First Flexible No. 2 PLC

UK-MBS

CLOSING DATE:
May 30, 2000

AUTHOR:

London
Stephen Murray
Vice President
Senior Analyst
(44-20) 7772-5341
Stephen.Murray@ moodys.com

CONTACTS:

London
Detlef Scholz
Managing Director
(44-20) 7772-5398
Detlef.Scholz@ moodys.com

Dominic Swan
Senior Vice President
(44-20) 7772-5354
Dominic.Swan@ moodys.com

New York
Sally Cornejo
All Mortgage Related and Fully Supported Securities
(212) 553-4806
Sally.Cornejo@ moodys.com

TRANSACTION IN BRIEF

	Class A	Class B
Rating:	**Aaa**	**A2**
Amount:	£276mm	£24mm
Margin over 1m Libor:	29 bps	80 bp
Step Up Date:	July 2007	July 2007
Step Up Margin:	58 bps	160 bp
Final Maturity:	2032	2032

Interest Payment Dates:	1st business day of each month starting on 1st July 2000
Issuer:	First Flexible No. 2 PLC
Originator:	First Active Financial plc
Administrator:	The Mortgage Corporation
Standby Servicer:	First Active plc (**A3**, **Prime-2**)
Basis Swap Provider:	Morgan Guaranty Trust Company of New York (**Aa3**, **Prime-1**)
GIC Provider:	Barclays Bank PLC (**Aa2**, **Prime-1**)
Principal Paying Agent:	Citibank, N.A.
Note Trustee:	Citicorp Trustee Company
Lead Manager:	JP Morgan

Summary of Provisional Pool (As at 30th April 2000)

Assets:	First residential (buy to let) flexible mortgages in England and Wales
Count:	4,418 residential loans
Principal Amount:	£296,117,093[1]
Redrawable Amount:	£10,653,997
LTV:	Weighted Avg: 72.1%
LTV (inc. undrawn):	Weighted Avg: 73.5%
Loan Size:	Avg: £67,025
Loan Usage:	Purchase 68%, Remortgage 32%
Concentration:	76% concentration in the South East inc. London
Seasoning:	Weighted Avg: 15.0 months
Credit Support:	Reserve Fund (175bps of original Note balance) building up to 250 bps of the original Note balance, Class B Notes (8% of original Note balance), and Excess Spread
Liquidity Support:	Reserve Fund, Liquidity Reserve Ledger (3% of the current balance of current balance of the Notes less the balance of the Reserve Fund, if First Active plc loses its **Prime-2** rating), £27million Redraw Facility
Closing Date:	30 May 2000

1 The loan balance is less than the Note balance. The excess proceeds will be used to purchase additional loans, or will be returned to investors.

RATING OPINION

Moody's has assigned long term credit ratings of **Aaa** to the Class A Notes and A2 to the Class B Notes issued by First Flexible No. 2 PLC.

The Notes are backed by a portfolio of residential "buy to let" mortgage loans originated by First Active Financial plc (FAF), the UK wholly-owned subsidiary of Irish mortgage lender First Active plc (**A3**, **Prime-2**). 87% of these loans by balance are flexible loans — the borrower is able to redraw partial prepayments of principal if he/she has previously made early repayments on the loan. This transaction is the first public rated securitisation of flexible buy to let mortgage loans.

The rating of the Class A Notes is based upon:

1. A loan by loan analysis of the characteristics of the mortgage pool backing the Notes.
2. The protection that the Notes receive from credit enhancement and liquidity support against defaults and arrears in the mortgage pool.
3. The role of First Active plc (**A3**, **Prime-2**) as standby servicer, which mitigates the risks associated with primary servicer default such as commingling and bankruptcy freezes.
4. The £27million Redraw Facility provided by Barclays Bank PLC (**Aa2**, **Prime-1**), which substantially mitigates the liquidity concern that more principal is redrawn by borrowers than is repaid in any period.
5. The role of Morgan Guaranty Trust Company of New York (**Aa2**, **Prime-1**) as swap and cap provider.
6. The legal and structural integrity of the issue.

The rating of the Class B Notes is based on the above factors, and on an assessment of the extent of their subordination to the Class A Notes.

The ratings of each of the Notes address the timely payment of interest, and ultimate payment of principal.

Moody's will monitor the transaction on an ongoing basis to ensure that the transaction continues to perform in the manner expected, including checking all supporting ratings and reviewing periodic servicing reports.

COLLATERAL

Buy to Let Loans

All of the loans in the provisional pool are Buy to Let (BTL) loans. Loans of this type have, through the recent benign economic environment, shown relatively low default rates, but our analysis of the volatility of outcomes allows for:

1. The uncertainty generated by the still relative novelty of this product and the absence of data through an economic downturn; and
2. Certain characteristics of the product which suggest that it may be more susceptible to default in a downturn. A BTL borrower is likely to prioritise payments due under his own home loan in times of economic stress. Also, there is some risk that the conditions and locations of these properties on repossession and sale might on average be of a lower standard than could be expected with owner occupied properties.

In Mitigation

- These loans were underwritten on the basis of rental valuation, so there is a reduced dependency on the borrower's personal income and there is some assurance as to the "rentability" of the property. FAF generally looks for a debt service coverage ratio of at least 125% of the initial starting rate under the loan. Across the provisional pool, actual coverage averages 180%.
- On enforcement, if there is a tenant in place, a receiver could be appointed who would assume control of the property and collect the rent from the existing tenant thereby reducing severity. The tenancy agreements are limited to 6 month assured shorthold tenancies (AST's) so FAF could normally take possession on expiry, and then sell the property with vacant possession.

- Much of the delay when enforcing owner occupied properties is taken up with the eviction process (issues concerning re-housing the occupier). In the few BTL repossession cases that FAF has thus far seen, the courts have taken a somewhat less liberal views of the rights of the borrower on the basis that the loan is a quasi-commercial arrangement.
- During a downturn, there may be greater demand for rented accommodation, as potential buyers may be unable or unwilling to buy their own home.
- The BTL product is generally likely to attract the better borrowers. They will be existing home owners (a condition to obtaining a FAF BTL loan) who are looking to invest accumulated income outside of the traditional personal savings routes. And at least 34% of the borrowers in the provisional pool have more than one BTL loan from FAF (some may have loans with other lenders) suggesting that they are “professional” rather than “amateur” landlords; although it might also suggest a risk of over-exposure of the borrower to the BTL market.

Flexible Loans

87% by balance of the loans in the provisional pool are flexible loans. The flexibility refers to the borrower’s ability to redraw principal that is prepaid ahead of his agreed amortisation schedule. So under an interest-only loan, all partial payments of principal (other than full redemption) are redrawable. Under a repayment/annuity loan, all payments of principal (other than full redemption) in excess of those due under the monthly instalment are redrawable. The borrower can only be refused a redraw if he is in breach of the terms of the loan. There is no re-underwriting process at the time the redraw is requested.

It is, however, a term of 86% of the flexible mortgage loans that, if the amount redrawable exceeds 20% of the original loan amount, then the borrower must pay a commitment fee of at least 1% on the excess, or he can cancel that excess so it is no longer redrawable. This should disincentify borrowers from running a large redrawable balance.

In the case of the provisional pool, redrawable amounts currently make up only 3.4% of the initial drawn pool balance.

Potential behaviour of a borrower under a flexi loan may differ from that expected under a conventional non-redrawable loan. Prepayments by the flexi-borrower will not necessarily reduce severity on repossession because he can draw down on his equity to meet monthly instalments in hard times undoing the effect of prepayments. Depending on the flexi-borrower’s circumstances and the magnitude of the downturn, redraws might be a valuable source of liquidity so decreasing default frequency, or they may just serve to delay repossession thereby increasing severity.

However, the bulk of historical repayment activity under conventional non-redrawable loans is in fact full redemption. So partial non-redrawable prepayments may be of limited value to a “normal” pool in any event. FAF have provided data that shows that, on average over the last 12 months, redemptions have comprised on average 81% of full redemptions and only 19% of partial (largely redrawable) prepayments. Notably, with BTL (as opposed to owner-occupier) flexi loans, there is a reduced incentive to prepay. Tax deductions are currently available for interest paid on BTL loans — prepayment reduces the benefits of these deductions.

But because of the possible effects of redraws, our Loan by Loan analysis (see our Special Report of April 1998 called “Moody’s Approach to Rating UK Residential Mortgage-Backed Securities”) focuses on the balance of the loans plus amounts redrawable, rather than the current balance only.

Despite the redraw right, borrowers still have to make their regular monthly payments, which in most cases are collected by Direct Debit from the borrower’s bank account. Nonetheless, properly timed redraws by the borrower could hide the true arrears position in the pool — ie if otherwise delinquent borrowers redraw in advance to meet interest payments.

Borrowers are also allowed to ask for payment holidays, but are not entitled to these as of right. Broadly, a payment holiday will only be given if the borrower is entitled to a redraw. The amount will be added to the capital balance of the loan.

Summary

On balance, we believe that there is some uncertainty as to how the pool would perform during an economic downturn due to the absence of data on these products. The enhancement levels address this uncertainty and the possibility that, both the BTL and the flexible features may mean that these loans will exhibit average or better than average performance in good times, but greater loss volatility in times of stress.

Other Factors

- About 76% of the pool is located in London or the South East. Geographic concentration increases the volatility of losses in a pool.
- Many of the borrowers have more than one loan with FAF. FAF will have the right to consolidate these loans should only one of them default. Multiples loans could mean overexposure of a borrower to the sector, but it also provides FAF/ the Issuer with the potential for greater recovery if the loans are cross-collateralised by the various properties in the borrower's portfolio.

Substitution

FAF can substitute new mortgage loans into the deal in the first 3 years subject to a number of conditions including the following:

- The resultant aggregate outstanding loan balances and redrawable amounts in the pool will not exceed the same amount as at the beginning of the current monthly interest period.
- The Reserve Fund (and, where required, the Liquidity Reserve Fund) are fully funded at the levels specified for the relevant interest period.
- If there is a principal deficiency recorded on the PDL, it does not exceed 0.1% of the aggregate principal amount outstanding of the Initial Mortgage Pool.
- There are no outstanding drawings under the Redraw Facility.
- The weighted average LTV across the pool will not increase by more than 1% from the figure as at closing (using historic valuations).
- TMC or First Active plc as standby servicer are still performing their obligations under the transaction and FAF is not in insolvency.
- The Issuer is not aware that substitution would cause a downgrade of the Notes.
- Appropriate hedging is in place if the loans are capped, collared or fixed.
- Following substitution, no more than 80% of the properties relating to loans in the pool are located in london and the South East
- The aggregate principal balance of arrears (greater than £100) loans is less than 2.5% of the then outstanding principal balance of the loans, and the amount of all outstanding interest arrears is less than 2% of the total amount of gross interest due on the loans then outstanding over the last 12 months.

In addition, no more than 3% of the pool balance as at the end of any month may be substituted in the following month. Substitute loans will be bought using principal if it is not needed to pay interest, fund the Liquidity Reserve Fund, repay the Redraw Facility, or meet new redraw requirements.

Conversions/Further Advances

First Active may convert loans from one type to another. It may also make further advances under loans in the securitisation and sell these to the Issuer provided that certain requirements are met, including requirements similar to those described for substitution. In addition, the total cumulative amount of further advances is limited to 10% of the initial outstanding pool balance, and a loan must be performing before a further advance can be made.

SET OFF

Flexi loans also create certain liquidity risks to the deal. Each borrower is legally entitled to a redraw provided he is not in default under the mortgage conditions. And the borrower could, if not provided with the redraw, sue FAF for damages representing his loss caused by FAF's contractual default. Importantly, the borrower would have no right to sue the Issuer as the obligation to provide redraws remains with FAF at all times including after perfection of the transfer of the loans to the Issuer. But the borrower would be entitled to off set any damages he was awarded against amounts due under his loan — even after a FAF insolvency, irrespective of whether the redraw was requested or due after a FAF insolvency and irrespective of whether the transfer of the loans has been perfected or notified.

The amount of the claim will most likely represent the cost of obtaining alternative finance elsewhere. This could be relatively material if the borrower could only obtain a second mortgage where interest would be charged at higher rates. The borrower is obliged to mitigate his loss so would have to seek finance at market rates. He could well obtain a remortgage at rates comparable to those applicable under his loans with FAF as BTL loans are currently widely available.

The risk of a borrower making a claim and setting off against his loan is mitigated in several ways:

- Principal redemptions received from borrowers are allocated first to meeting redraw obligations of FAF.
- If the amount of redraws exceeds the amount of principal collected, the Issuer can draw under a Redraw Facility provided by Barclays Bank PLC (**Aa2**, **Prime-1**). The facility equals £27million (or 9% of the initial Note balance). In subsequent periods, the facility is repaid from principal received under the mortgage loans, if not needed to fund further redraws in priority to Note amortisation. Amounts repaid under the facility, can be redrawn in future periods.
- If the facility is fully drawn and there are insufficient principal collections to meet redraw obligations, then FAF is still contractually obliged to make those redraws. FAF is a wholly owned subsidiary of First Active plc, the Irish mortgage lender rated **A3**, **Prime-2**, although there is no formal legal obligation on the parent company to support FAF.

The amount available under the Redraw Facility will decrease through time as the amount that can be drawn is limited to the lower of the £27 million and the then outstanding balance of Class A.

Barclays has agreed that, if it ceases to have a **Prime-1** rating, it will find a replacement Redraw Facility provider that is rated **Prime-1**. The facility may also be termed out at that point pending the replacement assuming its obligations.

The probability of redraws exceeding the principal receipts and amounts available under the redraw facility is very low, and the residual risk of a damages claim against the Issuer (which would also require a FAF default) is consistent with the enhancement in the deal.

HEDGING

The loans charge interest on different bases:

- Approximately 70% of the loans charge interest at a margin over FAF's own standard variable rate (SVR). FAF will operate a Threshold Interest rate Mechanism (TIM) whereby it will agree to keep the charging rate on these loans at a minimum rate of Libor applicable to the rated Notes plus 120bps. Alternatively, it can set the rate at a lower level and deposit the cash difference for next monthly period with the Issuer.
- About 26% of the loans in the pool charge 3m Libor. MGT will provide a basis swap for these loans swapping them into 1m Libor, the basis on which interest on the Notes accrues. About 4% of the loans in the pool charge 1m Libor. These will not be hedged. FAF will also ensure that if new Libor linked mortgages enter the pool, the average rate on the Libor linked loans in the pool will never be less than 120bps.
- Some of the SVR or Libor-linked loans are, however, capped or at fixed rates at the outset of the transaction. (Approximately 41% of the loans are SVR loans which initially charge a capped or fixed rate; and approximately 10% of the loans are 3m Libor loans which are capped.) The capped/fixed periods on these loans vary between four months and nine years. Whilst in a capped or fixed period, loans will be hedged relative to Note Libor plus 120bps via caps or swaps provided by Morgan Guaranty Trust Company (**Aa3**, **Prime-1**). But these may not be perfect hedges. In such a case, FAF will deposit the cash difference, for the period of the cap or swap, with the Issuer.

CREDIT ENHANCEMENT

Investors in the Notes are protected from the effect of credit losses on the pool in a number of ways.

Excess Spread

The first layer of protection for investors in the Notes is the Excess Spread in the transaction, which is the difference between:

- The income receivable by the Issuer under the mortgage loans and its other investments (such as the GIC), and under the Caps and Swaps provided by MGT; and
- Interest due by the Issuer on account of its various ongoing costs and expenses, including interest due under the Notes and the Swaps.

The actual Excess Spread in the deal will depend upon a number of factors such as the level of arrears in the deal, and the coupons on the Notes (which step up after June 2007). The Excess Spread will amount to approximately 75 bps per annum on the closing date.

Excess Spread is used first to top up the Reserve Fund to its target amount (see below). Any surplus is then to be applied in redeeming the Notes to the extent that a property has been liquidated following repossession and a principal deficiency on the loan incurred and recorded on the Principal Deficiency Ledger (PDL). In this way, Excess Spread is trapped in the transaction and used to redeem Notes to the extent of principal deficiencies incurred in the pool.

The value of Excess Spread as credit enhancement to the transaction depends on a number of factors such as prepayment speeds (as prepayment speeds increase following the end of the substitution period, the cash value of Excess Spread decreases) and the timing of losses in the pool (Excess Spread is available on a “use it or lose it” basis and so is paid back to FAF if not used to cover losses).

Reserve Fund

The second layer of protection for investors in the Notes is the Reserve Fund. The Reserve Fund at closing equals £5.25 million, but it is intended to build up linearly to its target amount of £7.50 million (250bps of the original balance of the Notes) using Excess Spread.

Principal Subordination

The third layer of protection for Class A investors is the subordination of principal due under the Class B Notes. Initially, only the Class A Notes redeem. However, Class A and Class B can redeem pro rata if the following conditions are met at the time:

1. The payment occurs more than 5 years after the end of the 3 year substitution period.
2. The ratio of outstanding Class B Notes plus the amount in the reserve fund to outstanding Class A and Class B Notes is twice the same ratio as at closing.
3. The Reserve Fund (and, where required, the Liquidity Reserve Fund) are fully funded at the levels specified for the relevant interest payment date.
4. There is noprincipal deficiency recorded on the PDL.
5. There are no outstanding drawings under the Redraw Facility.
6. The aggregate principal balance of arrears (greater than £100) loans is less than 2.5% of the then outstanding principal balance of the loans.

But pro rating cannot lead to the outstanding balance of Class B Notes to be less than 2 times the largest loan, or largest group (by principal value) of loans to any single obligor, then outstanding.

The Notes are to be redeemed using principal received after making redraws and repaying amounts due under the Redraw Facility (and funding up the Liquidity Reserve Fund, if required).

Interest/Interest Subordination

Further protection is provided via the subordination of interest due under the Notes; on each interest payment date, Class A interest is paid before Class B interest. Unpaid Class B interest can be deferred until later interest payment dates.

Interest/Principal Subordination
In addition, in certain circumstances Class B interest is subordinated to payment of principal under Class A. This occurs where the debit balance of the PDL exceeds the size of the Reserve Fund plus the amount of Class B then outstanding. In this case, Excess Spread is used to top up the Reserve Fund and to reduce any principal deficiency recorded on the PDL (ie to redeem Notes) before it is used to pay Class B interest.

LIQUIDITY
Several levels of protection are available to investors to counter the effect of temporary shortfall in cashflows from the loans caused by delinquencies in the pool or any interruption in the servicing functions or cash collection functions.

Principal Paying Interest
The first source of liquidity is the Issuer's ability to use principal receipts under the mortgage loans to meet its senior expenses obligations, including interest due under the Notes. Where there is an income shortfall, principal receipts will be applied in priority to repayment of the Redraw Facility, funding new redraws and Note amortisation.

Reserve Fund
The second source of liquidity is the Reserve Fund that is available to cover interest shortfalls under the Notes. The value of the liquidity support provided by the Reserve Fund is increased by the fact that the Reserve Fund is topped-up from Excess Spread in priority to reduction of principal deficiencies recorded on the PDL.

Liquidity Reserve Ledger
In addition, a Liquidity Reserve Ledger will be established to trap principal receipts under the loans if First Active ceases to have a rating of at least **Prime-2**. The target amount to be trapped will equal 3% of the current balance of the Notes less the current balance of the Reserve Fund (floored at zero). The Liquidity Reserve Ledger can be used to service Note interest but only after the Reserve Fund has been depleted. This protects the transaction against possible cashflow interruptions following a servicer default/insolvency.

COLLECTIONS AND BANK ACCOUNTS
Payments under the Loans are collected by TMC as administrator under a number of arrangements including by direct debit, cheque, standing order and cash, and are paid directly into the Collection Accounts of FAF with Barclays Bank PLC (**Aa2**, **Prime-1**). Cash in the Collection Accounts must be transferred by TMC on the day following receipt to the Issuer's Transaction Account with Royal Bank of Scotland (**Aa2**, **Prime-1**).

All bank accounts must be maintained with **Prime-1**-rated banks.

SERVICING
The Mortgage Corporation, a company connected to FAF, is the primary servicer of the loans. FAF's parent company, First Active plc (**A3**, **Prime-2**) has agreed to act as standby servicer in the event that TMC defaults on its obligations. This is a hot standby servicing arrangement given the connection between the two companies. The risk of there being cash flow interruptions on a servicer default (where cash trapped at the insolvent servicer level) is materially reduced.

STRUCTURE
The Issuer is a special purpose vehicle incorporated in the UK and ultimately owned by a charitable trust. The mortgage loans and other related rights were sold by way of silent equitable assignment to the Issuer which in turn created first fixed security over such assets in favour of the trustee for the Noteholders. The Issuer funded the purchase price of the loans using the proceeds of the Notes.

The Issuer is VAT grouped with a number of other companies, including TMC. VAT grouping means that the 10bps servicing fee payable to TMC is not subject to VAT. But members of a VAT group are jointly and severally liable for the VAT liabilities of all other members.

In mitigation, if TMC, as representative member of the VAT group, fails to pay VAT due by it or enters insolvency, or if there is a material increase in VAT liability of the group, the Issuer will attempt to de-group. On a degrouping, no new VAT liabilities will arise but any that exist remain. The VAT authority cannot prevent a company from de-grouping, but it must be given 90 days' prior notice and de-grouping can sometimes be a prolonged process. In addition, the groups's VAT liabilities have historically been limited to £6,000, and most of the members of the group are special purpose companies which should have limited activities and, therefore, limited scope for triggering extensive VAT liabilities.

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