INVESTOR CONTACT
Jocelyn Kukulka, 469.399.8544
jocelyn.kukulka@texascapitalbank.com

Texas Capital Bancshares, Inc.

Q1 2025 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes – *Chairman, President & Chief Executive Officer*

Matt Scurlock - *Chief Financial Officer*

Jocelyn Kukulka - *Head of Investor Relations & Corporate Development*

Operator

Hello, everyone. And welcome to the Texas Capital Bancshares, Inc. Q1 2025 Earnings Call. (Operator Instructions)

I will now hand over to Jocelyn Kukulka, Head of Investor Relations, to begin.

Please go ahead.

Jocelyn Kukulka

Good morning, and thank you for joining us for TCBI's First Quarter 2025 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 texascapital.com. Our speakers for the call today are Rob Holmes, Chairman, President and CEO; and Matt Scurlock, CFO. At the conclusion of our prepared statements, our operator will open up the call for Q&A.

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

Rob Holmes

Thank you for joining us today.

This quarter’s results continue to evidence our clearly differentiated strategy and operating model.

Contributions from across the Firm enabled another quarter of strong financial progress, with year-over-year revenue growth of 9%, adjusted pre-provision net revenue growth of 21%, and tangible book value per share growth of 11%, which ended the quarter at a record high for the Firm. The Company also maintained its peer leading capital levels, with tangible common equity to tangible assets of 10%, while continuing to effectively support client’s growth objectives during the first quarter of the year.

Earning the right to be our client’s primary operating bank remains the foundation of our transformation, with sustained success again displayed by another quarter of peer leading growth in Treasury Product fees, which increased 22% year over year to a record high for the Firm. Non-interest-bearing deposits, excluding mortgage finance, grew 7%, marking the Firm’s largest quarterly increase since 2021, and are up 11% since the first quarter of last year.

Consistently increasing client relevance through both breadth of services and quality of advice continues to deliver a longer duration, less rate sensitive deposit base, further evidenced this quarter by our ability to effectively reprice down our liabilities supporting a 26 bps increase in linked quarter net interest margin, and 10% increase in year over year quarterly net interest income.

Looking ahead, we remain confident in our ability to deliver risk-adjusted returns consistent with our published targets. Deliberate actions over the last four years purposefully positioned our Firm to operate through any market or rate cycle, with our financially resilient balance sheet, tailored coverage model, and breadth of products and services enabling us to uniquely serve clients as they navigate this period of elevated macro-economic uncertainty.

Recent tariff actions and resulting volatility in the financial markets could manifest in changes to client confidence affecting hiring, capital investment, and M&A.

To date, institutional debt markets are still functioning, albeit at higher costs, banks are still aggressively competing for high quality credits, and flows on our institutional sales and trading desk continue to grow in a consistent manner. Our perspectives are influenced by unique positioning as the only full service firm headquartered in Texas, with significant connectivity to small businesses through our top 5 SBA [7(a)] lending program, our loan syndications team, which has reached as high as the #8 lead arranger in league tables for middle market loan transactions in the country, our extensive reach into institutional credit markets, through the more than $25 billion of leveraged finance transactions we facilitated last year, and our institutional sales & trading business, which now transacts with over 1,000 active accounts.

You have often heard me say that we regularly prepare for a range of economic or geopolitical outcomes beyond the base case or consensus view. Strategically, that means operating without balance sheet concentrations, deploying products and services that allow us to comprehensively serve clients, and carrying liquidity, capital, and reserve levels that enable confidence and flexibility across a range of economic scenarios. We often refer to that as operating with a balance sheet and business model that is resilient to market and rate cycles. It is because of our deliberate preparation that we are confident about the future and expect to continue to onboard and serve the best clients in our markets.

Thank you for your continued interest in and support of our Firm. I'll turn it over to Matt to discuss the financial results

Matt Scurlock

Thanks, Rob, and good morning.

Starting on slide 5 –

First quarter total revenue increased $24.1 million or 9% relative to Q1 of last year, supported by 10% growth in net interest income and 8% growth in fee-based revenue.

Linked quarter total revenue declined by $3.2 million, or 1% for the quarter as a $6.4 million increase in net interest income was offset by a decline in fee revenue as mid-late quarter capital markets uncertainty limited pull through of a strong, and building investment banking pipeline.

Total non-interest expense increased $30.9 million quarter over quarter, due to $14 million of expected seasonal payroll and compensation expenses, resetting annual variable compensation accruals, and onboarding of previously discussed talent in fee income areas of focus, particularly Investment Banking.

Taken together, year-over-year pre-provision net revenue increased 21% or $13.5 million on an adjusted basis to $77.5 million which should, as expected, represent the low point for the year.

This quarter's provision expense of $17 million resulted from $422 million of growth in gross LHI, excluding mortgage finance, $10 million of net charge offs against previously identified problem credits, and our continued view of the uncertain macroeconomic environment, which remains decidedly more conservative than consensus expectations. The firm's allowance for credit loss increased $7.2mm to $332mm, finishing the quarter at 1.85% of LHI, when excluding the impact of mortgage finance allowance and loan balances.

Net income to common was $42.7 million, an increase of 44% compared to adjusted net income to common in Q1 of last year. This continued financial progress coupled with a consistent multi-year buyback approach, contributed to a 48% increase in quarterly earnings per share compared to adjusted earnings per share from a year ago.

The Firm continues to operate from a position of financial strength, with balance sheet metrics remaining exceptionally strong. Ending period cash and securities comprised 27% of total assets, as the Firm continues to onboard and expand client deposit relationships while supporting their broad needs, including access to credit.

These consistent client acquisition trends are increasingly resulting in risk-appropriate portfolio expansion, with ending period gross LHI balances, excluding mortgage finance, growing $422 million or 2% linked quarter.

Average commercial loan balances increased 4% or $401 million during the quarter with broad contributions across areas of industry and geographic coverage, and ending period balances now up approximately $1 billion, or 10% year over year.

Real estate loans also increased during the quarter, up $208 million, and were flat to first quarter 2024 levels as new volume resulting from our consistent market facing posture outpaced potential payoffs that could result should rates move lower.

As anticipated, average mortgage finance loans decreased 27% linked quarter to $4.0 billion, as quarterly seasonal homebuying activity hit its annual low in Q1.

Given ongoing rate volatility, we remain cautious on our mortgage outlook for the remainder of 2025, with full year expectations for a 10% increase in average balances predicated on a 1.9 trillion-dollar origination market.

Linked quarter deposit growth of $814 million, or 3%, was driven predominantly by our continued ability to onboard and expand core operating relationships while serving the entirety of our clients' cash management needs. This was the third consecutive quarter of growth in non-interest bearing deposits, excluding mortgage finance, which increased $250 million or 7% linked quarter, to finish at their highest level since Q2 2023.

Client's interest bearing deposit balances also continue to expand, and are now up approximately $2.9 billion, or 19% year over year. Our sustained success winning high quality deposit relationships continues to enable maintenance of decade low levels of brokered deposits and the select reduction of higher cost deposits we are unable to earn an adequate return on the aggregate relationship.

This is in part observed in the ratio of average mortgage finance deposits to average mortgage finance loans which improved to 113% this quarter, down significantly from 148% in Q1 of last year. We would expect this ratio to trend below 100% as loan volumes grow in the seasonally stronger second and third quarter.

Our modeled earnings at risk were relatively flat quarter over quarter, with current and prospective balance sheet positioning continuing to reflect a business model that is intentionally more resilient to changes in interest rates.

Improvements in rates fall earnings sensitivities were driven by adjustments in down rate deposit betas to better align with recent experience, and the addition of $300 million in forward starting receive fixed swaps that will become active in Q3. Given the volume of maturing swaps, we do anticipate future interest rate derivative or securities actions over the course of 2025, augmenting potential rates fall earnings generation at materially better terms than available during our deliberate pause through the mid-part of last year.

The total allowance for credit loss including off balance sheet reserves increased $7 million on a linked quarter basis to $332 million, up $28 million year-over-year, which when excluding the impact of Mortgage Finance allowance and loan balances is 1.85% of total LHI, 2 bps below our high since adopting CECL in 2020.

Despite a modest increase in linked quarter special mention loans, criticized loans decreased $96 million, or 11% year-over-year, supported by stable substandard loan balances and an $8.5 million, or 8% decline in year-over-year non-performing assets.

We remain highly focused on proactively managing credit risk across a range of both macroeconomic and portfolio-specific scenarios, including those associated with the recent trade policy induced market volatility, with our frequently discussed through cycle approach centered on quality client selection, excess capital and liquidity, and consistently applied reserving methodology.

Specifically, the Firm has been focused on the effects of possible tariffs since late summer 2024 as the Presidential Campaigns were moving towards the November election, with initial emphasis on Canada, Mexico, and China. While too early to know the precise impacts of the April 2 trade announcements, we remain confident in our routines to monitor and manage the portfolio while effectively supporting clients as they look to navigate considerable economic uncertainty.

Consistent with prior quarters, capital levels remain at or near the top of the industry.

Total regulatory capital remains exceptionally strong relative to both the peer group and our internally assessed risk profile. CET1 finished the quarter at 11.63%, a 25bps increase from prior quarter, supported by continued strong capital generation coupled with effective implementation of the enhanced credit structures discussed last quarter for 15% of our mortgage finance loan portfolio. Our continued client dialogue suggests at least 30% of Q2 ending period mortgage finance balances will qualify for the improved structure and associated reduction in risk weighted assets.

We continue to deploy the capital base in a disciplined and analytically rigorous manner focused on driving long-term shareholder value. During the first quarter, we repurchased approximately 396 thousand shares or 0.86% of prior quarter shares outstanding, for a total of $31 million at a weighted average price of $78.25 per share or 117% of prior month TBVPS.

Turning to our full year outlook, despite observed macro-economic uncertainty, we are raising our revenue guidance to low double digits percent growth, the higher end of our previously disclosed range as our ability to effectively serve clients across an increasingly broad platform should continue to differentiate in the market while providing revenue resilience across a wide range of potential scenarios.

We are maintaining our non-interest expense guidance of high single digits percent growth, which includes resumed progress associated with fee-based initiatives in the second half of the year.

The full year provision expense outlook remains 30-35 basis points of loans held for investment, excluding mortgage finance, which should enable the preservation of industry leading coverage levels, while effectively supporting our client's growth needs.

Taken together, this outlook suggests continued earnings momentum and achievement of quarterly 1.10% ROAA in the second half of the year.

Operator - we'd now like to open the call up for questions.

Operator

Thank you. (Operator Instructions) Our first question comes from Woody Lay with KBW.

Wood Lay

Wanted to start on the revenue guide and just wanted to better understand the motivation to the now targeting the higher end of the range. Is that really being driven by NII? I mean it was a nice NIM increase in the quarter, solid growth. Is that what is driving the higher revenue guidance?

Matt Scurlock

Yeah, you got it, Woody. So we noted on the [fourth] quarter call that we could move to the higher end of the revenue guide if we saw interest bearing deposit betas get to 60 prior to the mid part of the year, ultimately go higher than 60 if we saw LHI, excluding mortgage finance, deliver comparable loan growth to last year. And if we suspected that average mortgage finance volumes could be up 10% for the full year.

So those are the general components that we outlined that would move us to the higher end. Those are obviously all things that have either already transpired that the current outlook suggests will. There is no question that, earned net interest income improvement that you cited could potentially be partially offset by decreases in the fees, but as noted in both my comments as well as Rob's. The majority of the transactions in our invest making pipeline haven't been canceled, they've just been delayed.

If we get to the second half of the year in those transactions do start to fall away or push into 2026, you'll see us start to adjust down the expense outlook to reflect lower fee-based incentives. But at this point, we feel pretty confident in the ability to deliver double-digit growth in revenue across a pretty wide range of economic and interest outlooks.

Wood Lay

Got it. Yes. That's great to hear. Maybe shifting over to loan growth in the pipeline. It was a really strong growth quarter in the first quarter.

How is the pipeline shaping up into the second quarter? And are you seeing the macro uncertainty impact client demand for loans at this point?

Matt Scurlock

Yes. I'd note that along with the consistently growing and improving deposit franchise, we do continue to fill clients' capital needs through a variety of channels, which includes access to bank debt.

What are now pretty sustained client acquisition trends, coupled with multiple quarters of slowing capital recycling. That's what supported the $422 million or 10% annualized increase in LHI this quarter. There are some risks to that pace continuing, notably some of the previously discussed potential for accelerated payoffs in CRE, which should move slightly higher in Q2, but the outlook for onboarding new C&I relationships at this point is still quite strong.

Wood Lay

Got it. And then last for me, I wanted to touch on the buyback. It was great to see you all active again in the first quarter. Obviously with the market pullback the stock is a little bit cheaper today. So how are you thinking about forward buybacks from here?

Matt Scurlock

Yes. I'd say that we're pretty boring on this topic. There's no change in capital priorities, and we rely on the exact same highly disciplined approach to allocation that you've seen us employ since Rob arrived. With times like this precisely why we choose to carry excess capital. To your point, the stock is clearly trading below levels where we've previously been comfortable buying back shares and alongside opportunities for new client acquisition like we've got multiple compelling options for near-term capital deployment.

I'd call out that further supporting the optionality of the success that we've had implementing the enhanced credit structures for the mortgage finance clients. So we noted in the prepared remarks that as of 3/31, we had $715 million or 15% of clients that have moved into that structure, which reduced their risk weighting from 100% to 26% and resulting in a 21 basis point increase in regulatory capital. Based on current client interaction, we suspect we can get that number to 30% of ending period Q2 warehouse balances in the structure. So with your 10% tangible common equity, a lot new client acquisition and building regulatory capital, we've got a lot of options in terms of capital deployment.

Operator

Our next question comes from Ben Gerlinger with Citi.

Benjamin Gerlinger

I think you said in the commentary for clients, especially with the investment banking in that things are canceled that they have been pushed. Is there something that they're looking for either economically or political clarity that they're citing?

I'm just trying to think like the rate of change, it seems like every bank has said client activity slowed a little bit since Liberation Day. But all is equal, still see areas of healthy economy. I'm just kind of curious, is there any sticking points specifically because you do come kind of newer budding investment bank that seeing success? I'm just kind of what are they looking for?

Rob Holmes

They're just looking for certainty. It's very, very hard to project financial forecasts in a world of great uncertainties we have today, uncertainty is the great killer of all deals. You have -- like we said, the debt markets are functioning, but if you don't have to go in periods such as this, then you don't go. The only people go on or people that have to and they'll do it at wider spreads than maybe necessary or previously they could have achieved before what you call Liberation Day.

So I think the uncertainty index that people keeps referring to is very, very real. We had a low single-digit millions of investment banking fees fall away that won't come back. But the rest of the pipeline that Matt suggested was pushed out. It's really hard for a CEO or a Board to do something strategic in an environment such as this. It's also not a great time to refinance or plan capital investment or build your inventories until you know what the economic environment is going to be going forward?

Benjamin Gerlinger

Got you. That’s helpful.

Rob Holmes

Yeah, long way of saying there's a lot of factors -- sorry.

Benjamin Gerlinger

Right. No. No. I understand. Just more so thinking, and you answered it well Rob, I appreciate that. I was just more so thinking just kind of anything specific, but it's a tough environment for certainty. So not lost on me.

So when you look at loan yields and securities yields, they're up linked quarter. I mean does this trend continue? I'm just -- just wanted to double check on everything that you guys have done. Is there anything idiosyncratic within this quarter would have inflated it more than normal?

Matt Scurlock

You had the full quarter impact, Ben, of the mortgage finance deposit repricing that occurred in the back end of last year. So there's a couple of months delay before that ultimately shows up in loan yields. Those costs are split about 60% attributed to the mortgage warehouse and about 40% to commercial loans to mortgage companies, but aggregate yields as well as spread on new origination are roughly the same.

On the securities portfolio, we've got around $120 million a quarter of cash flows. We're reinvesting somewhere around 5.3%. That obviously changes every single day. You can expect to see us continue to do that.

Benjamin Gerlinger

Got you. Okay, that's helpful color. Appreciate it, guys.

Matt Scurlock

Maybe one other thing I would say, Ben, is clearly the guide relies on implied forwards for fed cuts, which at the time of compilation included two cuts in the year, one in June, one in October. So anticipated NII is also impacted by that.

Operator

Our next question comes from Brett Rabatin with Hovde Group.

Brett Rabatin

I wanted to ask about mortgage finance and the mortgage finance business is obviously competitive, but it seems like you guys might have taken some share this quarter. Any thoughts on market share gains this quarter? And just what you're trying to get with that business relative to maybe the top five in the space?

Matt Scurlock

Thanks, Brett. We landed full quarter average balance is right on top of the guide. So we guided to $4 billion, we landed right on $4 billion. We were higher on ending period balances, which was the impact of rates moving down in, call it, mid-February. There's a 40-day or so lag before you see a reduction in mortgage rates ultimately show up as warehouse balances.

We still sit around 5% total market share, which is where we anticipate staying. The guide suggests the $1.9 trillion origination market, which is predicated on 30-year fixed rate mortgages between 6.8% and 7%. If we see that, then we expect about a 10% increase in full year average balances. Thinking about Q2, we expect around $5.2 billion of average balances. And then we noted in the commentary, continued reduction and mortgage finance deposits, which is quite deliberate.

So you should see that self-funding ratio move from 113% to somewhere closer to 95% in the second quarter. And then the last comment I'd make on that is although it's steady market share, we continue to do more with those clients. So our ability to effectively help them hedge their portfolios, help them securitize, help provide leverage for other portions of their wallet are things we've worked quite hard on over the last few years, so its not solely a warehouse offering. It's a holistic offering to mortgage finance clients that generates much higher return on equity than we've had historically.

Rob Holmes

I would just emphasize the last part of Matt's comments, we are not focused at all on market share in mortgage warehouse. The mortgage warehouse balances are a result of our clients' needs that we are focused on in that space. And so we're focused on the very best clients in the mortgage origination space. And if that's their need, that's the result in the warehouse.

And I think you could further probably project that or assume that there will be a time that if you don't convert to the SPE structure in the warehouse that you may not be a client of the firm because that's where we're going because of the better capital treatment and all the different things that we do with those clients. It's more of a vertical than a warehouse.

Brett Rabatin

Okay. That's great color on that. And then you obviously changed the revenue guidance to be optimistic on NII and you took away the fee income guidance of $270 million for the year. If you were to think about the pipeline for investment banking from here, has it changed relative to previously? Or is it just the uncertainty that's kind of driving the near-term quarter lower?

Matt Scurlock

Go ahead, Rob.

Rob Holmes

No. I would just say it's growing. It's granular. It's been pushed back. So it's changing in a constructive way, not a different way. But to the [indiscernible] question earlier, just the uncertainty, it's really, really hard to transact at this moment.

Matt Scurlock

The only thing I'd add, Brett, just to emphasize the notion that it's much more heavily weighted now to the back half of the year. Our outlook for Q2 is $25 million to $30 million of investment banking fees. So the number of transactions in pipeline to Rob's point continues to increase. The delay is largely associated with awarded mandates and M&A and cap markets that folks have just put on pause. So there's very slight reduction in the overall fee outlook for the year, but it is more heavily weighted now to the third and fourth quarter.

Rob Holmes

Which is no different than the other banks reporting so far.

Operator

Our next question comes from Michael Rose with Raymond James.

Michael Rose

Just wanted to see if I could get a little color on the increase in special mention loans this quarter? And then to the extent that you can, what are some of the industry sectors that you'd be more worried about in your markets as it relates to tariffs?

Matt Scurlock

Happy to address that, Michael. So Rob reemphasized in his opening remarks that we regularly prepare for a range of economic or geopolitical outcomes that are considerably more stressful than a consensus view. And as you know those scenarios are directly connected to current and prospective balance sheet positioning.

We also noted that we entered the period in our view, well equipped to serve clients across a range of potential economic outcomes. And then we began specific preparations for changes in global trade policy late in the summer with a particular focus on implications for changes in policy with Mexico, China and Canada.

The current assessment indicates there is worthy of heightened monitoring our infrastructure, transportation, logistics as well as just general manufacturing within C&I. We also remain focused on commercial clients that serve the low end of the consumer markets where you could see increases in prices, put additional stress on those consumers. I'd say, importantly, none of those segments on their own comprise more than 1% to 2% of the overall loan portfolio.

And then the last point I'd make on credit is that our multiyear reserve build has relied on a set of economic assumptions materially more conservative than a consensus outlook, which alongside our observed performance in the portfolio, suggest the full year outlook still 30 to 35 basis points of provision relative to LHI, excluding mortgage finance.

Michael Rose

Very helpful. I appreciate the color. Just switching gears to fees. Just on the treasury solutions, you noted that kind of a record quarter for the third quarter in a row. Can you just give some color on the outlook there and why the growth has been so strong?

And then just separately on private wealth, it does say in the slide deck that you kind of anticipate improved kind of penetration as the year goes on. So just some color on those two areas would be helpful.

Rob Holmes

Yes, Michael. What I would say about treasury and if this is redundant, I apologize. So it's up 22% year-over-year. That's all products and services. Cash payments is up 11%. So that doesn't include FX or merchant or corporate card. It's just the payments and receivables of our clients, if you will. That is really, really strong. That business grows GDP or less for most banks. And this is eight straight quarters of 3x market rate of growth. So there is continued momentum and it's very simple. It's in our DNA now.

Our bankers don't talk about deposits. They don't talk about -- they don't go talk to their clients about we make you a loan or can you give us a deposit. We go talk to our clients about solutions and it could be any -- come in any form of debt, private credit, bank debt, institutional debt, what have you, equity or alike, converts, et cetera. So when you go talk to your clients about solutions, you add more value, you're more likely to become their primary bank, that comes with operating accounts. And so you see the cash fees go up like they did.

I would venture to say that we have only institutional sales and trading floor in America that sells treasury services. We all know that's the health of the bank. We are astute on the products and services in that space. We add value to our clients, reducing working capital and improving their operations and also making it safer and derisking. And that -- and it's easier. We developed through our own technology platform and onboarding platform called “initio” that we talked about in the past. And when it's easier to onboard operating accounts here when clients onboard an incremental account, they choose us other than a secondary or third bank because it's more simple.

And then if you go talk to our clients, they feel very safe and sound with our capital and our equity to give us all their primary operating business. So I would say it's -- because it's in our DNA -- I hope I explained that correctly on the treasury side.

And on the wealth side, we're behind in wealth. Okay. We kind of -- it's hard -- it was hard for us to go all in on wealth. We got a lot better. We have really good people. We have really good investors. We have a great go-to-market strategy. We have great clients. But they were burdened with a lesser platform. That platform was put in place fourth quarter of last year for new clients, kind of the first quarter of this year for current clients. That migration will go through the back half of this year, migrating our legacy clients onto the new platform. And what I mean by that is, it's the digital journey of our wealth clients.

So now they have a digital journey of their everyday operating accounts, if you will, with their investments and with their money transfer, et cetera, that you'll see at a money-centered bank. It's not an inferior client journey anymore. So now that we have an on par or better client journey than most banks with really good investors and really good performance and talented advisers we expect to make real progress in the wealth business moving forward, and we can get totally behind it.

Operator

Our next question comes from Anthony Elian with JPMorgan.

Anthony Elian

Matt, you mentioned in the prepared remarks, the anticipated future rate derivative or securities actions you plan to make sometime this year to potentially offset falling rates. Can you just provide a bit more color on this and the timing of it? And if it's included in your revenue outlook as well?

Matt Scurlock

It is included in the revenue outlook, Tony. We added $300 million of 2-year forward starting received fixed swaps this quarter. That obviously impacts the 12-month IRR sensitivities. But what also impacts is that sensitivity is being more effective in repricing down our liabilities. So the sensitivities are previously modeled at a 60% interest-bearing deposit beta, we moved that up to 70%, which we expect to hit in the mid-part of the year.

We've got about $500 million of prime swaps that mature in Q2 and then $1.5 billion of SOFR swaps that mature in the third quarter. So we do in the outlook expect to try to manage our balance sheet duration to more position to where we are today. You also see a selective, as I mentioned earlier, add to the securities portfolio, so we pushed about $200 million this quarter around 5.3 or 5.4. We expect to continue to manage that portfolio in a similar way.

Anthony Elian

And then on the enhanced credit structures you first outlined last quarter and the benefits to RWA, So you've implemented, I think you said 15% on the mortgage finance loan portfolio and then that could be at least 30%. Is the time of that in the second quarter or is that more of a second half of year event when you'd expect to be implemented on the 30%?

Matt Scurlock

Yes. We would expect that 30% of ending period balances into Q2 in the structure. And just to reiterate it, the risk weighting for those clients move from 100% to 26%. So the 15% already in has created 21 basis points of regulatory capital.

Operator

Our next question comes from John Arfstrom with RBC.

Jon Arfstrom

A couple of questions for you. Just on cap markets, is there a way to size the pipeline relative to where it's been historically?

Matt Scurlock

We entered the year with 2x the M&A pipe that we had entering the previous year. That's up 50%. The cap markets pipe is larger at this point in 2025 than it was at this point in 2024. We've onboarded a large quantity of new investment banking talent starting in the back end of Q4 through Q1. We talked about that a lot on the last call that our increase in full year noninterest expense guide was primarily related to adding new talent and fee income areas of focus, which is heavily includes treasury, but it's heavily weighted toward investment banking.

So Jon, I think all those factors suggest a really healthy business. And although the timing is somewhat difficult to predict, a lot of momentum as you move into the second half of the year.

Jon Arfstrom

Okay. This is an annoying question for you guys, I know but just the 1.10% ROAA level, I'm not too hung up over it.

I think it's time rather than timing, but what's different in the P&L later in the year to get there? Is it just your last answer? Is it the banking and treasury fees and maybe a little better noninterest-bearing, is that it? Or is there something else we're missing?

Matt Scurlock

We think there's a lot of balance sheet momentum as well, Jon, and increasingly so the balance sheet is growing and it's increasingly productive. We've said for a long time that we're generally product agnostic. We want to show up and serve clients in a way that best fulfills their needs, not ours. And that the P&L geography was not our primary concern. It was more onboarding the right relationships and serving them for the entirety of their life cycle.

The current outlook suggests a lot of momentum in balance sheet and a lot of associate momentum in NII. So PPNR this quarter is obviously going to be distorted by day count. So that's roughly $5 million of pretax income as well as the seasonal comp and benefits expense, which this quarter was $14 million. So that's another $20 million of PPNR in a seasonally slower quarter for us and that you should think about as you look towards the back half of the year and achievement of the 1.10%.

Jon Arfstrom

Yes, okay. Good. Rob, I wanted to -- yes, go ahead.

Rob Holmes

No. I was just going to add. Look, I think it's -- Matt said it well for modeling purposes.

But what I would just say is it's the improvement of the entirety of the balance sheet and income statement. We are now viewed very differently in the marketplace as a firm than we were before three years ago, four years ago and certainly before I got here, we did not have the right client selection.

We -- those clients bank with us because of rate not because of value that we brought to them, that is no longer the case. We can compete on NIM now. We expect to compete on NIM now and our best clients appreciate we may show up with an investment banker on the deal that the deal was pushed because of the uncertainty we talked about. But because you bring that advice and you're there frequently and you're highly valued, they don't care about rate nearly as much. And so I don't see any stop to that improvement over time.

And then you have fee growth on the other parts of the firm, and you have credit that looks really, really good. We've got peer-leading and industry-leading provisions from since I got here and criticized loans are down 11% year-over-year, and we feel really, really good. And that's primarily driven by client selection. So I think it's a combination of the entirety of balance sheet income statement, client selection and improvement of our ability to operate and gain efficiencies.

Jon Arfstrom

Got it. And then I wanted to say this last quarter, but I want to congratulate you on the Chairman title. And just curious if anything changes from your point of view with you adding that incremental responsibility?

Rob Holmes

Thank you, Jon. I think a lot changes as it comes with a lot of responsibility, but it also nothing changes So Bob Stallings went from Chairman to Lead Director. The Lead Director is very important here, like any public company. And so it's kind of a title, but it's not. What it will do is, look, I've got to shape the Board, I got to lead the Board. I'll have much more of a say in who's on the Board, what the Board focuses on, et cetera. But I'm really excited about Stallings staying as a Lead Director and I have a lot of immense amount of respect and appreciation for him doing so.

Operator

Our next question comes from Matt Olney with Stephens.

Matt Olney

I just want to follow up on the mortgage finance self-funding ratio. I think Matt said 95% in the second quarter.

Just remind us of the driver of that? And could we see further improvements throughout the year? Or did you just make some adjustments in the first quarter, we'll see the full impact in 2Q?

Matt Scurlock

Yes. We think $5.2 billion of average warehouse loan balances, $4.9 billion of average mortgage finance deposits. So Matt we talked a bit earlier about the expansion of products and services that we can offer those clients as well as the pretty significant growth in deposits outside of that area.

So we talked -- I think Rob articulated the growth in commercial noninterest-bearing up 7% linked quarter, 11% year-over-year. But we also have material growth in interest-bearing deposits with our core commercial clients. And we're up $3.4 billion or 26% year-over-year in interest-bearing deposits, excluding brokered and excluding institutional index, that's while pushing the deposit -- interesting-bearing deposit betas up to 67%.

So as we look across the franchise and relationships where we're unable to earn an acceptable return on aggregate relationship, there's a handful of those that resided in the mortgage finance business where we were paying outsized rate for deposits. And over the last year or so, we've been selectively reducing those where we couldn't earn the right to do more business with those clients.

So you should see us move below the 100% self-funding ratio in the second and third quarter as warehouse balances move higher. And then likely stay a hair below that even in the fourth quarter. So it's just a reflection of growth elsewhere on the platform.

Matt Olney

Okay. And then one more question. The hedge impact in the quarter we just saw in 1Q, didn't see any disclosure. I didn't know if you saw what the hedge impact was to the NII in the first quarter.

Matt Scurlock

It's coming down materially, Matt. I mean you're going to see the remainder of the hedges generally roll off by the end of the year with the big slug like I said, coming off in Q3.

Operator

Our next question comes from Jared Shaw with Barclays.

Jared Shaw

How should we think about sort of the pace of timing of getting to the 11% CET1? Is that just sort of consistently through the year? Or do you feel that there's an opportunity to maybe accelerate that earlier?

Matt Scurlock

Yes, Jared, the 11% isn't meant to suggest that we would push it all the way down to 11%. It's more -- you should more think about that as a floor. So we've talked quite frequently about what we believe is a real competitive advantage of operating with the most capital, in particular, the most TCE. So I don't know that I would look for us to push it all the way down to 11%. That just more indicates the amount of flexibility that we have near term.

If you look at all the metrics that we put out on September 1, 2021, the only metric that we backed away from is the CET1 guide. So we originally had that going down to 9% to 10% and just feel like it's prudent to now operate with materially higher levels of regulatory capital and, again, focus on real loss absorbing capital in TCE.

Jared Shaw

Okay. All right. Got that. And then just little bit of follow-up on Matt's question from before. I guess the hedge costs are what $12.5 million in fourth quarter. Do you have the actual number for first quarter?

Matt Scurlock

It should be around $8 million.

Jared Shaw

Okay. All right. And then just finally, when we look at the 1.10% ROA target or goal, is that before or after preferred dividends?

Matt Scurlock

That's all in 1.10% ROAA, as reported. There's no gimmick associated with it.

Jared Shaw

Okay. All right. So that's after paying the preferred dividends?

Matt Scurlock

It's before paying the preferred dividends. It's the same way we reported every single time.

Operator

Thank you very much. We currently have no further questions. So I will hand back to Rob Holmes for any closing remarks.

Rob Holmes

Just grateful for everybody's interest in the firm. And look forward to the next couple of quarters. Thank you.

Operator

Thank you very much, everyone, for joining. That concludes today's conference call.

You may now disconnect your lines.