STANDARD & POOR'S STRUCTURED FINANCE

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Analysis

New Issue: Paragon Mortgages (No. 1) PLC

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Ratings Detail

Profile

New Ratings

Class A	AAA
Class B	A

Closing date: June 9, 1999

Rationale

The ratings on Paragon Mortgages PLC. reflect, the strong protection for class A note holders provided by a combination of the subordinate class B notes totalling 9.2% of the notes issued, the first loss fund, totalling 2.5% of the notes issued; excess spread to cover credit losses and income shortfalls. Other considerations were, the strong protection for class B note holders provided by the first loss fund totalling 2.5% of the notes issued and excess spread to cover credit losses and income shortfalls. The servicer's ability to perform its roles in this transaction together with the sound legal, payment structures and cash flow mechanics of the transaction also lent support.

Main Transaction Parties

Paragon Mortgages (No.1) PLC (Issuer)
The issuer is a public company incorporated under the laws of England and a subsidiary of the Paragon Group of Cos. PLC, that has its shares listed on the London Stock Exchange. The issuer is a special-purpose entity, created for issuing the notes, purchasing the issuer mortgages and making term loan advances under the Luxembourg Loan Agreement (see below).

Paragon Mortgages (No.2) S.A. (PSA2)
Paragon Mortgages (No.2) S.A. was incorporated as a company in Luxembourg in March 1999 and is a subsidiary of the Paragon Group of Cos. (PGC). The issuer and PSA2 are bankruptcy-remote, special-purpose entities that conform to Standard and Poor's rating criteria.

Paragon Mortgages Ltd. (Originator)
Paragon Mortgages Ltd., (PML) a private company incorporated in England, is the originator of the mortgages in the portfolio, either directly or indirectly via broker intermediaries.

Citicorp Trustee Co. Ltd. (Trustee)
Citicorp Trustee Co. Ltd. as the trustee will supervise the administrator in its administration of the issuer under the terms of the transaction and will generally represent and protect the interests of noteholders. Only the trustee will be able to enforce the security under the terms and conditions of the notes and it will always have to act in the best interests of the noteholders.

Morgan Guaranty Trust Co. (Swap Counterparty)
Morgan Guaranty Trust Co. as the swap counterpary and the issuer have entered into a mortgage rate swap agreement with Morgan Guaranty Trust Co., to protect the issuer and note holders from variations between the interest rate received on the mortgages and that due on the notes. Under the transaction terms the issuer is only required to pay any swap breakage costs owed to the swap counterparty at a level subordinated to payments of class B payments in the priority of payments. However, it will be allowed to retain the benefit of any swap breakage income in its favor. The mechanism functions are similar to the benefit of an interest rate cap in the issuer's favor.

Paragon Finance PLC PFPLC (Administrator and Subordinated Loan Provider)
Paragon Finance PLC (PFPLC) as the administrator and subordinated loan provider will be responsible for the day-to-day administration and ongoing servicing of the underlying portfolio of mortgages. PFPLC is also responsible for producing all reports and accounts for the trustee and Standard & Poor's in connection with the performance of the mortgages.

PML's origination, underwriting and valuation processes as well as PFPLC's administrative functions on the collection and default management procedures have been reviewed. This is an integral part of the due diligence efforts undertaken during the rating process of any transaction and maintained throughout the life of the transaction. PFPLC is capable of performing the functions necessary to ensure the collection of borrower payments and management of the arrears and repossession cases.

PFPLC has provided a subordinated loan to the issuer that will fund the first loss fund; a cash reserve forming part of the credit enhancement for the notes. Step-down of the first-loss fund will be permitted after five years from the closing date subject to the balance of the fund being no less than 5% of outstanding notes, with a floor of the greater of £500,000 and twice the principal amount of the largest remaining mortgage loan.

National Westminster Bank PLC (Transaction Account Provider)
National Westminster Bank PLC is the transaction account provider for this deal and all of the borrower's payments will be lodged with it.

Transaction Structure
At closing, and in accordance with the terms of a mortgage sale agreement, the issuer acquired from PFPLC, the beneficial interest in certain mortgages originated by PML, known as the issuer mortgages, that form part of the security for the notes. The borrowers in respect of the issuer mortgages are individuals. Part of the note proceeds have been used to establish a prefunding reserve in an amount of approximately £22 million. Until the first principal determination date and, before the first interest payment date, the issuer may use the prefunding reserve to purchase further mortgages from PML, subject, among other things, to there being satisfactory evidence that the purchases will not adversely affect the existing note ratings. Any amounts outstanding in the prefunding reserve beyond the first principal determination date will be applied in redemption of the class A notes. Also at closing, PSA2 acquired the beneficial interest in a pool of mortgages from PFPLC which have been originated by PML as the PSA2 mortgages. The borrowers in respect of the PSA2 mortgages are limited liability companies incorporated in England, Wales, and Scotland. PSA2 funded the purchase of the mortgages from the proceeds of a loan to PSA2 by the issuer, which in turn was funded from part of the note proceeds. The issuer loan to PSA2 was made in accordance with a loan, termed the 'Luxembourg Loan Agreement'. The PSA2 mortgages form part of the security for the issuer and ultimately the

noteholders under the terms of the loan agreement. Both classes of notes are secured on all the mortgages and repayments to noteholders will be derived from the issuer mortgages and the PSA2 mortgages.

Note Terms and Conditions

The issuer issued class A 'AAA' notes and class B 'A' notes. The former ranks more senior.

Interest on the class A notes is payable at three-month British pound LIBOR plus a margin of 0.28% per year, stepping up to a margin of 0.56% per year after July 2004. Interest on the class B notes is payable at 3 month British pound LIBOR plus a margin of 0.80% per year, stepping up to a margin of 1.60% per year July 2004. Interest on the notes is payable quarterly in arrears on the 15th of January, April, July, and October each year, beginning in October 1999.

Mandatory Redemption

The notes are subject to mandatory redemption in part on each interest payment date from available funds. There will be no mandatory redemption of the class B notes for the first five years from the closing date. Thereafter, while class A and B notes remain outstanding, redemption will be applied on a pro-rata basis, subject to:

- The ratio of class B notes to the aggregate of outstanding class A and class B notes being no less than twice the ratio at closing;
- There being a zero balance on the principal deficiency ledger; and
- The minimum outstanding amount of class B notes is £8,500,000 while any class A notes remain outstanding.

Optional Redemption

The issuer may redeem all of the notes at their outstanding principal amount together with accrued interest under the following circumstances:

- A withholding tax is imposed on the notes or on payments by either party to the swap agreement;
- The aggregate principal amount outstanding of the notes becomes less than 20% of the original principal amount of the notes, including the original principal amount of any further notes issued; and
- The issuer may also redeem the notes on the interest payment date in July 2003 or at any time thereafter.

Final Redemption

If not already redeemed, the class A and class B notes will be redeemed at their legal final maturities in October 2030 and October 2041, respectively. The issuer will not be required to gross up for any withholding tax that might be imposed on the notes in future.

The Collateral

The loans in the provisional mortgage pool were originated by PML between January 1998 and April 1999 and have been administered by PFPLC since origination. Features of the mortgage pool include:

- Each loan is secured by a first legal charge of a residential property in England, Scotland and Wales;
- Around 88% of the pool are buy-to-let mortgages, with the remainder being owner occupied;

- Around 48% of the mortgages are capital repayment mortgages, and the balance are interest only mortgages;
- Around 48% of the loans were used for house purchases, 49% for remortgage and 3.04% for equity release;
- The weighted average loan to value of the mortgage pool is around 69%;
- The average outstanding mortgage balance is around £50,000. The mortgage balances range between £11,000 and £501,025.
- The largest concentration of mortgages by geographic area is in the Southeast, including London at around 58.04%. There are no significant concentrations in other regions; and
- The weighted average term to maturity is around 18.6 years.

Standard & Poor's Stress Test

The analysis includes a conservative assessment of the credit risk inherent in the transaction. The credit enhancement levels have been sized after analysing the impact that severe stress scenarios would have on the collateral. In determining the credit quality of a mortgage pool, an estimate must be made of a worst case of potential losses that could occur because of foreclosures. This estimate of potential losses is the required amount. All types of loans are eligible for inclusion in a pool, provided the credit risk can be quantified and adequate loss protection is supplied. A feature of the portfolio is the high level of different types of buy-to-let mortgages. These include professional, corporate and amateur lettings. The levels of underwriting by the originator are considered conservative, but the characteristics of the buy-to-let market create additional risks relative to a typical prime mortgage portfolio, notwithstanding the weighted average loan to value of this portfolio. The cash flows simulate the performance of this portfolio within the transaction's documented structure under certain stressful scenarios. In addition, the issuer will make use of the swap to prevent mismatches in interest rates. Any bank accounts of the issuer are required to be with appropriately rated providers. There will be continuous surveillance on the transaction until the notes mature, or are otherwise retired. This will include analysis of regular reports detailing the performance on the underlying assets, monitoring all supporting ratings and maintaining regular and close contact with the originator and administrator in order to monitor servicing standards and stay informed on changes to operations or the characteristics of the mortgages.

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