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OVERVIEW:

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PRESENTATION

Operator

Greetings, and welcome to the Comerica First Quarter 2024 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Kelly Gage, Director of Investor Relations. Thank you. Please go ahead.

Kelly Gage - *Comerica Incorporated - Senior VP & Director of IR*

Thanks, Donna. Good morning, and welcome to Comerica's First Quarter 2024 Earnings Conference Call. Participating on this call will be our President, Chairman and CEO, Curt Farmer; Chief Financial Officer, Jim Herzog; Chief Credit Officer, Melinda Chausse; and Chief Banking Officer, Peter Sefzik.

During this presentation, we will be referring to slides, which will provide additional details. The presentation slides and our press release are available on the SEC's website as well as in the Investor Relations section of our website, comerica.com.

This conference call contains forward-looking statements. In that regard, you should be mindful of the risks and uncertainties that can cause actual results to vary materially from expectations. Forward-looking statements speak only as of the date of this presentation, and we undertake no obligation to update any forward-looking statements.

Please refer to the safe harbor statement in today's earnings presentation on Slide 2, which is incorporated into this call as well as our SEC filings for factors that can cause actual results to differ. Also, this conference call will reference non-GAAP measures. And in that regard, I direct you to the reconciliation of these measures in the earnings materials that are available on our website, comerica.com.

Now I'll turn the call over to Curt, who will begin on Slide 3.

Curtis Chatman Farmer - *Comerica Incorporated - Chairman, CEO & President*

Thank you, Kelly, and good morning, everyone. Thank you for joining our call. Today, we reported first quarter earnings of $138 million or $0.98 per share. Although loan demand remained muted, we continued to see improvement in customer sentiment, translating into increased pipelines and signaling opportunities for growth.

Our historically strong deposit franchise demonstrated resilience as deposits outperformed expectations and normal seasonal patterns. These favorable trends enabled continued normalization of our liquidity position as we reduced wholesale funding by over $5 billion throughout the quarter. In fact, over the last 4 quarters, we repaid almost $12 billion in wholesale funding while preserving significant available capacity.

Beyond our financial results, we were incredibly proud of recognition we received for our efforts to prioritize our employees and communities. Greenwich Awards showcased our successful focus on small business, and we see great potential for continued growth in this space.

Earlier this month, we hosted an event at our new collaborative workspace in North Texas, and our second large office transformation is underway in Michigan. As a product of our modernization efforts, these business and innovation hubs leverage advanced technology designed to meet the evolving needs of our colleagues and customers through dedicated business centers. Immediate feedback has been overwhelmingly positive, and we feel this workplace strategy will be key to attracting and retaining talent while offering unique benefits to small businesses and local communities.

First quarter financial highlights are on Slide 4. Average loans were impacted by rationalization efforts from 2023, including the exit of Mortgage Banker Finance, which is now substantially complete. Deposits outperformed expectations and, in fact, would have been relatively flat, excluding the deliberate reduction in broker time deposits.

Net interest income was impacted by lower loans, slightly higher deposit costs and 1 less day in the quarter, but overall performed better than projected. Credit remained strong as net charge-offs moved even lower this quarter. Both noninterest income and noninterest expenses were impacted by notable items, and we saw a discrete benefit to taxes.

Prudent capital management and lower loans drove an increase in our estimated CET1 to 11.47% even higher above our 10% strategic target. Stepping back, strong liquidity, credit and capital supports our solid foundation and positions us to prioritize responsible growth in the second half of the year.

Now I'll turn the call over to Jim, who will review our financial results in some more detail. Jim?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Well, thanks, Curt, and good morning, everyone. Turning to Slide 5. Impacts from intentional balance sheet management efforts in 2023 carried over into the first quarter, and when coupled with soft demand, drove downward pressure on average loan balances. Lower utilization was a trend in both middle market where customers use deposits to repay debt and invest in their business and equity fund services, where we observed continued softness in private equity activity.

Conversely, commercial real estate utilization continued to trend higher as we funded multifamily and industrial construction projects while managing commitments lower. As we looked month-to-month throughout the quarter, we saw balances decrease only modestly and a steadily increasing pipeline, which together support our expectation for growth.

Slide 6 highlights the stability of our deposit base. Average deposit balances declined $700 million, but almost $600 million was attributed to lowering brokered time deposits. Otherwise, declines in technology and life sciences, equity funds services and commercial real estate were largely offset by increases in general middle market, entertainment and retail. In fact, retail balances are nearing pre-March 2023 levels with growth in both small business and consumer.

Our mix of noninterest-bearing balances remained a competitive advantage, averaging 40% for the quarter as both interest-bearing and noninterest-bearing deposits exceeded expectations. As anticipated, elevated rates continued to drive deposit pricing higher to 328 basis points and a cumulative beta of 62%.

However, the pace of increase continued to flatten as it has for the past 4 quarters. Our deposit profile remains a competitive strength, and we were encouraged by this quarter's results.

As shown on Slide 7, we normalized our liquidity position. And in this quarter alone, we were able to repay over $5 billion in wholesale funding while retaining significant capacity. Over the last year, our liquidity strategy proved effective as we added liquidity to navigate volatility and then methodically normalized our position as the market stabilized.

We were incredibly proud of our $1 billion debt issuance in late January, a record issuance for Comerica. Investor interest was high and the execution was effective, which to us signaled progress towards more normal market activity and interest in our value proposition. At 80%, our loan-to-deposit ratio remained below our 85% medium-term target, positioning us to prioritize high-return loan growth going forward.

Period-end balances in our securities portfolio on Slide 8 declined with continued paydowns and maturities in addition to a $268 million negative mark-to-market adjustment from a higher forward curve. We expect continued decline in this portfolio over the coming quarters.

Turning to Slide 9. Net interest income decreased $36 million to $548 million driven by lower loan balances and higher deposit pricing, partially offset by Fed deposits and lower wholesale funding. While lower noninterest-bearing balances also contributed to the quarter-over-quarter decrease, deposits overall outperformed expectations with favorable deposit trends, lower FHLB advances, a moderating deposit beta and a $3 million noncash BSBY accretion, net interest income exceeded guidance.

As shown on Slide 10, successful execution of our interest rate strategy and the composition of our balance sheet positions us favorably for a gradual 100 basis points or 50 basis points on average decline in interest rates. By strategically managing our swap and securities portfolio, while considering balance sheet dynamics, we intend to maintain our insulated position over time.

As a reminder, BSBY cessation does not impact the ongoing cash flow associated with the swap notionals listed on the slide. While we took noncash losses in the fourth and first quarters, we will accrete them back with the majority coming back into net interest income in 2025 and 2026. Now that we have fully redesignated the remaining impacted swaps, we have included quarterly BSBY-related net interest income projections in the appendix for your modeling.

Moving to Slide 11. We expect the attrition of our swap and securities portfolio to create positive earnings momentum. Scheduled swap maturities outpace the remaining forward starting swaps in 2024. By the end of 2025, we expect lower overall notional balances and a 14 basis point increase in swap yields creating a tailwind for net interest income.

Within our securities portfolio, we expect approximately $4 billion in repayments and maturities by the end of 2025. Although some of this may be partially offset by reinvestments in the portfolio, we expect to redeploy that liquidity at substantially higher rates. Altogether, we expect these portfolio trends to benefit our earnings trajectory.

Credit quality remained strong as highlighted on Slide 12. Net charge-offs of 10 basis points declined from the fourth quarter, which were already below our normal range. Elevated interest rates continued to pressure customer profitability and debt service ratios, which drove migration in general middle market and senior housing.

Our senior housing exposure is limited by design and with a geographically diverse new construction orientation, recourse and potential for favorable macroeconomic and demographic tailwinds, we feel the risk is very manageable. Total portfolio normalization trends resulted in an increase in the allowance for credit losses to 1.43% of total loans.

Nonperforming assets also increased, but still remained well below historical averages. Overall, our trends remained in line with expectations. And while we continue to monitor the portfolio very closely, we believe ongoing migration will remain manageable.

On Slide 13, first quarter noninterest income of $236 million included a $39 million noncash loss related to the BSBY loan hedges not yet redesignated. This compared to a $91 million BSBY impact in the fourth quarter. And since we have now fully redesignated the remaining impacted swaps, we do not expect additional mark-to-market volatility related to BSBY cessation.

Fiduciary income was impacted by accrual adjustments and trust and accounting changes associated with our Ameriprise transition. Initial feedback on Ameriprise has been positive, and we continue to think this partnership can drive meaningful revenue growth over time.

First quarter capital markets income was seasonally light as higher syndication fees were offset by declines in interest rate and energy derivative products. We had a $5 million miscellaneous item in the first quarter related to a vendor contract, but we would not expect that benefit to repeat.

Expenses on Slide 14 included an estimated $16 million additional special FDIC assessment, incremental to the $109 million charge taken in the fourth quarter. Excluding this assessment and deferred compensation, expenses performed in line with expectations for the quarter.

Generally, we saw seasonal declines across most expense categories with lower severance and temporary labor offset partially by stock compensation. Further, we saw the benefit of lower pension expense, which will be consistent throughout the year.

Expense recalibration actions announced last quarter are underway, and we expect the majority of identified colleague separations and banking center closures to occur in the second quarter. We remain keenly focused on ongoing expense management to support investments and enhance overall earnings.

Slide 15 highlights our conservative capital position as our estimated CET1 grew to 11.47%. Although we are below $80 billion in assets, our estimated CET1 adjusting for the AOCI opt-out was already above the required regulatory minimums and buffers.

Despite higher unrealized AOCI losses due to the rate movement, tangible common equity increased to 6.36%. We expect unrealized losses to burn down over time as securities repay and swaps mature but the rate curve continued to create near-term volatility.

As I mentioned on our last earnings call, we favor a conservative approach to capital management and plan to monitor ongoing AOCI movement and regulations as they evolve.

Our outlook for 2024 is on Slide 16. We project full year average loans to decline 3% largely due to optimization efforts in 2023. Despite soft first quarter demand and the higher rate curve, we still see constructive signs in customer sentiment and pipeline, supporting our projected 4% to 5% point-to-point growth. With average loans expected to be flat to down 1% in the second quarter, we still anticipate broad-based growth in the second half of the year.

Full year average deposits are expected to be down 2% to 3% from 2023 or down 1% to 2% point-to-point. This assumes our new lower level brokered time deposits remain flat from March 31 and represents an improved average customer deposit outlook for the year. Excluding brokered time deposits, we expect year-end 2024 deposits to exceed year-end 2023.

Our year-over-year net interest income outlook down 11% remains unchanged despite movement in the rate curve. Strong deposit performance as well as moderating deposit betas, largely offset the reduction in the number of rate cuts.

As a point of clarity, we used the April 10 forward curve to reflect the most recently published CPI number and market consensus reflecting 2 rate cuts in the second half of the year. As I mentioned at a conference last month, movement in the rate curve since 12/31 does push our projected net interest income trough into the second quarter. But as you can see in our guide, we do not expect the quarter-over-quarter decline to be significant.

Credit quality remains strong, and we expect continued migration to be manageable. We forecast full year net charge-offs to move into the lower half of our normal 20 to 40 basis point range. We expect noninterest income to grow 1% to 2% on a reported basis, which would be down 1% year-to-year when adjusting for BSBY and Ameriprise as detailed on Slide 39.

With the higher forward curve, risk management income is expected to remain strong, and we project growth in most customer-related fee income categories in the second quarter and throughout the year.

Full year noninterest expenses are expected to decline 3% on a reported basis but grow 3% after adjusting for special FDIC assessments, expense recalibration and Ameriprise. As always, this assumes deferred compensation of $0 for the remaining quarters.

Projected second quarter expenses should come down from the first quarter due in part to seasonal compensation and we expect to see the benefit of savings related to our recalibration efforts throughout the year.

Continued strategic investment remains a priority and the bar for regulatory compliance and risk management framework continues to rise. So we are working to offset and self-fund these increasing pressures. We saw a discrete tax benefit in the first quarter, but excluding discrete items, we project a 24% tax rate for the full year.

Even with projected loan trends, we expect to maintain capital well in excess of our 10% target. We will continue to monitor AOCI volatility and the evolving regulatory environment as we continue to take a conservative approach to share repurchases. Overall, favorable deposit trends put us on a great path to start the year, and we feel very good about the earnings trajectory of our business.

Now I'll turn the call back to Curt.

Curtis Chatman Farmer - *Comerica Incorporated - Chairman, CEO & President*

Thank you, Jim. We understand the heightened industry focus on the timing of rate cuts and what that means for quarterly net interest income, and we think we have a compelling earnings trajectory. However, as we think about the true value in our business, we think it's important to take a step back and reinforce our differentiated value proposition, as shown on Slide 17.

As a leading bank for business with strong wealth management and retail capabilities, our tenured colleagues deliver value-added expertise to our enviable customer base. Our highly regarded approach to credit coupled with our commitment to diversification mitigates risk of loss and historically outperformed peers.

Customer feedback reinforces our belief that we are the right size to deliver tailored products by adding value to their business and providing a high level of service. Product investment and strategic partnerships, such as Ameriprise that we entered into last year are designed to further enhance our core set of solutions.

The resilience of our operational deposit base was highlighted this quarter as we outperformed normal seasonal patterns and maintained a favorable deposit mix. We remain committed to managing the company for the long term, which means taking targeted expense actions like those announced last quarter while still prioritizing investments in our future.

With our strong capital base, proven approach to credit and commitment to risk management. We see positive momentum for reasonable growth and enhanced profitability. I appreciate your time this morning, and now we'd be happy to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Today's first question is coming from Ken Usdin of Jefferies.

Kenneth Michael Usdin - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

About improving profitability and the implied improvement in NII throughout the year. I'm just wondering I want to make sure that after this dip in the second quarter then it seems like we could see quite a sharp increase in second half NII. Just can you help us understand like what that cadence looks like. So if it's down a little bit, is it up and even more up to exit? Or because the implied sequential feels like it could be like 570-ish kind of getting towards the end of the year. And I just want to make sure we understand like how that looks as these deposit pricing and last kind of things move through.

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

All right. Ken, it's Jim. Happy to answer that question. Yes, number one, we do see an increasing rate of improvement quarter-to-quarter as we go through the year from second to third and third to fourth, and frankly, I expect that trend to continue even beyond the fourth quarter of this year. We do have a lot of momentum behind us.

If I look at some of the big drivers that are driving that momentum, probably at the top of the list would be the maturing swaps and securities. And we did try to outline what that benefit could be on Slide 11, showing those various maturities, and they do pick up momentum as we move through the year and into next year. So I'd probably list that as one of the biggest drivers.

But I would also say loan volume is going to almost be an equally large driver. If you look at the guide that we gave, it implies a pretty significant hockey stick up in the last couple of quarters of the year. And so we'll certainly pick up some income there, probably on a lesser basis.

Obviously, we'll get some more days in the second half of the year and then the liability sensitivity, which will not be as large, but will be a factor will start to kick in, in the second half of the year, too. So it will be a nice smooth trajectory upward, and we do feel really good about that momentum.

Kenneth Michael Usdin - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

Great. Okay. And as a follow-up, just on the deposit side, you mentioned that you think deposits will end higher at the end of the year. I think the mix is still important. How do you expect that DDA to total deposit mix to go? I mean, granted, it's all good in the absolute range if it's still all moving up. But just can you help us understand the mix?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes, happy to do that. And just to reclarify that will be excluding broker deposits, time brokered deposits since obviously, we don't consider those customer related. Those are down quite a bit even since the end of '23. So that guide was excluding those. But putting that aside, we do expect the mix to stay somewhat consistent right now.

We'll continue to monitor it and is a little bit higher for longer environment, but it's been holding up very good to date. And as we look out into the future, we do expect it to continue to hold up. To the extent it dips below 40%, which we're not projecting at this time, it's more likely to be due to the success with interest-bearing deposits as opposed to any challenge with noninterest bearing. So we think our mix will continue to be peer-leading and a real competitive advantage for us.

Operator

The next question is coming from John Pancari of Evercore ISI.

John G. Pancari - *Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst*

Also on the NII expectation, I know you indicated that the curve has essentially pushed the NII trough into the second quarter, but you also mentioned some of the dynamics of an improving trajectory. Can you maybe give us some color if we do not get the forward curve, and we do not get cuts at all in 2024, what does that mean for your NII, not only the timing of the trough, but the broader outlook? And then can you just remind us what Fed cut assumption do you have currently in your expectation?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes. I mean, right now, the expectations we follow the forward curve that came out right after the CPI report. So we're sticking pretty closely to that, which reflects just under 2 cuts in the second half of the year. If we don't get those cuts, I did mention the liability sensitivity. And that's a very slight sensitivity position. We're very close to interest neutral. So I would not want to overplay that.

I think if we don't get the cuts because we are so close to interest neutral, it's not so much the sensitivity that causes the challenge. But I think what causes the challenge for the whole industry is with flat rates, you still have the potential for depositors to ask for higher pay rates. So I do think probably all banks will see slight increases in pay rates over the course of the year and into next year if rates weren't going to change.

I do expect that to be a slight impact, but those would be the 2 factors. We lose a tiny bit of liability sensitivity, which is more of a minor factor for this year, but you also run the risk of continued rising pay rates as we move through the year also.

John G. Pancari - *Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst*

Okay. Great. That helps. And then separately, on the loan growth side, I know you revised your average loan growth guide to down 3%. And you cited some muted demand, but improving pipeline and the expectation of the back half pickup in growth. Can you maybe talk about the confidence in that pick up? Where do you see loan generation strengthening? What anecdotal data supports that expectation? Because clearly, we're seeing industry pressure at this point.

Peter L. Sefzik - *Comerica Incorporated - Senior EVP & Chief Banking Officer*

John, this is Peter. So yes, when you say 3% down, that's the average year-over-year and our outlook now is 4% to 5% point to point for 2024. And I would say, as we did in the comments here, it's pretty broad-based. We've got some give and takes as we go throughout the year across our portfolio.

I think in general, though, middle market is kind of where we feel probably the best about that. We did a lot of rationalization in '23 coming into '24 that I think is sort of affected us for the first quarter, and will a little bit in the second, but we're pretty much past that rationalization. And I think from here on, we feel good about being able to project the 4% to 5% point to point.

And again, I'd say it's pretty broad-based across really all of our businesses that you see in the deck that we show. There are kind of some that I would say are probably more impacted by the interest rates higher for longer than others. But I would say that that's mostly kind of in our small business, business banking, maybe private banking space. But in general middle market and up, I think, it seems like we're seeing really, really good opportunities. And again, the pipeline has grown and really feel like that's going to be an opportunity throughout the year.

John G. Pancari - *Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst*

And did you comment on your utilization rate for the quarter?

Peter L. Sefzik - *Comerica Incorporated - Senior EVP & Chief Banking Officer*

I believe it's in our deck, but it's down just a little bit on utilization across the portfolio.

Operator

The next question is coming from Scott Siefers of Piper Sandler.

Robert Scott Siefers - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

So Jim, I was hoping a lot of good detail on Slide 11 regarding the swaps in the securities that will become a pretty meaningful tailwind as we go forward. Are you able to sort of help size just the way you sort of think about things internally, just order of magnitude of how much NII could improve over the course of the next couple of years.

Some of your peers have given sort of a longer out margin outlook. Just anything you're comfortable giving. I think there's sort of a wide range of expectations for what earnings could look like at Comerica over the next couple of years. So just anything that helps sort of narrow the cone a little would be great.

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes, happy to do that, Scott. It's going to depend somewhat on how we've redeployed that liquidity. So there's going to be a range of outcomes there. But we do pick up increasing momentum as we move through this year. That will continue in the next year. Next year, we are going to be pretty far north of $100 million of net benefit, netting out the maturing securities and swaps versus what we might reinvested in.

And that benefit next year will also increase with positive momentum upward as we move through '25. And so the exit rate for '25 going into '26 will also be very substantial. So there is a pretty incredible tailwind come in our direction as it relates to some of these maturities.

Robert Scott Siefers - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Okay. Perfect. And then maybe if you could speak in a bit more detail around thoughts on capital management. You've been very appropriately conservative. I think the rate moves in the first quarter in particular, kind of validated that. But just curious if there's a point where you just get more comfortable in resuming repurchase in spite of kind of the volatility in the rate backdrop just given what we know will be coming due and sort of going away over the next couple of years?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes, that is something we continue to monitor very closely. Obviously, the first -- as we've said many times before, the first use of capital for us is for our customers and -- as you heard from Peter, we are expecting pretty significant loan growth in the second half of the year. So we want to make sure we're there to support the customers. And certainly, we're going to be in very good shape from that standpoint.

In terms of turning on the share repurchase, I think we're going to be in really strong shape from a capital ratio standpoint, even with that loan growth. But we continue to look at the interest rate environment and the AOCI and the new end game rules whenever they should happen to come out. We want to make sure we're comfortable from that standpoint.

And we have seen the interest rate environment kind of shift on us in recent months, and the momentum seems to be a little more upward than backwards -- downwards. So that gives us some pause in terms of turning on the share repurchase. And we would like to see some stability in interest rates in the overall curve before we turn the share repurchase back on. So that continues to be the #1 factor that we're looking at.

Operator

Our next question is coming from Steven Alexopoulos of JPMorgan Chase.

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

So last quarter, when the forward curve, I think, had 6 cuts in it, Jim, you talked about NIM dipping down a bit in 1Q, then a steady climb. I think you said by the end of 2024, you could get to a NIM that was above the 4Q '23 level, which was 291. It sounds now that the NIM will likely bottom. I think you're saying in 2Q, do you think you could still get up to that 291 level by the end of the year?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes, I do. We never give a precise NIM percentage for the reasons I've talked about in the past. But I will clarify, even though we see the dollars of net interest income troughing in the second quarter, I do think NIM percentage has troughed in the first quarter that we just saw. And that's because the balance sheet will continue to shrink a little bit as we, on average, have repaid some debt maturities and seeing cash come down. And again, that's one of the reasons I never offer a precise percentage or NIM percentage, because the two of them have two different answers.

But we do see NIM percentage continuing to rise up as we move through the year. I think we'll be closer to that 290, quite frankly, in the second quarter. If you exclude the BSBY impact, you'll see that we're going to have a $3 million BSBY negative impact in the second quarter compared to the positive $3 million we saw in the first quarter. You'll see that in the BSBY amortization slide.

But excluding that, we do expect to be approaching the 290 in the second quarter. And at this point, I would expect to be near or slightly above 3% by the end of the year. So we are on a very positive trajectory as it relates to both net interest income dollars and NIM percentage.

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

That's helpful. It's interesting. The key to all of this seems to be this hockey stick you're talking about of loan growth coming back in the back half of the year. It's interesting when you look like current GDP is fairly strong. Your markets, in particular, it's fairly strong. You have general middle market balance is still declining. And I feel like we've been down this road before, not only with Comerica, with the industry where pipeline has improved, but then we don't see it translate into actual loan growth.

What gives you that confidence? Like, what is going to change with the economic picture right now versus the second half where you will suddenly see so much more commercial loan growth in the second half?

Peter L. Sefzik - *Comerica Incorporated - Senior EVP & Chief Banking Officer*

Steve, it's Peter. I mean I guess that I would say prior to the banking crisis, we were seeing pretty good loan growth across all of our portfolio, particularly in middle market. And you're right, our geographies -- I mean I think the diversity of our portfolio continues to show really, really well.

And -- in middle market, in our geographies, we're having really good results, believe it or not in Michigan, in Texas, California is probably the most challenged. But a lot of our national businesses are not necessarily geographic specific. And so I think that, that sort of broad-based regular growth is what we would expect to see across a lot of our businesses.

And we've got different levers there that we can pull on how much we want to do in one business at any one time. And I think we feel really good about the overall trajectory in the second half of the year. So you're right. I mean the first quarter came in a little lower than we maybe had expected. But I think what we're seeing in the pipeline growth and our customer sentiment continues to improve quarter-over-quarter. And so that's what gives us the confidence that we expect to see that in the second half of the year.

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

Got it. Peter, do we need to see the Fed cutting rates to get this loan growth story moving? Like if we don't get rate cuts this year, are you guys still confident we'll see that improvement in the second half?

Peter L. Sefzik - *Comerica Incorporated - Senior EVP & Chief Banking Officer*

That's a really good question. I would say that the last 45 days, that's probably a little bit of our factor into going from 5% to -- 4% to 5% I would say a little bit. In some markets, that interest rate issue is bigger than others and in some businesses, as I said a little while ago, I think you see that in business banking. I think you see that in small business. I would say California Middle Market is a little more interest rate sensitive. It seems like in our other markets.

But when you look at kind of our broader specialty businesses, I don't know that the interest rate outlook is per se a headwind or a tailwind really for that space. So again, I think the diversity of the portfolio gives us some good tailwinds into whatever kind of interest rate environment we're going to see. But I guess I would say the smaller more consumer-oriented businesses, smaller businesses probably have a little bit of an interest rate headwind to them, but that's not a large, large percentage of our book overall.

Operator

The next question is coming from Bernard Von Gizycki of Deutsche Bank.

Bernard Von Gizycki - *Deutsche Bank AG, Research Division - Research Analyst*

So you introduced the expense recalibration last quarter and just wanted to get an update on the optimization of the real estate footprint and headcount reductions. I think headcount declined about 82 versus last quarter, and you noted the remaining will get done in 2Q. So how do we think about that $45 million cost savings being realized throughout the year?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Bernard, it's Jim. We still feel very good about that $45 million. We're very much on track what we had expected. Relative to headcount, we did recognize some of that change in headcount in the first quarter. Some of the colleagues have been notified, but actually hadn't moved off the payroll yet. So we haven't seen all that headcount reduction yet. But we have seen a piece of it.

There is a much smaller portion of that headcount that has been redeployed into other open positions, but we would expect it to fill those positions anyway. And so we will continue to see some attrition of count just as we continue to implement the savings ideas. But virtually all colleagues have been notified at this point, and we're very much on track.

I had mentioned in the last call that we do plan on reinvesting many of that savings and some of that investment -- a fair amount of it will be in risk management profile and the risk framework. And some of that will entail hiring colleagues in that space. So you won't necessarily see the same drop on a net basis that we talked about on a gross basis in the last call. But I would just summarize it to say that we are very much on track with that $45 million that we talked about.

Bernard Von Gizycki - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. Great. And then just -- you've highlighted the nice progress, obviously, on reducing the FHLB advances and brokered deposits. How should we think about the opportunity to further reduce wholesale funding throughout the rest of the year?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Well, we -- at this point, we've done a large portion of what we plan to do. We don't have any near-term FHLB maturities. We finished a lot of that up this quarter. And so we don't necessarily want to prepay that and incur the penalty. So I think where we're going to be from -- in large part, FHLB borrowings for right now.

We do have a lot of brokered deposits. Most of our brokered deposits on the books do mature this year. And we will let some of those roll off the books permanently, and some of those we will roll over. So it depends on the shape of the balance sheet at that point. We do have a senior debt issuance that matures later this summer.

And depending on the state of the capital markets, we would love to go out and term out more of our funding. So that's going to depend on market receptiveness and overall credit spreads. But you're not going to see as significant of a change in summary in the remaining 9 months is what you've seen in recent months and what you saw in the first quarter.

Operator

The next question is coming from Manan Gosalia of Morgan Stanley.

Manan Gosalia - *Morgan Stanley, Research Division - Equity Analyst*

So I wanted to ask on deposits. I can see that they're tracking relatively flat across the commercial bank. But I think rate expectations moved more meaningfully in the back half of the quarter, and again, more recently after quarter ended. Is there much of a headwind from commercial clients may be taking a look -- like taking another look at their NIB balances in a higher for longer rate environment. Maybe if you can talk about what are you hearing from them? Is that something they could do? Or do you think that's pretty much -- that move from NIB to IB is pretty much done at this stage?

Peter L. Sefzik - *Comerica Incorporated - Senior EVP & Chief Banking Officer*

Manan, that's a good question. This is Peter. I would say, overall, we believe that, that move from NIB to IB is over. But I think you probably still have some moving parts to Jim's point, if interest rates stay higher for longer, that conversation probably continues throughout the year.

But I don't think it's at the pace that what we saw the last 18 months. So what we continue to hear is that our customers are really confident in Comerica. They're really happy with what we're providing them, products and services for their liquidity. And we feel like the rates that we're putting out are very competitive.

So overall, the feedback that we're getting from our managers and our customers is, I would tell you, it feels like the answer to that is yes, that we think it's over. But I think particularly in our larger businesses, that's going to be a regular dialogue throughout the year as we kind of see what the interest rate outlook is.

I would remind you, though, when you look at the -- you talk about the commercial bank deposits, we've got a very healthy retail bank deposit base, very healthy wealth management deposit base, both of which have really performed really well lately. And so I think that when you look at the balance sheet for us, again, the diversity of our deposit base is terribly powerful on a go-forward basis. So there's a lot of levers that we can move when it comes to interest rates and how we go out and attract deposits.

Manan Gosalia - *Morgan Stanley, Research Division - Equity Analyst*

Yes. I appreciate that. Yes, that didn't go unnoticed. Maybe just shifting over to credit. The NPLs and criticized assets both increased Q-on-Q. I know you mentioned that the migration should be manageable, but how much of this is just a normalization in the level of NPLs and criticized assets versus the impact of higher for longer rates on your borrowers? And also if you can throw any more light on what you're seeing in specific industries?

Melinda A. Chausse - *Comerica Incorporated - Senior EVP & Chief Credit Officer*

Sure. This is Melinda. Thanks, Manan. I appreciate the question. Yes, I would characterize credit overall as being in really good shape. And I know the term normalization has been used a lot over the last couple of quarters, but I would characterize our movement as definitely in that normalization phase. All of our metrics still are meaningfully below kind of our long-term average, particularly the nonperforming assets are less than half of what our normal range would be. So those are very, very well controlled.

The increase in the criticized category this quarter came almost exclusively from a portion of our large corporate portfolio in that services the senior housing space. And so we've been watching this portfolio for a couple of quarters. As Jim mentioned in his comments, we tend to focus on newer construction type projects.

These are progressive living type facilities that are very, very appealing to an aging population but they have an element that's more real estate oriented, so very sensitive to high interest rates, but it's also an operating business in the health care space. So they've had a lot of labor challenges coming out of COVID. They've also had a lot of challenges just in getting back to an occupancy level that would allow them to get to stabilization, impacted again by some of the inflationary pressures.

So we -- this quarter, over the last couple of quarters, we've been diving deep into this portfolio. We did a 100% portfolio review and felt like we took a very appropriately conservative posture around risk rating. We've been in the business for 30 years. We've got very experienced colleagues on the line credit and our special assets team that is monitoring this portfolio.

We have not 1 nonperforming asset. We have very strong customers and the majority of the portfolio has recourse. So -- I think the -- I feel pretty good about what the outcome here is going to be, although headwinds will continue to be a higher for longer rate environment. There's a lot of tailwinds for this space, including an aging population. The demographic that this portfolio serves would tend to be a little bit more affluent because it is all private pay.

So again, the senior housing portfolio was the biggest mover in the quarter. Everything else is actually performing quite well. I would call commercial real estate very stable. And in fact, if you look in the slides, there are some positive trends in commercial real estate.

Leverage portfolio is very stable. Automotive is stable and TLS always has elevated criticized and losses there have been very manageable. So I think we'll continue to see some moderate level of migration, but our reserve levels are very appropriate for where we are in the cycle.

Operator

The next question is coming from Mike Mayo of Wells Fargo.

Michael Lawrence Mayo - *Wells Fargo Securities, LLC, Research Division - MD, Head of U.S. Large-Cap Bank Research & Senior bank Analyst*

I heard you credit is strong or quote really good shape. You had lower charge-offs quarter-over-quarter. Criticized loans are below historical. Loan loss reserves are flat. And you also added on Slide 25, you've had no big net charge-offs in commercial real estate since 2014. So it's been a decade since anything major. But I'm just trying to reconcile kind of a good environment today based on your comments with the headwinds from external factors possibly in the future.

So specifically, multifamily with about half of your total commercial real estate, 60% in California and Texas. And I think some of the issues out there and correct me if I'm wrong, but falling rental rates, higher interest rates, higher cap rates and impending loan maturities. So the question is under what scenarios would Comerica feel the need to build reserves on multifamily or other CRE?

Melinda A. Chausse - *Comerica Incorporated - Senior EVP & Chief Credit Officer*

Mike, this is Melinda. Thanks for the question. So let's talk just a little bit about our multifamily portfolio. You're right, we do have a large portfolio there. We've been in this business for many, many decades. It is a product category that we specifically leaned into post Great Recession because of its general resiliency.

Our underwriting criteria is very conservative in this space. We are a loan-to-cost lender. So the amount of equity that goes into these projects generally at 35% to 40%. We are having very successful exits when loans are ready to either mature or properties are sold. Appraisals, although they are down from what we underwrote are still well within guidelines, in fact, below guidelines because of the amount of equity that we have on the front end.

So we are seeing a little bit of softness in rent growth. We underwrite to sensitize rent. So there's a tremendous amount of leeway within the project. So we have -- as you said, we have no criticized assets. We've had no charge-offs. We have 0 delinquencies where it's appropriate for exits that the borrower has decided to either sell the property or move it into long-term financing. There is still that opportunity. Plenty of equity in the projects to make that happen.

So I feel very, very confident. Majority of this portfolio -- the vast majority is floating rate. So it's already absorbed kind of current rates. I mean if rates were to continue to go up, if we had an upward trajectory, there would be a little bit more downward pressure, but I don't see a scenario, honestly, where we have losses in this portfolio, just given who we do business with, how we underwrite and where we stand from a collateral perspective.

Michael Lawrence Mayo - *Wells Fargo Securities, LLC, Research Division - MD, Head of U.S. Large-Cap Bank Research & Senior bank Analyst*

That's helpful. So when you say the appraisals are down from when you underwrote them, how much are the appraisals down? And what would be kind of a trigger point that would cause some concern?

Melinda A. Chausse - *Comerica Incorporated - Senior EVP & Chief Credit Officer*

Appraisals, the recent appraisal, call it, in the last 90 days or so are down anywhere from 10% to 20%, which, again, most of our loan-to-values are sub-60%. So we're still well within reasonable guidelines from a loan-to-value perspective. So we're just not seeing -- we're not seeing massive deterioration of value in the multifamily space.

There are some headwinds for multifamily. Obviously, there's a lot of supply coming online, but there's also tailwinds. I mean where our projects are tend to be in areas where employment and population growth is strong. That would be Texas, particularly. And again, because of the conservative underwriting, even with rent growth declining and some amount of -- small amount of concessions needed to get these projects to stabilization, we just don't see any credit deterioration.

Michael Lawrence Mayo - *Wells Fargo Securities, LLC, Research Division - MD, Head of U.S. Large-Cap Bank Research & Senior bank Analyst*

And one last pushback. Again, you have the track record. You've been in the business decades. You've had a decade of great performance. But when you say there's no scenarios where you'd have serious losses there. Is that a little bit -- do you want to be a little bit more conservative with that statement because that's been pretty strong. I mean, that's a high level of conviction for sure.

Melinda A. Chausse - *Comerica Incorporated - Senior EVP & Chief Credit Officer*

Well, I think if -- if I think about what -- if we go into a massive recession, is it possible? Yes. I think we're pretty confident that the economy is on reasonably good footing and the outlook for a soft landing is certainly what the consensus is. So even if rates went up, call it, 50, 100 basis points, I think this portfolio would still perform.

So yes, I'm pretty confident that we're in really good footing. Now with all that said, we do have reserves on this portfolio, and we continue to build the reserve on our commercial loan -- commercial real estate book just in case that's why the reserves are there. And so again, even if we did have some losses, we're well reserved.

Operator

The next question is coming from Chris McGratty of KBW.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - Head of United States Bank Research & MD*

Jim, I want to go back to the securities comments, and you have a couple of comments in the deck. When should we think the security book trough on a dollar basis? I know you're starting to reinvest a little bit. But just conceptually the mix of the balance sheet over the next couple of years, bonds, cash, loans, loan to deposit. How do we think about just the ultimate troughing of the bond book?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Chris, right now, we still are carrying a little higher level of securities than we typically would. We do think we're going to get to the point somewhat of a trough, probably let's call it, in the first quarter of next year, give or take, where we'll start to reinvest in our MBS portfolio. As we imply in the slide, we are doing some very minor amounts of treasury reinvestments starting around now, but those are relatively small amounts.

In the past, if you look at our securities as a percentage of the balance sheet, it's going to vary, and it should vary based on the composition of the balance sheet and deposit levels and the types of deposits we have. But in the past, we've carried securities on the balance sheet anywhere from mid- to high teens of total assets.

I would see that probably going up a couple of percentage points going forward just because we're hearing and putting ourselves relative against higher liquidity runoffs just to be that much more conservative given what we saw with the regional bank crisis last year and the higher regulatory bar.

And so we probably will carry relative to history, a little higher percentage than we have in the past. But we're still not there quite yet, but I suspect we will be by the first quarter or so of next year.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - Head of United States Bank Research & MD*

Great. That's helpful. And then maybe one quick modeling. You mentioned the discrete tax benefit. What was the dollar amount of that in the quarter?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

On a net basis, it was $11 million.

Operator

The next question is coming from Zach Westerlind of UBS.

Zachary C. Westerlind - *UBS Investment Bank, Research Division - Associate Analyst*

My question is just on the NII guide. I think a key piece of that was around the beta assumptions. So I was wondering if you could provide any color on that? And kind of like what are your assumptions around the down beta compared to the up-cycle beta?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

We actually are assuming in the guide that we stick pretty close to that sensitivity -- alternate sensitivity that we provide on the asset sensitivity slide, which is 60%, and we're at a cumulative beta, of course, right now 62%. So we would expect initially to go down something close to the current cumulative beta of 60%. We would expect probably up to a 1-month lag likely relative to Fed cuts.

But I will emphasize that every cycle is a little bit different in terms of how quickly the industry is allowed to cut. And I continue to say that it depends on, frankly, the reason for the Fed cuts. If it's a very orderly takedown and it's a very soft landing, you might see a little bit more delay in those cuts. And if it's due to some concern in the economy, it makes it a lot easier to enforce some of those cuts. So it's going to really depend on how the overall landscape of the economy lays out and the reason for those cuts.

But we feel pretty confident that we can get some significant reductions from those customers that most recently pushed the beta up. And I continue to say that we're on a little bit of a LIFO basis, last in first out. Some of the bigger increases that we've seen came in the last few months from a beta standpoint. And those will probably be the easiest ones to push back down since they were closer to that 100% beta level. So anyway, the short answer to your question is we are assuming a 60% beta on the way down with about a 1-month lag.

Operator

At this time, I would like to turn the floor back over to Curt Farmer, President, Chairman and Chief Executive Officer, for closing comments.

Curtis Chatman Farmer - *Comerica Incorporated - Chairman, CEO & President*

Well, thank you to those of you that participated in our call this morning. As always, thank you for your interest in Comerica, and we hope you have a good day. Thank you.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's event. You may disconnect your lines and log off the webcast at this time, and enjoy the rest of your day.