

Appendix to October 2023 TLTA Cost of Capital report  
re: updating the 2023 cost of capital calculations for use in September 2025

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### Background

- I prepared a report for TLTA in October 2023 in which I calculated the cost of capital for the Texas Title Insurance Industry. I submitted this report and provided testimony regarding my calculations and my conclusions in a meeting with the Texas Department of Insurance and TLTA members in December 2023.
- In late August 2025 TLTA informed me that the Texas Department of Insurance has requested a stakeholder meeting involving my calculated cost of capital on September 22, 2025. TLTA asked me if I thought that I would need to update my calculated cost of capital from 2023 in preparation for the September 2025 rate hearing. This appendix presents my review of economy-wide interest rates over the time since I calculated the cost of capital, my thinking about what parts of my cost of capital calculation should be updated, and a minor update to my cost of capital calculations from 2023 for use in the rate hearing in September 2025.

### A broad review of economy-wide market interest rates

- Interest rates are a cost of capital. I reviewed various interest rates over the time period since my 2023 calculation of the cost of capital. All my interest rate charts, presented at the end of this appendix, are taken from the Federal Reserve of St. Louis website, FRED, and show the interest rate over the past 5 years
  - Fed Funds rate – the Fed Funds rate is set by the Federal Reserve and represents the cost of capital for banks borrowing from the Federal Reserve. The Fed Funds rate is a short-term rate, and represents the annualized interest rate charged to banks to borrow overnight from the Fed. The Fed Funds rate has declined by 100 basis points, or 1%, from 5.33% to 4.33% since my 2023 cost of capital calculation.
  - Bank Prime Loan Rate – the prime rate is the interest rate charged by banks on loans to their most credit-worthy customers. The prime rate does not have a maturity and is most often used as a reference rate by banks for loans where interest rates are set using a spread, e.g., 150 basis points, added to the prime rate. The prime rate has also declined by 100 basis points, or 1%, from 8.5% to 7.5% since my 2023 cost of capital calculation.
  - Moody's seasoned Aaa Corporate Bond Yield – the Moody's Aaa corporate rate is the rate that investors earn by investing in Aaa bonds, or equivalently

the interest rate paid by very creditworthy Aaa corporations on issued bonds. The Moody's Aaa bond yield has increased by 74 basis points, about  $\frac{3}{4}$  of 1%, from 4.66% to 5.40% since my 2023 cost of capital calculation.

- ICE BofA US High Yield Index Effective Yield – the US High Yield rate is the rate earned by investors from investing in riskier, non-investment grade bonds, or equivalently the borrowing rate paid by non-investment grade corporations in the bond market. The High Yield index has declined by 161 basis points, or 1.61%, from 8.25% to 6.64% since my 2023 cost of capital calculation.
- 30-year Fixed Rate Mortgage Average – home mortgage rates, as measured by the 30-year mortgage rate, are down roughly 75 basis points, from about 7.25% to 6.5% since my 2023 cost of capital calculation. Because current mortgage rates of 6.5% are still well above the roughly 3% mortgage rates from the time period prior to 2022, the residential real estate market still has many home owners feeling 'stuck' in their current homes because they do not want to sell their current home with a low interest rate and move to a different home with a new mortgage at a much higher interest rate.
- My broad review of economy-wide market interest rates indicates to me that interest rates have not changed significantly from the time of my cost of capital calculation in summer/fall of 2023. The US moved into a higher interest rate/higher cost of capital environment in 2021 and 2022, and interest rates across the economy have not declined significantly since moving into this higher rate environment.

#### A more specific look at the cost of capital equations

- The primary cost of capital models I used in my cost of capital calculation in 2023 are the Capital Asset Pricing Model (CAPM), and the Fama-French (FF) 3-factor model. The first term in both of these cost of capital models, or equations, is a long-term risk-free interest rate, usually the rate on 10-year Treasury bonds. Both the CAPM and the FF equations add a risk-premium to the 10-year Treasury bond rate to represent the idea that the cost of capital for a risky firm or industry must be at least the rate that capital suppliers can earn on a risk-free investment, i.e., the 10-year Treasury rate, and an additional yield, i.e., the risk premium, to compensate capital suppliers for the risk they take when they supply capital to a risky firm or industry.
- The risk premium in an industry cost of capital is generally constant over time if the industry does not experience large changes in its business model or the way that it operates in the economy. The risk premium in the Texas Title industry cost of capital comes from the risk of operating in the real estate industry within the overall US economy. It is my opinion that the underlying real estate markets that affect the cost of capital for the Texas Title Insurance industry are in roughly the same depressed position as they were when I calculated the cost of capital in mid-2023. Interest rate increases since 2021, specifically higher residential and commercial

mortgage rates, have caused real estate transactions to be reduced, and this market of reduced transactions has been relatively the same since I calculated the cost of capital in 2023. I realize that this reduced level of transactions has caused continued, and in some ways, increasing, pain in many parts of the real estate industry, including the title insurance sector of the industry, but it is my opinion that because the lower rate of real estate transactions was present when I calculated the cost of capital last summer/fall 2023, there is no reason to re-estimate the industry risk premiums included in my 2023 cost of capital report. Additionally, as previously stated, the risk premium in a firm or industry cost of capital is generally unchanged over time as long as the firm or industry is operating the same business model and faces the same business risks, which I believe is an accurate description of the Texas title insurance industry over the last two years.

#### Conclusion and updated cost of capital

- The cost of capital equations I use contain a base risk-free rate, represented by the 10-year Treasury rate, and a risk premium. It is my opinion that the risk premium in the cost of capital I calculated does not need to be updated, but the rate on the 10-year Treasury bond should be updated.
- I used a 10-year Treasury rate of 4.59% in my 2023 cost of capital calculation. The current 10-year Treasury rate, observed on August 22, 2025, is 4.33%, reflecting a decline of 0.26%, or 26 basis points from the 4.59% rate used in my 2023 calculations and report.<sup>1</sup>
- In my 2023 cost of capital report I carried my calculations to two decimal places and then rounded the final 15.83% to 15.8%. Updating the 15.83% cost of capital for the 0.26% decline in the 10-year Treasury rate gives me  $15.83\% - 0.26\% = 15.57\%$ , which I would again round to one decimal point for an updated cost of capital of 15.6%.

**2025 COST OF CAPITAL FOR THE TEXAS TITLE INSURANCE INDUSTRY = 15.6%**

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<sup>1</sup> This is slightly higher than the 4.17% noted in my fall 2024 review of these values.

### Interest Rate Charts

- The following interest rate charts were all taken from the Federal Reserve of St. Louis website, FRED (fred.stlouisfed.org), on August 25, 2025.





