How Mortgage Rates Work

Rates, points, and buydowns — explained in plain English

Your mortgage rate isn't picked at random. It's a mix of what's happening in the broader economy and things specific to you as a borrower. This sheet breaks down where rates come from, why loans differ, and two ways to pay less over time: discount points and temporary rate buydowns.

WHAT SETS THE “BASE” RATE

- **The Bond Market**
  Mortgages get bundled and sold to investors as bonds. When investors want them badly, rates drop; when they don't, rates rise.
- **The 10-Year Treasury**
  Mortgage rates roughly track this benchmark government bond, plus an added cushion for risk.
- **The Federal Reserve**
  The Fed doesn't set your rate directly, but its policy moves ripple through to mortgage pricing.
- **Inflation**
  When investors expect higher inflation, they demand higher rates to make lending worth their while.
- **The Economy Overall**
  Growth, jobs, and uncertainty all sway how much investors will pay for mortgage bonds.

WHAT SETS YOUR RATE

- **Your Credit Score**
  Higher scores signal reliability to a lender, which usually means a lower rate quote.
- **Your Down Payment**
  More money down means less risk for the lender — which usually means a lower rate.
- **Your Loan Type**
  Conventional, FHA, VA, and USDA loans price differently based on who backs the risk.
- **Your Loan Term**
  Shorter terms (like 15 years) usually carry a lower rate than a 30-year loan.
- **Your Home's Location**
  Rates can vary slightly by state and county, even for the same borrower.

Fixed vs. Adjustable-Rate, at a Glance

Fixed-Rate	Adjustable-Rate (ARM)	Index + Margin	Rate Caps
Same rate for the entire loan; payment never changes	Lower rate at first, then adjusts with the market	After the intro period, new rate = a market index + your lender's margin	Limits on how much your rate can jump at each adjustment, and over the loan's life

An ARM's initial rate is often lower than a fixed rate, but once it starts adjusting, changes are based on the market — not your finances. Common ARMs (like a “5/1”) keep the intro rate for 5 years, then adjust once a year after that.

Two Ways to Pay Less: Discount Points vs. 2-1 Buydown

	Discount Points	2-1 Buydown
What It Does	Permanently lowers your rate for the entire loan	Temporarily lowers your rate for the first 2 years
Typical Cost	About 1% of your loan amount per point	Often paid by the seller or builder as a concession
How the Savings Work	Roughly 0.25% off your rate per point (varies by lender)	Year 1: rate is 2% lower; Year 2: 1% lower; Year 3 on: full rate
Best For	Buyers keeping the loan long enough to recoup the cost	Buyers easing into payments, or expecting things to improve
The Math to Do	Upfront cost ÷ monthly savings = your break-even point	No break-even math — it's a temporary discount, not a purchase

Example: if 1 point costs $4,000 and saves you $67/month, your break-even point is about 60 months (5 years) — if you sell or refinance sooner, you lose money on the points.

Questions to Ask Your Lender

- **“What's my break-even point if I buy discount points?”** Make sure the upfront cost actually pays off before you plan to sell or refinance.
- **“Is a 2-1 buydown available, and who's paying for it?”** It's often a negotiating tool with the seller or builder, not an out-of-pocket cost to you.
- **“If I choose an ARM, what's the index, margin, and rate caps?”** These three numbers determine how high your payment could eventually climb.
- **“How would my rate change with a bigger down payment or higher credit score?”** Small changes on your end can meaningfully move the rate you're offered.

SOURCE: Consumer Financial Protection Bureau (consumerfinance.gov) — "Seven factors that determine your mortgage interest rate," ARM index/margin/rate-cap guidance, and points & lender credits guidance; Fannie Mae Selling Guide B2-1.4-04 (Temporary Interest Rate Buydowns); Federal Reserve Bank of Boston research on mortgage rate spreads.

EFFECTIVE DATE OF DATA: General mechanics current as of August 2026. Actual rates, point costs, and buydown terms change daily and vary by lender — always confirm current numbers with your lender before making a decision.

DISCLAIMER: This fact sheet is for general information only and is not exhaustive. The author is not a licensed mortgage lender or financial advisor. Consult a mortgage lender or licensed mortgage professional for guidance specific to your situation.