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Texas Capital Bancshares, Inc.

Q1 2023 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*

Operator

Hello, everyone. Welcome to the Texas Capital Bancshares, Inc. Q1 2023 Earnings Call. (Operator Instructions) I will now hand over to your host, Jocelyn Kukulka, Head of Investor Relations to begin. Jocelyn, please go ahead.

Jocelyn Kukulka

Good morning. Thank you for joining us for TCBI's first quarter 2023 earnings conference call. I'm Jocelyn Kukulka, Head of Investor Relations. Before we begin, please be aware that 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. 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 open up a Q&A session. Now I'll turn the call over to Rob for opening remarks.

Rob Holmes

Thank you for joining us today. The collective actions taken over the last several years enabled the firm to enter 2023 operating from an unprecedented position of strength with sector-leading capital and liquidity.

Our goal since our arrival was to build a firm characterized by the strength of its balance sheet and the breadth of its platform, a firm that is resilient through market and interest rate cycles.

Our closely held belief was that doing so would enable us to confidently engage our clients when they needed us most, bringing forward a suite of solutions centered on their needs, not ours.

Client and prospect engagement since the events of March 10th have been significantly and constructively heightened, with the agenda focused on their needs and what is in their best interest. We believe being in market during times of volatility is paramount.

Our ability to be front-footed during this period of industry instability is in no small part routed in the completely rebuilt liquidity risk framework installed during 2022. Our structure includes daily liquidity KRIs monitoring in normal times. Then in times of changing market conditions, these lies on a defined and well-rehearsed set of governance and operating procedures to ensure we can react quickly if needed.

As events began to unfold on March 9, we were confident that our multiyear operational derisking would ensure that we have the right data and a full real-time view into our deposit and liquidity positions.

By Monday morning, our bankers were also equipped with the information necessary to proactively reach out to clients and prospects with a set of solutions meant to ensure their business operations continued seamlessly, despite financial industry turmoil. I'm incredibly proud of the response of our people and of our ability to be there for our clients at a time of great uncertainty and elevated apprehension.

As I was in our markets visiting clients during the following weeks, they expressed appreciation for our proactive outreach. And in many instances, we were the first and sometimes only call they received that Monday morning. And they thanked us for the education we provided on what was transpiring in the market real time.

Initial deposit flows following the weekend of March 10th were highly consistent with the assumptions in our liquidity stress testing framework, as the first focus has shifted over the last two years to emphasize businesses where clients find benefit from our broad set of solutions, we have aggressively reduced our reliance on disconnected deposit sources.

They are highly credit or rate sensitive and hold highly liquid assets for what little portion remains. This effort has been well highlighted for the past eight quarters.

Overall, for the quarter, deposits excluding areas previously disclosed as targeted for reduction increased 3%, an indication of the strength of our platform and the depth of our client relationships.

Noninterest-bearing deposits were down only 1%, the majority of which related to normal business activity such as quarterly tax payments, capital expenditures, acquisitions and quarterly distributions. We did see some activity whereby clients shifted excess operating account balances to treasuries on our platform.

Additionally, noninterest-bearing operating account balances associated with the previously divested interest premium finance entity were transitioned to their new owner. As expected, on the heels of a seasonally weak deposit quarter in Q4 due to larger balances of escrow tax payments, mortgage finance noninterest-bearing deposit balances increased meaningfully as we remain focused on deepening relationships with top-tier clients in the space.

In total, deposit balances were down just 3% for the quarter, a testament to both our proactive business model and the hard work of our employees who are actively calling on their clients to provide best-in-class treasury advisory services.

The deposit flows we experienced in March did not require us to access brokered CD markets or to utilize any of our other available sources of contingent liquidity. We exited the quarter in the same strong

position in which we entered 2023, with the balance sheet necessary to continue executing against our strategy and supporting our clients.

Our proprietary account opening and onboarding solution called INITIO has been fully implemented and delivered to the market, with over 70% of all treasury onboarding processes now occurring digitally.

Texas Capital's commercial clients can self-serve account openings and fund them within 24 hours, a unique advantage we utilized during the middle of March, as clients and pipeline as well as others were looking for a new banking partner with capital and liquidity.

In total, we doubled the number of accounts opened in March compared to February on the INITIO solution, and account openings have improved 60% compared to January. The previously detailed technology-enabled solution is making us safer, more efficient and easier to do business with, while improving the client journey.

Investment banking and trading income had a second consecutive record quarter, with revenue up $6.8 million or 57% quarter-over-quarter to $18.8 million, with contributions from multiple components of our newly built platform.

We continue to achieve milestones along our product road map with the successful execution of the first securitization and the first mortgage finance whole loan trade from the sales and trading desk.

Sales and trading has now completed over $17 billion in notional riskless flat trades since the first trade last May, closing every day flat, as we said we would. Additionally, in April, the first gestation transactions were completed, and we expect gestation activity to be a consistent part of our mortgage finance business going forward.

We are very proud of the business we built in a short period and believe the diversified revenue stream will be an important contributor to earnings going forward. With the substantial and transformative investments made over the last two years to deliver a higher-quality operating model, supporting a defined set of scalable businesses, we are now generating expected efficiencies.

Last quarter, we noted that the pace of noninterest expense growth would moderate in 2023. And with additional selected actions recently completed, we will begin realizing these efficiencies in Q2, allowing us to confidently pull in our expense guidance, again, which Matt will detail in his comments.

Year-over-year quarterly PPNR grew 55% in Q1, an acceleration of over the 20% growth, excluding nonrecording items experienced in Q4. As a foundational tenet of the financial resiliency we have established and will continue to preserve, along with the value creation for our shareholders, tangible book value per share grew 3% quarter-over-quarter and 6% year-over-year, ending at $58.06, a record level for our firm.

As you have heard me say in the past, while fully committed to improving financial performance over time, maximizing near-term results is not the primary goal. We are instead focused on responsibly scaling high-value businesses through improved client adoption and realized operational efficiencies.

The thoughtfully and deliberately rebuilt client-focused business model is designed to earn above our cost of capital through cycle and drive structurally higher, more sustainable earnings. Importantly, as a reminder, our strategic planning process acknowledged that we would go through an economic slowdown during our planned horizon.

As such, we are prepared and positioned to continue investing against the strategy to bank the best clients and support them through cycles. We do not manage the bank in a risk-on or risk-off posture, but instead, based on the belief that client selection is always paramount.

This remains our focus as we help our clients continue navigating a challenging operating environment in 2023. Thank you for your continued interest and support of our firm. I'll turn it over to Matt to discuss the quarter's results.

Matt Scurlock

Thanks, Rob, and good morning. Starting on Slide 4. As Rob described, we're proud of the deliberate steps taken over the last two years to solidify our competitive positioning. The firm continues to maintain substantially more liquidity and capital than required to sustainably deliver against our strategic objectives.

At quarter end, on-hand cash liquidity totaled $3.6 billion or 13% of total assets compared to 3% median in our peer group. Total shareholders' equity is 6.7x that of total unrealized loss compared to 3.6x for large U.S. financial services firms. Uninsured deposits as a percentage of total deposits decreased to 45% in the quarter.

Deposit coverage ratios were strong at quarter end and compare favorably to peers, with the ratio of cash and contingent funding to uninsured deposits of 153% and cash and contingent funding to total deposits of 69%.

Moving to Slide 5. Capital levels remain near the top of the industry. CET1 finished the year at 12.4%, with tangible common equity to tangible assets increasing slightly to 9.72%, a record since the year of the firm's founding and reflective of our stated objective to manage the balance sheet in a manner supportive of tangible book value with lower than peer levels of unrealized losses.

The allowance for credit losses continues to increase and is now at 55 basis points since day 1 CECL. This, alongside a multiyear transition to a more balanced loan portfolio, positions us well as the industry prepares for credit migration.

Turning to Slide 6. We delivered notable progress in our fee-generating businesses in the quarter, which continue to grow in contribution as we improve our relevance with a now consistently expanding client base.

Quarterly investment banking and trading income was $18.8 million, up more than 300% from the first quarter of last year and 57% linked quarter. Notably, this was our second consecutive record quarter since launching the business last year.

Treasury product fees increased 4% quarter-over-quarter as our advisory-centered offering and newly built cash management and payment capabilities are enabling clients to more effectively manage liquidity based on their individual business objectives. This is in part reflected in linked quarter AUM growth of 10%, as select clients decided to augment their liquidity strategies by purchasing U.S. treasuries, leveraging our broad platform to satisfy their changing needs.

Taken together, fee income from our areas of focus increased by approximately $14 million or 91% year-over-year, representing steadily improving client receptivity to the completely refreshed operating model and capability set.

Turning to Slide 7. As expected, adjusted total revenue decreased $4 million linked quarter, seasonality associated with the mortgage business and increases in deposit costs offset continued structural improvements across the franchise. It is precisely the seasonality that causes us to anchor operating leverage guidance for the same quarter in the previous year.

Revenue increased $68.9 million or 34% when compared to Q1 2022. Year-over-year results benefited from an 84% increase in noninterest income, coupled with disciplined balance sheet repositioning into higher earning assets, including loans, following the sale of our insurance preen finance business last quarter.

We stated that while our long-term plans do account for continued investment, much of the initial lift to deliver the foundational talent, technology and capabilities to support our 2025 objectives was incurred over the past several years. And that as our target operating model begins to mature, expense growth will slow in 2023.

Total adjusted noninterest expenses increased 6% linked quarter as Q1 salaries and benefits reflected increases of approximately $9 million in seasonal payroll and compensation expenses that peak annually in Q1 and $12 million in annual incentive and insurance accruals that reset annually.

Taken together, quarterly PPNR increased 55% year-over-year to $78.7 million. As Rob mentioned, after achieving this important milestone in the third quarter of last year, we do expect to maintain year-over-year quarterly PPNR growth moving forward.

Net income to common was $34.3 million for the quarter, down $1 million year-over-year, while earnings per share increased $0.01. Overall, credit quality remained stable, although we are seeing the early signs of inevitable normalization we expect and are prepared for. We recognized $19.9 million in net charge-offs during the quarter compared to net charge-offs of $15 million in Q4.

Criticized loans increased $48 million quarter-over-quarter to 2.8% of LHI, primarily as a result of continued migration in a small number of consumer-dependent C&I credits. This quarter's provision expense was impacted by both realized charge-offs and observed and anticipated portfolio trends.

Turning to the balance sheet on Page 8. Balance sheet metrics remained strong, with end-of-period positioning reflective of continued execution on a previously defined set of core objectives.

Investments in the securities portfolio of $850 million, coupled with approximately $750 million of largely Texas-based C&I-related loan growth, reduced Fed cash balances by $1.4 billion, an intended result of the repositioning of proceeds related to the insurance premium finance divestiture.

The loan-to-deposit ratio rose during the quarter to 91% from 84% in the prior quarter. This is within a range we're generally comfortable with, although we would expect loan and deposit growth to be more evenly matched moving forward, as we continue our now multiyear process of aggressively recycling capital into relationships, consistent with our defined strategy.

As evidenced by this quarter's results, we continue to bias capital use towards supporting franchise accretive client segments where we are delivering our entire platform. Share repurchases remain a secondary tool for creating longer-term shareholder value. Although the March market dislocation did provide opportunities to selectively repurchase $25 million at prices below tangible book.

When paired with shares repurchased in January as part of the completion of our inaugural program, we repurchased 1 million shares or $59.7 million of common stock in the quarter.

Finally, the decline in interest rates across three- to five-year point of the curve resulted in a modest AOCI improvement of $44 million, which contributed to record tangible book value per share of $58.06 at quarter end.

Turning to Slide 9. C&I loans grew $747 million or 7% quarter-over-quarter as a result of continued discipline calling from our still new coverage teams equipped with a recently developed but highly competitive product suite. While aggregate C&I loan balances are essentially flat year-over-year at $10.8 billion, when including historical insurance prefinance loans, this now sustained loan growth past five quarters has added $2.8 billion of C&I client balances, consistent with our strategy, a 34% year-over-year increase when adjusting for divested loans.

This represents a nearly 100% recycling of capital previously attributed to loan-only relationships in the insurance brand finance business into a client base that benefits from our broadening platform of available product solutions, delivered within a rebuilt and enhanced client journey.

Growth in the quarter centered in our middle market and corporate verticals continues to come primarily from new and expanded relationships, as utilization rates were constant quarter-over-quarter at 51%. Period-end real estate balances increased $74 million or 1% in the quarter. We continue to experience the expected but still material slowdown in payoff rates from record highs over the last few years.

This is one of the most mature businesses at the firm, and we take a through-cycle view grounded in client selection, managing the portfolio using well-established and tested concentration limits.

New origination volumes slowed in recent quarters and remains focused on multifamily, reflecting both our deep experience in the space and observed performance through credit and interest rate cycles. Only 16% of the real estate portfolio has a maturity date in 2023, while over 50% of the portfolio matures in '25 or later.

Our exposure to at-risk asset classes is limited, with office exposure of $466 million, approximately 9% of the total commercial real estate portfolio. The office portfolio has strong underwriting characteristics with a current average LTV of 58%, 90% recourse as well as strong market characteristics is over 75% of Class A properties and over 60% is located in Texas.

Average mortgage finance loans declined by 23% in the quarter as broad market contraction outpaced year-end estimates from professional forecasters. As a reminder, outstanding balances in this business reflect the typical seasonality associated with home buying activity, rising in the second and third quarter and following in the fourth and the first.

Assuming the current rate outlook remains intact, expectations are for total market originations increased by 35% to 40% in the second quarter, with full year expectations still showing a decline of 25% to 30% in origination volume.

Moving to Slide 10. Total ending period deposits declined 3% quarter-over-quarter, with changes in the underlying mix reflective of both a continued funding transition in a tightening rate environment, coupled with market-driven trends and predictable seasonality.

As Rob discussed, our well-known strategy to proactively reposition away from our highest cost shortest duration index deposit sources has now been underway for over 2 years, with guidance last quarter that continued intentional reduction would persist as improving the quality of our liquidity is a prerequisite to establishing a more efficient balance sheet.

Including the $842 million, a 34% reduction experienced this quarter, we have now exited over $8.2 billion of these deposits since year-end 2020, with the period end balances now 7% of the total deposit base, down from 32% at year-end 2020.

The current client composition is now more consistent with our go-forward strategy. We would expect near-term quarterly fluctuations to moderate. As a result of our sound current and prospective liquidity position, we also had $225 million of brokered CDs mature in the quarter without need for replacement.

We maintain ample brokered capacity, and we'll always evaluate future liquidity composition, consistent with established balance sheet management priorities.

Core to our strategy remains an intense focus on thoughtfully shifting our balance sheet to businesses where we believe multiple client touch points will, over time, result in higher quality funding dates increasingly comprised of our client's primary operating accounts.

Noninterest-bearing deposits remained stable quarter-over-quarter and proportion to total deposits increased modestly to 43% from 42% at year-end. The underlying composition did shift, however, as noninterest-bearing deposits associated with mortgage finance grew $853 million or 24%, benefiting both from Q1 seasonal inflows and continued enhancements of available services to this important client base.

We expect average quarterly mortgage finance deposits to remain between 100% to 120% of average total mortgage finance loans through the year. These inflows were partially offset as commercial noninterest-bearing deposits declined mainly impacted by normal business and a predictable shift into other cash management products on our platform.

Overall noninterest-bearing deposits were down only 1% as we experienced little to no relationship movement to larger banks. Our expectation is that we will be able to grow deposits, but at a marginal cost in excess of previous expectations given the material change in market conditions experienced over the last 45 days.

This increased cost of liquidity is reflected in our NII sensitivity modeling on Page 11. As expected, after increasing modestly from the cash proceeds related to the insurance print finance sale in Q4, our earnings at risk decreased this quarter to 3.4% or $34 million and a plus 100 basis point shock scenario and minus 4.6% or $46 million and a down 100 basis point shock scenario.

We described last quarter our intent to reduce the firm's interest rate risk sensitivity from 8% in an up 100 scenario, down to the mid-single digits by the middle of the year, a goal that was accelerated and achieved this quarter given the market backdrop.

This is primarily accomplished through growth in the investment portfolio, as we continue the multi-quarter process of remixing excess cash into primarily capital-efficient Agency MBS. We added $850 million to the portfolio in the quarter, with new purchases coming on at a 4.9% yield versus those rolling off around 1.5%. The duration of the entire portfolio is now approximately 4.5 years.

We exited the quarter with 15% of total assets and securities, which is aligned with our target, and we believe an efficient and prudent portion of our liquid asset composition at this time. The actions taken in the quarter increased our anticipated base net interest income, while reducing the amount of future income exposed to rate changes not currently contemplated in the forward curve.

The core component of our naturally asset-sensitive profile is the large portion of earning asset mix that reprices with changes in short-term rates. 94% of the total LHI portfolio, excluding MFLs, is now variable rate, up slightly from 93% at year-end, with 88% of these loans tied to either prime or a one-month index.

Notably this quarter, we increased our model deposit beta assumptions to account for recently observed and expected continued industry-wide increases in funding costs. The increased beta assumptions also contributed to contracting expectations for additional future rate-driven impacts to net interest income.

Moving to Slide 12. Net interest margin increased by 7 basis points this quarter, while net interest income declined $12.3 million, predominantly as a function of higher loan yields and increased income from cash

and investments, partially offset by an expected increase in funding costs and decreased quarterly average loan balances.

The slight pullback in net interest income is entirely consistent, both disclosed expectations and historical precedent for the first quarter of each year. The systematic realignment of our expense base with published strategic priorities is beginning to deliver the expected efficiencies associated with a rebuilt and more scalable operating model.

The improvements noted in our fourth quarter call, we expect to see contraction in quarterly noninterest expense over the remainder of the year, which, when coupled with continued revenue expansion resulting from strong execution on behalf of our clients, will enable core earnings expansion, despite the market backdrop.

Moving to Page 13. Criticized loans increased $48 million or 9% in the quarter to $561.1 million, or 2.8% of total LHI. It's great migration in these categories continues to be driven by commercial clients reliant specifically on consumer discretionary income, as we've identified in the past.

During the quarter, we recognized net charge-offs of $19.9 million primarily related to 1 C&I loan. The loan was to a Texas-based public company with a management team well known in this market as part of a widely syndicated credit facility.

The allowance for credit loss was $283 million or 1.41% of total LHI at quarter end, up almost $56 million or 36 basis points year-over-year, in anticipation of slowing economic conditions.

If system-wide credit availability contracts, we are prepared for the breadth of industries and client types experiencing great migration to expand in coming quarters across the banking sector.

Moving briefly to capital on Page 14. Tangible book value per share and tangible common equity to tangible assets finished the quarter at record levels, evidence of our commitment to managing the hard-earned capital base in a disciplined manner focused on driving long-term shareholder value.

Finally, we include updated guidance on Page 15. Our guidance accounts for the market-based forward curve and assumes a peak Fed funds rate of 5% in mid-2023, the year-end exit rate of 4.25. While we are confident in our ability to continue delivering in areas that define focus, given the changes in anticipated system-wide funding costs, we do expect net interest income expansion to be slower than contemplated in previous quarter's guidance, and our lower outlook for full year revenue growth to low double digits.

As Rob and I both indicated earlier, the significant investments made over the last two years are yielding expected operating efficiencies that will begin positively contributing to financials in Q2. We are lowering guidance on full year expense growth from low double digits to mid-single digits.

Together, these expectations should result in the maintenance of operating leverage as defined as year-over-year quarterly PPNR growth. We remain committed to maintaining our strong liquidity and capital positions, and our intent remains to hold greater than 20% of our total assets in cash and securities and to exit the year with CET1 of at least 12%.

Lastly, as previously communicated, our strategic plan accounted for an economic decline during the planning horizon. And our long-term financial targets are achievable, with most normalized levels of credit costs and under a variety of different interest rate scenarios.

Despite the economic backdrop, we are firmly committed to delivering the 2025 financial targets set forth as part of our strategic plan. I'll hand the call back over to Rob for closing remarks.

Rob Holmes

Thanks, Matt. Operator, why don't you go start the questions?

Operator

(Operator Instructions) And our first question today goes to Michael Rose of Raymond James.

Michael Rose

Just wanted to kind of address what was kind of out there in the news the other day around some headcount reduction, just given that you guys have been pretty aggressive on the hiring front since you came in, Rob. Just wanted to get a sense. I assume that plays into the reduction in noninterest expenses, but just wanted to get some color there.

Rob Holmes

Yes. Thanks for the question. Look, we were led by disciplined process reengineering and review covered by our investments over the past two years and dramatically improved operating data.

And the ultimate impact was an outcome, not a predetermined reduction target. This product transformation is meaningfully complete now, and we have a permanently improved operating discipline.

I think it's really important to point out that when we started this journey, we said that by 2025, we'd have 2.3x front-line client-facing professionals than in 2025. And today, it's at 2.0x.

So the strategy intact, we're front footed, we're with clients, we're in market, and this has to do with becoming more efficient in breaking the cost curve. It will make us a more structurally profitable firm going forward.

And we don't capture -- you mentioned that perhaps that's understandable based on rumor and assumptions. But we don't talk about it in terms of percent reduction in head count because that implies

the onetime save. And our transformation is permanent improvement and the operating efficiency. We're really excited to break down guidance on expense.

And one more thing related -- sorry, really, I think one more thing that's important is it makes the firm safer. We're more automated, and it improves the client journey. So anyway, sorry.

Michael Rose

No. No problem. Appreciate it. Maybe just going to this quarter's loan growth, and I hopped on a little bit late, so sorry if I missed it, but it looked to be, again, kind of very strong ex warehouse that's held for sale.

Can you just give us an update on pipelines and migration trends just given the lenders that you've hired? And if you have semblance for what the puts your case could be to growth outlook for the rest of the year.

Rob Holmes

Sure. Look, I think it's -- Matt mentioned it in his comments. I think it's important to point out that we expect loan to deposit activity to mirror more consistently one another in the future. I think this is -- our pipelines are really, really strong with new client onboarding.

We onboarded new clients -- more new clients in the first quarter than in the history of the firm. We onboarded more new clients in March than any other month. But I think it's also really important to note that we have not deviated from loan growth not being a goal.

It is not our goal. Our goal is client acquisition and banking the best clients in our markets. And if you look at what's come through balance sheet committee, which is, remember, we have two approvals to extend credit. One is risk and the other is the use of capital.

Balance Sheet Committee approves the use of capital after the risk has been approved. And in 95% of the submissions by our bankers and Balance Sheet Committee have been more than loan only. So our clients have taken advantage of the broader platform, which is an imperative for us to earn more than our cost of capital.

Michael Rose

Helpful. I appreciate the color. Maybe just one final one for me. So the interest-bearing deposit costs continue to kind of move higher. Do you think we're getting to a point though where we're going to start to see that peak off? And sorry if I missed any sort of commentary, but any sense for kind of what you'd expect for updated betas as we move through the rest of the year, assuming the forward curve?

Matt Scurlock

Yes, Michael, I think terminal beta implies you know where the Fed is going to stop. And at this point, I don't think that we do. I think the broad deposit shift, certainly, in our base have occurred. We wouldn't expect a continuation of that trend. But I would expect interest-bearing deposits to generally stay on the same trajectory in terms of beta until the Fed let slow their trajectory.

Operator

The next question goes to Brett Rabatin of Hovde Group.

Brett Rabatin

Wanted to start off on just provisioning and looking at the commercial criticized change. It didn't seem like you had significant changes in your criticized assets. I was a little surprised at the provisioning level.

Was there any change in terms of what you're waiting maybe on the CECL Moody's model? Or can you walk us through a little bit more the changes and dynamics of the model for the provision?

Matt Scurlock

Brett, this is Matt. We continue to experience pretty substantial new client acquisition that's showing up as loan growth. And have been committed since Rob's arrival, our words being aggressively conservative and establishing a reserve.

So over the last four quarters, we've increased our ACL by $56 million or 36 bps. So the aggregate level as a percentage of total loans leveled off this quarter. And I think at this point, we're pretty comfortable with positioning.

There was a modest increase in NPAs that's worth describing. It's -- the incremental NPA this quarter is really just concentrated in a small number of lower LGD credits. At this point, we think we're pretty well reserved for.

Brett Rabatin

Okay. That's helpful. And then the strength of the investment banking this quarter, do you think that's sustainable? Or was that a couple of transactions that maybe won't be quite as meaningful going forward as you see the pipeline?

Rob Holmes

No. We that highly sustainable. My comments, I think I mentioned that it was broad-based. So there's multiple products and services that our clients are using, some new for the first time, others much improved.

And so you have capital solutions, which is rate. You've got syndications, you have M&A, you've got sales and trading, capital markets. And there is a broad acceptance in the market across the entirety of the platform that, frankly, I'm surprised has matured as quick as it has.

And so we're really -- we're highly confident in -- the other thing that's really encouraging is the model itself is working the way it should. So a lot of these referrals -- remember, we didn't build the investment bank for a different set of clients. We built the investment bank for our current clients and new clients in our target markets.

So it's not a disparate line of business. It's only one. And they are being referred to the investment bank through private wealth advisers, through middle market bankers, through corporate bankers. If the model is working, the platform is working as intended.

Matt Scurlock

Which, Brett, as you know, exactly how we believe you're going to start to see expansion and returns over time. I mean, the $3 billion of C&I loan growth over the last year, to Rob's point, that balance sheet that we're giving to clients who are going to benefit from the rest of the platform.

Brett Rabatin

Okay. That's helpful. And if I could sneak one last one in on -- a follow-up on the expense guidance. Is the pivot to lower expense guide, is that -- do you think totally a function of just a lower revenue environment? Can you talk maybe about there could be a thesis of, hey, you take market share more proactively while others pull back from a credit availability perspective?

Rob Holmes

I'll comment, then I'll let Matt I'll comment and let not go in with numbers. This is -- the expense guidance is due to a structurally improved operating platform, which has been not only processes being reengineered and automation, but the entirety of the platform working together. It is totally rebuilt and fit for purpose. And so the guidance is not like a onetime save. We think our efficiencies will scale as revenue grows.

Matt Scurlock

Brett, the only thing I would add to that is that these are enhancements that we've been working on for a long time. Rob spent a good portion of the fourth quarter call discussing that disciplined and pretty significant reengineering.

So as those enhancements matured, we were able to actually get the efficiency at the end of this quarter. An important point of Rob's earlier comments is that these are largely operational reductions.

So frontline employees are still up 2.0x since Rob's arrival first quarter of '21. So we're proactively in market this quarter on March 13, Monday after the SVB issues, proactively calling on clients, availing to them the entirety of our platform and trying to go make the best clients in our mortgages.

Rob Holmes

Just one more comment just not to pile on, but in the proxy, you may have seen the CEO goals last year. One of them was -- it seems kind of try for a lot of companies. But for us, it was one of my goals that we had as a firm was cost allocation and to understand that much better through the entirety of the platform.

And that was leading to our ability to be able to have the structural operating and tech improvements. So it's all tied together.

Operator

The next question goes to Brody Preston of UBS.

Brody Preston

I wanted -- just to, I guess, maybe put a finer point on the expense front. I hear everything you're saying from an operational perspective. But maybe, Matt, if I could try to dive into the numbers, right, the -- I guess, the mid-single digits, kind of assuming 5%, assumes that like the average quarterly run rate for the remainder of the year would step down like by about $20 million or so.

I guess, could you -- I guess, maybe could you help us think about the glide path of how the quarterly run rate is going to look throughout the remainder of the year?

Matt Scurlock

Yes, happy to start on all expenses, not called salaries and benefits. So coming off the fourth quarter call where we had some nonrecurring items, we said when that $81 million down to about $65 million to $70 million a quarter through 2023. Brody, I think that's still the right assumption.

If it moves towards 70, that's an indication that rates are elevated. If that blends down to 65, it's that the forward curve has been realized, and the Fed had stopped tightening. So then on the 128 7, which is salaries and benefits expense for the first quarter, as I mentioned in my comments, about $7.5 million of that is seasonal, which takes you to $121 million.

And then about $12 million of that $121 million is the annual reset on health care and incentive accrual. So $121 million is the right starting number as you look out for the duration of the year. And then we would expect the majority of the reduction in noninterest expense guide to occur from previously implemented actions to reduce salaries and benefits. And you should see it start to show up this quarter.

Brody Preston

Got it, got it. So it seems like it's a little bit more immediate than is how I should interpret that.

Matt Scurlock

Yes, we took the actions in...

Brody Preston

Got it. Okay. And then on the mortgage warehouse front, I think it seems like, at least from my perspective, that was an area of strength. for you all this quarter, with the balances being relatively flat, and we should have seasonally stronger warehouse going forward.

And so could you talk maybe about how you're expecting warehouse balances to flow in the second quarter? And then importantly, how that should positively impact deposit flows, particularly NIB here in the short term?

Rob Holmes

I'll comment then Matt can answer your question. I would say that the strong performance in mortgage, the continuation of our ability to do more business with the best clients in that space as a direct result, but having created a very broad product offering with really good operating capabilities and great professionals.

So, we see (inaudible) to do more business with the best clients with deeper relationships, which sends -- (inaudible) more deposits and loan balances to us. Matt, do you have anything else?

Matt Scurlock

Yes, I'd say that ending period balance and (inaudible) were 24% higher than average, which does indicate strong momentum going into Q2. Ending balances were about 2% higher than average in the first quarter of last year. We still believe that warehouse balances are likely to be a reduction or help balances through the year likely to be about 75% of aggregate, one to four family originations, which Moody's is now forecasting that to be down by about 30%.

And then the previously established guidance on deposit -- average deposits relative to mortgage finance loan balance is 100% to 120%. I think we're likely to land toward the higher end of that range. As to Rob's point, we're able to do more with the clients that we have on the platform.

Brody Preston

Got it. That's helpful. And then if I could just switch over to credit. I guess, on the one-off charge-off that you called out, could you give us a sense for what industry that was in?

I think you had previously mentioned last quarter that there was some of the charge-offs from last quarter related to some older vintages. Does this kind of fall into that same category?

Rob Holmes

So I'll comment, then let Matt -- look, this is a -- I think Matt said just commented a C&I client, Texas public company, a lot of high-quality banks were in this credit and, it's still from a seemingly unforeseeable risk. There was a consumer rewards nature to this business, which had a large exposure to Eastern Europe, and the war in Ukraine actually really negatively impacted the consumer behavior and confidence.

And it led over to the Americas businesses. So I would say it was a unique credit because we don't have a lot with international exposure like that. We did like this management team. The company was strong and had a great bank following, but that risk is hard to foresee. And it migrated very, very fast, obviously.

But no, that is -- that was a new vintage, non-legacy risk exposure that was highly correlated, consistent with our strategy, unfortunately. Matt, do you have anything else, no? Did that answer your question?

Brody Preston

Yes. No, that's very helpful. And then just lastly, on the nonaccrual balances, I noticed that the nonaccruals, it's off a very low level, obviously, but I noticed the nonaccruals ticked up from $48 million to, looks like about $94 million. So you wanted to get a sense for what drove that, if it was related to this credit that you charged off or if it was more related to some of the other credits that you talked about with the criticized and classified moving higher.

Matt Scurlock

Yes, Brody, not related to the credit that was charged off. It's concentrated to a small number of lower LGD credits that we, at this point, believe are appropriately reserved for.

Brody Preston

Got it. Okay. And then just one last one. That's the C&I credit that you did charge off, did you charge off the bulk of that loan? Or -- just wanted to get a sense for if the charge-offs would be fully behind you there.

Rob Holmes

Yes, It's behind (inaudible).

Operator

And the next question goes to Matt Olney of Stephens.

Matt Olney

Wanted to dig into the revenue guidance that you guys provided, and I'm trying to separate the fees from the NII. Any color you can provide us as far as what that implies for the NII growth in 2023?

Matt Scurlock

Yes, I'm happy to take that. So I think Rob articulated really well in his comments that we are focused exclusively on making really strong clients, with a solution set that we believe increasingly enables them to address their needs while, over time, enables us to earn the right return on allocated capital.

This is the exact same playbook that we've been operating from since we rolled out the strategy in September of '21.-- but while that playbook cape changed, the marginal -- the math on the marginal transaction has changed a little bit as the cost of capital and liquidity has increased for everybody in the industry, including us.

So our view as it relates to guidance is that is going to slow -- result in slower than previously expected loan growth and likely result in higher funding costs, which is going to drag on industry NII.

So adjusting for that reality is what's caused the move down from mid-double digits year-over-year to low double digits.

And then I'd also point out that in our guidance, we, of course, assume not the TCBI curve, but the market curve, and that market curve has moved down 25 to 50 basis points relative to when we announced full year guidance on our last call. And that certainly has an impact on the NII outlook.

Matt Olney

So it sounds like incrementally met from, I guess, the guide down from last quarter, it's going to be substantially all on NII and not as much on fees. Is that fair?

Matt Scurlock

Exactly, exactly. Structural trends across the industry as well as reduction in forward rate outlook.

Matt Olney

Got it. Okay. That's helpful. And then I guess on the interest rate sensitivity discussion, it sounds like you guys made some good progress moving that a little bit lower this quarter with the securities purchases and some more swaps. Are we now where the bank wants to be? Or is there still more work to be done here in the future?

Matt Scurlock

Yes. As of now, where we want to be, Matt. So we've laid out a target to get to mid-single digits by the middle of the year. The market backdrop was conducive for us to move there a bit quicker.

As an example, the received fixed swaps we put on this quarter had a receive rate of 4.4% same swap as of yesterday would have a receive rate of 3.89%. So we took advantage of what we thought was a pretty good market opportunity and are comfortable with where we reside now in terms of earnings at risk, both in an up and down scenario.

Operator

The next question goes to Brad Milsaps of Piper Sandler.

Brad Milsaps

Matt, I was curious if you could offer maybe a little color on the decline in the yield on mortgage warehouse loans this quarter. I apologize if you addressed it earlier. I joined a little late. But I know that can bounce around based on the deposit relationship as well.

But it looked like it was down a little more than 50 basis points linked quarter. So just curious if you had any additional color there on maybe the reasons and maybe the trajectory going forward.

Matt Scurlock

No. Yes, I appreciate the question, Brad. So as you know, the mortgage loans do have similar repricing and beta characteristics for the rest of the LHI portfolio, but there is a relatively static portion of the mortgage finance deposits that received payment through yield.

So as the warehouse balances come down and the deposit level stay stagnant, you'll see a compression on the printed mortgage warehouse yields. As you move into the second quarter, and those loan balances expand seasonally, you'll see some of that pressure abate would be a more logical representation for you.

Brad Milsaps

Okay. Great. That's helpful. And then just maybe a bigger picture question to follow up on Matt's question. You guys have -- made a lot of moves to reduce your asset sensitivity. Texas Capital's history is unfortunately having a bit of a volatile margin. You'll never sort of get rid of all of your asset sensitivity.

But just curious if the Fed does stop and does, at some point, begin to go the other way, do you feel like you're better locked into a certain margin floor or number that you'd be willing to share that would stabilize maybe earning power a little bit more?

Just kind of curious kind of how you think about that bigger picture, just given the past and kind of the steps that you've made to kind of remove maybe some of that downside going forward?

Matt Scurlock

Yes, Brad, I think we often talk about that, both in terms of structural changes to the business model and the balance sheet. So the business model itself is less interest rate sensitive, meaning these fee generation categories continued to receive real receptivity from the client base, and expectation is that those will continue to increase in contribution to overall revenue as well as present different opportunities for client-facing bankers to provide value to their clients in a rates fall scenario.

And then just structurally on the balance sheet, the down 100 scenario is now inside of 5%. Obviously, that's a shock scenario with a lot of assumptions. That excludes any of the real benefit that we would realize through expansion across the mortgage finance businesses should rates fall to a point sufficient to generate new refi volume.

So we're really proud, to be honest, with the progress made to generate an offering that's going to sustain a bit more stable revenue and earnings generation, regardless of what rate environment we're in.

Brad Milsaps

So the 5%, does it include a big pickup in mortgage warehouse volume?

Matt Scurlock

Zero. The loan balances are static in that view.

Operator

The next question goes to Brady Gailey of KBW.

Brady Gailey

Yes. I wanted to start on the mid-single-digit expense growth guidance for this year. Is that -- that feels like a level that could be kind of the longer-term expense growth trajectory.

So I mean, I know your guidance is only for this year. But beyond this year, does it feel like you're kind of settling in to see expenses grow at a mid-single-digit pace?

Matt Scurlock

I think, Brady, it's too early to talk about '24, but I would reemphasize all of Rob's comments. We've spent a significant amount of time, energy and resource getting a better understanding for the very granular cost structure of this firm and have taken material steps to implement permanent solutions to ensure we can scale this for a long time.

So I don't anticipate -- similar to what we said in the third and fourth quarter of last year that once we cross this PPNR, we would never go back. We're never going to see expense growth faster than revenue. We're going to expand operating leverage to find this quarterly year-over-year PPNR for a long time. And this is an important step in realizing a lot of tech-enabled process reengineering benefit that we think is key to that long-term growth trajectory.

Rob Holmes

Yes. Brady, I would just say this was holistic, and it took -- there may have been frustration for the time it took to do. But for two years, we've been really, really focused on cost allocation, data, process, the entirety of the infrastructure of the firm. And we're just getting to a place where we feel really, really good about it.

And we're excited about the go forward. This was not changed on the margin. These are a deep structural changes.

Brady Gailey

Yes. Understood. And then I know you guys are sticking with the 1.1% ROA guidance for 2025. That's a long way from here. You did 50 basis points last year. You're roughly at 50 basis points in the first quarter.

I mean, is it just as simple as you expect revenue growth to be off the chart and it's just the revenue growth that allows you to hit the 1.1% ROA?

Matt Scurlock

It's 55% increase in quarterly year-over-year PPNR, Brady, is our path for the ROA target. I mean, you're not going to see 55% every single quarter.

But as you know, Q1 is seasonally the lowest quarter for us in terms of earnings performance. So the structural expense infrastructure that we just described, coupled with now a very defined set of businesses, where we're able to deliver the entire platform to a single client.

I think we described it in the past is those are in our view were the foundational tenets for future scale, and we'd expect to start to see that materialize this year.

Brady Gailey

All right. And then finally for me, just bigger picture on credit quality. It's the second quarter that we've seen NPAs increase. I know they're still at a relatively low level. In the second quarter, the net charge-offs have been a little higher.

You just hired a new Chief Credit Officer. Should we -- are these just 2 quarters that are kind of one-offs? Or should we expect to continue to see a little bit of credit noise this year?

Rob Holmes

I would say we reaffirm our guidance on credit costs through cycle. And we feel really, really good about the portfolio from real estate all the way through C&I. But Matt, do you have anything else?

Matt Scurlock

Way think about Brady. I think we've talked before that good range for '23 provision expense is likely 45 to 50 basis points of average LHI.

I think that's still a good way to view it. Importantly, we've not been chasing loan growth to expand the balance sheet. We've been a recipient of high-quality Texas-based loan growth primarily because we have a lot of highly qualified bankers presenting a great platform that we think is differentiated into the market. So new client acquisition for us has been on target, and we expect it to match up with our long-term views on credit performance.

Rob Holmes

And lastly, there is one dynamic that is at work. Remember, we had a premium finance business with very, very, very little loss history. And as you rotate and recycle all that capital into C&I, which is much better, higher returning, structurally better business, you're going to have increased provision. That doesn't mean losses, but you're going to have provision increase.

Operator

And our final question today goes to Brandon King of Truist Securities.

Brandon King

So I just had a -- hey, I just had a question on non-mortgage DDAs, and I understand that the can was clients still mix shifting to higher interest-bearing accounts. But I'm curious kind of what's your outlook there. Do you think we see more stabilization going forward in those balances?

Matt Scurlock

Yes. I think that operating deposits held up pretty well. So there was select instances of excess, noninterest-bearing not being used to meet seasonal payments moving elsewhere on the platform, which is based on a list of requests based on our own priority. So we're happy to avail our clients with different solutions on the platform. I think that the moves that were going to be made in Q1.

Brandon King

Okay. And just into quarter, as far as the outflows were they a mix shift was kind of consistent through the quarter? Or did it accelerate kind of towards the end of the quarter given all the turmoil?

Matt Scurlock

We saw no acceleration. The behavior was generally consistent with our expectations. So I think you're aware, our liquidity framework is pretty similar to what you find in a money center bank, as you think about process modeling or procedures.

So we describe deposit values based on stress 30-day or 12-month outflow rate similar to what you would find in LCR-like framework, and then we manage the balance sheet every day in compliance with those thresholds.

So the fact that we let the brokered CDs rolled off, we maintain normal levels of wholesale borrowing, which I want to come back to in a second, and then perhaps most importantly, we're actively calling on clients and prospects, I think L3 enforced the view that things behaved as anticipated.

FHLB is an important constituent for us. We have a long history of having outstanding FHLB or short-term borrowing levels equal to about 1/3 of end-of-period warehouse balances. This quarter, we added $750 million in the last few days of the quarter.

We had no idea about the health of other banks and wanted to ensure that we had adequate on-hand liquidity to meet what could have been exceptionally high levels of mortgage finance period and mortgage finance inflows.

We had a bit of a pickup. It certainly wasn't as large as it could have been, and that $750 million was out the door by Monday. So you can see that in our average short-term borrowing levels in the earnings release. There's really no movement. It's just that period in at about 750 to absorb potential pickup in warehouse volumes.

Operator

That's all the questions we have time for today. I'll now hand back to Rob for any closing comments.

Rob Holmes

Thanks, everybody, for your interest in the firm and the thoughtful questions. We're really, really excited about the platform that we've built and the prospects going forward, and look forward to continued conversations. Thank you for your time.

Operator

This now concludes today's call. Thank you so much for joining. You may now disconnect your lines.