Mortgage Rates 101, Part 5: What Causes Mortgage Rates to Change?

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Mortgage rates change daily, and sometimes multiple times per day. In this article, "mortgage rates" will refer to the combination of upfront cost and actual interest rate described here: The 2 Components of Mortgage Rates. For example, if we talk about "higher rates," it could either mean that the interest rate is higher, or simply that the upfront cost is higher for the same interest rate.

These frequent changes are not arbitrary in any way. Instead they are the **result of multiple factors** with varying levels of importance and interdependence. Mortgages exist because investors want to earn interest by offering loans. Because of this, mortgage rates end up being directly driven by all the various market forces and operational considerations that dictate what those investors can/should/must charge.

Factors relating to market forces

Much like mortgage borrowers need money to buy a home, the US government needs money to finance Federal spending. Political commentary aside, this creates a massive market for government debt, which in turn serves as the plainest, most risk-free benchmark for many other types of debt. Collectively, this is known as **"the bond market."**

There are many other types of bonds with varying levels of risk and different features. They all exist because investors need or want to lend money and various entities need or wants to borrow money and. Mortgage borrowers are one such entity. When lenders have enough of the same type of loan from mortgage borrowers with similar circumstances, those loans can be **grouped together to form a bond** that can then be sold to other investors. Once the mortgage lender sells those loans to other investors, they now have the cash flow to go make news loans—assuming there are other investors who are interested in buying more loans.

Thus, a market for these **mortgage-backed-securities (MBS)** is born. It's quite a bit more complex in practice, but generally speaking, it's simply a market for groups of loans. These trade on the open market and tend to follow the broader movements of more mainstream bonds like US Treasuries. In short, all the factors that can affect interest rates in the bond market can also affect the price that investors are willing to pay for these groups of mortgages. Those prices have a more direct influence on the rates that mortgage lenders can offer than anything else!

Bottom line: loans become mortgage-backed-securities which trade on the open market, and the prices of mortgage-backed-securities dictate the rates that lenders can offer to new mortgage borrowers.

Factors relating to operational considerations

Knowing the price that investors are willing to pay for a group of similar mortgages gives lenders a **baseline** for the costs they must charge borrowers. The lender's operational considerations will account for the rest. These considerations are all directly or indirectly related to how much profit the lender wants to make or how much business they are capable of doing.

For instance, we tend to think of banks as always being available to make loans to borrowers who fit the right criteria, but that isn't always the case. Many mortgage lenders have a certain amount of cash flow that they'd ideally like to use over a certain time frame. If a lender isn't on pace to lend as much as they'd like, they might lower rates in order to entice more business. Conversely, if a lender is on pace to lend out more money than it has, it could raise rates in order to deter business.

Apart from the availability of funding, lenders must also consider the availability of personnel. It takes human beings to make loans happen, and at a certain point, a lender will be at capacity. It can then either hire more staff or simply raise rates to throttle the amount of incoming business.

These are two of the most basic operational considerations for lenders that complement the actual market-driven prices of mortgages. This can be thought of as any sort of business that sells a product made from raw materials. A car company, for **example**, is greatly affected by the cost of steel and aluminum, but the cost that buyers end up paying is also greatly affected by how that car company does business. How many factories do they have? How well-trained are their employees? How efficient are they?

In the mortgage world, mortgage-backed-securities would be like the steel and aluminum while individual lenders would be like auto manufacturers, each trying to build/sell cars as efficiently and as profitably as possible.

Bringing it all together

The lender-specific considerations certainly change and certainly account for a portion of any given mortgage rate offering. Quite simply, this is why **different lenders offer loans at different rates** even though they're all working with the same raw materials.

But it's those raw materials—those mortgage-backed-securities—that move throughout the day and do most to affect the **moment-to-moment changes** in lenders' rate sheets. If something in the world is happening to cause investor demand to increase in bond markets, MBS tend to benefit as well. When MBS prices rise, investors are willing to pay more for those bundles of loans, meaning that lenders may be able to offer lower rates. Conversely, if investors are seeking riskier investments for whatever reason, MBS prices could fall, meaning investors aren't paying as much for mortgages, thus forcing lenders to raise rates.

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