THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

FRC - Q1 2019 First Republic Bank Earnings Call

EVENT DATE/TIME: APRIL 12, 2019 / 2:00PM GMT

OVERVIEW:

Co. reported 1Q19 results.

CORPORATE PARTICIPANTS

Hafize Gaye Erkan *First Republic Bank - President & Director*

James H. Herbert *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Michael Ioanilli *First Republic Bank - Vice President and Director of Investor Relations*

Michael J. Roffler *First Republic Bank - Executive Vice President and Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Aaron James Deer *Sandler O'Neill + Partners, L.P., Research Division - MD, Equity Research and Equity Research Analyst*

Arren Saul Cyganovich *Citigroup Inc, Research Division - VP & Senior Analyst*

Brian D. Foran *Autonomous Research LLP - Partner, Universal and Regional Banks*

Brocker Clinton Vandervliet *UBS Investment Bank, Research Division - Executive Director & Senior Banks Analyst of Mid Cap*

Christopher Edward McGratty *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

David Patrick Rochester *Deutsche Bank AG, Research Division - Equity Research Analyst*

Jared David Wesley Shaw *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Kenneth Allen Zerbe *Morgan Stanley, Research Division - Executive Director*

Matthew Timothy Clark *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Steven A. Alexopoulos *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

PRESENTATION

Operator

Greetings, and welcome to the First Republic Bank's First Quarter 2019 Earnings Conference Call. (Operator Instructions) I would now like to turn the call over to Mike Ioanilli, Vice President and Director of Investor Relations. Please go ahead.

Michael Ioanilli - *First Republic Bank - Vice President and Director of Investor Relations*

Thank you, and welcome to First Republic Bank's First Quarter 2019 Conference Call. Speaking today will be Jim Herbert, the Bank's Chairman, Chief Executive Officer and Founder; Gaye Erkan, President; and Michael Roffler, Chief Financial Officer.

Before I hand the call over to Jim, please note that we may make forward-looking statements during today's call that are subject to risks, uncertainties and assumptions. For a more complete discussion of the risks and uncertainties that could cause actual results to differ materially from any forward-looking statements, see the bank's FDIC filings, including the Form 8-K filed today, all are available on the bank's website.

And now I'd like to turn the call over to Jim Herbert.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Thank you, Mike. It was a strong first quarter. Loans, deposits and wealth management assets have all grown nicely compared to a year ago. I'm pleased to say that we have now surpassed $100 billion of total bank assets during this first quarter.

We've achieved this milestone after a bit of over 34 years of organic growth. This growth has been guided and driven by delivering exceptional client service, one client at a time as our cultural bedrock. We intend to continue our approach to banking in the similar manner.

Let me share some year-over-year highlights. Total revenue growth was 12%. Net interest income was up 15%, earnings per share grew by 11.5% and tangible book value per share increased by 13%. These results have been driven by strong performance year-over-year across the franchise. Total deposits have grown by 14.5%, total loans have been up by 18.5% and wealth management assets have grown by 24%.

Credit quality and capital strength, each also remain very strong. Nonperforming assets were very low, 5 basis points; while net charge-offs for the quarter were nominal, $127,000.

Our Tier 1 leverage ratio increased to 8.84% at the end of the first quarter, a bit up year-over-year in spite of our asset growth. This is due, in part, to the completion of an aftermarket common stock offering in early January, at the same time as we were added to the S&P 500 Index. This offering raised approximately $170 million net in new common equity.

Our client satisfaction levels remain strong as reflected in our recently received 2018 Net Promoter Score. The third-party compiled Net Promoter Score measures our clients' satisfaction and our clients' willingness to refer First Republic to their friends and colleagues.

Our 2018 score is 72. This is very strong and remains more than twice the banking industry average. Indeed, this score is higher or equal to many of the world's leading consumer and service brands, not just higher than banking. When clients identify us as their lead bank, which is more than half of our clients doing so, our Net Promoter Score increases further to 81. The differentiated level of First Republic service delivery results in a very stable client base and their continual word-of-mouth referrals. These two points drive our strong organic growth at all levels.

Shifting for a moment, in recent years we've been very successful in attracting new millennial households to the bank. This is continuing to be the case. They come to us through a variety of channels, but importantly, including student loan refinance and our professional loan programs, as well as a full range of banking, home lending and wealth management services. Such millennial households now total fully 1/3 of our total consumer borrowing households. Reflecting this success, quite importantly, our household acquisition rate has been exceptionally strong in recent years, 50% higher than our historical growth rate. In 2017, 2018 and first quarter of this year, for instance, was an acquisition rate of households at above 18% per annum. The preceding 5 years, this was approximately 12%, a 50% increase.

Turning to our geographic markets for a moment, economic conditions in our primarily urban, coastal areas continue to be quite strong, and our clients remain very active and financially well-off. Given our continued strong rate of client acquisition, the hiring of additional teams - particularly wealth management - and the strength of our markets, we have recently entered into 2 meaningful real estate facility leases in San Francisco and in New York, one each. These leases will support the ongoing growth in our 2 largest markets.

In San Francisco, we leased an additional 260,000 square feet in a building which is part of our existing corporate campus, in Downtown San Francisco. We will grow into the additional space over the next 5 years, and importantly, we have met and secured our expansion needs for this period of time.

In New York, we signed a lease in the very exciting Hudson Yards area. Importantly, this lease covers 2 retail offices at the very key corners of 10th Avenue and 31st Street West and 34th Street West. It additionally includes approximately 200,000 square feet of office space, which we will take down beginning in late 2021. Our presence in the Hudson Yards/ Manhattan West area will allow us to continue serving existing clients and to acquire new ones among those many firms which are moving to this new neighborhood.

In both cases, we retain full sublease rights, and we take down the space over a period of time, thus allowing us to manage our growth and our cost in a very prudent manner, but importantly, we are established for our future growth in these 2 markets.

Before I turn the call over to Gaye, I wanted to say how very pleased I am, and our Board of Directors, also, are quite pleased to have recently appointed Gaye to the Board of Directors of First Republic Bank. She has made a tremendous impact on our business across a number of strategic areas, and this appointment is an important next step in our planned leadership succession.

Now let me turn the call over to Gaye Erkan, President.

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Thank you, Jim. It is an honor to be part of the Board.

Overall, this was a strong quarter. Loan origination volume was $6.7 billion during the quarter, down just slightly from a record first year -- first quarter in 2018. Additionally, our term-loan pipeline is one of the strongest we have experienced and is picking up weekly.

Given our strong pipeline and client activity, we continue to expect mid-teens loan growth for 2019.

Single-family residential volume was $2.2 billion during the quarter, in line with the first quarter a year ago.

Importantly, credit quality remains excellent, and we continue to maintain our conservative underwriting standards.

Our weighted average loan-to-value ratios for loans originated during the first quarter were 59% for single-family residential and 47% for multifamily and commercial real estate together.

Turning to business banking, business line commitments continue to increase nicely, up $1.1 billion from year-end 2018. This was mainly driven by capital call lines of credit.

Business lines outstanding were down this quarter due to a decline in utilization rates from 37% to 33%. This is not unusual as utilization rates fluctuate regularly from one quarter to another, driven primarily by size and timing of deal activity. For perspective, utilization rates have ranged from 31% to 39% over the past 2 years.

Turning to deposits, it was a very good quarter in terms of both deposit growth and deposit rate. Deposits were up 15% from a year ago. Importantly, checking deposits remain strong, representing 59% of our total deposits at quarter-end. Business-related deposits represented 56% of total deposits, consistent with the prior quarter. We are particularly pleased that we have been able to maintain a diversified deposit funding base. In the first quarter, our average rate on all deposits increased only 6 basis points from last quarter to 57 basis points. The average rate on total liabilities also remains low at just 79 basis points. Compared to the 123 basis points average of the 3 banks that reported today, that is 40% less expensive.

Additionally, in the first quarter, our total liability cost increased only 5 basis points, which is less than half the increase reported by these banks.

The strength of our deposit franchise is the very result of our client-centric business model as well as the depth and stability of our client relationships.

In terms of private wealth management, it was another strong quarter. Wealth management assets were up 11% for the quarter and up 24% year-over-year. This continued strong growth was driven by net client inflows from both new and existing clients, along with market appreciation. Wealth management fee revenues for the quarter were up 8% compared to a year ago. Investment management fee revenues will increase meaningfully in the second quarter due to the strong growth in AUM in the first quarter.

I'm pleased to say that 4 new wealth management teams joined First Republic during the first quarter. We continue to successfully recruit new wealth professionals, who are attracted to our holistic, client-centric approach and who embrace our unique service culture.

Overall, we are quite pleased with our performance this quarter across lending, deposits, and wealth management.

Now I would like to turn the call over to Mike Roffler, Chief Financial Officer.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Thank you, Gaye. Our liquidity position remains very strong. High-quality liquid assets were 15.5% of total average assets in the first quarter. Net interest income, which we view as one of our key growth metrics, was up 15% year-over-year. This reflects our ability to maintain a stable net interest margin, combined with growing our earning assets.

During the first quarter, our net interest margin was 2.97%. This is slightly above our guidance for the year and was largely the result of better-than-expected deposit pricing. We would note that loan pricing over the past 30 days has become even more competitive, while long-term interest rates have also moved lower. For 2019, we continue to expect net interest margin to be in a range from 2.85% to 2.95%.

Our efficiency ratio for the first quarter was 65%. As a reminder, the efficiency ratio during the first quarter is always elevated due to the front-loaded seasonal impact of payroll taxes. These expenses typically add 1.5% to our efficiency ratio in the first quarter. We continue to expect our efficiency ratio to be in the range of 63% to 64% for 2019.

Importantly, as we grow, we continue to make focused investments in technology to further enhance our ability to provide exceptional client service, improve our client's digital experience and to continue building a strong, scalable foundation for our operations.

Our effective tax rate for the quarter was 15.6%, which benefited from a significant increase in the exercise of stock options by employees during the quarter. We continue to expect the bank's effective tax rate to be between 19% and 20% for all of 2019.

Thank you. Now I'll turn the call back over to Jim.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Thank you, Mike and Gaye. It was a strong first quarter, and we have very good momentum on the loan front and the asset under management front going into the second quarter. Looking ahead to the rest of the year, we're quite confident that our consistent, stable, client-focused model, combined with a very conservative approach to credit will allow us to continue to deliver safe, steady growth.

Thank you. Now we'd be happy to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Steven Alexopoulos with JPMorgan.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

I wanted to start first on NIM. I was surprised by how resilient the margin was in the quarter. And if we look, loan yields actually helped -- and Mike you just said that the competitive environment has worsened a bit. First, how do we think about loan yields trending forward from here, from the portfolio yield?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Sure. So in the first quarter, Steve, we were pleased that they were up 7 basis points from the fourth quarter. We do have some benefit in the first quarter from the LIBOR and prime portfolios, which went up from December's rate hike. And so that benefit usually is about, call it, 4 basis points in a quarter. With the lack of a rate move, you don't get that same uptick. So here, we're at a pretty consistent rate with where sort of new lock volume is coming in, but there could be a modest increase in the quarter, but competition is pretty tough right now, so it won't be as robust as it has been in the last few quarters.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

Okay. And then maybe for Gaye. So the forward look on interest rates has changed quite a bit, in terms of your ability to go out and raise new deposit funding, has deposit competition eased at all relative to that? Do you expect to see the price increase in deposits moving forward to ease a bit?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

The -- high speed -- the competition remains quite fierce on the deposit side as well, having said that, we are very pleased with the growth, both the growth and the ability to lag. The first half of the year is always the toughest. Obviously, the second quarter is the tax outflows. And the second half is where we're seeing the great pick up, in general. But given the loan competition in the second quarter with the tax outflows, we remain confident in the 2.85%, 2.95% NIM guidance.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

Okay. And can you help us think about -- it's a pretty wide range, particularly given where we are. Should we expect NIM to trend down modestly 1 or 2 basis points a quarter? Could it get much more pronounced, just given what you're talking about on the loan environment side?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

So, a lot of it will depend on sort of loan competition and pricing. And as Gaye said, the second quarter has some of the challenges. It's typically where we use some of our federal home loan bank if you were to look seasonally a bit more because of tax outflows, which have just started to start here in April. So, it could be a little bit more than 1 or 2, but then I think it sort of stabilizes there because the second half typically gets better from deposit funding.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

Got you. And then maybe one last one for Jim. So if we look, the banks seems to be in a great position here to boost loans and wealth management, given all these large tech IPOs coming out of the Valley and Bay Area, one, have you seen any improvement? I know Gaye said that loan pipeline has improved. Has any of it tied to that? And how do you think about this opportunity for you guys? Thanks.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Well, the IPO opportunity is hard to measure. We have done the obvious. We know the employees working in the firms that are teed up and whether we bank them or not. And then we also have a pretty good way of digitally marketing into those that we don't now bank. The concentration in a couple of our key markets, particularly New York and San Francisco, is quite stunning actually. I would say, it isn't yet impacting the house prices or loan demand because very -- only -- as we know, the lineup is just beginning and there are lockups in most cases. So my guess, Steve, is that the net impact on house prices and house activity is more likely to be summer or fall in our market. The problem in San Francisco, honestly, is the shortage of supply, more constrained volume more than anything elsewhere.

Operator

Our next question comes from the line of Jared Shaw with Wells Fargo.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

I guess, maybe just following up on the tech question. Do you see -- yes, I know that you have been doing a lot of personal lending to -- with security of the private securities. Do you anticipate any refi'ing or any pay-down on consumer lending as a result of the tech IPOs, as people do get some liquidity?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Yes. To the extent that there would be payback on some of the secured loans that are outstanding against the privately held stock, but the majority of monies -- remember where the money flows, you have venture capital funds cashing out, money goes out into their partners; we bank a lot of them. Money goes to their investors; we bank a lot of them. And so everyone focuses on the employment base of the companies, but actually they are second to receive proceeds. Because of lock-ups unless there is a specific underwritten secondary amount, which, in most cases, there are some at least for the executives. But I think that we don't see it being a negative for our lending outstanding if that's what you're implying in the question, no. It would actually be a positive for economic activity in virtually all of our markets, but particularly San Francisco.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

And then looking at the business lending category this quarter, down from fourth quarter, how much of that was driven by capital call lending? And are you seeing any change in either the demand for capital call lines right now or the competitive landscape in that line?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Gaye?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Yes. The market -- the capital call line commitments, the market continues to be strong and the line usage is expected to continue as well. The real focus where we focus is the business line commitment, which eventually leads to growth and balances over time. And our commitments were up 26% quarter-over-quarter annualized, and they were up 35% year-over-year. And as Jim mentioned related to the IPO activity as well, there is continued appetite for new fund formation as well as continued appetite for line commitments in the capital call business.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

And just final one for me on the student loan business, seeing -- continuing to seeing good growth there. Could you share with us, I guess, what your plan is in terms of ultimately as a target for concentration in student lending? Or is that still in flux as you're sizing up the market?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Well, what's interesting about that is that we don't have a target per se. We take in each individual household based on their credit capability, what their needs are and service needs are. As we meet them and establish a relationship one at a time. Last year, we grew by about 8,000, 9,000 such households. Our percentage of millennial households is now about 33% of our borrowing base -- of our consumer borrowers, sorry, in the company. That's up from 14% or 15%, like, 3 years ago. I would guess and I'm only guessing that with the current trends, it will be half the bank in terms of household numbers, not dollars, but household numbers, in a couple of years. Buried inside that group obviously are a significant number of people that are involved in a lot of the tech companies. So we don't know where it's going to go. The outstanding balance is about $2.3 billion roughly, and I can see that growing about $1 billion a year. Although, we're beginning -- we now have several thousand such clients that are fully paid off their loans already and are moving into home ownership status or soon will. So it's a good program. It's working well. We're sticking to our knitting in our markets markets, high FICO scores, couple of years of work, minimum loan sizes, et cetera. And so it's working quite well.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

And what's the yield on that portfolio for the quarter?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

About 3.1%, 3.2%, overall, composite. Remember, the duration is only about 6, 7 years.

Operator

Our next question comes from the line of Arren Cyganovich with Citi.

Arren Saul Cyganovich - *Citigroup Inc, Research Division - VP & Senior Analyst*

With the 10 year coming down so much in the first quarter, are you seeing any increase in demand for mortgages in your markets?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Yes. The refi volume is -- purchase has been strong year-over-year and the refi is picking up as well, given the rate environment.

Arren Saul Cyganovich - *Citigroup Inc, Research Division - VP & Senior Analyst*

Any kind of magnitude that you could provide around that?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

The rate -- the pipeline is very strong. The rate locks have increased significantly both compared to a prior quarter and prior years. And that's why we continue to expect the mid-teens loan growth for 2019 is significantly stronger than what we have seen last year.

Arren Saul Cyganovich - *Citigroup Inc, Research Division - VP & Senior Analyst*

Okay, great. And then you'd mentioned that you have the seasonal issue with the taxes in the second quarter. Are you seeing any difference in magnitude, and last year was particularly high for you? Is it going to be as bad as last year from what you're seeing thus far?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

You're right, last year was a bit higher compared to the prior year then. Yet so far, it's similar magnitude, not big difference, but it's early. So over the next couple of weeks, we will see more into it. We expect the tax payments to be consistent, if slightly higher this year, and their positions now given the deposit growth and the cash position on the balance sheet.

Operator

Our next question comes from the line of Ken Zerbe with Morgan Stanley.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

Starting off with wealth management. I think I heard it was Gaye, who mentioned that you expect an improvement in wealth fees. But can you just remind us, like, how much of those fees are tied to beginning of period balances because it seems like first quarter is a little weaker than what we would have expected, and obviously, market has come back lot since?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Yes. It is -- so the investment management fee revenues, which is by and large the large component of the wealth management fee revenues. Those revenues are tied to the prior ending balance of AUM. So Q1 is tied to the end of year 2018 AUM. Given the strong increase, strong growth in AUM in Q1, that's why we expect the second quarter investment management fee revenues to be increasing meaningfully.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

All right, perfect. And then just in terms of expenses and particularly the 2 leases that Jim mentioned, are those lease expenses fully in your run rate in first quarter? I understand your guidance was 63% to 64%. I'm just trying to figure out how meaningful those were in terms of total expenses?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes. So Ken, there is really no cost in the first quarter, and most of the cost is going to come in later periods because as Jim mentioned, the New York, for example, is not until 2021. And so you won't really have any cost this year, maybe a little next year, but really 2021 when that hits. In San Francisco, again, the floors that we take are spaced nicely over time. So it really impacts us a little bit this year, but not meaningfully where we would change our guidance and then it phases in over time.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Ken, let me -- it's Jim. Let me add a comment to that. The reason we have even brought that up because we take space all the time is it's indicative of 2 things: one, as we do our forward-looking and planning, the momentum of the enterprise is stronger than we have ever seen it before at all sorts of levels. And we began to -- it began to dawn on us, we realized that if we ran the numbers carefully, one of the constraints that we could run into rather easily was space. And by that I don't mean just absolute amount of space available, but wanting to have our organization tightly focused together. We do not put loan servicing in South Dakota. We keep it together. The client service comes from that in part. And so we decided, particularly in San Francisco, where space is getting quite taken very quickly actually, we decided to move quickly and preemptively. That's a reason I mentioned sublease rights in both cases. In the Hudson Yards area, the construction going on in Hudson Yards' office, new A office construction going on in Hudson Yards, is somewhere around 25 million square feet. To give you a perspective, San Francisco, all of it, only 55 million square feet of A office. So what's being built in Hudson Yards is 50% of San Francisco. And so we took a significant and very important locational position in Hudson Yards when we could in a situation that appeared -- and we moved honestly very quickly on it. It also gives us growth room in New York for a period of -- for a quite a number of years. So basically in our 2 largest markets, we're space not constrained for about 5 or 7 years.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

All right. Perfect. That totally makes sense. And then, sorry, just one last question, going back to the margin, if I could Mike on this. It seems like you guys have consistently above your 2.85% to 2.95% for, let's say, several quarters. I think I heard down 1 to 2 basis points, maybe a little bit more, but when you think about the full year, are we thinking -- I think last quarter, you mentioned it's going to be middle of that range. Are we now sort of at the high-end of that range? I'm just trying to make sure how we think about the path of that over time?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, I don't think from last quarter, I would change much. We are really pleased with how the first quarter came out. I think we even talked in January that were operating at the high end, and we were able to stay there. It is pretty competitive and the yield curve has move down a little bit. So that's why feeling that midpoint feels good to us, and that's why we sort of give the range, too.

Operator

Our next question comes from the line of Brock Vandervliet with UBS.

Brocker Clinton Vandervliet - *UBS Investment Bank, Research Division - Executive Director & Senior Banks Analyst of Mid Cap*

I just wanted to circle back on the capital call area because that growth is just so strong, 26% sequentially, in terms of commitments. Could you just frame out where that growth is coming from in terms of new funds, expanded lines to existing relationships? Is any of that, including direct partner lending, just trying to get that growth rate a bit more?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Sure. Just at a broad level, at the sector level, the forecast for new venture capital and PE fund raising in 2019 and 2020 is quite strong. And there is a lot of appetite for new fund formation. So thus the outlook for the capital call line business is quite positive. It is a combination of existing fund clients who are continuing in their business as well as new clients coming in, and you are seeing both the appetite as well as the valuations remaining strong and high, and that's also driving the increased commitments over time.

Brocker Clinton Vandervliet - *UBS Investment Bank, Research Division - Executive Director & Senior Banks Analyst of Mid Cap*

And as you approach the market, I understand the structure of these -- most of these loans is pretty straightforward. Are you seeing laser-sharp competition? Or is it somewhat less?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

There is competition. Just a couple of thoughts on your question. So one, we tend to do the short-term un-called capital, raising the financing, 90 to 180 days. We don't tend to do the longer-term ones. That's number one. And number two, just from a business model perspective, these business banking and the line commitments are the result of us following the individuals. The principals' partners having done private banking with us, and they like the service they were providing and they took us to their businesses, and that's how we ended up. So yes, there is price competition, but the relationships and the service that we provide on the operational nature of those deposits, is really what wins the deals over time. And the credit standards, the way we look at it, we keep or maintain our conservative credit standards.

Operator

Our next question comes from the line of Matthew Clark with Piper Jaffray.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Just wondering how much the systems upgrade may have contributed to expenses in the first quarter? And whether or not that's a good run rate going forward? And kind of when you think about overall expenses is mid-double digits still kind of the right way to think about the growth there this year?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, I think, mid-double digits does feel right to us. It allows us to continue to invest in the franchise. We are making digital investments. We're beginning to work on the core systems that we've talked about. The costs there have remained relatively modest thus far. We are in sort of the ramp-up phase, and it will pick up as we move into the second quarter and to the later part of the year, but the overall expense growth mid-double digits feels about right to us.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. And then it looks like you increased your posted rates on your money market product this quarter. Just wanted to get the spot rate on your interest-bearing deposits at the end of the quarter? And what your expectations were for that cost maybe in the upcoming quarter?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Sure. The -- for overall deposits, the spot rate is at mid-60s.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. And then kind of expectations for the upcoming quarter, you're just a little bit higher than that maybe?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Well, it depends on the tax outflows and the rate environment, in general, and competition. But I would reinforce so far quarter-over-quarter our deposit...

(technical difficulty)

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Hello

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Matthew, are you there?

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

I' am, thank you. And then just last one. Just last one on the HQLAs, in terms of how quickly you might grow into the excess. Just trying to get a kind of the pace at which you might be able to, to where things kind of stabilize?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Yes. So we expect to manage towards 12% HQLA ratio. We have communicated earlier. I would note that we have elevated cash levels that contributes to the HQLA ratio and it is well-timed given the second quarter tax outflow that we expect. But we would continue to manage towards 12% while being opportunistic in the market as we see opportunities in HQLA, both agency and muni-HQLA.

Operator

Our next question comes from the line of Aaron Deer with Sandler O'Neill Partners.

Aaron James Deer - *Sandler O'Neill + Partners, L.P., Research Division - MD, Equity Research and Equity Research Analyst*

Just to add a question. It sounds like you're starting to see a pickup in refi volumes, given the drop in mortgage rates. I'm just curious looking back here at the first quarter, what was a mix of purchase versus refi?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

About 50-50.

Aaron James Deer - *Sandler O'Neill + Partners, L.P., Research Division - MD, Equity Research and Equity Research Analyst*

Okay. And then Gaye, you gave kind of a good explanation behind the wealth management revenues in the quarter related to the entire end of period or start of period balances and the timing on some of the inflows and appreciation. But are you generally seeing any sort of systemic price competition within brokerage and investment management, just due to broader competition?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

No, not necessarily, nothing significant of that sort. It was really 2 things: One, the AUM declined in the fourth quarter, that translates to the fee revenues, which rebounded nicely in the first quarter, thus the expected increase. And also the insurance revenues are just seasonal. Q4 is the strongest for insurance. Other than that, it's normal business. No additional impact.

Operator

Our next question comes from the line of Dave Rochester with Deutsche Bank.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Just back on the fee analysis, the comments you made. We expected the investment management fees to be a little bit lower this quarter, obviously, just given the dip in the AUM in the fourth quarter. But it looked like the fee rate actually came down a bit as well. We've generally only seen a drop like that in the first quarter when you had some lumpy performance fees in the fourth quarter, which didn't look like you had in 4Q '18. So just wondering what drove that decline in that rate? Is there anything onetime in that? Or it's a good level going forward?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Yes, it is a modest shift temporarily, given the asset allocation mix changes as markets fluctuate between equities and fixed income, so that would be temporary with the market shift.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

So, this lower rate, we should not assume that continues, that could rebound in 2Q?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Yes, not necessarily. So we had a little bit more allocation towards fixed income, which had slightly lowered that basis point. It's just the allocation as the equity markets continue to be strong it would shift back in. And similarly, sweeps, for instance, have increased their sweep deposits quarter-over-quarter as well.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

If you think about it year-end, David, it was very volatile, and so there are some clients that may have moved to cash and fixed income. And as they come out of that into equities, you should naturally see the fee rate increase a little bit.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Yes, that make sense. Great. And then just a quick one on the NIM. Just curious given the competitive dynamics that you're talking about on the deposit side, as to what you're baking into that NIM guidance for how long deposit cost will continue to increase over time. Do you think 2Q will be the end of that increase? Or do you think it will continue to increase through the end of the year? And I was also wondering what you're assuming for the interest rate curve from here if you're looking for any kind of a steepener? Or if you're just sort of projecting the current curve through the end of this year?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

So let me start by saying, first of all, as you were mentioning the spot rates -- we had a technical difficulty. So the response to that, the spot rate for overall deposits was in the mid-60s for the next quarter. And now coming to your question for a second. When we look back historically, even if the fed funds rate were to stay flat at this level, we would still expect gradual increases in the deposit rate towards the equilibrium rate. And when we look back in '04, '07 type of time frame, it lasts for about 4 to 6 quarters after the fed fund stops, but it's very gradual shift in deposit rates. The second quarter happens to be the tax outflows as well. And thus the NIM guidance that Mike Roffler has mentioned for the year, the 2.85%, 2.95% we assume zero increase in fed funds.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes. So the guidance for NIM assumes 0 rate hikes for the rest of the year and the curve stays pretty flat, which it is now. I think Gaye covered some of this in her prepared remarks. If you look at our changes in our funding mix and funding liabilities, the increases have been quite considerably better in a lot of cases, especially if you look at total liabilities paid relative to peers or relative to the guys reporting today. And so that's been very supportive of keeping our NIM stable over the past year in spite of the continued increase in the fed funds rate.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Yes. Okay. Great. Maybe just one last one on deposits. It sounded like given your comments earlier just on the tax payment expectations. You guys aren't really looking for any kind of notable impact from the SALT cap this year, right?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Not necessarily. No meaningful impact so far from that category.

Operator

Our next question comes from the line of Chris McGratty with Keefe, Bruyette, & Woods.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Mike or Jim, based on the reiteration of the mid-teens growth and the rally of your stock year-to-date, any updated thoughts on capital, either common or preferred?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

I think we're in pretty good shape for now. The unexpected opportunity was the S&P 500. And as a result, we put out the equity at the end of the year that we probably would have needed and we would have done it later in the year. So at this point, we're pretty well capitalized.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. And Mike, maybe for you. Any kind of preliminary thoughts on CECL?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

So, thanks for the note. We're busy, real busy validating models, getting ready to run parallel. So no numerics yet, but obviously coming soon. Again, I reiterate the strength of our credit in our loss history will play a key role in this as we go forward because you do use of our history for a lot of the loan life, and our history is obviously very good.

Operator

Our next question comes from the line of Brian Foran with Autonomous.

Brian D. Foran - *Autonomous Research LLP - Partner, Universal and Regional Banks*

I was hoping I could just ask a follow-up on SALT. It seems anecdotally a lot of people, it just become real for them this year and maybe the sticker shock as they write their tax checks in April. Just one follow up, I think, Gaye, you said you're not seeing a big impact so far. If you could just kind of -- when you say that is it the last week tax-driven outflows and deposits? Or what metric you're looking at there? And then just more broadly, when you step back and talk to clients, I mean, do you think this is something we're all going to gripe about, but ultimately live with? Or does it feel little bigger and maybe you could start driving behavior changes, people moving and all that kind of good stuff?

Hafize Gaye Erkan - *First Republic Bank - President & Director*

Got it. So far there is not been a noticeable impact from the SALT. But again clients will be paying their taxes now, so they will know more the real impact in a while. But ultimately, talking to the clients, we think that clients will stay where the jobs are and that continues to be in our markets. We have some clients -- we may have some clients that have more flexibility to move to markets like Palm Beach or Jackson, where we have offices and we would welcome them over there as well, but so far really no meaningful impact.

Brian D. Foran - *Autonomous Research LLP - Partner, Universal and Regional Banks*

And then maybe just the Net Promoter Score. I realize asking about the year-over-year transition, kind of missing the forest for the trees, the bigger thing is your 2x the industry. But they were down a couple of points from what you printed last year. I don't really understand the full inner working of NPS. Is that kind of noise? Or was it 2 or 3-point decline, meaningful and attributed to anything?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

It's pretty much just noise. We have range of results. What we look at, which we don't necessarily report in detail for obvious reasons, but we have a great deal of depth on where it's up and where it's down inside the bank. We haven't moved around, though. We don't get excited about a couple of points. We do get excited about sort of 5 to 7 points. That did not happen this year anywhere actually, except on the upside in one area, which we're pleased with.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session. And I would like to turn the call back to Jim Herbert for closing remarks.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer and Founder*

Thank you very much, everyone, for attending the call today. We appreciate your time and attention.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.
