over the last four quarters has better positioned us for what we knew would be a pullback from record-high mortgage volumes experienced over the prior two years. Average mortgage MFLs declined by 27% in the quarter, on par with the contraction experienced by the broader industry, but in excess of market-based expectations shared on our January call. During the quarter, the 10-year treasury rate increased 80 basis points, which eliminated the economic incentive to refinance for many remaining homeowners. Primarily driven by mortgage finance loan activity, brokered loan fees also declined $1.7 million quarter-over-quarter, and will likely remain near these levels in the second quarter.

As we said on our last call, mortgage finance is an increasingly broad and important business for us. Rob noted in his comments that we are progressing on our plans to become less dependent on the mortgage warehouse alone to drive revenues, launching our first set of mortgage finance-related capital markets products this quarter.

Moving to Slide 11, quarterly non-interest-bearing deposits were down, reflecting predictable seasonal movements. Despite the quarterly fluctuation, underlying core trends remain strong, with corporate and middle market non-interest-bearing up 48% and 13%, respectively, year-over-year, and real estate up 20% year-over-year. Focused reductions in quarterly average interest-bearing deposits of nearly $5 billion from fourth quarter 2020 levels included the runoff of $1.1 billion in high priced brokered CDs and the intentional actions taken to reduce $3.9 billion in higher cost, rate-sensitive indexed deposits. Collectively, these actions improved our ratio of quarterly average non-interest-bearing deposits to total deposits to 51% at 1Q 2022, up from 43% at 1Q 2021.

At the outset of potentially rising rates, both the changes to our business model and the ongoing refocusing of our balance sheet leaves us with an improved funding position relative to the same point in the last tightening cycle. Ending period indexed deposits are now 23% of total deposits, versus 32% at the end of 2015. We also have a higher mix of non-interest-bearing deposits, 53%, now versus the 42% at the end of 2015, and, most importantly, we have a focused strategy to generate and sustain core operating account growth across the platform. The improvement in core funding signifies an increasingly valuable franchise and, when coupled with robust liquidity levels at this point in the rate cycle, an enhanced ability to reliably realize the benefits of our asset sensitivity profile.

Turning to NII sensitivity, on Page 12, as you may recall, our multi-quarter build in disclosed asset sensitivity is the result of deliberate actions to reposition the balance sheet. In addition to the programmatic exit of high-cost, high-beta indexed deposits over the last five quarters, we moderated our bond buying program in Q3 of last year, choosing to simply reinvest cash flows, as opposed to locking up excess liquidity ahead of a potentially tightening rate environment and improved loan demand. Asset sensitivity was also enhanced last quarter, as a portion of floored loans rose off their floors after the FOMC actions in March.

Shown to the left side on Slide 12 is the results for our asset sensitivity modeling, which increased again this quarter to 9.5%, or $71 million, in a plus 100-basis-point shock scenario. The modeled results are a valuable risk management tool and helpful in horizontal comparisons across the peer set. It is important to keep in mind key high level assumptions, such as the use of a static non-growth balance sheet. The core component of our asset sensitivity profile is the 82% of the total LHI portfolio, excluding MFLs, that is variable rate. 69% of these loans are tied to either prime or one-month LIBOR. Today, 70% of variable rate loans with floors are still at their floors. However, with a 50-basis-point rise in rates, 55% of floored loans will rise off their floors; meaning, $1.9 billion of loans acting as fixed rate today will return to variable rate.

While we are pleased with our current positioning, as mentioned before, we will look to neutralize our asymmetric interest rate exposure over time, insulating our strategy from unanticipated changes in market conditions and enabling sustained investment in performance through cycle. The accelerated moves in the rate curve have potentially pulled forward this opportunity and we are thoroughly evaluating how to best position our balance sheet going forward. We have a variety of tools to prudently achieve this goal, including expanding the use of fixed rate loans, managing duration in the investment portfolio, and the use of derivatives.

Moving to Slide 13, net interest margin increased by 11 basis points this quarter, while net interest income declined $10.5 million, predominantly as a function of decreased mortgage finance loan volumes, partially offset by increased yields in the investment portfolio. During the quarter, increasing rates caused actual and expected prepayments on the securities portfolio to decrease, substantially reducing the amount of amortization expense required. Cash flows remain approximately $100 million a quarter, with securities coming off the book at a roughly 1.2% book yield, versus new securities, which are primarily five-year treasuries, coming on closer to 2.65%.

It is important to note that while variable rate asset yields have now reset to higher levels, timing associated with the 20-basis-point increase and one-month LIBOR that occurred in March had little impact on loan yield or interest income this quarter.

Turning to Page 14, as I mentioned, we are systematically aligning our expense base behind our strategic priority and continue to reallocate the $130 million of run rate saves generated last year into an ultimately larger, but significantly more productive, expense base. While total non-interest expense has increased by only $2.8 million year-over-year, salaries and benefits are up $12.6 million and now comprise 65% of total non-interest expense, up from 58% in Q1 of last year. Our expense growth guidance is unchanged, as we remain confident in the cadence of expense save redeployment and investment in the Bank.

We continue to build on the foundational actions taken last year and are progressing meaningfully toward our defined strategic goal of financial resilience. Despite observable credit metrics improving again this quarter, we are proactively monitoring for potential recessionary exposures caused by economic and geopolitical uncertainty. Credit disciplines established at the beginning of COVID, including quarterly borrower-specific reviews, quarterly portfolio reviews and client-specific strategy assessments, remain in place. We have recently enhanced the scope of this process to include the current geopolitical and macro-economic environment and are prioritizing risk assessments based on industries and clients who may have heightened interest rate, commodity price or supply chain pressures.

In addition to the described improvements in the quality of on-hand and contingent liquidity, regulatory capital levels continue to build above already record highs, with CET1 and total risk-based capital reaching 11.46% and 15.68%, respectively, this quarter, comparing favorably to peers and in excess of internal targets.

As I described on our last call, we adhere to a disciplined and analytically rigorous approach to managing our capital base in a way that we believe will drive long-term shareholder value. I also noted in January that, given the combination of suppressed short-term earnings and anticipated balance sheet growth associated with our strategy, it would be prudent to preserve excess capital. To reiterate, the benefits of the strategy are appearing at the pace and magnitude we anticipated, expected growth is materializing, and our belief we can achieve the plan remains unchanged. What has changed, however, is the economic backdrop, which has already lowered balance sheet capacity needed for mortgage finance, and the potential for rate increases, which could lead to earnings generation above our near-term capital demands.

As Rob mentioned, the unique intersection of interest rate dynamics, the Bank's expected earnings profile generated through organic growth and the current market valuation has created the potential opportunity for the Company to accelerate capital return to shareholders through a tangible book value accretive share repurchase program.

An update to full year guidance is contained on Page 15. Our methodology remains consistent and the impact of forward interest rates is isolated to mortgage finance volumes. Mortgage finance loan yields have improved modestly, with refreshed expectations in current market conditions. With no changes to 3/31 interest rates, the impact of lower mortgage finance balances will result in full year revenue contracting low-single-digits. As mentioned, our expense guidance remains unchanged, and, importantly, our published target to achieve quarterly operating leverage is also unchanged.

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

Rob Holmes

Thank you, Matt.

Operator, we're available to take questions.

Question and Answer

Operator

Our first question is from the line of Brady Gailey with KBW. You may proceed.

Brady Gailey

Hey, thanks. Good afternoon, guys.

Rob Holmes

Hey, Brady.

Matt Scurlock

Hey, Brady.

Brady Gailey

I just wanted to start with the mortgage warehouse. I know, historically, Texas Capital has had the off-balance sheet program, where you farm some of those balances out to other banks. Is that an opportunity to bring back on-balance sheet to help to kind of buffer this downturn we're seeing in volumes?

Rob Holmes

I would say, for the most part, on the volumes for mortgage finance, the six tools we talked about using in the past, we've used all of them, so we've used the tools. The things that we have done to really help with mortgage finance is, over the past year, for the first quarter of 2021, till March of '22, is we positioned the mix of mortgages that we finance with our clients, based on our client base, to a much higher percentage of purchase from refinance. We've also made a very deliberate rating move in terms of client selection. We had a purposeful rotation and remix of the client base, where we focused over the last 12 months, to a better capitalized, stronger client base. So, we feel really, really good about the credit of our clients, we feel good about the mix of their business, and we feel good about the other opportunities that we're introducing, such as gestation and TBA with the client base that we have.

Matt Scurlock

Hey, Brady, this is Matt. The only thing I would add, I would add to that, is the original guidance considered a Mortgage Bankers Association forecast where the note rate on a 30-year fixed rate mortgage exited the year at about 4.50. As you know, we were at 5% exiting the first quarter. So, the environment has dramatically changed there. Hence, the change in guide. We won't be immune to broader market pressures, but, as we've said, both in this commentary, as well as on the last call, that's a really important business for us and one that we want to be increasingly relevant to our clients in; hence, the products that we're rolling out this quarter in the Investment Bank.

Brady Gailey

Yes, and, Matt, just to clarify, on the full year 2022 guidance, the mortgage warehouse yield of 3%, that does not include any sort of rate hikes. I know the warehouse, I think, floats maybe daily, but with the rate hikes that we're expecting to see, that yield could be a lot higher than 3%, realistically, right?

Matt Scurlock

Yes, Brady, that's a bit of a unique component of the business, as you know. The move to 3% guidance certainly reflects the move up in rates experienced in the first quarter, as well as the anticipation that it's going to remain a very competitive environment, and then I would point you to the increased exposure we gave around overall asset sensitivity. You can think about the mortgage finance business is absolutely encapsulated in the 9.5% up 100, and the 20% up 200 view. But, all of the guidance, which is how we will do it for a while, is exclusive of any additional rate moves. The volumes, of course, for mortgage warehouse, the forward curve is implied. That's the only piece of the guidance that is subject to rate moves.

Brady Gailey

That's helpful. Then, finally, for me, it's great to see the $150 million buyback, especially with the capital build this quarter and the stock trading basically at tangible book value. That buyback authorization, is that just a tool that's out there, maybe you use it, maybe you don't use it, or do you guys plan on really getting aggressive and using that amount this year?

Rob Holmes

Yes, Brady, I would say that we have a number of new financial disciplines in place that we've lacked in the past, frankly. There's more of a new normal now with finance at Texas Capital. We have a distribution policy governance and tools in place, and obviously (inaudible). We didn't have a shelf always in place before, you'll never see us without a shelf. We also have much greater talent pool tools and governance to proactively and perpetually manage the interest rate risk and the balance sheet going forward. It's just a broader extension of the tools and disciplines, talent, governance that we have at the firm.

Matt, do you want to add anything?

Matt Scurlock

Yes, I'd just say that, Brady, we're not ready to disclose any parameters or pace, but, as you would expect, the factors that we would consider are the stability of our credit profile, which, as you noticed in the metrics, continues to improve the decreased need to support cyclically high levels of mortgage warehouse assets. So, implied in the guidance is about $1.5 billion decrease in average balance. If you imagine your whole 10% capital against that $1.5 billion, that's roughly $150 million of buyback capacity. Then, something different now from the last quarter is this real potential for improvement in earnings from realized rate increases. Those are the factors we'll evaluate. Then, importantly, we also see real momentum in the core business, which gives us confidence to manage our capital in a broader set of ways.

Rob Holmes

Yes, and as you say, it's a very benign portfolio in risk and credit, as well.

Brady, you know our background. I've advised a lot of Boards on distribution policy and this is not just emphatically safe. This is not inconsistent with our strategy. This is a side part to our strategy and a good corporate finance discipline.

Brady Gailey

Yes, that makes sense. Thanks, guys.

Operator

Thank you. The next question is from the line of Brock Vandervliet with UBS. Please proceed.

Rob Holmes

Hey, Brock.

Brock Vandervliet

Hey, good afternoon, guys. Just going back to mortgage warehouse a bit, by our kind of back-of-the-envelop, if we just keep the balances kind of flat for the rest of the year, I'm getting to a 27% drop in average balances full year-over-full year, '22 over '21, implying that there's not much left to go to meet that 30% guide. Am I kind of on track there?

Matt Scurlock

Yes, we don't—I mean, at this point, Brock, we don't see the typical resurgence in mortgage warehouse volume occurring in the Q2 and Q3 period. The pool of eligible refis is essentially gone at this point and affordability is still an issue. So, we're comfortable with mix, and I think you're on the right track related to the guidance.

Brock Vandervliet

Yes, I think the flip side of that is the pain is visible now, as opposed to, you know, a lot of it dribbling out later in the year. Okay, good.

Just in terms of—another guidance question. I noticed operating leverage, that's unchanged, revenue guide is down. What does that imply for the inflection in operating leverage? Does that make it weaker when it occurs or does that just kind of change the timing of some of the pressure that you may see? How should we think about that?

Matt Scurlock

Yes, I'll start on that, Brock, and, Rob, please jump in. I think at this point in the transformation, Brock, we're right on track. The only thing for us that's really changed in the outlook is lower mortgage warehouse volumes. We're adding the talent, we're laying the capabilities. We're beginning to realize the balance sheet growth and the anticipated revenue pickup. So, the only thing that's moved is the warehouse, hence, the move down on the revenue guide, and we still feel comfortable with the back end of this year, early next year to grow year-over-year quarterly PPNR.

Rob Holmes

Yes, I would just say the same. A new business-banking vertical, new products and services, pipelines are good, activity is good, middle market is very robust, the TS products been well received. Loan growth is good, as you saw, broad loan growth across all middle market, which is the first product usually in a relationship, and then all the industry verticals in place, all the leads in place, most all of the bankers now in place. Pipelines are very good, but you've got to also remember, immature, at this firm, by these verticals, but we're confident, by the activity, the client receptivity, the Investment Banking product and services, all on time. In the first quarter of this year—I'm sorry, the second quarter of this year, we'll have gestation and TBA, corporate debt securities, etc., tech is on time. So, to Matt's point, the strategy that we had to land technology, products, services, talent and the reorg is in place and we're encouraged by the pipeline build to date. So, there's no other message there.

Matt Scurlock

I guess the only other thing, too, I'd mention, Brock, is it's a full year view on the guide, and it took us about two quarters to pull out all of the revenue related to correspondent lending last year. So, we started to dismantle some components of the business that were no longer relevant for the go-forward strategy, but that were accretive to revenue, sort of troughed in the middle of the year. So, that's another component as you think about full year to full year.

Brock Vandervliet

Got it. Okay, appreciate the color.

Matt Scurlock

You bet.

Operator

Thank you, Mr. Vandervliet. The next question is from the line of Jennifer Demba with Truist. You may proceed.

Rob Holmes

Jennifer?

Operator

One moment. Ms. Demba, you may proceed.

Jennifer Demba

Can you hear me now?

Rob Holmes

We got you. Go ahead.

Jennifer Demba

Hello?

Ron Holmes

Hi, Jennifer.

Jennifer Demba

Sorry. Your credit profile looks really good right now, but, as you said, the economic backdrop and amount of uncertainty going forward has changed. How do you look at your credit costs in the next few quarters, your reserves, and what you're expecting for loan losses; and also, what do you feel are the most vulnerable portfolios or buckets in a rapidly rising environment, rate rising environment?

Rob Holmes

I'm sorry, I didn't write down all those questions, but we'll just take it at a high level and then Matt can follow up, and then you can ask again if I didn't answer your question. What I would say is we're really pleased with the asset quality that we have in the portfolio. We've said in the past we do have some legacy issues, I would say, in the C&C category in the portfolio, that we're still working through in a very measured and intent way. But, nonetheless, overall, one of the things that gave us the confidence to do a share buyback was our asset quality, the new disciplines that we have in place to actually onboard new clients in this environment. While I have a bearish view, as most people, to inflation and geopolitical, supply chain and talent shortages, and everything else, we are very mindful of those, but we have a lot of really good processes in place to make sure we're onboarding the right clients. We're just as much focused on the right client as the right structure. The good news about environments such as this, and going into higher risk environments, is banks become more rational. So, we will actually be able to do deals today with clients we wouldn't do in the past because of the rationalization of the banking industry. So, it can be a positive.

Then, the pockets of the portfolio that we would worry about are the exact same ones that you would worry about, which would be ones that are susceptible to inflationary issues, like commodities, or had exposure to Europe, which is in a recession—if not formally, soon to be, is my view. So, there's a lot of things that we're looking at. We're very measured, but it's all about client selection.

Then, the last one, real estate, we talk about that a lot. We feel great about our client selection there. We're with 15 of the largest 25 developers in the country. We have very large exposure to multi-family versus other classes, that's intentional. As I've said, if that business hadn't been proven successful through COVID, as it has been, and we hadn't played it so well, if they didn't perform as well as they did, our strategy would have been delayed. So, we feel really good about the real estate exposure, as well. We're not immune to it and we're very aware of the rising rate environment and issues that presents to the people in the real estate industry, but we're underwriting for that and using those sensitivities in our underwriting standards.

Do you want to add anything?

Matt Scurlock

The only thing I'd quickly add, just to get to your question on the numbers, Jennifer, is we've been pretty consistent over the last year in our internally described posture of being aggressively conservative. Our ALLL to total loans is still sitting right at about 100 basis points, so well above day-one CECL, the coverage ratios look really good, but we are cautious on the outlook. If you try to translate that into a provision forecast, it's pretty tough. We said in the first call that we disclosed that through cycle net charge-off range, 25 basis points being the low end. I think that's probably still a good assumption. But, we are cautious.

Jennifer Demba

Okay, thank you.

Operator

Thank you, Ms. Demba. The next question is from the line of Michael Rose with Raymond James. Please proceed.

Michael Rose

Hey, good afternoon, and thanks for taking my questions. It looks like you're about halfway through, or close to halfway through of the hiring expectations to get to 2.3x client-facing from the base. Just given the lower revenue expectations, is there any thought process given to maybe slowing down the pace of hiring and maybe like some of the revenues begin to catch up, or is it just kind of full steam ahead, build up the teams, and then the revenue will come later? I'm just trying to balance kind of the near term with the intermediate term. Thanks.

Rob Holmes

Yes, no, thanks, it's a great question. We're not close to the end. The 2.1x is C&I. The 60% more is frontline-facing bankers across the platform. The 2.3x was for overall frontline-facing. So, we've got a ways to go. I will say we're really pleased with the people that we have in place and with the people that have said yes and not on the platform to date. I would say that everywhere we've added people from business banking to middle market banking to real estate to corporate, every single industry vertical where we've added talent, we've seen new pipelines with tangible and qualified that is coming, but for time. So, we're not slowing down a bit. We're really excited about it.

We've also been able to—Matt may want to talk about this a little bit. I'm surprised more people haven't asked about it. For us, to be up on non-interest expense, where we are versus as a whole, we've been able to self-fund a great deal of this through savings in tech, through savings in vendors, savings in different processes, and really just stopping stupid things. The ability to self-fund is greater than we had hoped. We hope to have more to go there on a go-forward basis. We're going to invest it in the strategy, and where we have invested, we see very good return.

Matt Scurlock

Yes, just to add to that, Michael—Rob did steal my major soundbite for the entire call—just kidding. We're incredibly pleased with our ability to remix the non-interest expense base. I mean, we've said directly that we want to make it a more productive expense base, that's focused directly on our strategic objectives. If you would have told me last year that the increased expense by 2%, or $3 million, would now equate to doubling C&I bankers, adding 60% to frontline, onboarding the technology talent necessary to develop internally a new commercial onboarding platform, $2 billion of C&I loans in the rear-view, I would take that trade all day. So, we're very pleased with returns on the investment to date. We had no additional big expense moves this quarter, so no additional big realized savings, but I'd just say we're in the early innings still of really establishing the right process hierarchies and operational design to drive long-term efficiency. So, we're just getting going on that.

Rob Holmes

Yes, I'm going to add one thing, if that's okay, Matt. Just as an example, on technology, we haven't seen the benefits of this yet, but last June we were on-prem and with third-party service providers, and today we're primarily on cloud platforms, which allows for less capex. It'll be faster time to market, we can move faster, and it'll give us a variable cost structure, which will be very helpful to earnings going forward.

Then, to Matt's point about the digital onboarding, we now have engineering proficiency at Texas Capital Bank, which allows for a much more cost-effective time to develop, and as such—I mean, we're on track with many more products. We have consumer onboarding, commercial onboarding, guided this quarter. We'll do commercial onboarding self-service in the fourth quarter—that's actually working, though, right now as a pilot and guided. Our pilot for sales enablement is working and will be rolled out this quarter. Bask, the interest rate product, up, running, close to $1 billion of deposits. So, we're consumer onboarding, is delivered this quarter, and we're on track for the MVP of instantaneous payments. So, we're doing a lot. We paid for it, self-funded, and none of this has showed up in revenue to date for the expense that we have against it.

Then, lastly, this is just fact, not an excuse at all, but I hope everybody remembers that, talking about the revenue concern, the revenue generated this quarter was determined, literally, several years ago, with the investment and structure and products and services that were in place. These bankers—we came out with a strategy September 1, as you know. We didn't get our FINRA license till, I think, December 18. Most of these bankers landed in the back half of the fourth quarter and we're already seeing pipeline builds. So, we're actually really encouraged about revenue.

Michael Rose

Okay, that's great color, thanks. Maybe just one follow-up question. If I exclude PPP, it looks like total loans, HFI, were about 15% annualized higher, so obviously good growth, yet utilization was down. Can you just give maybe some color there; and maybe, outside of C&I, which looks to be the bulk of the growth, there's probably some CRE paydowns, but would you expect those to slow and maybe get some tailwinds, just given the relative strength of the Texas economy and the impact of higher rates as we move forward? Thanks.

Matt Scurlock

Yes, happy to take that. We're pleased with another quarter of continued C&I loan growth. I think we described it on a very early call that we would anticipate an outcome of—it's actually in the strategy that we'd grow loans in excess of Texas GDP, and likely in excess of peers. So, we continue to see that come through, with really flat utilization. Utilization's been sitting at high 40s, or around 50, for the last three quarters, which means it's almost entirely new client acquisition, which is core to the strategy. We think we've got really deep markets, where we can invest pretty aggressively against that opportunity, delivering really strong talent equipped with a bunch of new products and services to a bunch of new clients. Those are metrics that, while they're not going to determine loan growth, in particular, it's not going to be our guiding light to determine if we're successful or not, it is a really good early indicator at this point of us taking the market share that we want.

On the real estate side, we mentioned last year that was 50% of the book payoff, and that ticked down to 36% this quarter. We've been really steady on our origination volume. We've got great bankers, as Rob mentioned, matched up against really good clients. The strategy has worked for us for a long time. The pace of origination has been about the same over the last, call it 18/24 months. The tickup in balances this quarter, 14% annualized, was largely a result of those payoffs ticking down. Some of that, to be honest, was just a return to seasonal norms, so we'll see if that sustains over the next couple of quarters, but that will be the driver of C&I loan growth, is a result of the payoffs.

Michael Rose

Helpful color. Thanks for taking my questions.

Operator

Thank you, Mr. Rose. The next question is from the line of Brad Milsaps with Piper Sandler. Please proceed.

Brad Milsaps

Hey, good afternoon.

Rob Holmes

Hey, Brad.

Matt Scurlock

Hey, Brad.

Brad Milsaps

Am I coming through?

Matt Scurlock

Yes.

Rob Holmes

We got you.

Brad Milsaps

Okay, great, great. Rob, I know there's a lot of good things going on with the deposit base, with you moving out indexed money and higher cost money and bringing in more core accounts. Just kind of curious, do you think you've reached kind of a stabilization in deposits—I know there's some seasonality in 1Q, as well—or do you plan to kind of continue to chip away at that indexed money to where we could see deposits continue to come down? I just want to get a sense of kind of how to think about the remaining cash you have on the balance sheet.

Matt Scurlock

Hey, Brad, it's Matt. I'm happy to answer that. We're largely done at this point on the large proactive reductions in institutional index money. We've got a published target, we want it to be less than 15% of the total deposit base. That'll be achieved through growth in the rest of the deposit base. I think you're likely seeing a floor at this point and start to see things build again starting this quarter, and we don't have any—other than an item or two here and there, we don't have any in-place plans to push out any more of the high-cost, high-beta deposits.

Rob Holmes

I think this is also where …

Brad Milsaps

Okay, great, and then …

Rob Holmes

This is the reason, Brad, that we built the digital onboarding consumer commercial and the different industry verticals, revenue cycle management, the unique products for different industries, so we'll see the PxV grow as our pipelines mature.

Brad Milsaps

Understood, and just as a follow-up, kind of a bigger picture question. You guys alluded to it several times, maybe managing your interest rate risk position, particularly as rates rise. There's probably several ways you can do that, some more quickly, some more slowly. Is there a level of Fed Funds that you would maybe become more aggressive in doing that? I'm just curious if there's, in your mind, Rob, an optimum margin that you have in mind for the Bank, that you kind of feel like you can generate the returns that you want to generate year-in, year-out. I'm sure hires is the right answer, but just kind of curious if there's like an optimum number you have in mind.

Rob Holmes

I'm going to take that, but I'll let Matt follow up. What I would say is this Bank has been way too asset sensitive for a very long time. We're uniquely positioned to take advantage of this current rate environment, given where we are and our over-reliance on asset sensitivity. However, we do not want to be overly reliant and subject to rate cycles. So, I think you'll see a very disciplined, measured approach here going forward, indifferent of the rate cycle, to have the right asset and liability sensitivity, so that you can judge us by the execution of our strategy and not market cycles.

Do you want to add anything?

Matt Scurlock

That was pretty good.

Rob Holmes

Thanks.

Matt Scurlock

If I may, I would add just a couple of additional points of color for you, Brad. We've said really directly that we have a strategic goal to be financially-resilient, and to Rob's comments earlier in the discussion, that really means insulating the Bank's strategy from changes in the economy or rate environment. Our strategy, in general, is just a set of financial returns. It's really to serve clients with the offering and capability that we've described, which we believe if we do that well, it's going to generate some pretty

impressive turns—pretty impressive returns. The complexion of the business model today, in the midst of the transition, we're still working through it, is that the strategy is more risk in a rate-fall scenario than in a scenario when rates rise. So, we don't think it makes a ton of sense to increasingly tie a larger part of our future earnings to realizing potential rate increases. We've talked a bit before that the warehouse is a great earnings hedge as rates fall, and it certainly is, but when warehouse volumes flex up, the rest of the portfolio prices down, and that dramatically increases the amount of capital that we need to generate the same amount of earnings. So, you get a ton of stress on the balance sheet, which would really lessen our ability to invest in the rest of the business.

We learned that lesson the hard way during the last rate cycle. The portion of securities that we moved to HTM this quarter, it was largely purchase at the lows in the summer of 2020. because the Bank's historical strategy was to maximize asset sensitivity at all times, There was almost a 15-year gap between bond purchases. When rates fell in early '20, there's a lot of excess liquidity, strained capital, so you redeployed to try to generate some earnings, but you're pretty limited on strategic options. I'd just say very simply we're just not going to let that happen again.

So, today, very deliberately, we're in a position of strength, we've got ample capital, a much better funding base, stable credit, a couple billion dollars of C&I loan growth in our rear-view mirror, and I think we're in a really good position to start taking actions, and our preference to do so would be properly priced fixed rate loan capacity, managing duration in the investment book, and then the select use of derivatives. We're not ready yet to disclose target positioning to you guys yet, but we'll certainly share some more detail as our ALCO aligns on the timing and magnitude of the actions, and then, of course, we'll tactically reposition over time, which we just did, in fact, slowing purchases in the bond portfolio and pushing out of high-cost deposits, but we just want to be really clear. In general, we want to move away from asymmetric bets on the direction of rates, sectors or markets. It's our view that we're not going to achieve the strategy by taking outsized exposures. We're going to achieve the strategy by trying to avoid them.

Rob Holmes

And taking care of our clients.

Brad Milsaps

Very helpful. Thank you, guys.

Operator

Thank you, Mr. Milsaps. That concludes the question-and-answer session. I will now turn the call over to Rob Holmes for closing remarks.

Rob Holmes

I'd like to thank everybody for your interest in the firm. We're really excited about our accomplishments to date, the people on this journey with us, and where we're headed, looking forward to talking to you about it in the future. Sorry we didn't get to all the people in the question queue. Thank you. Have a good day.

Operator

That concludes today's conference call. Thank you for your participation. You may now disconnect your lines.